FONAR CORP
Form 10-K
September 21, 2018

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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FORM 10-K

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[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended **June 30, 2018**

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND

EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File No. 0-10248

_____

FONAR CORPORATION
(Exact name of registrant as specified in its charter)

DELAWARE	11-2464137
(State of incorporation)	(IRS Employer Identification Number)

110 Marcus Drive, Melville, New York	11747
(Address of principal executive offices)	(Zip Code)

(631) 694-2929
(Registrant's telephone number,

including area code)

_____

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, par value $.0001 per share

Securities registered pursuant to Section 12(g) of the Act:

None

_____

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ____ No __X__

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ____ No __X__

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 ___X___ No _____

FONAR CORPORATION AND SUBSIDIARIES

Indicate by check mark whether the registrant (1) has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ___X____ No _____

Indicate by check mark if disclosure of delinquent filers, pursuant to Item 405 of Regulation S-K, §229.405 of this Chapter, is not contained, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this 10-K or any amendment to the Form 10-K. [X]

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

Large accelerated filer	[ ]	Accelerated filer	[X]
Non-accelerated filer	[ ] (Do not check if smaller reporting company)	Smaller reporting company	[ ]
Emerging growth company	[ ]		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ____

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

The aggregate market value of the shares of Common Stock held by non-affiliates as of December 29, 2017 based on the closing price of $24.35 per share on such date as reported on the NASDAQ System, was approximately $152.6 million. The other outstanding classes do not have a readily determinable market value.

As of September 10, 2018, 6,357,482 shares of Common Stock, 146 shares of Class B Common Stock, 382,513 shares of Class C Common Stock and 313,438 shares of Class A Non-voting Preferred Stock of the registrant were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None

FONAR CORPORATION AND SUBSIDIARIES

FORM 10-K ITEMS

PART I

ITEM 1. BUSINESS

GENERAL

Fonar Corporation, sometimes referred to as the "Company" or "Fonar", is a Delaware corporation which was incorporated on July 17, 1978. Our address is 110 Marcus Drive, Melville, New York 11747 and our telephone number is 631-694-2929. Fonar also maintains a website at www.fonar.com. Fonar provides copies of its filings with the Securities and Exchange Commission on Forms 10-K, 10-Q and 8-K and amendments to these reports to stockholders on request.

We conduct our business in two segments. Our medical equipment segment is conducted directly through Fonar. Our physician management and diagnostic services segment is conducted through our subsidiary Health Management Company of America ("HMCA"), also called Health Diagnostics Management, LLC. HMCA provides management services, administrative services, billing and collection services, office space, equipment, repair, maintenance service, and clerical and other non-medical personnel to medical providers engaged in diagnostic imaging. In addition to acting as a management company, HMCA owns and operates four diagnostic imaging facilities in Florida, where the corporate practice of medicine is permitted.

FONAR CORPORATION AND SUBSIDIARIES

We restructured the corporate organization of our physician and diagnostic services management segment of our business effective July 1, 2015. Imperial Management Services, LLC (“Imperial”), a subsidiary which owned the assets used in the business of its parent, Health Management Corporation of America (which is wholly-owned by Fonar), transferred those assets to Health Diagnostics Management, LLC (“HDM”), which is another subsidiary of Health Management Corporation of America. As a result, going forward our physician and diagnostic management business will be conducted entirely through HDM, which is operating under the assumed name Health Management Company of America.

Fonar is engaged in the business of designing, manufacturing, selling and servicing magnetic resonance imaging scanners, also referred to as "MRI" or "MR" scanners, which utilize MRI technology for the detection and diagnosis of human disease, abnormalities, other medical conditions and injuries. Fonar’s founders built the first MRI scanner in 1977 and Fonar introduced the first commercial MRI scanner in 1980. Fonar is also the originator of the iron-core non-superconductive and permanent magnet MRI technology.

Fonar’s iron frame technology made Fonar the originator of "open" MRI scanners. We introduced the first "open" MRI in 1980. Since that time we have concentrated on further application of our “open” MRI, introducing most recently the Upright® Multi-Position™” MRI scanner (also referred to as the “Upright®” or “Stand-Up®” MRI scanner) and the Fonar 360™ MRI scanner. The Fonar 360™ MRI is not presently being marketed.

See Note 16 to the Consolidated Financial Statements for separate financial information regarding our medical equipment and physician and diagnostic management services segments.

FORWARD LOOKING STATEMENTS.

Certain statements made in this Annual Report on Form 10-K 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. These forward-looking statements 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. These assumptions 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 forward-looking statements included in this Annual Report will prove to be accurate. In light of the significant uncertainties inherent in our forward-looking statements, 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.

THE UPRIGHT® MRI SCANNER

The Upright® MRI scanner is the product we are presently promoting. The Upright® MRI (also known as the "Stand-Up® MRI") is a "whole-body" MRI, meaning it can be used to scan any part of the body. Unlike conventional recumbent MRI scanners, the Upright® MRI permits MRI scans to be made in the weight-bearing state. The Upright® MRI allows patients to be scanned while standing, sitting, bending or lying down. This means that an abnormality or injury, such as a slipped disk, may be scanned in a weight-bearing posture, which more often than not is the position in which patients experience pain. An adjustable bed allows patients to stand, sit or lie on their backs, sides or stomachs. The Upright® MRI is by design a non-claustrophobic MRI scanner. We have introduced the name "Upright®" as an alternative to "Stand-Up®" because of the multiplicity of positions in which the patient may be scanned where the patient is not standing.

HMCA manages a total of 26 MRI scanning facilities, four of which are owned by subsidiaries of HMCA. Nineteen facilities are located in New York and seven are located in Florida. (The four facilities owned by HMCA subsidiaries are in Florida, where the corporate practice of medicine is permitted.) Twenty-four facilities are equipped with Upright® MRI scanners. We believe that the utilization of Fonar Upright® MRI scanning systems, which are produced under the protection of our patents, have been a significant factor in the increased patient volume of the scanning facilities.

FONAR CORPORATION AND SUBSIDIARIES

MEDICAL EQUIPMENT SEGMENT

PRODUCTS

The Fonar Upright® MRI is a weight-bearing whole-body open MRI system which enables positional MRI (pMRI®) applications. Operating at a magnetic field strength of 0.6 Tesla, the scanner is a powerful, diagnostically versatile and cost-effective open MRI that provides a broad range of clinical capabilities and a complete set of imaging protocols. Patients can be scanned standing, bending, sitting, upright at an intermediate angle and in the conventional recumbent position. This multi-positional MRI system accommodates an unrestricted range of motion for flexion, extension, lateral bending, and rotation studies of the cervical (upper) and lumbar (lower) spine. Previously difficult patient scanning positions can be achieved and compared using the system's MRI-compatible, three-dimensional, motorized patient handling system. The system's lift and tilt functions deliver the targeted anatomical region to the center of the magnet. True image orientation is assured, regardless of the rotation angle, via computer read-back of the table's position.

There is considerable evidence that the weight-bearing Upright® MRI provides medical benefits not duplicated by any other MRI scanner because patient positioning plays a critical role in detecting clinically significant pathology.

For instance, the Fonar Upright® technology has demonstrated its key value on patients with the Arnold-Chiari Syndrome, which is believed to affect 200,000 to 500,000 Americans. In this syndrome, brain stem compression and subsequent severe neurological symptoms occur in these patients, when because of weakness in the support tissues within the skull, the brain stem descends and is compressed and entrapped at the base of the skull in the foramen magnum, which is the circular bony opening at the base of the skull where the spinal cord exits the skull. The brain structures "entrapped" in Chiari Syndrome are the lowest lying structures of the brain, the tonsils of the cerebellum. The Chiari Syndrome is therefore alternately named Cerebellar Tonsillar Ectopia (CTE) indicating the displacement (ectopia) of these Cerebellar tonsils in this syndrome. Classic symptoms of the Chiari Syndrome include the "drop attack," where the patient unexpectedly experiences an explosive rush or nervous discharge at the base of the brain which rushes down the body to the extremities, causing the patient to collapse in a temporary neuromuscular paralysis; this subsides when the patient is lying down. Conventional lie-down MRI scanners cannot make an adequate evaluation of the pathology since the patient's pathology is most visible and the symptoms are most acute when the patient is scanned in the upright weight-bearing position.

A publication in the Journal "Brain Injury" (Brain Injury 2010, 24 (7-8) 988-994) of 1,200 neck pain patients reported that the fallen cerebellar tonsils of the brain (CTE) were missed 75% of the time when the patient was scanned only in the recumbent position. It is critical to have an image of the patient in an upright position so that the neurosurgeons can fully evaluate the extent of the brain stem and choose the most appropriate surgical approach for the operative repair.

The study was published by 10 authors from distinguished universities in the United States and around the world. The study reported that Cerebellar Tonsillar Ectopia Herniation (CTE) was missed 75% of the time when the patient was scanned lying down instead of upright. At the current rate of 1,000,000 automobile whiplash injuries in the U.S. per year, 600,000 patients each year would have the pathology responsible for their symptoms go undetected if they were examined solely in a conventional recumbent-only MRI.

The Upright® MRI has also demonstrated its value for patients suffering from scoliosis. Scoliosis patients have been typically subjected to routine x-ray exams for years and must be imaged upright for an adequate evaluation of their scoliosis. Because the patient must be standing for the exam, an x-ray machine has been the only modality that could provide that service. The Upright® MRI is the only MRI scanner that allows the patient to stand during the MRI exam. Fonar has developed a new RF receiver and scanning protocol that for the first time allows scoliosis patients to obtain diagnostic pictures of their spines without the risks of x-rays. A study by the National Cancer Institute (2000) of 5,466 women with scoliosis reported a 70% increase in breast cancer resulting from 24.7 chest x-rays these patients received on the average in the course of their scoliosis treatment.

Other important new applications are Upright® imaging of the pelvic floor and abdomen to image prolapses and inguinal hernias. Fonar has also developed the first non-invasive method to image the prostate: the patient simply sits on a flat, seat-like coil.

The Upright® MRI is also the world's most non-claustrophobic whole-body MRI scanner. Patients can simply walk into the magnet, stand or sit for their scans and then walk out. The magnet's front-open and top-open design provides an unprecedented degree of comfort because there is nothing in front of the patient's face except a large (42") flat-screen TV that is mounted on the wall. The default position for the bed is a tilt back of six degrees that minimizes patient motion. Special RF receiver coil fixtures, a patient seat, Velcro straps, and transpolar stabilizing bars are also used to keep the patient comfortable and motionless throughout the scanning process.

Full-range-of-motion studies of the joints in a multiple of directions are possible, an especially promising feature for sports injuries. Full range of motion cines, or movies, of the lumbar spine can also be achieved under full body weight.

Fonar created the high-field open MRI market segment. The Fonar Upright® MRI operates at a significantly higher magnetic field strength than the 0.2-0.35 Tesla open MRIs that preceded it, and, therefore, benefits from more of the MRI image-producing signal needed to make high-quality MRI images.

Fonar maximizes image quality through an optimal combination of image signal to noise (S/N) and contrast-to noise (C/N) ratios. Technical improvements incorporated into the scanner design include increased image processing speed, high-S/N Organ Specific(TM) RF receiver coils, high performance front-end electronics featuring high-speed, wide-dynamic-range analog-to-digital conversion and a miniaturized ultra-low-noise pre-amplifier, high-speed automatic tuning, bandwidth-optimized pulse sequences, multi-bandwidth sequences, and off-center FOV imaging capability.

In addition to the signal-to-noise ratio, however, a major determinant of image quality that must be considered is contrast, the quality that enables reading physicians to clearly distinguish adjacent, and sometimes minute, anatomical structures from their surroundings. This quality is measured by contrast-to-noise ratios (C/N). Unlike S/N, which increases with increasing field strength, relaxometry studies have shown that C/N peaks in the mid-field range and actually falls off precipitously at higher field strengths. The Upright® MRI scanners operate squarely in the optimum C/N range.

FONAR's scanners are equipped with a variety of software features which enhance versatility and diagnostic capability. For example, SMART™ scanning allows for same-scan customization of multi-slice scans, each slice with its

own thickness, resolution, angle and position. This is an important feature for scanning parts of the body that include small-structure sub-regions requiring finer slice parameters. There is also Multi-Angle Oblique™ (MAO) imaging, and oblique imaging.

During fiscal 2018, sales of our Upright® MRI scanners accounted for approximately 0.5% of our total revenues and 0.4% of our medical equipment revenues, as compared to 0.9% of total revenues and 6.4% of medical equipment revenues in fiscal 2017, and 1.1% of our total revenues and 7.7% of medical equipment revenues in fiscal 2016.

FONAR's principal selling, marketing and advertising efforts have been focused on the Upright® MRI, which we believe is a particularly unique product, being the only MRI scanner which is both open and allows for weight-bearing imaging. We expect to continue our focus on the Upright® MRI in the immediate future.

The materials and components used in the manufacture of our products (circuit boards, computer hardware components, electrical components, steel and plastic) are generally available at competitive prices. We have not had difficulty acquiring such materials.

FONAR CORPORATION AND SUBSIDIARIES

PRODUCT MARKETING

The principal markets for the Company's scanners are private diagnostic imaging centers and hospitals.

We use internal and independent manufacturer’s representatives for domestic and foreign markets. None of Fonar’s competitors are entitled to make the Fonar Upright® MRI scanner.

Fonar’s Website includes interactive product information for interested customers.

Fonar’s marketing strategy has been designed to reach key purchasing decision makers with information concerning the Upright® MRI. This has led to many inquiries and to some sales of the Upright® MRI scanner and is intended to increase Fonar’s presence in the medical market. Fonar focuses on four target audiences: neurosurgeons, orthopaedic surgeons, radiologists and physicians in general.

1) Neurosurgeons and Orthopaedic Surgeons: These are the surgeons who can most benefit from the superior diagnostic benefits of the Fonar Upright® MRI with its Multi-Position® MRI diagnostic ability.

2) Radiologists: These physicians can now offer a new modality to their referring physicians.

3) All Physicians: The vast number of doctors who send patients for MRI’s need to be aware of the diagnostic advantages of the Fonar Upright® Multi-Position™.

Our advertising for Fonar and HMCA re-enforces the unique value provided by Fonar MRI scanners. We have increased internet awareness of our product by driving patient traffic to the Upright® scanning centers we manage via the Fonar website (www.fonar.com) as well as by creating Websites for each HMCA location. These websites give prospective customers of Upright® MRI scanners a view of operating Upright® MRI centers and highlight the benefits of using an Upright® MRI scanner. The success of HMCA-managed sites not only increases management fees to HMCA but encourages new sales for Fonar as well. A complete list of the sites managed by HMCA can be found at HMCA’s website, hmca.com.

SERVICE AND UPGRADES FOR MRI SCANNERS

Our customer base of installed scanners has been and will continue to be an additional source of income, independent of direct sales.

Income is generated from the installed base in two principal areas, namely, service and upgrades. Service and maintenance revenues from our external installed base were approximately $9.6 million in fiscal 2017 and $9.2 million in fiscal 2018. Our objective is to maintain service revenues at present levels or better, based on the longevity of the technology, and the refurbishments and upgrades which keep the scanners competitive with the latest techniques.

We also anticipate that our scanners will result in upgrades income in future fiscal years. The potential for upgrades income, originates in the versatility and productivity of the Upright® Imaging technology. New medical uses for MRI technology are constantly being discovered and are anticipated for the Upright® Imaging technology as well. New features can often be added to the scanner by the implementation of little more than versatile new software packages, which when coupled with hardware upgrades can add years of useful life to the scanner.

FONAR CORPORATION AND SUBSIDIARIES

RESEARCH AND DEVELOPMENT

During the fiscal year ended June 30, 2018, we incurred expenditures of $1,755,747, none of which were capitalized, on research and development, as compared to $1,480,670, none of which were capitalized, during the fiscal year ended June 30, 2017.

Research and development activities have focused principally on software improvements to the user interface of the MRI scanner. The Windows-based Sympulse™ platform controls all of the functions of the Upright® scanner except those of the versatile, multi-position patient table. Separate, dedicated, motion-control software is used to maneuver the Upright® bed, and development of this software is ongoing as well.

While software improvements to the user interface are important in their own right, significant value is added to the MRI scanner by the modification of existing protocols for examining various parts of the body, and the development of new protocols that utilize new underlying capabilities of the pulse sequence software. Over time, FONAR users have become accustomed to the steady improvement in the recommended clinical protocols that accompany new software releases. More significantly, in recent years we have seen increasing adoption of FONAR-recommended clinical protocols over those developed on site. This is a testament to the superior image quality they produce in attractively short scan times.

The development of clinically practical scan protocols and software depends on close contact between research and development scientists and engineers, and end users. That close contact is facilitated in part by the relationship with HMCA and the scanning centers. In addition to that collaboration, R&D staff have pursued a variety of novel and Upright® MRI-specific research projects. It is anticipated that these will ultimately lead to new applications that are made available to existing customers as upgrade add-ons to their machines. For example, phase-contrast imaging techniques originally developed for angiography have recently been applied to cerebro-spinal fluid (CSF) flow. Analysis of CSF flow in upright and recumbent postures may prove to be of significant value in the evaluation of a variety of disorders.

BACKLOG

Our backlog of unfilled orders at September 5, 2018 was approximately $692,000, as compared to $735,000 at September 13, 2017. It is expected that the existing backlog of orders will be filled within the 2018 fiscal year.

PATENTS AND LICENSE

We currently have numerous patents in effect which relate to the technology and components of our MRI scanners. We believe that these patents, and the know-how we have developed, are material to our business.

One of our patents, issued in the name of Dr. Damadian and licensed to Fonar, was United States patent No. 3,789,832, Apparatus and Method for Detecting Cancer in Tissue, also referred to in this report as the "1974 Patent". The 1974 Patent was the first MRI patent issued by the United States Patent Office. The development of our MRI scanners has been based upon the 1974 Patent, and we believe that the 1974 Patent was the first of its kind to utilize MR to scan the human body and to detect cancer. The 1974 Patent was extended beyond its original 17-year term and expired in February, 1992.

We have significantly enhanced our patent position within the industry and now possesses a substantial patent portfolio which provides us, under the aegis of United States patent law, "the exclusive right to make, use and sell" many of the scanner features which Fonar pioneered and which are now incorporated in most MRI scanners sold by the industry. As of June 30, 2018, 209 patents had been issued to Fonar, and approximately 20 patents were pending. A number of Fonar’s existing patents specifically relate to protecting Fonar’s position in the Upright MRI market. The patents further enhance Dr. Damadian's pioneer patent, the 1974 Patent, that initiated the MRI industry and provided the original invention of MRI scanning. The terms of the patents in Fonar’s portfolio extend to various times.

We also have patent cross-licensing agreements with other MRI manufacturers. We have not licensed, however, any technology relating to Upright® MRI scanning.

FONAR CORPORATION AND SUBSIDIARIES

PRODUCT COMPETITION

MRI SCANNERS

MRI takes advantage of the nuclear magnetic resonance signal elicited from the body's tissues and the exceptional sensitivity of this signal for detecting disease discovered by Fonar. Much of the serious disease of the body occurs in the soft tissue of vital organs. The maximum contrast available by x-ray with which to discriminate disease is 4%. Brain cancers differ from surrounding healthy brain by only 1.6% while the contrast in the brain by MRI is 25 times greater at 40%. X-ray contrasts among the body’s soft tissues are maximally 4%. Their contrast by MRI is 32.5 times greater (130%).

The soft tissue contrasts with which to distinguish cancers on images by MRI are up to 180%. In the case of cancer these contrasts can be even more marked making cancers readily visible and detectable anywhere in the body. This is because the nuclear resonance signals from the body's normal soft tissue vital organs, as discovered in the original publication that founded MRI, differ so dramatically from each other (e.g. small intestine 257 milliseconds, brain 595 milliseconds). Liver cancer and healthy liver signals differ by 180% for example.

A majority of the MRI scanners in use in hospitals and outpatient facilities and at mobile sites in the United States are based on high field (1.5 - 3.0 Tesla) air core superconducting magnet technology.

The remainder, described as Open MRIs, are recumbent-only machines based on Fonar’s original iron-frame vertical magnetic field magnet design. These systems have been manufactured and sold by many of our largest competitors over the years. They generally operate at low field strengths (0.2 - 0.35 Tesla). Their prevalence in the marketplace has led to the perception of the medical community that Open MRIs are useful only for anxious and claustrophobic patients, that the Open MRI’s image quality is poor, and that the scan times are long. Recently our competitors have introduced higher field strength Open MRI products (0.5 – 1.2 Tesla). Significantly better imaging performance (especially at 1.2 T) compared to the low field strength systems, is beginning to change that perception. However, Fonar continues to maintain its competitive advantage at 0.6 Tesla due to our front-open non-claustrophobic configuration in which there is nothing in front of the patient’s face, and our unique ability to scan patients in weight-bearing positions that is sometimes more consequential than a small increase in the image resolution and decrease in scan time. It is also noteworthy that our horizontal transaxial magnetic field allows the Upright MRI, in contrast to the recumbent-only Open MRIs, to use the same flat planar-style radiofrequency receiver coil as the high-field MRI systems to image the lumbar and thoracic spine.

One of the Upright MRI's big competitive advantages is that it is dramatically different from the Open MRI in several important ways:

The Upright MRI does something clinically valuable that the high-field MRI machines cannot do (i.e. positional imaging, weight-bearing imaging).

Although the patient can extend his arms and possibly see out the sides while recumbent in an Open MRI, there is still a large intimidating magnet pole very close to and directly in front of the patient's face. The Upright MRI allows the patient to look directly out of the scanner and view a large flatscreen TV.

The Upright MRI uses the same configuration RF receiver coil as a high-field MRI system to image the spine. Open MRIs cannot do this. (This is because of the rule in MRI that the axis of symmetry of the RF receiver coil should be perpendicular to the direction of the main magnetic field). The upright patient sits comfortably with his back against a flat ("planar") RF receiver coil in our horizontal transaxial magnetic field. In contrast, the vertical magnetic field in the recumbent-only Open MRI precludes the use of this type of receiver coil.

FONAR CORPORATION AND SUBSIDIARIES

Relative to the high-field systems, the Upright MRI has two major competitive advantages:

Sometimes patient positioning is more consequential than a small increase in the image resolution and decrease in the scan time. As it is critical for physicians to not “miss” anything in the images, they recognize that the position-dependent pathology visualized with the Upright MRI will be invisible (“missed”) if their patients are scanned at a higher field strength.

Image artifacts arising from metal implants such as surgical screws are diminished with the 0.6 Tesla Upright MRI compared to those from the high-field MRIs. It is well known that such artifacts get smaller as the MRI magnet’s field strength is reduced, so the anatomy adjacent to implanted hardware will be less obscured with the Upright MRI. This is particularly valuable for surgeons referring their postoperative patients for diagnostic imaging studies.

Fonar faces competition within the MRI industry from such firms as General Electric Company, Philips N.V., Toshiba Corporation, Hitachi Corporation and Siemens A.G. Most competitors have marketing and financial resources more substantial than those available to us. They have in the past, and may in the future, heavily discount the sales price of their scanners. Such competitors sell both high field air core superconducting MRI scanners and iron frame products. Fonar’s original iron frame design, ultimately imitated by Fonar’s competitors to duplicate Fonar’s origination of “Open” MRI magnets, gave rise to current patent protected Upright® MRI technology with the result that Fonar today is the unique and only supplier of the highest field MRI magnets (0.6 Tesla) that are not superconducting, do not use liquid helium and are not therefore susceptible to severe consequences and downtime cause by a system quench.

The iron frame, because it controls the magnetic lines of force and places them where wanted and removes them from where not wanted, provides a more versatile magnet design than is possible with air core magnets. Air core magnets contain no iron but consist entirely of turns of current carrying wire.

Fonar expects to be the leader in weight-bearing and positional MRI for providing dynamic visualization of body parts including the spine and extremities.

OTHER IMAGING MODALITIES

Fonar’s MRI scanners also compete with other diagnostic imaging systems, all of which are based upon the ability of energy waves to penetrate human tissue and to be detected by either photographic film or electronic devices for presentation of an image on a display monitor. Three different kinds of energy waves - X-ray, gamma and sound - are used in medical imaging techniques which compete with MRI medical scanning, the first two of which involve exposing the patient to potentially harmful radiation. These other imaging modalities compete with MRI products on

the basis of specific applications.

X-rays are the most common energy source used in imaging the body and are employed in three imaging modalities:

1. Conventional X-ray systems, the oldest method of imaging, are typically used to image bones and teeth. The image resolution of adjacent structures that have high contrast, such as bone adjacent to soft tissue, is excellent, while the discrimination between soft tissue organs is poor because of the nearly equivalent penetration of x-rays.

2. Computerized Tomography, also referred to as "CT", systems couple computers to x-ray instruments to produce cross-sectional images of particular large organs or areas of the body. The CT scanner addresses the need for images, not available by conventional radiography, that display anatomic relationships spatially. However, CT images are generally limited to the transverse plane and cannot readily be obtained in the two other planes, sagittal and coronal. Improved picture resolution is available at the expense of increased exposure to x-rays from multiple projections. Furthermore, the pictures obtained by this method are computer reconstructions of a series of projections and, once diseased tissue has been detected, CT scanning cannot be focused for more detailed pictorial analysis or obtain a chemical analysis.

FONAR CORPORATION AND SUBSIDIARIES

3. Digital radiography systems add computer image processing capability to conventional x-ray systems. Digital radiography can be used in a number of diagnostic procedures which provide continuous imaging of a particular area with enhanced image quality and reduced patient exposure to radiation.

Nuclear medicine systems, which are based upon the detection of gamma radiation generated by radioactive pharmaceuticals introduced into the body, are used to provide information concerning soft tissue and internal body organs and particularly to examine organ function over time.

Ultrasound systems emit, detect and process high frequency sound waves reflected from organ boundaries and tissue interfaces to generate images of soft tissue and internal body organs. Although the images are substantially less detailed than those obtainable with x-ray methods, ultrasound is generally considered harmless and therefore has found particular use in imaging the pregnant uterus.

X-ray machines, ultrasound machines, digital radiography systems and nuclear medicine compete with the MRI scanners by offering significantly lower price and space requirements. However, Fonar believes that the utility of the images produced by its MRI scanners is generally superior to the utility of the images produced by those other methodologies.

GOVERNMENT REGULATION

FDA Regulation

The Food and Drug Administration in accordance with Title 21 of the Code of Federal Regulations regulates the manufacturing and marketing of Fonar's MRI scanners. The regulations can be classified as either pre-market or post-market. The pre-market requirements include obtaining marketing clearance, proper device labeling, establishment registration and device listing. Once the products are on the market, Fonar must comply with post-market surveillance controls. These requirements include the Quality Systems Regulation, or "QSR", also known as Current Good Manufacturing Practices or CGMPs, and Medical Device Reporting, also referred to as MDR regulations. The QSR is a quality assurance requirement that covers the design, packaging, labeling and manufacturing of a medical device. The MDR regulation is an adverse event-reporting program.

Classes of Products

Under the Medical Device Amendments of 1976 to the Federal Food, Drug and Cosmetic Act, all medical devices are classified by the FDA into one of three classes. A Class I device is subject only to general controls, such as labeling requirements and manufacturing practices; a Class II device must comply with certain performance standards established by the FDA; and a Class III device must obtain pre-market approval from the FDA prior to commercial marketing. Fonar's products are Class II devices. Class II devices are subject to "General Controls"; General Controls include:

1. Establishment registration of companies which are required to register under 21 CFR Part 807.20, such as manufacturers, distributors, re-packagers and re-labelers.

2. Medical device listing with FDA of devices to be marketed.

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FONAR CORPORATION AND SUBSIDIARIES

3. Manufacturing devices in accordance with the Current Good Manufacturing Practices Quality System Regulation in 21 CFR Part 820.

4. Labeling devices in accordance with labeling regulations in 21 CFR Part 801 or 809.

5. Submission of a Premarket Notification, pursuant to 510(k), before marketing a device.

In addition to complying with general controls, Class II devices are also subject to special controls. Special controls may include special labeling requirements, guidance documents, mandatory performance standards and post-market surveillance.

On October 3, 2000 Fonar received FDA clearance for the Upright® MRI under the name “Indomitable”.

Premarketing Submission

Each person who wants to market Class I, II and some III devices intended for human use in the U.S. must submit a 510(k) to FDA at least 90 days before marketing unless the device is exempt from 510(k) requirements. A 510(k) is a pre-marketing submission made to FDA to demonstrate that the device to be marketed is as safe and effective, that is, substantially equivalent, SE, to a legally marketed device that is not subject to pre-market approval, PMA. Applicants must compare their 510(k) device to one or more similar devices currently on the U.S. market and make and support their substantial equivalency claims.

The FDA is committed to a 90-day clearance after submission of a 510(k), provided the 510(k) is complete and there is no need to submit additional information or data.

The 510(k) is essentially a brief statement and description of the product. As Fonar’s scanner products are Class II products, there are no pre-market data requirements.

An investigational device exemption, also referred to as IDE, allows the investigational device to be used in a clinical study pending FDA clearance in order to collect safety and effectiveness data required to support the Premarket Approval, also referred to as PMA, application or a Premarket Notification pursuant to 510(k), submission to the FDA. Clinical studies are most often conducted to support a PMA.

For the most part, however, we have not found it necessary to utilize IDE's. The standard 90 day clearance for our new MRI scanner products classified as Class II products makes the IDE unnecessary, particularly in view of the time and effort involved in compiling the information necessary to support an IDE.

Quality System Regulation

The Quality Management System is applicable to the design, manufacture, administration of installation and servicing of magnetic resonance imaging scanner systems. The FDA has authority to conduct detailed inspections of manufacturing plants, to establish Good Manufacturing Practices which must be followed in the manufacture of medical devices, to require periodic reporting of product defects and to prohibit the exportation of medical devices that do not comply with the law.

FONAR CORPORATION AND SUBSIDIARIES

Medical Device Reporting Regulation

Manufacturers must report all MDR reportable events to the FDA. Each manufacturer must review and evaluate all complaints to determine whether the complaint represents an event which is required to be reported to FDA. Section 820.3(b) of the Quality Systems regulation defines a complaint as, "any written, electronic or oral communication that alleges deficiencies related to the identity, quality, durability, reliability, safety, effectiveness, or performance of a device after it is released for distribution."

A report is required when a manufacturer becomes aware of information that reasonably suggests that one of their marketed devices has or may have caused or contributed to a death, serious injury, or has malfunctioned and that the device or a similar device marketed by the manufacturer would be likely to cause or contribute to a death or serious injury if the malfunction were to recur.

Malfunctions are not reportable if they are not likely to result in a death, serious injury or other significant adverse event experience.

A malfunction which is or can be corrected during routine service or device maintenance still must be reported if the recurrence of the malfunction is likely to cause or contribute to a death or serious injury if it were to recur.

We have established and maintained written procedures for implementation of the MDR regulation. These procedures include internal systems that:

provide for timely and effective identification, communication and evaluation of adverse events;

provide a standardized review process and procedures for determining whether or not an event is reportable; and

provide procedures to insure the timely transmission of complete reports.

These procedures also include documentation and record keeping requirements for:

information that was evaluated to determine if an event was reportable;

all medical device reports and information submitted to the FDA;

any information that was evaluated during preparation of annual certification reports; and

systems that ensure access to information that facilitates timely follow up and inspection by FDA.

FDA Enforcement

FDA may take the following actions to enforce the MDR regulation:

FDA-Initiated or Voluntary Recalls

FONAR CORPORATION AND SUBSIDIARIES

Recalls are regulatory actions that remove a hazardous, potentially hazardous, or a misbranded product from the marketplace. Recalls are also used to convey additional information to the user concerning the safe use of the product. Either FDA or the manufacturer can initiate recalls.

There are three classifications, i.e., I, II, or III, assigned by the Food and Drug Administration to a particular product recall to indicate the relative degree of health hazard presented by the product being recalled.

Class I

Is a situation in which there is a reasonable probability that the use of, or exposure to, a violative product will cause serious adverse health consequences or death.

Class II

Is a situation in which use of, or exposure to, a violative product may cause temporary or medically reversible adverse health consequences or where the probability of serious adverse health consequences is remote.

Class III

Is a situation in which use of, or exposure to, a violative product is not likely to cause adverse health consequences.

Fonar has initiated six voluntary recalls. Five of the recalls were Class II and one was Class III. The recalls involved making minor corrections to the product in the field. Frequently, corrections which are made at the site of the device are called field corrections as opposed to recalls.

Civil Money Penalties

The FDA, after an appropriate hearing, may impose civil money penalties for violations of the FD&C Act that relate to medical devices. In determining the amount of a civil penalty, FDA will take into account the nature, circumstances, extent, and gravity of the violations, the violator's ability to pay, the effect on the violator's ability to continue to do business, and any history of prior violations.

Warning Letters

FDA issues written communications to a firm, indicating that the firm may incur more severe sanctions if the violations described in the letter are not corrected. Warning letters are issued to cause prompt correction of violations that pose a hazard to health or that involve economic deception. The FDA generally issues the letters before pursuing more severe sanctions.

Seizure

seizure is a civil court action against a specific quantity of goods which enables the FDA to remove these goods from commercial channels. After seizure, no one may tamper with the goods except by permission of the court. The court usually gives the owner or claimant of the seized merchandise approximately 30 days to decide a course of action. If they take no action, the court will recommend disposal of the goods. If the owner decides to contest the government's charges, the court will schedule the case for trial. A third option allows the owner of the goods to request permission of the court to bring the goods into compliance with the law. The owner of the goods is required to provide a bond or, security deposit, to assure that they will perform the orders of the court, and the owner must pay for FDA supervision of any activities by the company to bring the goods into compliance.

Citation

A citation is a formal warning to a firm of intent to prosecute the firm if violations of the FD&C Act are not corrected. It provides the firm an opportunity to convince FDA not to prosecute.

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Injunction

An injunction is a civil action filed by FDA against an individual or company. Usually, FDA files an injunction to stop a company from continuing to manufacture, package or distribute products that are in violation of the law.

Prosecution

Prosecution is a criminal action filed by FDA against a company or individual charging violation of the law for past practices.

Foreign and Export Regulation

We obtain approvals as necessary in connection with the sales of our products in foreign countries. In some cases, FDA approval has been sufficient for foreign sales as well. Our standard practice has been to require either the distributor or the customer to obtain any such foreign approvals or licenses which may be required.

Legally marketed devices that comply with the requirements of the Food Drug & Cosmetic Act require a Certificate to Foreign Government issued by the FDA for export. Other devices that do not meet the requirements of the FD&C Act but comply with the laws of a foreign government require a Certificate of Exportability issued by the FDA. All products which we sell have FDA clearance and would fall into the first category.

Foreign governments have differing requirements concerning the import of medical devices into their respective jurisdictions. The European Union, also referred to as EU, has some essential requirements described in the EU's Medical Device Directive, also referred to as MDD. In order to export to one of these countries, we must meet the essential requirements of the MDD and any additional requirements of the importing country. The essential requirements are similar to some of the requirements mandated by the FDA. In addition the MDD requires that we enlist a Notified Body to examine and assess our documentation, a Technical Construction File, and verify that the product has been manufactured in conformity with the documentation. The notified body must carry out or arrange for the inspections and tests necessary to verify that the product complies with the essential requirements of the MDD, including safety performance and Electromagnetic Compatibility, also referred to as EMC. Also required is a Quality System, ISO-9001, assessment by the Notified Body. We were approved for ISO 9001 certification for its

Quality Management System in April, 1999.

We received clearance to sell the Upright® MRI scanners in the EU in May, 2002.

Other countries require that their own testing laboratories perform an evaluation of our devices. This requires that we must bring the foreign agency's personnel to the USA to perform the evaluation at our expense before exporting.

Some countries, including many in Latin America and Africa, have very few regulatory requirements, beyond FDA clearance.

To date, Fonar has been able to comply with all foreign regulatory requirements applicable to its export sales.

PHYSICIAN AND DIAGNOSTIC SERVICES MANAGEMENT BUSINESS

In 2011, Health Management Corporation of America (HMCA) transferred its business and assets to Imperial management Services, LLC ("Imperial"), a New York limited liability company, in connection with raising capital from investors. HMCA maintained a majority interest in Imperial. The assets continued to be used in our business of managing diagnostic imaging centers.

FONAR CORPORATION AND SUBSIDIARIES

Through an agreement dated March 6, 2013, HMCA acquired another business engaged in the management and, in the case of four sites located in Florida, the ownership, of diagnostic imaging facilities. The purchase was made through a new limited liability company, Health Diagnostics Management, LLC ("HDM"), which raised part of the capital necessary for the acquisition from investors. (HDM did not take over the operation of the four Florida sites until April, 2013.)

On July 1, 2015, the corporate organization was restructured under HDM.

On June 30, 2016, the Company purchased 100% of the equity in Turnkey Services of New York, LLC and 100% of the equity in TK2 Equipment Management, LLC. Turnkey Services of New York, LLC and TK2 Equipment Management, LLC, both by way of several operating leases, had provided the Company with ancillary diagnostic imaging equipment to our managed (and in the case of four Florida sites, owned) MRI facilities.

As a result of acquisitions, restructuring and re-acquisitions of interest held by investors as of July 1, 2016, HDM now is owned by Health Management Corporation of America (70%) and investors (30%).

HDM now operates under the assumed name "Health Management Company of America" ("HMCA").

The combined business (HDM, Imperial and Health Management Corporation of America) will be referred to as "HMCA" for all periods before and after July 1, 2015, unless otherwise indicated.

HMCA provides comprehensive non-medical management services to diagnostic imaging facilities. These services include development, administration, leasing of office space, facilities, equipment, provision of supplies, staffing, training and supervision of non-medical personnel, credentialing, accounting, billing and collection, assistance with compliance matters and the development and implementation of practice growth and marketing strategies.

As of August 1, 2018, HMCA managed a total of 26 MRI centers. For the 2018 fiscal year, the revenues HMCA recognized from the MRI facilities had increased to $71.7 million, and for the 2017 fiscal year the revenues were increased to $66.8 million. Four of these facilities in Florida are owned by HMCA subsidiaries.

HMCA GROWTH STRATEGY

HMCA’s growth strategy focuses on upgrading and expanding the existing facilities it manages and expanding the number of facilities it manages for its clients, including new sites. In connection with improving the performance of the facilities, we have added high field MRI scanners, extremity scanners and x-ray machines to the Upright® MRI scanner at certain of the sites where such additional diagnostic imaging modalities are expected to produce the greatest return.

PHYSICIAN AND DIAGNOSTIC MANAGEMENT SERVICES

HMCA’s services to the facilities it manages encompass substantially all of their business operations. Each facility is controlled, however, not by HMCA, but by the physician owner, or in the case of the four Florida sites owned by HMCA subsidiaries, by the medical director, and all medical services are performed by physicians and other medical personnel under the physician-owner’s supervision. HMCA is the management company and performs services of a non-medical nature. These services include:

1. Offices and Equipment. HMCA identifies, negotiates leases for and/or provides office space and equipment to its clients. This includes technologically sophisticated medical equipment. HMCA also provides improvements to leaseholds, assistance in site selection and advice on improving, updating, expanding and adapting to new technology.

2. Personnel. HMCA staffs all the non-medical positions of its clients with its own employees, eliminating the client's need to interview, train and manage non-medical employees. HMCA processes the necessary tax, insurance and other documentation relating to employees.

FONAR CORPORATION AND SUBSIDIARIES

3. Administrative. HMCA assists in the scheduling of patient appointments, purchasing of office and medical supplies and equipment and handling of reporting, accounting, processing and filing systems. It prepares and files the physician portions of complex applications to enable its clients to participate in managed care programs and to qualify for insurance reimbursement. HMCA assists the clients to implement programs and procedures to ensure full and timely regulatory compliance and appropriate cost reimbursement under no-fault insurance and Workers' Compensation guidelines, as well as compliance with other applicable governmental requirements and regulations, including HIPAA and other privacy requirements.

4. Billing and Collections. HMCA is responsible for the billing and collection of revenues from third-party payors including those governed by No-Fault and Workers' Compensation statutes. HMCA is presently using a third party to perform its billing and collection services for its clients' No-Fault and Workers' Compensation scanning business.

5. Cost Saving Programs. Based on available volume discounts, HMCA seeks to assist in obtaining favorable pricing for office and medical supplies, medical imaging film, equipment, contrast agents, such as gadolinuim, and other inventory for its clients.

6. Diagnostic Imaging and Ancillary Services. HMCA can offer access to diagnostic imaging equipment through diagnostic imaging facilities it manages. The Company is expanding the ancillary services offered in its network to include x-rays, and other MRI equipment such as high-field (1.5 or 3.0 Tesla magnet strength) MRI scanners and extremity MRI scanners.

7. Marketing Strategies. HMCA is responsible for developing and proposing marketing plans for its clients.

8. Expansion Plans. HMCA assists the clients in developing expansion plans including the opening of new or replacement facilities where appropriate.

HMCA's objective is to free physicians from as many non-medical duties as is practicable, allowing physicians to spend less time on business and administrative matters and more time practicing medicine.

The exceptions to this general model of operation are four of the facilities acquired by HMCA from Health Diagnostics, LLC in April, 2013 in Florida. These Florida facilities are owned by limited liability companies which, as our subsidiaries, conduct their operations directly and bill and collect their fees from the patients and third party payors.

The facilities enter into contracts with third party payors, including managed care companies. None of HMCA's clients, however, participate in any capitated plans or other risk sharing arrangements. Capitated plans are those HMO programs where the provider is paid a flat monthly fee per patient.

The management fees payable by the facilities to HMCA are flat monthly fees. In fiscal 2017, the aggregate amount of management fees was $3,926,536 per month. In fiscal 2018, the aggregate amount of management fees was $4,061,255 per month.

Fees under the management agreements are subject to adjustment by mutual agreement on an annual basis.

Dr. Damadian owns three HMCA-managed MRI facilities in Florida. The fees for these three sites in Florida owned by Dr. Damadian are flat monthly fees which are subject to adjustment by mutual agreement on an annual basis. In fiscal 2018, the aggregate monthly amount of management fees payable to HMCA by these sites was $748,907.

The Florida facilities owned by HMCA subsidiaries directly bill their patients or the patients' insurance carriers. Patient fees net of provision for bad debt were $21,268,885 in fiscal 2018.

FONAR CORPORATION AND SUBSIDIARIES

HMCA contracts with an outside billing company (located in Melville, New York) to perform billing and collection for their clients' No-Fault and Workers' Compensation business. The fixed monthly fees were $85,000 for HMCA in fiscal 2017 and fiscal 2018.

HMCA MARKETING

HMCA's marketing strategy is to expand the business and improve the facilities which it manages. HMCA is seeking to increase the number of locations of those facilities where market conditions are promising and to promote growth of our clients' and Florida subsidiaries' patient volume and revenue.

DIAGNOSTIC IMAGING FACILITIES

Diagnostic imaging facilities managed or owned by HMCA provide diagnostic imaging services to patients referred by physicians. The facilities are operated in a manner which eliminates the admission and other administrative inconveniences of in-hospital diagnostic imaging services. Imaging services are performed in an outpatient setting by trained medical technologists under the direction of physicians. Following diagnostic procedures, the images are reviewed by the interpreting physicians who prepare reports of these tests and their findings. Reports for the New York facilities are transcribed by HMCA personnel and reports for the Florida facilities are outsourced to professional transcription services.

HMCA develops marketing programs and educational programs in an effort to establish and maintain referring physician relationships for our clients and Florida subsidiaries and to maximize reimbursement yields. HMCA also directs its marketing and educational efforts to managed care providers.

Managed care providers are an important factor in the diagnostic imaging industry. To further its position, HMCA is seeking to expand the imaging modalities offered at its managed and owned diagnostic imaging facilities. Three facilities in New York and four facilities in Florida have two or more MRI scanners. One facility in New York and two in Florida also perform x-rays. An additional MRI scanner is also being added to the Tallahassee, Florida site and should be completed by December 2018.

REIMBURSEMENT

Facilities managed or owned by HMCA receive reimbursements for their services through Medicare, Medicaid, managed care, private commercial insurance, third party administrators, Workers' Compensation, No-Fault and other insurance.

Medicare

The Medicare program provides reimbursement for hospitalization, physician, diagnostic and certain other services to eligible persons 65 years of age and over and certain other individuals. Providers are paid by the federal government in accordance with regulations promulgated by the Department of Health and Human Services, HSS, and generally accept the payment with nominal deductible and co-insurance amounts required to be paid by the service recipient, as payment in full. Hospital inpatient services are reimbursed under a prospective payment system. Hospitals receive a specific prospective payment for inpatient treatment services based upon the diagnosis of the patient.

Under Medicare's prospective payment system for hospital outpatient services, or OPPS, a hospital is paid for outpatient services on a rate per service basis that varies according to the ambulatory payment classification group, or APC, to which the service is assigned rather than on a hospital's costs. Each year the Centers for Medicare and Medicaid Services, or CMS, publishes new APC rates that are determined in accordance with the promulgated methodology.

Services provided in non-hospital based freestanding facilities are paid under the Medicare Physician Fee Schedule, or MPFS. All of HMCA's clients are presently in this category. The MPFS is updated on an annual basis and sometimes modified more frequently.

Healthcare Reform Legislation

Healthcare reform legislation enacted in the first quarter of 2010 by the Patient Protection and Affordable Care Act or PPACA, specifically requires the U.S. Department of Health and Human Services, in computing physician practice expense relative value units, to increase the equipment utilization factor for advanced diagnostic imaging services (such as MRI, CT and PET) from a presumed utilization rate of 50% to 65% for 2010 through 2012, 70% in 2013, and 75% thereafter. Excluded from the adjustment are low-technology imaging modalities such as ultrasound, X-ray and fluoroscopy. The Health Care and Education Reconciliation Act of 2010 (H.R. 4872) or Reconciliation Act, which was approved by the President on March 30, 2010, amends the provision for higher presumed utilization of advanced diagnostic imaging services to a presumed rate of 75%. These changes may result in decreased revenue for the services performed by our clients for Medicare beneficiaries. Other changes in reimbursement for services rendered by Medicare Advantage plans may also reduce the revenues for services rendered to Medicare Advantage enrollees.

We have experienced reimbursement reductions for radiology services provided to Medicare beneficiaries, including reductions pursuant to the Deficit Reduction Act, or DRA.

The DRA, which became effective in 2007, set reimbursement for the technical component for imaging services (excluding diagnostic and screening mammography) in non-hospital based freestanding facilities at the lesser of OPPS or the MPFS.

In addition to the foregoing changes to the usage assumptions, CMS' 2010 regulatory changes to the MPFS also included a downward adjustment to services primarily involving the technical component rather than the physician work component, by adjusting downward malpractice payments for these services. These adjustments have been phased in over a four year period. For our fiscal year ended June 30, 2018, Medicare revenues represented approximately 4.4% of the revenues for HMCA's clients and subsidiaries as compared to 4.8% for the fiscal year ended June 30, 2017. In January, 2014 additional reductions in Medicare reimbursement were adopted, and New York State is expected to propose reducing Workers' Compensation reimbursements.

Because of the many variables involved, we are unable to predict how the legislative mandates contained in PPACA will be implemented, in their complete and final form, whether any additional changes to PPACA or regulations (including interpretations), will occur in the future, or what effect any other future legislation or regulation would have

on our business. Many commercial insurance companies, however, tie their reimbursement rates to the government reimbursement levels.

Medicaid

The Medicaid program is a jointly-funded federal and state program providing coverage for low-income persons. In addition to federally-mandated basic services, the services offered and reimbursement methods vary from state to state. In many states, Medicaid reimbursement is patterned after the Medicare program; however, an increasing number of states have established or are establishing payment methodologies intended to provide healthcare services to Medicaid patients through managed care arrangements. In fiscal 2018, approximately 0.15% of the revenues of HMCA's clients were attributable to Medicaid, as compared to 0.19% in fiscal 2017. Four of the Florida facilities (those owned by HMCA subsidiaries) do not participate in Medicaid.

FONAR CORPORATION AND SUBSIDIARIES

Managed Care and Private Insurance.

Health Maintenance Organizations, or HMO's, Preferred Provider Organizations, or PPOs, and other managed care organizations attempt to control the cost of healthcare services by a variety of measures, including imposing lower payment rates, preauthorization requirements, limiting services and mandating less costly treatment alternatives. Managed care contracting is competitive and reimbursement schedules in many cases can be at or below Medicare reimbursement levels. Some managed care organizations have reduced or otherwise limited, and other managed care organizations may reduce or otherwise limit, reimbursement in response to reductions in government reimbursement. These reductions could have an adverse impact on our financial condition and results of operations. These reductions have been, and any future reductions may be, similar to the reimbursement reductions proposed by CMS, Congress and the current federal government administration.

HMCA COMPETITION

The physician and diagnostic management services field is highly competitive. A number of large hospitals have acquired medical practices and this trend may continue. HMCA expects that more competition will develop. Many competitors have greater financial and other resources than HMCA.

With respect to the diagnostic imaging facilities managed by HMCA, the outpatient diagnostic imaging industry is highly competitive. Competition focuses primarily on attracting physician referrals at the local market level and increasing referrals through relationships with managed care organizations, as well as emphasizing to potential referral sources the advantages of Upright® MRI scanning. HMCA believes that principal competitors for the diagnostic imaging centers are hospitals and independent or management company-owned imaging centers. Competitive factors include quality and timeliness of test results, ability to develop and maintain relationships with managed care organizations and referring physicians, type and quality of equipment, facility location, convenience of scheduling and availability of patient appointment times. HMCA believes that it will be able to effectively meet the competition in the outpatient diagnostic imaging industry with the Fonar Upright® MRI scanners and strategically placed high field MRI scanners at its facilities.

GOVERNMENT REGULATION APPLICABLE TO HMCA

FEDERAL REGULATION

The healthcare industry is highly regulated and changes in laws and regulations can be significant. Changes in the law or new interpretation of existing laws can have a material effect on our permissible activities, the relative costs

associated with doing business and the amount of reimbursement by government and other third-party payors.

Federal False Claims Act

The federal False Claims Act and, in particular, the False Claims Act's "qui tam" or "whistleblower" provisions allow a private individual to bring actions in the name of the government alleging that a defendant has made false claims for payment from federal funds. After the individual has initiated the lawsuit the government must decide whether to intervene in the lawsuit and to become the primary prosecutor. If the government declines to join the lawsuit, the individual may choose to pursue the case alone, although the government must be kept apprised of the progress of the lawsuit, and may intervene later. Whether or not the federal government intervenes in the case, it will receive the majority of any recovery.

When an entity is determined to have violated the federal False Claims Act, it must pay three times the actual damages sustained by the government, plus mandatory civil penalties for each separate false claim and the government's attorneys' fees. Liability arises when an entity knowingly submits, or causes someone else to submit, a false claim for reimbursement to the federal government. The False Claims Act defines the term "knowingly" broadly, though simple negligence will not give rise to liability under the False Claims Act. Examples of the other actions which may lead to liability under the False Claims Act:

FONAR CORPORATION AND SUBSIDIARIES

Failure to comply with the many technical billing requirements applicable to our Medicare and Medicaid business.

Failure to comply with the prohibition against billing for services ordered or supervised by a physician who is excluded from any federal healthcare program, or the prohibition against employing or contracting with any person or entity excluded from any federal healthcare program.

Failure to comply with the Medicare physician supervision requirements for the services we provide, or the Medicare documentation requirements concerning physician supervision.

The Fraud Enforcement and Recovery Act of 2009 expanded the scope of the False Claims Act by, among other things, broadening protections for whistleblowers and creating liability for knowingly retaining a government overpayment, acting in deliberate ignorance of a government overpayment or acting in reckless disregard of a government overpayment. The recently enacted healthcare reform bills in the form of the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010 (collectively, “PPACA”) expanded on changes made by the 2009 Fraud Enforcement and Recovery Act with regard to such “reverse false claims.” Under PPACA, the knowing failure to report and return an overpayment within 60 days of identifying the overpayment or by the date a corresponding cost report is due, whichever is later, constitutes a violation of the False Claims Act. HMCA and its clients have never been sued under the False Claims Act and believe they are in compliance with the law.

Stark Law

Under the federal Self-Referral Law, also referred to as the "Stark Law", which is applicable to Medicare and Medicaid patients, and the self-referral laws of various States, certain health practitioners, including physicians, chiropractors and podiatrists, are prohibited from referring their patients for the provision of designated health services, including diagnostic imaging and physical therapy services, to any entity with which they or their immediate family members have a financial relationship, unless the referral fits within one of the specific exceptions in the statutes or regulations. The federal government has taken the position that a violation of the federal Stark Law is also a violation of the Federal False Claims Act. Statutory exceptions under the Stark Law include, among others, direct physician services, in-office ancillary services rendered within a group practice, space and equipment rental and services rendered to enrollees of certain prepaid health plans. Some of these exceptions are also available under the State self-referral laws. HMCA believes that it and its clients are in compliance with these laws.

Anti-kickback Regulation

We are subject to federal and state laws which govern financial and other arrangements between healthcare providers. These include the federal anti-kickback statute which, among other things, prohibits the knowing and willful

solicitation, offer, payment or receipt of any remuneration, direct or indirect, in cash or in kind, in return for or to induce the referral of patients for items or services covered by Medicare, Medicaid and certain other governmental health programs. Under PPACA, knowledge of the anti-kickback statute or the specific intent to violate the law is not required. Violation of the anti-kickback statute may result in civil or criminal penalties and exclusion from the Medicare, Medicaid and other federal healthcare programs, and according to PPACA, now provides a basis for liability under the False Claims Act. In addition, it is possible that private parties may file “qui tam” actions based on claims resulting from relationships that violate the anti-kickback statute, seeking significant financial rewards. Many states have enacted similar statutes, which are not limited to items and services paid for under Medicare or a federally funded healthcare program. Neither HMCA nor its clients engage in this practice.

In fiscal 2018, approximately 4.4% of the revenues of HMCA’s clients were attributable to Medicare and 0.15% were attributable to Medicaid. In fiscal 2017, approximately 5% of the revenues of HMCA’s clients were attributable to Medicare and 0.19% were attributable to Medicaid.

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Deficit Reduction Act (DRA)

On February 8, 2006, the President signed into law the DRA. Effective January 1, 2007, the DRA provides that Medicare reimbursement for the technical component for imaging services (excluding diagnostic and screening mammography) performed in freestanding facilities will be capped. Payment is the lesser of the Medicare Physician Fee Schedule or the Hospital Outpatient Prospective Payment System (OPPS) rates. Implementation of these reimbursement reductions contained in the DRA has had an adverse effect on our business. We have been able to counter this effect by increasing scan volumes at our owned and managed sites, through our vigorous marketing efforts installing additional equipment, and reducing our operating expenses.

The DRA also codified the reduction in reimbursement for multiple images on contiguous body parts previously announced by CMS, the agency responsible for administering the Medicare program. In November 2005, CMS announced that it would pay 100% of the technical component of the higher priced imaging procedure and 50% of the technical component of each additional imaging procedure for imaging procedures involving contiguous body parts within a family of codes when performed in the same session. CMS had indicated that it would phase in this 50% rate reduction over two years, so that the reduction was 25% for each additional imaging procedure in 2006 and another 25% reduction in 2007. However, for services furnished on or after July 1, 2010, the PPACA requires the full 50% reduction to be implemented.

Health Insurance Portability and Accountability Act

Congress enacted the Health Insurance Portability and Accountability Act of 1996, or HIPAA, in part, to combat healthcare fraud and to protect the privacy and security of patients' individually identifiable healthcare information. HIPAA, among other things, amends existing crimes and criminal penalties for Medicare fraud and enacts new federal healthcare fraud crimes, including actions affecting non-government healthcare benefit program by means of false or fraudulent representations in connection with the delivery of healthcare services is subject to a fine or imprisonment, or potentially both. In addition, HIPAA authorizes the imposition of civil money penalties against entities that employ or enter into contracts with excluded Medicare or Medicaid program participants if such entities provide services to federal health program beneficiaries. A finding of liability under HIPAA could have a material adverse effect on our business, financial condition and results of operations.

Further, HIPAA requires healthcare providers and their business associates to maintain the privacy and security of individually identifiable protected health information ("PHI"). HIPAA imposes federal standards for electronic transactions, for the security of electronic health information and for protecting the privacy of PHI. The Health Information Technology for Economic and Clinical Health Act of 2009 ("HITECH"), signed into law on February 17,

2009, dramatically expanded, among other things, (1) the scope of HIPAA to now apply directly to “business associates,” or independent contractors who receive or obtain PHI in connection with providing a service to a covered entity, (2) substantive security and privacy obligations, including new federal security breach notification requirements to affected individuals, DHHS and prominent media outlets, of certain breaches of unsecured PHI, (3) restrictions on marketing communications and a prohibition on covered entities or business associates from receiving remuneration in exchange for PHI, and (4) the civil and criminal penalties that may be imposed for HIPAA violations, increasing the annual cap in penalties from $25,000 to $1.5 million per occurrence. In 2013 additional legal requirements were adopted to provide further protection for PHI.

In addition, many states have enacted comparable privacy and security statues or regulations that, in some cases, are most stringent than HIPAA requirements. In those cases it may be necessary to modify our operations and procedures to comply with the more stringent state laws, which may entail significant and costly changes for us. We believe that we are in compliance with such state laws and regulations. However, if we fail to comply with applicable state laws and regulations, we could be subject to additional sanctions.

We believe that we are in compliance with the current HIPAA requirements, as amended by HITECH, together with other legislation and regulations, and comparable state laws, but we anticipate that we may encounter certain costs associated with future compliance. Moreover, we cannot guarantee that enforcement agencies or courts will not make interpretations of the HIPAA standards that are inconsistent with ours, or the interpretations of our contracted radiology practices or their affiliated physicians. A finding of liability under the HIPAA standards may result in significant criminal and civil penalties. Noncompliance also may result in exclusion from participation in government programs, including Medicare and Medicaid. These actions could have a material adverse effect on our business, financial condition, and results of operations.

Civil Money Penalty Law and Other Federal Statutes

The Civil Money Penalty, or CMP, law covers a variety of practices. It provides a means of administrative enforcement of the anti-kickback statute, and prohibits false claims, claims for medically unnecessary services, violations of Medicare participating provider or assignment agreements and other practices. The statute gives the Office of Inspector General of the HHS the power to seek substantial civil fines, exclusion and other sanctions against providers or others who violate the CMP prohibitions.

In addition, in 1996, Congress created a new federal crime: healthcare fraud and false statements relating to healthcare matters. The healthcare fraud statute prohibits knowingly and willfully executing a scheme to defraud any healthcare benefit program, including private payors. A violation of this statute is a felony and may result in fines, imprisonment or exclusion from government sponsored programs such as the Medicare and Medicaid programs.

Certificates of Need

Some states require hospitals and certain other healthcare facilities and providers to obtain a certificate of need, or CON, or similar regulatory approval prior to establishing certain healthcare operations or services, incurring certain capital projects and/or the acquisition of major medical equipment including MRI and PET/CT systems. We are not operating in any such states.

Patient Protection and Affordable Care Act

On March 23, 2010, President Obama signed into law healthcare reform legislation in the form of PPACA. The implementation of this law will likely have a profound impact on the healthcare industry. Most of the provisions of PPACA are being phased in over time and can be conceptualized as a broad framework not only to provide health insurance coverage to millions of Americans, but to fundamentally change the delivery of care by bringing together elements of health information technology, evidence-based medicine, chronic disease management, medical “homes,” care collaboration and shared financial risk in a way that will accelerate industry adoption and change. There are also many provisions addressing cost containment, reductions of Medicare and other payments and heightened compliance requirements and additional penalties, which will create further challenges for providers.

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State Regulation

In addition to the federal self-referral law and federal Anti-kickback statute, many States, including those in which HMCA and its clients operate, have their own versions of self-referral and anti-kickback laws. These laws are not limited in their applicability, as are the federal laws, to specific programs. HMCA believes that it and its clients are in compliance with these laws.

Various States prohibit business corporations from practicing medicine. Various States, including New York, also prohibit the sharing of professional fees or fee splitting. Consequently, in New York HMCA leases space and equipment to clients and provides clients with a range of non-medical administrative and managerial services for agreed upon fees. Under Florida law a business entity can bill patients and third party payors directly if that entity is properly licensed through AHCA. Four of the seven facilities in Florida are licensed healthcare clinics through AHCA.

HMCA’s clients and subsidiaries generate revenue from patients covered by no-fault insurance and workers' compensation programs. For the fiscal year ended June 30, 2018 approximately 56.8% of our clients’ receipts were from patients covered by no-fault insurance and approximately 8.3% of our client’s receipts were from patients covered by workers’ compensation programs. For the fiscal year ended June 30, 2017, approximately 54.5% of HMCA’s clients’ receipts were from patients covered by no-fault insurance and approximately 8.0% of HMCA’s clients’ receipts were from patients covered by workers’ compensation programs. The foregoing numbers do not include payments from third party administrators. In the event that changes in these laws alter the fee structures or methods of providing service, or impose additional or different requirements, HMCA could be required to modify its business practices and services in ways that could be more costly to HMCA or in ways that decrease the revenues which HMCA receives from its clients.

Compliance Program

We maintain a program to monitor compliance with federal and state laws and regulations applicable to the healthcare entities. We have a compliance officer who is charged with implementing and supervising our compliance program, which includes the adoption of (i) Standards of Conduct for our employees and affiliates and (ii) a process that specifies how employees, affiliates and others may report regulatory or ethical concerns to our compliance officer. We believe that our compliance program meets the relevant standards provided by the Office of Inspector General of the Department of Health and Human Services.

An important part of our compliance program consists of conducting periodic audits of various aspects of our operations and that of the contracted radiology practices. We also conduct mandatory educational programs designed to familiarize our employees with the regulatory requirements and specific elements of our compliance program.

HMCA believes that it and its clients are in compliance with applicable Federal, State and local laws. HMCA does not believe that such laws will have any adverse material effect on its business.

EMPLOYEES

Fonar and HMCA had approximately 525 employees as of September 5, 2018. This total number included 12 in production, 27 in customer support, 10 in research and development, 9 in information technology, 63 in marketing and sales, 37 Florida technologists, 59 in billing and collections, 1 in field services and 307 in various administrative positions. Approximately 301 employees were employed at the MRI facilities managed or owned by HMCA, primarily in administrative positions.

ITEM 1A. RISK FACTORS

An investment in our securities is subject to various risks, the most significant of which are summarized below.

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1. Reduced Reimbursement Rates. Most of our revenues are derived from our scanning center business conducted by HMCA. We are experiencing lower reimbursement rates from Medicare, other government programs and private insurance companies. To date, we have been able to counter the impact of these reductions by increasing our volume of scans and reducing our operating expenses, thereby maintaining profitability in this business segment. There is, however, no assurance that we will be able to continue to do so.

2. Demand for MRI Scanners. The reduced reimbursement rates also affects our sales of MRI scanners negatively. With lower revenue projections, prospective customers would demand lower prices for scanners. Although the reduced reimbursements may not affect foreign demand, a lower number of sales in the aggregate could reduce economies of scale and consequently, profit margins.

3. Manufacturing Competition. Many if not most of our competing scanner manufacturers have significantly greater financial resources, production capacity, and other resources than we do. Such competitors would include General Electric, Siemens, Hitachi and Phillips. Although Fonar is the only company which can manufacture and sell the unique Stand-Up® (Upright®) MRI scanner, potential customers must be convinced that the purchase of a Fonar scanner is their best choice. We believe that with time, that objective will be reached, particularly with customers scanning patients having neck, back, knee and various orthopedic issues who would benefit from being scanned in weight-bearing positions.

4. Dependence on Referrals. HMCA derives substantially all of its revenue, directly or indirectly, from fees charged for the diagnostic imaging services performed at the facilities. We depend on referrals of patients from unaffiliated physicians and other third parties to the facilities we manage or own for the services we perform. If these physicians and other third parties were to reduce the number of patients they refer or discontinue referring patients, scan volumes could decrease, which would reduce our net revenue and operating margins.

5. Pressure to Control Healthcare Costs. One of the principal objectives of health maintenance organizations and preferred provider organizations is to control the cost of healthcare services. Healthcare providers participating in managed care plans may be required to refer diagnostic imaging tests to certain providers depending on the plan in which a covered patient is enrolled. In addition, managed care contracting has become very competitive. The expansion of health maintenance organizations, preferred provider organizations and other managed care organizations within New York or Florida could have a negative impact on the utilization and pricing of services performed at the facilities HMCA manages or owns to the extent these organizations exert control over patients' access to diagnostic imaging services, selections of the provider of such services and reimbursement rates for those services.

6. Scanning Facility Competition. The market for diagnostic imaging services is highly competitive. The facilities we manage or own compete for patients on the basis of reputation, location and the quality of diagnostic imaging services. Groups of radiologists, established hospitals, clinics and other independent organizations that own and operate imaging equipment are the principal competitors.

7. Eligibility Changes to Insurance Programs. Due to potential decreased availability of healthcare through private employers, the number of patients who are uninsured or participate in governmental programs may increase. Healthcare reform legislation will increase the participation of individuals in the Medicaid program in states that elect to participate in the expanded Medicaid coverage. A shift in payor mix from managed care and other private payors to government payors or an increase in the number of uninsured patients may result in a reduction in the rates of reimbursement or an increase in uncollectible receivables or uncompensated care, with a corresponding decrease in net revenue. Policies now being offered under various insurance plans are expected to reduce demand for MRI scans as they become less affordable. Changes in the eligibility requirements for governmental programs such as the Medicaid program and state decisions on whether to participate in the expansion of such programs also could increase the number of patients who participate in such programs and the number of uninsured patients. Even for those patients who remain in private insurance plans, changes to those plans could increase patient financial responsibility, resulting in a greater risk of uncollectible receivables. These factors and events could have a material adverse effect on our business, financial condition, and results of operations.

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8, Proposed Changes to New York Workers' Compensation Benefits. A proposal was published by the New York State Workers' Compensation Board ("NYSWCB") in 2014 to change the fee schedule for Workers' Compensation payments. Initially, the fees proposed would be set at approximately 130% of the Medicare fees. This would reduce fees for the most commonly billed radiology procedures by approximately 60%. Further, since the Workers' Compensation fees are coupled with the New York State No Fault Program, radiology providers would suffer similar reductions for No-Fault fees. We and the HMCA clients wrote to the NYSWCB to argue against this proposal, and other affected parties commented as well. Since then, no further action has been taken by the NYSWCB to advance the 2014 proposal. On the contrary, the NYSWCB recently established an overall statewide fee increase for all provider types for services performed on or after October 1, 2018. There can be no assurance, however, that the NYSWCB will not modify their present position, or if they elect to do so, the extent to which the NYSWCB would do so. A significant reduction in Workers' Compensation and No-Fault fees could have a material adverse impact on our business while an increase would further improve financial results.

9. Possible changes in Florida Insurance Law. A bill has been introduced into the Florida legislature, whose goal is to eliminate the no-fault system and the requirement that motorists carry personal injury protection, commonly referred to as "PIP". In March of 2018, however, a Florida senate subcommittee rejected a bill to repeal PIP. Future efforts to repeal PIP, however, may be successful. Currently, drivers and passengers get car damages and PIP, paid for up to $10,000, no matter who is at fault in an accident. Drivers have to pay an additional cost to insurance companies to pay for bodily injuries, which covers them if they are at fault. While PIP is required, coverage for bodily injury is not. The insurance industry is pushing to scrap PIP and instead mandate all motorists to carry coverage that includes a minimum of $25,000 bodily injury if they are at fault. Eliminating PIP would mean that the $10,000 drivers now get paid toward medical costs through their insurers might not be there for them to pay for injured drivers. Importantly, payments would be reduced by approximately 60% due to claims being paid at commercial rates or through legal settlements instead of at the presently prevailing PIP fee schedule. This would negatively impact our seven diagnostic imaging facilities (both those we own and those we manage) with more unpaid bills, lower reimbursement rates and elongated waiting times.

10. Federal and state privacy and information security laws. We must comply with numerous federal and state laws and regulations governing the collection, dissemination, access, use, security and privacy of PHI, including HIPAA and its implementing privacy and security regulations, as amended by the federal HITECH Act and collectively referred to as HIPAA. If we fail to comply with applicable privacy and security laws, regulations and standards, properly maintain the integrity of our data, protect our proprietary rights to our systems, or defend against cybersecurity attacks, our business, reputation, results of operations, financial position and cash flows could be materially and adversely affected. Information security risks have significantly increased in recent years in part because of the proliferation of new technologies, the use of the internet and telecommunications technologies to conduct our operations, and the increased sophistication and activities of organized crime, hackers, terrorists and other external parties, including foreign state agents. Our operations rely on the secure processing, transmission and storage of confidential, proprietary and other information in our computer systems and networks.

11. Changes in Domestic and Worldwide Economic Conditions. We are subject to risk arising from adverse changes in general domestic and global economic conditions, including recession or economic slowdown and disruption of

credit markets. Turbulence and uncertainty in the United States and international markets and economies may adversely affect our liquidity, financial condition, revenues, profitability and business operations generally.

ITEM 1B. UNRESOLVED STAFF COMMENTS - None.

ITEM 2. PROPERTIES

Fonar and HMCA currently lease approximately 78,000 square feet of office and plant space at its principal offices in Melville, New York. The term of the lease runs through November, 2026. Management believes that the premises will be adequate for its current needs. HMCA also maintains office space for the Facilities owned by its subsidiaries in Florida and for its clients at the clients' sites in New York and Florida under leases having various terms. HMCA owns the building for the client's premises in Tallahassee, Florida. The Company received approval from the Suffolk County IDA on February 29, 2016 of a 50% property tax abatement, valued at $440,000, over a 10 year period commencing January, 2017.

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ITEM 3. LEGAL PROCEEDINGS

Matt Malek Madison v. Fonar Corporation, United States District Court, Northern District of California, was commenced by plaintiff on August 27, 2007 to recover a down payment for a scanner in the amount of $300,000, with interest. The plaintiff sought costs of suit and attorney's fees as well. Fonar answered the complaint and sued the plaintiff for breach of contract in the amount of $450,000. Although down payments are usually expressly non-refundable in Fonar's quotations and agreements, in this case, the quotation contemplated the sale of four scanners, and provided that the deposit would be refundable with interest, if the customer were unable to find suitable locations in the San Francisco Bay area. The issue was whether the customer made a good faith effort to find locations; Fonar's position was that the customer did not. The case went to trial before a judge; the parties submitted post-trial briefs, and judgment was awarded to the plaintiff. Fonar appealed the trial court's decision, but on January 31, 2012, the U.S. Court of Appeals for the 9th Circuit affirmed the lower court's decision awarding the plaintiff the $300,000 deposit with prejudgment interest from July 1, 2006. Fonar sought to have the Court of Appeals reconsider the decision en banc, (by all or a larger number of the judges on the Circuit Court of Appeals), but this was not granted. After no action being taken by the plaintiff for several years, on June 30, 2016 Fonar received a letter from plaintiff's attorney seeking payment of the judgment. The plaintiff has agreed to accept the sum of $300,000 in full satisfaction of the judgment, which amount was paid in October, 2016.

Shapiro v. Fonar Corporation, New York Supreme Court, Suffolk County. Previously, Fonar and Dr. Shapiro had settled an action commenced in Nassau County under the same name. The amount remaining payable under the settlement agreement according to Fonar's records is $258,400, but the payment and timing of the payment was dependent on obtaining an order for an Upright® MRI Scanner for Fonar and the making of installment payments thereunder by the customer. Briefly stated, the balance of $258,400 was not yet due. Dr. Shapiro claimed that Fonar was in breach of the settlement agreement. Following settlement negotiations, Fonar agreed to pay Dr. Shapiro the sum of $258,400 in installments with interest.

ITEM 4. MINE SAFETY DISCLOSURES. Not Applicable

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our Common Stock is traded in the Nasdaq SmallCap market under the National Association of Securities Dealers Automated Quotation System, also referred to as "NASDAQ", under the symbol FONR. The following table sets forth the high and low trades reported in NASDAQ System for the periods shown.

Fiscal Quarter			High	Low
January	— March	2016	$18.27	$12.76
April	— June	2016	$21.95	$13.65
July	— September	2016	$23.90	$19.10
October	— December	2016	$21.01	$15.70
January	— March	2017	$20.85	$17.30
April	— June	2017	$29.40	$17.20
July	— September	2017	$31.90	$25.31
October	— December	2017	$33.75	$21.10
January	— March	2018	$29.95	$22.15
April	— June	2018	$30.10	$25.31
July	— September 11	2018	$28.80	$23.70

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The following graph compares the annual change in the Company's cumulative total shareholder return on its Common Stock during a period commencing on June 30, 2013 and ending on June 30, 2018 (as measured by dividing (i) the sum of (A) the cumulative amount of dividends for the measurement period, assuming dividend reinvestment and (B) the difference between the Company's share price at the end and the beginning of the measurement period; by (ii) the share price at the beginning of the measurement period) with the cumulative total return of each of: (a) the CRSP Composite Total Return Index for Nasdaq ("Nasdaq"); (b) the CRSP Total Return Index for Nasdaq Medical Equipment Manufacturers ("Nas-MED"); and (c) the CRSP Total Return Index for Nasdaq Healthcare companies ("Nas-Hea.") during such period, assuming a $100 investment on June 30, 2013. The stock price performance on the graph below is not necessarily indicative of future price performance.

Relative Dollar Values

FONAR Common Stock	6/29/2013	6/28/2014	6/30/2015	6/30/2016	6/30/2017	6/30/2018
FONR	$ 100.00	185.98	161.28	310.37	423.03	404.74
NASDAQ	$ 100.00	131.17	150.1	147.56	189.34	234.02
NAS-Med	$ 100.00	130.18	153.47	178.47	211.8	244.63
NAS-Hea	$ 100.00	124.03	177.66	168.09	201.55	249.93

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ITEM 6. SELECTED FINANCIAL DATA.

The following selected consolidated financial data has been extracted from our consolidated financial statements for the five years ended June 30, 2018. This consolidated selected financial data should be read in conjunction with our consolidated financial statements and the related notes included in Item 8 of this form.

As of and For the Periods Ended June 30,

As of and For the Periods Ended June 30,	2018	2017	2016	2015	2014
STATEMENT OF OPERATIONS					
Revenues	$81,515,994	$78,036,586	$73,368,210	$69,050,996	$68,505,477
Cost of revenues	$41,950,770	$38,052,425	$38,870,898	$38,404,281	$37,247,449
Research and Development Expenses	$1,755,747	$1,480,670	$1,631,846	$1,812,398	$1,760,821
Net Income	$25,452,185	$23,678,798	$18,795,517	$15,430,383	$13,396,769
Basic Net Income per common share	$3.16	$2.98	$2.43	$2.00	$1.62
Diluted Net Income per common share	$3.10	$2.92	$2.38	$1.95	$1.58
Basic weighted average number of shares outstanding	6,287,510	6,161,599	6,050,893	6,050,632	6,009,822
Diluted Weighted average number of shares outstanding	6,415,014	6,289,103	6,178,397	6,178,136	6,137,326
BALANCE SHEET DATA					
Working capital	52,497,840	39,177,703	$24,946,326	$24,828,161	$21,898,699
Total Assets	$118,310,945	$98,762,566	$84,887,606	$76,492,077	$76,789,843
Long-term debt and obligations under capital leases	$306,035	$336,761	$2,059,236	$5,699,302	$8,481,830
Stockholder’s equity	$102,234,471	$82,909,953	$60,776,307	$50,783,513	$45,906,592

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION.

INTRODUCTION.

Fonar was formed in 1978 to engage in the business of designing, manufacturing and selling MRI scanners. HMCA, a subsidiary of Fonar, provides management services to diagnostic imaging facilities.

Fonar's principal MRI product is its Stand-Up® MRI (also called Upright® MRI) scanner. The Stand-Up® MRI allows patients to be scanned for the first time under weight-bearing conditions. The Stand-Up® MRI is the only MRI capable of producing images in the weight-bearing state.

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At 0.6 Tesla field strength, the Upright® MRI is among the highest field open MRI scanners in the industry, offering non-claustrophobic MRI together with high-field image quality. Fonar's open MRI scanners were the first high field strength open MRI scanners in the industry.

HMCA generates revenues from providing comprehensive management services, including development, administration, accounting, billing and collection services, together with office space, medical equipment, supplies and non-medical personnel to its clients. Revenues are in the form of fees which are earned under contracts with HMCA's clients except for its three Florida subsidiaries which engage in the practice of medicine, and bill and collect fees from patients, insurers and other third party payors directly.

For the fiscal years ended June 30, 2018 and June 30, 2017 11.0% and 10.5%, respectively, of total revenues were derived from contracts with facilities owned by Dr. Raymond V. Damadian, the President and principal stockholder of Fonar. The agreements with these MRI facilities are for one-year terms which renew automatically on an annual basis, unless terminated. The fees for these sites, which are located in Florida, are flat monthly fees.

For services for which Medicare is billed directly, the sites are paid under the Medicare Physician Fee Schedule, which is updated on an annual basis. Under the Medicare statutory formula, payments under the Physician Fee Schedule would have decreased for the past several years if Congress failed to intervene.

Many private payors use the Medicare Physician Fee Schedule to determine their own reimbursement rates.

Critical Accounting Policies

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

Our reported amounts of assets and liabilities in our consolidated balance sheets at the dates of the financial statements;

Our disclosure of contingent assets and liabilities at the dates of the financial statements; and

Our reported amounts of net revenue and expenses in our consolidated statements of operations during the reporting periods.

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

The Securities and Exchange Commission defines critical accounting estimates as those that are both most important to the portrayal of a company's financial condition and results of operations and require management's most difficult, subjective or complex judgment, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods. In the notes to our consolidated financial statements, we discuss our significant accounting policies.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements. We recognize revenue and related costs of revenue from sales contracts for our MRI scanners and major upgrades, under the percentage-of-completion method. Under this method, we recognize revenue and related costs of revenue, as each sub-assembly is completed. Amounts received in advance of our commencement of production are recorded as customer advances.

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We continuously, qualitatively and quantitatively evaluate the realizability (including both positive and negative evidence) of the net deferred tax assets and assess the valuation allowance periodically. Our evaluation considers the financial condition of the Company and both the business conditions and regulatory environment of the industry. If future taxable income or other factors are not consistent with our expectations, an adjustment to our allowance for net deferred tax assets may be required. For net deferred tax assets we consider estimates of future taxable income, including tax planning strategies, in determining whether our net deferred tax assets are more likely than not to be realized. Our ability to project future taxable income may be significantly affected by our ability to determine the impact of regulatory changes which could adversely affect our future profits. As a result, the benefits of our net operating loss carry forwards could expire before they are fully utilized.

At June 30, 2018, the deferred tax asset was valued at $22,689,011. At June 30, 2017, the net deferred tax asset was valued at $17,861,777.

For the year ended June 30, 2018, the Company recorded income tax benefits associated with changes to the net deferred income tax assets of $4,827,234 and also the benefits associated with an AMT Carryforward Tax Credit of $1,200,000, available as a cash refund. These income tax benefits were precipitated in combination by both the Tax Cuts and Jobs Act enacted in December, 2017, which decreased the corporate income tax rate from 35% to 21%, effective January 1, 2018, and the continued strength of the business.

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

The Company provides for medical receivables that could become uncollectible by establishing an allowance for doubtful accounts in order to adjust medical receivables to estimated net realizable value. In evaluating the collectability of medical receivables, the Company considers a number of factors, including the age of the account, historical collection experiences, payor type, current economic conditions and other relevant factors. There are various factors that impact collection trends, such as payor mix, changes in the economy, increase burden on copayments to be made by patients with insurance and business practices related to collection efforts. These factors continuously change and can have an impact on collection trends and the estimation process.

We amortize our intangible assets, including patents, and capitalized software development costs, over the shorter of the contractual/legal life or the estimated economic life. Our amortization life for patents and capitalized software development costs is 15 to 17 years and 5 years, respectively. Our amortization of the non-competition agreements entered into with certain individuals in connection with the HDM transaction are depreciated over seven years, and

customer relationships are amortized over 20 years.

Goodwill is recorded as a result of business combinations. Management evaluates goodwill, at a minimum, on an annual basis and whenever events and changes in circumstances suggest that the carrying amount may not be recoverable. Impairment of goodwill is tested by comparing the reporting unit's carrying amount, including goodwill, to the fair value of the reporting unit. The fair value of a reporting unit is estimated using a combination of the income or discounted cash flows approach and the market approach, which uses comparable market data. If the carrying amount of the reporting unit exceeds its fair value, goodwill is considered impaired and a second step is performed to measure the amount of impairment loss, if any. Based on our test for goodwill impairment, we noted no impairment related to goodwill. However, if estimates or the related assumptions change in the future, we may be required to record impairment charges to reduce the carrying amount of goodwill.

We periodically assess the recoverability of long-lived assets, including property and equipment, intangibles and management agreements, when there are indications of potential impairment, based on estimates of undiscounted future cash flows. The amount of impairment is calculated by comparing anticipated discounted future cash flows with the carrying value of the related asset. In performing this analysis, management considers such factors as current results, trends, and future prospects, in addition to other economic factors.

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In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, (Topic 606). ASU 2014-09 requires an entity to recognize as revenue the amount that reflects the consideration which it expects to be entitled in exchange for goods and services as it transfers control to its customers. It also requires more detailed disclosures to enable users of the financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The Company earns revenue from the sale of scanners, maintenance contracts, product upgrades, patient services and management fees. Under the new guidance, the reporting for patient services revenue will be reported differently. All other streams of revenue will not be impacted by the new guidance. The primary change for healthcare providers under the new guidance relates to revenue generated from patient services, with patient responsibility for payment. Under the new guidance, the Company is required to report an implicit price concession (both initially and for the subsequent changes in estimates) as a reduction of revenues as opposed to bad debt expense as a component of operating expenses. The Company will record any changes in expectation of collection amounts due to patient specific events that suggests that the patient no longer has the ability and intent to pay the amount due through the bad debt expense, as that is more indicative of a change in the customer’s credit worthiness as opposed to change in the transaction price.

The new standard supersedes most current revenue guidance, including industry-specific guidance. The guidance became effective for the Company on July 1, 2018 and as part of adopting the standard, the Company identified revenue streams of like contracts to allow for ease of implementation. The Company used primarily a portfolio approach to apply the new model to classes of customers with similar characteristics. The impact of adopting the new standard on our total revenue; and income from operations is not material. While the adoption of ASU 2014-09 will impact the presentation of net operating revenues in our Consolidated Statements of Operations and will impact certain disclosures, it will not materially impact our financial position, results of operations or cash flows. There was no cumulative effect of a change in accounting principle recorded related to the adoption of ASU 2014-09 on July 1, 2018.

RESULTS OF OPERATIONS. FISCAL 2018 COMPARED TO FISCAL 2017

In fiscal 2018, we recognized net income of $25.5 million on revenues of $81.5 million, as compared to net income of $23.7 million on revenues of $78.0 million for fiscal 2017. This represents an increase in revenues of 4.5%. Patient fee revenue net of contractual allowances increased by 7.7%. Total costs and expenses increased by 4.9%. Our consolidated operating results improved by $600,000 to an operating income of $19.7 million for fiscal 2018 as compared to operating income of $19.1 million for fiscal 2017.

Discussion of Operating Results of Medical Equipment Segment

Fiscal 2018 Compared to Fiscal 2017

Revenues attributable to our medical equipment segment decreased by 12.3% to $9.8 million in fiscal 2018 from $11.2 million in fiscal 2017, with product sales revenues decreasing by 61.7% from $1.6 million in fiscal 2017 to $603,000 in fiscal 2018. Service revenue decreased from $9.6 million in fiscal 2017 to $9.2 million in fiscal 2018.

The Upright® MRI is unique in that it permits MRI scans to be performed on patients upright in the weight-bearing state and in multiple positions that correlate with symptoms.

We believe that one of our principal challenges in achieving greater market penetration is attributable to the better name recognition and larger sales forces of our larger competitors such as General Electric, Siemens, Hitachi, Philips and Toshiba and the ability of some of our competitors to offer attractive financing terms through affiliates, such as G.E. Capital.

In addition, lower reimbursement rates have reduced the demand for our MRI products, resulting in lower sales volumes. As a result of fewer sales, service revenues have decreased since as older scanners are taken out of service, there are fewer new scanners available to sign service contracts.

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The operating results for the medical equipment segment increased from an operating loss of $2.3 million in fiscal 2017 to an operating loss of $3.0 million in fiscal 2018. The losses are attributable most significantly to the fact that costs increased by a greater amount than revenues.

We recognized revenues of $43,000 from the sale of our Upright® MRI scanners in fiscal 2018, while in fiscal 2017, we recognized revenues of $714,000 from the sale of Upright® MRI scanners.

Research and development expenses, increased to $1.8 million in fiscal 2018 from $1.5 million in fiscal 2017. Our expenses for fiscal 2018 represented continued research and development of Fonar’s scanners, Fonar’s new hardware and software product, Sympulse® and new surface coils to be used with the Upright® MRI scanner.

Discussion of Operating Results of Physician and Diagnostic Services Management Segment.

Fiscal 2018 Compared to Fiscal 2017

Revenues attributable to the Company's physician and diagnostic services management segment, HMCA, increased by 7.3% to $71.7 million in fiscal 2018 from $66.8 million in fiscal 2017. The increase in revenues was due to $1.0 million of patient fees (net of contractual allowances and discounts less provision for bad debts) from patient and third party payors recognized by four of the facilities in Florida. One of these locations added additional medical equipment which allowed it to increase volume coupled with an increase in management and other fees of $5.0 million.

Cost of revenues as a percentage of the related revenues for our physician and diagnostic services management segment increased from $34.1 million or 51.0% of related revenues for the year ended June 30, 2017 to $37.9 million, or 52.0% of related revenues for the year ended June 30, 2018. The revenues increased more than the costs relating to these revenues.

Operating results of this segment increased from operating income of $21.4 million in fiscal 2017 to operating income of $22.7 million in fiscal 2018. We believe that our efforts to expand and improve the operation of our physician and diagnostic services management segment are directly responsible for the profitability of this segment and our company as a whole.

Discussion of Certain Consolidated Results of Operations

Fiscal 2018 Compared to Fiscal 2017

Interest and investment income increased in 2018 compared to 2017. We recognized interest income of $262,569 in 2018 as compared to $193,141 in fiscal 2017, representing a increase of 35.9%.

Interest expense of $160,074 was recognized in fiscal 2018, as compared to interest expense recovery of $28,299 in fiscal 2017. This was due to additional principal payments being made to retire our debt.

While revenue increased by 4.5%, selling, general and administrative expenses decreased by 6.6% to $18.1 million in fiscal 2018 from $19.4 million in fiscal 2017.

The compensatory element of stock issuances decreased from approximately $2,397,276 in fiscal 2017 to $0 in fiscal 2018, reflecting a decrease in Fonar’s use of its stock bonus plans.

FONAR CORPORATION AND SUBSIDIARIES

A recovery of bad debts of $614,680 in fiscal 2018, as compared to a provision for bad debts of $477,577 in fiscal 2017, reflected an increase in reserves for certain indebtedness and some bad debt recoveries in fiscal 2018 by our physician and diagnostic services management segment. In addition in fiscal 2018, the Company recorded a provision for bad debts for patient fee revenue of $17.9 million for the MRI facilities in Florida which bill patients and third party payors directly. The three Florida sites managed by HMCA jointly and severally guaranteed the payment of their management fees to HMCA, further securing HMCA's management fee receivables.

Revenue from service and repair fees decreased from $9.6 million in fiscal 2017 to $9.2 million in fiscal 2018.

Continuing our tradition as the originator of MRI, we remain committed to maintaining our position as the leading innovator of the industry through investing in research and development. In fiscal 2018 we continued our investment in the development of our new MRI scanners, together with software and upgrades, with an investment of $1,755,747 in research and development, none of which was capitalized, as compared to $1,480,670, none of which was capitalized, in fiscal 2017. The research and development expenses were approximately 17.8% of revenues attributable to our medical equipment segment and 2.1% of total revenues in 2018, and 13.21% of medical equipment segment revenues and 1.9% of total revenues in fiscal 2017. This represented a 18.6% decrease in research and development expenditures in fiscal 2018 as compared to fiscal 2017.

For the physician and diagnostic services management segment, HMCA, revenues increased, from $66.8 million in fiscal 2017 to $71.7 million in fiscal 2018. This is primarily attributable to an increase in patient scans resulting from our marketing efforts.

For the fiscal year 2018 the Company recorded an income tax benefit, net of $4.9 million compared with $5.0 million for 2017. The income tax benefits is attributable to the expected tax benefits associated with the projected realization and utilization of our net operating losses in future periods. The Company has recorded a deferred tax asset of $22.7 million as of June 30, 2018, primarily relating to the tax benefits from the net operating loss carry forwards available to offset future taxable income. The utilization of these tax benefits is dependent on the Company generating future taxable income. The Company is projecting to generate taxable income in future periods, although they cannot accurately anticipate the full impact of the adoption or repeal of healthcare regulations, including changes in MRI scanning reimbursement rates, which could impact operations.

RESULTS OF OPERATIONS. FISCAL 2017 COMPARED TO FISCAL 2016

In fiscal 2017, we recognized net income of $23.7 million on revenues of $78.0 million, as compared to net income of $18.8 million on revenues of $73.4 million for fiscal 2016. Our consolidated operating results improved by $4.5 million to an operating income of $19.1 million for fiscal 2017 as compared to an operating income of $14.4 million for fiscal 2016.

Discussion of Operating Results of Medical Equipment Segment

Fiscal 2017 Compared to Fiscal 2016

Revenues attributable to our medical equipment segment increased by 4.0% to $11.2 million in fiscal 2017 from $10.8 million in fiscal 2016, with product sales revenues increasing by 23.1% from $1.3 million in fiscal 2016 to $1.6 million in fiscal 2017. Service revenue increased from $9.5 million in fiscal 2016 to $9.6 million in fiscal 2017.

Product sales to unrelated parties decreased by 23.1% in fiscal 2017 from $1.3 million in fiscal 2016 to $1.6 million in fiscal 2017. There were no product sales to related parties in fiscal 2017 or 2016.

The operating results for the medical equipment segment decreased from loss of $1.9 million in fiscal 2016 to an operating loss of $2.3 million in fiscal 2017. This decrease was attributable most significantly to the fact that costs increased and the revenues decreased.

FONAR CORPORATION AND SUBSIDIARIES

We recognized revenues of $714,000 from the sale of our Upright® MRI scanners in fiscal 2017, while in fiscal 2016, we recognized revenues of $834,000 from the sale of Upright® MRI scanners.

Research and development expenses, decreased to $1.5 million in fiscal 2017 from $1.6 million in fiscal 2016. Our research and development expenses represented continued research and development of our scanners, our new hardware and software product, Sympulse® and new surface coils to be used with the Upright® MRI scanner.

Discussion of Operating Results of Physician and Diagnostic Services Management Segment.

Fiscal 2017 Compared to Fiscal 2016

Revenues attributable to the Company's physician and diagnostic services management segment, HMCA, increased by 6.8% to $66.8 million in fiscal 2017 from $62.6 million in fiscal 2016. The increase in revenues was primarily due to including $1.8 million of patient fees (net of contractual allowances and discounts less provision for bad debts) from patient and third party payors recognized by four of the facilities in Florida.

Cost of revenues as a percentage of the related revenues for our physician and diagnostic services management segment decreased from $35.4 million or 56.6% of related revenues for the year ended June 30, 2016 to $34.1 million, or 51.0% of related revenues for the year ended June 30, 2017.

Operating results of this segment increased from operating income of $16.3 million in fiscal 2016 to operating income of $21.4 million in fiscal 2017. We believe that our efforts to expand and improve the operation of our physician and diagnostic services management segment are directly responsible for the profitability of this segment and our company as a whole.

Discussion of Certain Consolidated Results of Operations

Fiscal 2017 Compared to Fiscal 2016

Interest and investment income decreased in 2017 compared to 2016. We recognized interest income of $193,141 in 2017 as compared to $224,263 in fiscal 2016, representing a decrease of 13.9%.

Interest expense recovery of $28,299 was recognized in fiscal 2017, as compared to $262,193 in fiscal 2016.

While revenue increased by 6.4%, selling, general and administrative expenses increased by 4.8% to $19.4 million in fiscal 2017 from $18.5 million in fiscal 2016.

The compensatory element of stock issuances decreased from $2,006 in fiscal 2016 to $2,397,276 in fiscal 2017, reflecting a decrease in Fonar's use of its stock bonus plans to pay employees and others.

The higher provision for bad debts of $477,577 in fiscal 2017 as compared to $202,000 in fiscal 2016, reflected an increase in reserves for certain indebtedness in fiscal 2017 by our physician and diagnostic services management segment. In addition in fiscal 2017, the Company recorded a provision for bad debts for patient fee revenue of $16.2 million for the four MRI facilities in Florida which bill patients and third party payors directly. The three Florida sites managed by HMCA jointly and severally guaranteed the payment of their management fees to HMCA, further securing HMCA's management fee receivables.

For the fiscal year 2017 the Company recorded an income tax benefit of $5.0 million compared with $4.3 million for 2016. The income tax benefit is attributable to the income tax benefits associated with the increase in the deferred tax asset for the years then ended. The Company recorded a deferred tax asset of $17.9 million as of June 30, 2017 relating to the tax benefits resulting from the net operating loss carry forwards available to be offset in the future.

FONAR CORPORATION AND SUBSIDIARIES

Revenue from service and repair fees increased from $9.5 million in fiscal 2016 to $9.6 million in fiscal 2017.

In fiscal 2017 we continued our investment in the development of our new MRI scanners, together with software and upgrades, with an investment of $1,480,670 in research and development, none of which was capitalized, as compared to $1,631,846, none of which was capitalized, in fiscal 2016. The research and development expenditures were approximately 13.2% of revenues attributable to our medical equipment segment and 1.9% of total revenues in 2017, and 15.1% of medical equipment segment revenues and 2.2% of total revenues in fiscal 2016. This represented a 9.3% decrease in research and development expenditures in fiscal 2017 as compared to fiscal 2016.

We have been taking steps to improve HMCA revenues by our marketing efforts, which focus on the unique capability of our Upright® MRI scanners to scan patients in different positions. We have also been increasing the number of health insurance plans in which our clients participate.

Our management fees are dependent on collection by our clients of fees from reimbursements from Medicare, Medicaid, private insurance, no fault and workers' compensation carriers, self–pay and other third-party payors. The health care industry is experiencing the effects of the federal and state governments' trend toward cost containment, as governments and other third-party payors seek to impose lower reimbursement and utilization rates and negotiate reduced payment schedules with providers. The cost-containment measures, consolidated with the increasing influence of managed-care payors and competition for patients, have resulted in reduced rates of reimbursement for services provided by our clients from time to time. Our future revenues and results of operations may be adversely impacted by future reductions in reimbursement rates.

Certain third-party payors have proposed and implemented changes in the methods and rates of reimbursement that have had the effect of substantially decreasing reimbursement for diagnostic imaging services that HMCA's clients provide. To the extent reimbursement from third-party payors is reduced, it will likely have an adverse impact on the rates they pay us, as they would need to reduce the management fees they pay HMCA to offset such decreased reimbursement rates. Furthermore, many commercial health care insurance arrangements are changing, so that individuals bear greater financial responsibility through high deductible plans, co-insurance and higher co-payments, which may result in patients delaying or foregoing medical procedures. More frequently, however, patients are scanned and we experience difficulty in collecting deductibles and co-payments. We expect that any further changes to the rates or methods of reimbursement for services, which reduce the reimbursement per scan of our clients may partially offset the increases in scan volume we are working to achieve for our clients, and indirectly will result in a decline in our revenues. We have offset reimbursement cuts by increasing capacity at existing sites and by acquiring new centers. While there can be no assurance we will be able to continue this in the future, we are continuously on the lookout for growth opportunities.

On March 23, 2010, President Obama signed into law healthcare reform legislation in the form of the Patient Protection and Affordable Care Act, or PPACA. Healthcare cost containment, reductions of Medicare and other payments, and increased regulation will present additional challenges for healthcare providers. We are unable to predict the full impact of PPACA, or the possible amendment or repeal and replacement of PPACA. It may, however, adversely affect the revenues or the profitability of either or both our medical equipment segment and physician and diagnostic services management segment.

In addition, the use of radiology benefit managers, or RBM's has increased in recent years. It is common practice for health insurance carriers to contract with RBMs to manage utilization of diagnostic imaging procedures for their insureds. In many cases, this leads to lower utilization of imaging procedures based on a determination of medical necessity. The efficacy of RBMs is still a highly controversial topic. We cannot predict whether the healthcare legislation or the use of RBMs will negatively impact our business, but it is possible that our financial position and results of operations could be negatively affected.

FONAR CORPORATION AND SUBSIDIARIES

LIQUIDITY AND CAPITAL RESOURCES

Cash, and cash equivalents increased by 93.6% from $10.1 million at June 30, 2017 to $19.6 million at June 30, 2018.

Cash provided by operating activities for fiscal 2018 approximated $18.7 million. Cash provided by operating activities was attributable to the net income of $25.5 million, depreciation and amortization of $3.9 million, which was offset by the deferred income tax benefit of $4.9 million and the increase in accounts, medical and management fee receivables of $4.3 million.

Cash used in investing activities for fiscal 2018 approximated $2.9 million. The use of cash from investing activities was attributable to purchases of property and equipment of $2.8 million, costs of acquisitions of $58,000, and costs of patents of $109,000.

Cash used by financing activities for fiscal 2018 approximated $6.3 million. The principal uses of cash in financing activities included the repayment of loans and capital lease obligations of $172,000 million, and distributions to non-controlling interests of $6.1 million.

Total liabilities increased by 1.4% during fiscal 2018, from approximately $15.9 million at June 30, 2017 to approximately $16.1 million at June 30, 2018.

As at June 30, 2018, our obligations included approximately $3.6 million in various state sales taxes, inclusive of penalties and interest. The Company is in the process of negotiating settlements of these obligations.

At June 30, 2018, we had working capital of approximately $52.5 million as compared to working capital of $39.2 million at June 30, 2017, and stockholders’ equity of $102.2 million at June 30, 2018 as compared to stockholders’ equity of $82.9 million at June 30, 2017. For the year ended June 30, 2018, we realized a net income of $25.5 million.

Our principal sources of liquidity are derived from revenues.

Our business plan includes a program for manufacturing and selling our Upright® MRI scanners. In addition, we are enhancing our revenue by participating in the physician and diagnostic services management business through our subsidiary, HMCA and have upgraded the facilities which it manages, most significantly by the replacement of the original MRI scanners with new Upright® MRI scanners. Presently, 24 of the 26 MRI facilities managed by HMCA, are equipped with Upright® MRI scanners. We have also intensified our marketing activities through the hiring of additional marketers for HMCA's clients.

Our business plan also 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. Fees for on-going service and maintenance from our installed base of scanners were $9.6 million for the year ended June 30, 2017 and $9.3 million for the year ended June 30, 2018.

In order to promote profitability and to reduce demands on our cash and other liquid reserves, we maintain an aggressive program of cost cutting. Previously, these measures included consolidating HMCA's office space with Fonar's office space and reducing the size of our workforce, compensation and benefits. We continue to reduce and contain expenses across the board. The cost reductions are intended to enable us to withstand periods of low volumes of MRI scanner sales, by keeping expenditures at levels which can be supported by service revenues and HMCA revenues.

Current economic credit conditions have contributed to a slower than optimal business environment. Given liquidity and credit constraints in the markets, our business may suffer, should the credit markets not improve in the near future. The direct impact of these conditions is not fully known.

FONAR CORPORATION AND SUBSIDIARIES

Revenues from HMCA have been the principal reason for our profitability, and we have so far been able to maintain and increase such revenues by increasing the number of scans being performed by the sites we manage and those we own, notwithstanding reductions in reimbursement rates from third party payors. The likelihood and effect of any subsequent reductions is not fully known.

Capital expenditures for fiscal 2018 approximated $2.9 million. Capitalized patent costs were approximately $109,000 Purchases of property and equipment were approximately $2.8 million.

Fonar has not committed to making capital expenditures in the 2019 fiscal year, except for acquiring an additional scanner to place at the Tallahassee site and providing a new scanner to replace the scanner at the Miami site.

The Company believes that its business plan has been responsible for the past four consecutive fiscal years of profitability (fiscal 2018, fiscal 2017, fiscal 2016 and fiscal 2015) and that its capital resources will be adequate to support operations at current levels through June 30, 2019.

ITEM 7A. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET

RISK

The Company does not have any investments in marketable securities, foreign currencies, mutual funds, certificates of deposit or other fixed rate instruments. All of our funds are in cash accounts or money market accounts which are liquid.

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

See Note 10 to the consolidated Financial Statements for information on long-term debt.

FONAR CORPORATION AND SUBSIDIARIES

ITEM 8.

FINANCIAL STATEMENTS

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

FONAR Corporation and Subsidiaries

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of FONAR Corporation and Subsidiaries (the "Company") as of June 30, 2018 and 2017, the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended June 30, 2018, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of June 30, 2018 and 2017, and the consolidated results of its operations and its cash flows for each of the three years in the three year period ended June 30, 2018, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the Company's internal control over financial reporting as of June 30, 2018, based on the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in 2013 and our report dated September 20, 2018, expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Marcum LLP

We have served as the Company's auditor since 1990, such date takes into account the merger of Tabb, Conigliaro and McGann, P.C. ("Tabb") into another firm in approximately 2001 and the former partners of Tabb joining Marcum LLP in 2002.

Marcum LLP

New York, New York

September 20, 2018

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FONAR CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

ASSETS

	June 30, 2018	2017
Current Assets:		
Cash and cash equivalents	$19,633,742	$10,139,621
Accounts receivable – net of allowances for doubtful accounts of $190,244 at June 30, 2018 and 2017	3,813,576	4,321,760
Medical receivables –net of allowances for doubtful accounts of $22,727,698 and $19,853,318 at June 30, 2018 and 2017, respectively	13,350,772	11,744,704
Management and other fees receivable – net of allowances for doubtful accounts of $10,983,022 and $12,859,750 at June 30, 2018 and 2017, respectively	21,863,431	18,593,894
Management and other fees receivable – related party medical practices – net of allowances for doubtful accounts of $1,711,385 and $582,001 at June 30, 2018 and 2017, respectively	5,535,096	4,959,598
Costs and estimated earnings in excess of billings on uncompleted contracts	86,638	736,061
Inventories	1,431,380	1,624,262
Prepaid expenses and other current assets	1,349,907	1,293,806
Total Current Assets	67,064,542	53,413,706
Income taxes receivable	1,200,000	—
Deferred income tax asset	22,689,011	17,861,777
Property and Equipment – Net	16,492,278	16,462,504
Goodwill	3,985,397	3,927,123
Other Intangible Assets – Net	5,601,656	6,644,504
Other Assets	1,278,061	452,952
Total Assets	$118,310,945	$98,762,566

See accompanying notes to consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

LIABILITIES

	June 30, 2018	2017
Current Liabilities:		
Current portion of long-term debt and capital leases	$38,332	$180,090
Accounts payable	1,300,250	1,423,217
Other current liabilities	8,177,995	7,203,278
Unearned revenue on service contracts	4,191,930	4,641,534
Customer deposits	858,195	787,884
Total Current Liabilities	14,566,702	14,236,003
Long-Term Liabilities:		
Deferred income tax liability	239,011	331,527
Due to related party medical practices	227,543	227,543
Long-term debt and capital leases, less current portion	306,035	336,761
Other liabilities	737,183	720,779
Total Long-Term Liabilities	1,509,772	1,616,610
Total Liabilities	16,076,474	15,852,613

Commitments, Contingencies and Other Matters

See accompanying notes to consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

STOCKHOLDERS' EQUITY

	June 30, 2018	2017
Stockholders' Equity:		
Class A non-voting preferred stock $.0001 par value; 453,000 shares authorized at June 30, 2018 and 2017, 313,438 issued and outstanding at June 30, 2018 and 2017	$31	$31
Preferred stock $.001 par value; 567,000 shares authorized at June 30, 2018 and 2017, issued and outstanding – none	—	—
Common stock $.0001 par value; 8,500,000 shares authorized at June 30, 2018 and 2017, 6,299,154 issued at June 30, 2018 and 2017; 6,287,511 outstanding at June 30, 2018 and 2017	630	630
Class B convertible common stock (10 votes per share) $.0001 par value; 227,000 shares authorized at June 30, 2018 and 2017, 146 issued and outstanding at June 30, 2018 and 2017	—	—
Class C common stock (25 votes per share) $.0001 par value; 567,000 shares authorized at June 30, 2018 and 2017, 382,513 issued and outstanding at June 30, 2018 and 2017	38	38
Paid-in capital in excess of par value	179,131,780	179,131,780
Accumulated deficit	(79,772,587)	(101,003,389)
Notes receivable from employee stockholders	(9,213)	(16,546)
Treasury stock, at cost – 11,643 shares of common stock at June 30, 2018 and 2017	(675,390)	(675,390)
Total Fonar Corporation’s Stockholders’ Equity	98,675,289	77,437,154
Noncontrolling interests	3,559,182	5,472,799
Total Stockholders' Equity	102,234,471	82,909,953
Total Liabilities and Stockholders' Equity	$118,310,945	$98,762,566

See accompanying notes to consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

	For the Years Ended June 30,		
	2018	2017	2016
Revenues			
Product sales – net	$602,541	$1,572,148	$1,276,882
Service and repair fees – net	9,124,728	9,537,040	9,396,736
Service and repair fees – related parties – net	110,000	110,000	110,000
Patient fee revenue, net of contractual allowances and discounts	39,165,413	36,400,600	32,985,809
Provision for bad debts for patient fee	(17,896,528)	(16,171,434)	(14,539,786)
Management and other fees – net	41,422,958	38,361,514	36,633,230
Management and other fees – related party medical practices – net	8,986,882	8,226,718	7,505,339
Total Revenues – Net	81,515,994	78,036,586	73,368,210
Costs and Expenses			
Costs related to product sales	751,221	931,501	1,254,328
Costs related to service and repair fees	3,212,527	2,996,736	2,148,143
Costs related to service and repair fees – related parties	38,728	34,564	25,147
Costs related to patient fee revenue	10,256,951	8,987,673	9,418,935
Costs related to management and other fees	22,778,202	20,828,581	21,949,583
Costs related to management and other fees – related party medical practices	4,913,141	4,273,370	4,074,762
Research and development	1,755,747	1,480,670	1,631,846
Selling, general and administrative, inclusive of compensatory element of stock issuances of $0, $2,397,276 and $2,006 for the years ended June 30, 2018, 2017 and 2016, respectively	18,125,266	19,407,411	18,509,850
Total Costs and Expenses	61,831,783	58,940,506	59,012,594
Income from Operations	19,684,211	19,096,080	14,355,616
Other Income and (Expenses):			
Interest expense	(160,074)	28,299	(262,193)
Investment income	262,569	193,141	224,263
Other (expense) income – net	(4,271)	(1,156)	190,560
Income before benefit for income taxes and noncontrolling interests	19,782,435	19,316,364	14,508,246
Benefit for Income Taxes	5,669,750	4,362,434	4,287,271
Net Income	$25,452,185	$23,678,798	$18,795,517
Net Income – Noncontrolling Interests	(4,221,383)	(4,058,177)	(3,070,892)
Net Income – Attributable to FONAR	$21,230,802	$19,620,621	$15,724,625

See accompanying notes to consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME (Continued)

	For the Years Ended June 30,		
	2018	2017	2016
Net Income Available to Common Stockholders	$19,899,823	$18,390,586	$14,702,834
Net Income Available to Class A Non-Voting Preferred Stockholders	$992,005	$916,769	$761,561
Net Income Available to Class C Common Stockholders	$338,974	$313,266	$260,230
Basic Net Income Per Common Share Available to Common Stockholders	$3.16	$2.98	$2.43
Diluted Net Income Per Common Share Available to Common Stockholders	$3.10	$2.92	$2.38
Basic and Diluted Income Per Share – Class C Common	$0.89	$0.82	$0.68
Weighted Average Basic Shares Outstanding – Common Stockholders	6,287,510	6,161,599	6,050,893
Weighted Average Diluted Shares Outstanding – Common Stockholders	6,415,014	6,289,103	6,178,397
Weighted Average Basic and Diluted Shares Outstanding – Class C Common	382,513	382,513	382,513

See accompanying notes to consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

FOR THE YEARS ENDED JUNE 30, 2018, 2017 AND 2016

	Class A Non-Voting Preferred	Common Shares	Stock Amount	Class C Common Stock
Balance - June 30, 2015	$ 31	6,050,840	$ 607	$ 38
Net income	—	—	—	—
Stock issued to employees under stock bonus plans	—	146	—	—
Payments on notes receivable from employee stockholders	—	—	—	—
Stock option exercised	—	180	—	—
Redemption of noncontrolling interests	—	—	—	—
Distributions to noncontrolling interests	—	—	—	—
Balance - June 30, 2016	$ 31	6,051,166	$ 607	$ 38
Net income	—	—	—	—
Stock issued to employees under stock bonus plans	—	193,221	19	—
Payments on notes receivable from employee stockholders	—	—	—	—
Issuance of stock for acquistion	—	42,884	4	—
Distributions to noncontrolling interests	—	—	—	—
Stock option exercised	—	240	—	—
Balance - June 30, 2017	$ 31	6,287,511	$ 630	$ 38
Net income	—	—	—	—
Payments on notes receivable from employee stockholders	—	—	—	—
Distributions to noncontrolling interests	—	—	—	—
Balance - June 30, 2018	$ 31	6,287,511	$ 630	$ 38

See accompanying notes to consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

FOR THE YEARS ENDED JUNE 30, 2018, 2017 AND 2016

	Paid-in Capital in Excess of Par Value	Accumulated Deficit	Notes Receivable From Employee Stockholders
Balance - June 30, 2015	$175,447,586	$(136,348,635)	$ (31,495)
Net income	—	15,724,625	—
Stock issued to employees under stock bonus plans	2,006	—	—
Payments on notes receivable from employee stockholders	—	—	7,616
Stock option exercised	1,755	—	—
Redemption of noncontrolling interests	(1,749,012)		—
Distributions to noncontrolling interests	—	—	—
Balance - June 30, 2016	$173,702,335	$(120,624,010)	$ (23,879)
Net income	—	19,620,621	—
Stock issued to employees under stock bonus plans	4,636,559	—	—
Payments on notes receivable from employee stockholders	—	—	7,333
Issuance of stock for acquisition	791,206	—	—
Distributions to noncontrolling interests	—		—
Stock option exercised	1,680	—	—
Balance - June 30, 2017	$179,131,780	$(101,003,389)	$ (16,546)
Net income	—	21,230,802	—
Payments on notes receivable from employee stockholders	—	—	7,333
Distributions to noncontrolling interests	—	—	—
Balance - June 30, 2018	$179,131,780	$(79,772,587)	$ (9,213)

See accompanying notes to consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

FOR THE YEARS ENDED JUNE 30, 2018, 2017 AND 2016

	Treasury Stock	Noncontrolling Interests	Total
Balance - June 30, 2015	$(675,390)	$12,390,771	$50,783,513
Net income	—	3,070,892	18,795,517
Stock issued to employees under stock bonus plans	—	—	2,006
Payments on notes receivable from employee stockholders	—	—	7,616
Stock option exercised	—	—	1,755
Redemption of noncontrolling interests	—	(1,155,988)	(2,905,000)
Distributions to noncontrolling interests	—	(5,909,100)	(5,909,100)
Balance - June 30, 2016	$(675,390)	$8,396,575	$60,776,307
Net income	—	4,058,177	23,678,798
Stock issued to employees under stock bonus plans	—	—	4,636,578
Payments on notes receivable from employee stockholders	—	—	7,333
Issuance of stock for acquistion	—	—	791,210
Distributions to noncontrolling interests		(6,981,953)	(6,981,953)
Stock option exercised	—	—	1,680
Balance - June 30, 2017	$(675,390)	$5,472,799	$82,909,953
Net income	—	4,221,383	25,452,185
Payments on notes receivable from employee stockholders	—	—	7,333
Distributions to noncontrolling interests	—	(6,135,000)	(6,135,000)
Balance - June 30, 2018	$(675,390)	$3,559,182	$102,234,471

See accompanying notes to consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended June 30,		
	2018	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES			
Net Income	$25,452,185	$23,678,798	$18,795,517
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	3,899,851	3,533,564	3,297,289
Abandoned patents or software written off	—	—	88,796
Provision for bad debts	(614,680)	477,577	(201,949)
Deferred income tax benefit – net	(4,919,750)	(4,969,669)	(4,647,767)
Income tax receivable	(1,200,000)	—	—
Gain on acquisition	—	—	(192,999)
Compensatory element of stock issuances	—	2,397,276	2,006
Stock issued for costs and expenses	—	2,239,302	—
Stock option exercised	—	1,680	1,755
(Increase) decrease in operating assets, net:			
Accounts, medical and management fee receivables	(4,328,239)	(5,899,611)	(3,557,507)
Notes receivable	(894,665)	11,511	28,280
Costs and estimated earnings in excess of billings on uncompleted contracts	649,423	(736,061)	681,660
Inventories	192,882	450,038	117,549
Prepaid expenses and other current assets	(1,553)	(513,507)	72,718
Other assets	15,008	254,721	18,054
Increase (decrease) in operating liabilities, net:			
Accounts payable	(122,967)	168,733	(527,957)
Other current liabilities	525,113	(3,660,895)	3,065,673
Customer advances	70,311	(410,855)	(739,074)
Billings in excess of costs and estimated earnings on uncompleted contracts	—	(206,623)	64,406
Other liabilities	16,404	8,783	242,798
Due to related party medical practices	—	(17,498)	8,121
NET CASH PROVIDED BY OPERATING ACTIVITIES	18,739,323	16,807,264	16,617,369

See accompanying notes to consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended June 30,		
	2018	2017	2016
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of property and equipment	(2,777,948)	(2,851,158)	(712,216)
Cost of acquisition	(58,274)	(1,312,769)	(4,223,567)
Cost of patents	(108,829)	(155,156)	(113,072)
NET CASH USED IN INVESTING ACTIVITIES	(2,945,051)	(4,319,083)	(5,048,855)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Repayment of borrowings and capital lease obligations	(172,484)	(3,990,078)	(3,682,519)
Repayment of notes receivable from employee stockholders	7,333	7,333	7,616
Distributions to noncontrolling interests	(6,135,000)	(6,981,953)	(5,909,100)
Redemption of noncontrolling interests	—	—	(2,905,000)
Proceeds received from acquisition -net	—	87,829	—
NET CASH USED IN FINANCING ACTIVITIES	(6,300,151)	(10,876,869)	(12,489,003)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	9,494,121	1,611,312	(920,489)
CASH AND CASH EQUIVALENTS – BEGINNING OF YEAR	10,139,621	8,528,309	9,448,798
CASH AND CASH EQUIVALENTS – END OF YEAR	$19,633,742	$10,139,621	$8,528,309

See accompanying notes to consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018, 2017 and 2016

NOTE 1 - DESCRIPTION OF BUSINESS AND LIQUIDITY AND CAPITAL RESOURCES

Description of Business

FONAR Corporation (the “Company” or “FONAR”) is a Delaware corporation, which was incorporated on July 17, 1978. FONAR is engaged in the research, development, production and marketing of medical scanning equipment, which uses principles of Magnetic Resonance Imaging ("MRI") for the detection and diagnosis of human diseases. In addition to deriving revenues from the direct sale of MRI equipment, revenue is also generated from our installed-base of customers through our service and upgrade programs.

FONAR, through its wholly-owned subsidiary Health Management Corporation of America ("HMCA") provides comprehensive management services to diagnostic imaging facilities. The services provided by the Company include development, administration, leasing of office space, facilities and medical equipment, provision of supplies, staffing and supervision of non-medical personnel, legal services, accounting, billing and collection and the development and implementation of practice growth and marketing strategies.

On June 30, 2016, the Company purchased 100% of the equity in Turnkey Services of New York, LLC and 100% of the equity in TK2 Equipment Management, LLC. Turnkey Service of New York, LLC and TK2 Equipment Management, LLC. These entities had provided the Company with ancillary diagnostic imaging equipment (under operating leases) to our managed MRI facilities. The Company paid $4,223,567 to acquire these two entities with net assets at fair value of $2,861,506.

On July 1, 2015, the Company restructured the corporate organization of the management of diagnostic imaging centers segment of our business. The reorganization was structured to more completely integrate the operations of Health Management Corporation of America and HDM. Imperial contributed all of its assets (which were utilized in the business of Health Management Corporation of America) to HDM and received a 24.2% interest in HDM. Health Management Corporation of America retained a direct ownership interest of 45.8% in HDM, and the original

investors in HDM retained a 30.0% ownership interest in the newly expanded HDM. The entire management of diagnostic imaging centers business segment is now being conducted by HDM.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of FONAR Corporation, its majority and wholly-owned subsidiaries and partnerships. The operating activities of subsidiaries are included in the accompanying consolidated statements from the date of acquisition. All significant intercompany accounts and transactions have been eliminated in consolidation.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018, 2017 and 2016

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Use of Estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities in the consolidated financial statements and accompanying notes. The most significant estimates relate to receivable allowances, intangible assets, income taxes and related tax asset valuation allowances, useful lives of property and equipment, contingencies, revenue recognition and the assessment of litigation. In addition, healthcare industry reforms and reimbursement practices will continue to impact the Company's operations and the determination of contractual and other allowance estimates. Actual results could differ from those estimates.

Inventories

Inventories consist of purchased parts, components and supplies, as well as work-in-process, and are stated at the lower of cost, determined on the first-in, first-out method, or market.

Property and Equipment

Property and equipment procured in the normal course of business is stated at cost. Property and equipment purchased in connection with an acquisition is stated at its estimated fair value, generally based on an appraisal. Property and equipment is being depreciated for financial accounting purposes using the straight-line method over their estimated useful lives. Leasehold improvements are being amortized over the shorter of the useful life or the remaining lease term. Upon retirement or other disposition of these assets, the cost and related accumulated depreciation of these assets are removed from the accounts and the resulting gains or losses are reflected in the results of operations. Expenses for maintenance and repairs are charged to operations. Renewals and betterments are capitalized.

Maintenance and repair expenses totaled approximately $1,451,000, $1,116,000 and $1,113,000 for the years ended June 30, 2018, 2017 and 2016, respectively. The estimated useful lives in years are generally as follows:

Diagnostic equipment	5–13
Research, development and demonstration equipment	3-7
Machinery and equipment	2-7
Furniture and fixtures	3-9
Leasehold improvements	2–10
Building	28

Long-Lived Assets

The Company periodically assesses the recoverability of long-lived assets, including property and equipment and intangibles, other than goodwill, when there are indications of potential impairment, based on estimates of undiscounted future cash flows. The amount of impairment is calculated by comparing anticipated discounted future cash flows with the carrying value of the related asset. In performing this analysis, management considers such factors as current results, trends, and future prospects, in addition to other economic factors.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018, 2017 and 2016

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Deferred Rent

Rent expense is recorded on the straight-line method based on the total minimum rent payments required over the term of the lease. The cumulative difference between the lease expense recorded under this method and the contractual lease payment terms is recorded as deferred rent.

Other Intangible Assets

1) Capitalized Software Development Costs

Capitalization of software development costs begins upon the establishment of technological feasibility. Technological feasibility for the Company’s computer software is generally based upon achievement of a detail program design free of high risk development issues and the completion of research and development on the product hardware in which it is to be used. The establishment of technological feasibility and the ongoing assessment of recoverability of capitalized computer software development costs require considerable judgment by management with respect to certain external factors, including, but not limited to, technological feasibility, anticipated future gross revenue, estimated economic life and changes in software and hardware technology. Prior to reaching technological feasibility those costs are expensed as incurred and included in research and development.

Amortization of capitalized software development costs commences when the related products become available for general release to customers. Amortization is provided on a product by product basis. The annual amortization is the greater of the amount computed using (a) the ratio that current gross revenue for a product bears to the total of current and anticipated future gross revenue for that product, or (b) the straight-line method over the remaining estimated

economic life of the product.

The Company periodically performs reviews of the recoverability of such capitalized software development costs. At the time a determination is made that capitalized amounts are not recoverable, based on the estimated cash flows to be generated from the applicable software, any remaining capitalized amounts are written off.

2) Patents and Copyrights

Amortization is calculated on the straight-line basis over 15 years.

3) Non-Competition Agreements

The non-competition agreements are being amortized on the straight line basis over the length of the agreement (7 years).

4) Customer Relationships

Amortization is calculated on the straight line basis over 20 years.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018, 2017 and 2016

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Goodwill

Generally accepted accounting principles in the United States require the Company to perform a goodwill impairment test annually and more frequently when negative conditions or a triggering event arises. Impairment of goodwill is tested at the reporting unit level by comparing the reporting unit's carrying amount, including goodwill to the fair value of the reporting unit. If the carrying amount of the reporting unit exceeds its fair value, goodwill is considered potentially impaired and a second step is performed to measure the amount of impairment loss, if any.

Acquired assets and assumed liabilities

Pursuant to ASC No. 805-10-25, if the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, but during the allowed measurement period not to exceed one year from the acquisition date, the Company adjusts the provisional amounts recognized at the acquisition date by means of adjusting the amount recognized for goodwill.

Revenue Recognition

Revenue on sales contracts for scanners, included in "product sales" in the accompanying consolidated statements of operations, is recognized under the percentage-of-completion method in accordance with FASB ASC 605-35, "Revenue Recognition – Construction-Type and Production-Type Contracts". The Company manufactures its scanners under specific contracts that provide for progress payments. Production and installation take approximately three to six months.

Revenue on scanner service contracts is recognized on the straight-line method over the related contract period, usually one year.

Revenue from product sales (upgrades and supplies) is recognized upon shipment.

Revenue under management contracts is recognized based upon contractual agreements for management services rendered by the Company primarily under various long-term agreements with various medical providers (the "PCs"). As of June 30, 2018, the Company has twenty two management agreements of which three are with PC’s owned by Raymond V. Damadian, M.D., Chairman of the Board of FONAR (“the Related medical practices”) and nineteen are with PC’s, which are all located in the state of New York (“the New York PC’s”), owned by two unrelated radiologists. The contractual fees for services rendered to the PCs consists of fixed monthly fees per diagnostic imaging facility ranging from approximately $66,000 to $439,000. All fees are re-negotiable at the anniversary of the agreements and each year thereafter. Revenue under lease contracts is recognized based upon contractual agreements for the leasing of medical equipment primarily under long term contracts to various unrelated PC’s. All fees are re-negotiable at the anniversary of the agreements and each year thereafter.

Patient fee revenue, net of contractual allowance and discounts, consist of net patient fees received from insurance companies, third party payors (including federal and state agencies under Medicare and Medicaid programs), hospitals and patients themselves based mainly upon established contractual billing rates, less allowances for contractual adjustments and discounts. Patient fee revenue is recorded in the period in which services are provided.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018, 2017 and 2016

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Revenue Recognition (Continued)

The Company’s patient fee revenues, net of contractual allowances and discounts less the provision for bad debts for the years ended June 30, 2018, 2017 and 2016 are summarized in the following table.

	For the Year Ended June 30,		
	2018	2017	2016
Commercial Insurance/ Managed Care	$4,729,514	$4,904,892	$4,659,322
Medicare/Medicaid	1,233,078	1,274,436	1,182,552
Workers' Compensation/Personal Injury	25,358,543	23,240,829	20,888,856
Other	7,844,278	6,980,443	6,255,079
Patient Fee Revenue, net of contractual allowances and discounts	39,165,413	36,400,600	32,985,809
Provision for Bad Debts	(17,896,528)	(16,171,434)	(14,539,786)
Net Patient Fee Revenue	$21,268,885	$20,229,166	$18,446,023

Allowance for Doubtful Accounts – Patient Fee

The Company provides for medical receivables that could become uncollectible by establishing an allowance for doubtful accounts in order to adjust medical receivables to estimated net realizable value. In evaluating the collectability of medical receivables, the Company considers a number of factors, including the age of the account, historical collection experiences, payor type, current economic conditions and other relevant factors. There are various factors that impact collection trends, such as payor mix, changes in the economy, increased burden on copayments to be made by patients with insurance and business practices related to collection efforts. These factors continuously change and can have an impact on collection trends and the estimation process.

Research and Development Costs

Research and development costs are charged to expense as incurred. The costs of equipment that are acquired or constructed for research and development activities, and have alternative future uses (either in research and development, marketing or production), are classified as property and equipment and depreciated over their estimated useful lives.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expense approximated $607,000, $531,000 and $535,000 for the years ended June 30, 2018, 2017 and 2016, respectively.

Shipping Costs

The Company’s shipping and handling costs are included in revenue from product sales and the related expense included in costs related to product sales is $9,370, $8,224 and $11,077 for the years ended June 30, 2018, 2017 and 2016, respectively.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018, 2017 and 2016

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes

Deferred tax assets and liabilities are determined based on the difference between the financial statement carrying amounts and tax basis of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse.

Customer Advances

Cash advances and progress payments received on sales orders are reflected as customer advances until such time as revenue recognition occurs.

Earnings Per Share

Basic earnings per share (“EPS”) is computed by dividing net income available to common stockholders by the weighted average number of shares of common stock outstanding during the period. In accordance with ASC topic 260-10, “Participating Securities and the Two-Class Method”, the Company used the Two-Class method for calculating basic earnings per share and applied the if converted method in calculating diluted earnings per share for the years ended June 30, 2018, 2017 and 2016.

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. For the years ended June 30,

2018, 2017 and 2016, diluted EPS for common shareholders includes 127,504 shares upon conversion of Class C Common.

	June 30, 2018		
Basic	Total	Common Stock	Class C Common Stock
Numerator:			
Net income available to common stockholders	$21,230,802	$19,899,823	$338,974
Denominator:			
Weighted average shares outstanding	6,287,510	6,287,510	382,513
Basic income per common share	$3.38	$3.16	$0.89
Diluted			
Denominator:			
Weighted average shares outstanding		6,287,510	382,513
Class C Common Stock		127,504	—
Total Denominator for diluted earnings per share		6,415,014	382,513
Diluted income per common share		$3.10	$0.89

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018, 2017 and 2016

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Earnings Per Share (Continued)

	June 30, 2017		
Basic	Total	Common Stock	Class C Common Stock
Numerator:			
Net income available to common stockholders	$19,620,621	$18,390,586	$313,266
Denominator:			
Weighted average shares outstanding	6,161,599	6,161,599	382,513
Basic income per common share	$3.18	$2.98	$0.82
Diluted			
Denominator:			
Weighted average shares outstanding		6,161,599	382,513
Class C Common Stock		127,504	—
Total Denominator for diluted earnings per share		6,289,103	382,513
Diluted income per common share		$2.92	$0.82

	June 30, 2016		
Basic	Total	Common Stock	Class C Common Stock
Numerator:			
Net income available to common stockholders	$15,724,625	$14,702,834	$260,230

Denominator:			
Weighted average shares outstanding	6,050,893	6,050,893	382,513
Basic income per common share	$2.60	$2.43	$0.68
Diluted			
Denominator:			
Weighted average shares outstanding		6,050,893	382,513
Class C Common Stock		127,504	—
Total Denominator for diluted earnings per share		6,178,397	382,513
Diluted income per common share		$2.38	$0.68

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018, 2017 and 2016

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash and Cash Equivalents

The Company considers all short-term highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Concentration of Credit Risk

Cash: The Company maintains its cash and cash equivalents with various financial institutions, which exceed federally insured limits throughout the year. At June 30, 2018, the Company had cash on deposit of approximately $17,478,000 in excess of federally insured limits of $250,000.

Related Parties: Net revenues from related parties accounted for approximately 11%, 11% and 10% of the consolidated net revenues for the years ended June 30, 2018, 2017 and 2016, respectively. Net management fee receivables from the related party medical practices accounted for approximately 12%, 13% and 12% of the consolidated accounts receivable for the years ended June 30, 2018, 2017 and 2016, respectively.

See Note 3 regarding the Company’s concentrations in the healthcare industry.

Fair Value of Financial Instruments

The financial statements include various estimated fair value information at June 30, 2018 and 2017, as required by ASC topic 820, "Disclosures about Fair Value of Financial Instruments". Such information, which pertains to the Company's financial instruments, is based on the requirements set forth in that Statement and does not purport to represent the aggregate net fair value to the Company.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and cash equivalents: The carrying amount approximates fair value because of the short-term maturity of those instruments.

Receivable and accounts payable: The carrying amounts approximate fair value because of the short maturity of those instruments.

Notes receivable: The carrying amount approximates fair value because the discounted present value of the cash flow generated by the parties approximates the carrying value of the amounts due to the Company.

Long-term debt and notes payable: The carrying amounts of debt and notes payable approximate fair value due to the length of the maturities, the interest rates being tied to market indices and/or due to the interest rates not being significantly different from the current market rates available to the Company.

All of the Company's financial instruments are held for purposes other than trading.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018, 2017 and 2016

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, (Topic 606). ASU 2014-09 requires an entity to recognize as revenue the amount that reflects the consideration which it expects to be entitled in exchange for goods and services as it transfers control to its customers. It also requires more detailed disclosures to enable users of the financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The Company earns revenue from the sale of scanners, maintenance contracts, product upgrades, patient services and management fees. Under the new guidance, the reporting for patient services revenue will be reported differently. All other streams of revenue will not be impacted by the new guidance. The primary change for healthcare providers under the new guidance relates to revenue generated from patient services, with patient responsibility for payment. Under the new guidance, the Company is required to report an implicit price concession (both initially and for the subsequent changes in estimates) as a reduction of revenues as opposed to bad debt expense as a component of operating expenses. The Company will record any changes in expectation of collection amounts due to patient specific events that suggests that the patient no longer has the ability and intent to pay the amount due through the bad debt expense, as that is more indicative of a change in the customer’s credit worthiness as opposed to change in the transaction price.

The new standard supersedes most current revenue guidance, including industry-specific guidance. The guidance became effective for the Company on July 1, 2018 and as part of adopting the standard, the Company identified revenue streams of like contracts to allow for ease of implementation. The Company used primarily a portfolio approach to apply the new model to classes of customers with similar characteristics. The impact of adopting the new standard on our total revenue; and income from operations is not material. While the adoption of ASU 2014-09 will impact the presentation of net operating revenues in our Consolidated Statements of Operations and will impact certain disclosures, it will not materially impact our financial position, results of operations or cash flows. There was no cumulative effect of a change in accounting principle recorded related to the adoption of ASU 2014-09 on July 1, 2018.

In January 2017, the FASB issued Accounting Standards Update (“ASU”) 2017-04, Intangibles – Goodwill and Other (Topic 350). The amendments in this update simplify the test for goodwill impairment by eliminating Step 2 from the impairment test, which required the entity to perform procedures to determine the fair value at the impairment testing date of its assets and liabilities following the procedure that would be required in determining fair value of assets

acquired and liabilities assumed in a business combination. The amendments in this update are effective for public companies for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. We are evaluating the impact of adopting this guidance on our Consolidated Financial Statements.

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805); Clarifying the Definition of a Business. The amendments in this update clarify the definition of a business to help companies evaluate whether transactions should be accounted for as acquisitions or disposals of assets or businesses. The amendments in this update are effective for public companies for annual periods beginning after December 15, 2017, including interim periods within those periods. We are evaluating the impact of adopting this guidance on our Consolidated Financial Statements.

In March 2016, the FASB issued ASU No. 2016-09, “Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting”. This update includes provisions intended to simplify various aspects of accounting for share-based compensation. ASU No. 2016-09 will take effect for public companies for the annual periods beginning after December 15, 2016. The Company has adopted ASU No. 2016-09. Our adoption of ASU No. 2016-09 did not have an impact on the Company’s financial statements.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018, 2017 and 2016

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements (Continued)

During February 2016, FAS issued ASU 2016-02, Leases (Topic 842). The new standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases based upon the principle of whether or not the lease is effectively a financed purchase by the lessee. This classification will determine whether lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Lease with a term of 12 months or less will be accounted for similar to existing guidance for operating leases. The new guidance will be effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period and is applied retrospectively. Early adoption is permitted. The Company is currently in the process of assessing the impact the adoption of this guidance will have on the Company’s consolidated financial statements.

In July 2015, the FASB issued Accounting Standards Update No. 2015-11, “Simplifying the Measurement of Inventory” (“ASU 2015-11”). ASU 2015-11 requires an entity to measure inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory measured using last-in, first-out (“LIFO”) or the retail inventory method. It is effective for annual reporting periods beginning after December 15, 2016. The Company has adopted ASU 2015-11. Our adoption of ASU 2015-11 did not have an impact on the Company’s financial statements.

FASB, the Emerging Issues Task Force and the SEC have issued certain other accounting standards, updates, and regulations as of June 30, 2018 that will become effective in subsequent periods; however, management does not believe that any of those updates would have significantly affected our financial accounting measures or disclosures had they been in effect during 2018 or 2017, and it does not believe that any of those pronouncements will have a significant impact on our consolidated financial statements at the time they become effective.

Reclassifications

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

NOTE 3 – ACCOUNTS RECEIVABLE, MEDICAL RECEIVABLE AND MANAGEMENT AND OTHER FEES RECEIVABLE

Accounts Receivable

Credit risk with respect to the Company’s accounts receivable related to product sales and service and repair fees is limited due to the customer advances received prior to the commencement of work performed and the billing of amounts to customers as sub-assemblies are completed. Service and repair fees are billed on a monthly or quarterly basis and the Company does not continue providing these services if accounts receivable become past due. The Company controls credit risk with respect to accounts receivable from service and repair fees through its credit evaluation process, credit limits, monitoring procedures and reasonably short collection terms. The Company performs ongoing credit authorizations before a product sales contract is entered into or service and repair fees are provided.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018, 2017 and 2016

NOTE 3 – ACCOUNTS RECEIVABLE, MEDICAL RECEIVABLE AND MANAGEMENT AND OTHER FEES RECEIVABLE (Continued)

Medical Receivable

Medical receivables are due under fee-for-service contracts from third party payors, such as hospitals, government sponsored healthcare programs, patient's legal counsel and directly from patients. Substantially all the revenue relates to patients residing in Florida. The carrying amount of the medical receivable is reduced by an allowance that reflects management's best estimate of the amounts that will not be collected. The Company continuously monitors collections from its clients and maintains an allowance for bad debts based upon the Company's historical collection experience. The Company determines allowances for contractual adjustments and uncollectible accounts based on specific agings, specific payor collection issues that have been identified and based on payor classifications and historical experience at each site.

Management and Other Fees Receivable

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

Payment of the management fee receivables from the PC's may be impaired by the inability of the PC's to collect in a timely manner their medical fees from the 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 65%, 62% and 59%, respectively, of the PCs' 2018, 2017 and 2016 net revenues 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. The Company generally takes all legally available steps to collect its receivables. Credit losses associated with the receivables are provided for in the consolidated financial statements and have historically been within management's expectations.

Net revenues from management and other fees charged to the related party medical practices accounted for approximately 11%, 11% and 10%, of the consolidated net revenues for the years ended June 30, 2018, 2017 and 2016, respectively.

Tallahassee Magnetic Resonance Imaging, PA, Stand Up MRI of Boca Raton, PA and Stand Up MRI & Diagnostic Center, PA (all related party medical practices) entered into a guaranty agreement, pursuant to which they cross guaranteed all management fees which are payable to the Company, which have arisen under each individual management agreement.

The following table sets forth the number of our facilities for the years ended June 30, 2018, 2017 and 2016.

	For The Year Ended June 30,		
	2018	2017	2016
Total Facilities Owned or Managed (at Beginning of Year)	26	25	24
Facilities Added by:			
Acquisition	—	1	1
Internal development	—	—	—
Managed Facilities Closed	—	—	—
Total Facilities Owned or Managed (at End of Year)	26	26	25

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018, 2017 and 2016

NOTE 4 - COSTS AND ESTIMATED EARNINGS ON UNCOMPLETED CONTRACTS

Information relating to uncompleted contracts as of June 30, 2018 and 2017 is as follows:

	As of June 30,	
	2018	2017
Costs incurred on uncompleted contracts	$448,437	$1,030,675
Estimated earnings	309,248	999,433
	757,685	2,030,108
Less: Billings to date	671,047	1,294,047
	$86,638	$736,061

NOTE 5 – INVENTORIES

Inventories included in the accompanying consolidated balance sheets consist of:

	As of June 30,	
	2018	2017
Purchased parts, components and supplies	$1,312,299	$1,430,901
Work-in-process	119,081	193,361
	$1,431,380	$1,624,262

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018, 2017 and 2016

NOTE 6 - PROPERTY AND EQUIPMENT

Property and equipment, at cost, less accumulated depreciation and amortization, at June 30, 2018 and 2017, is comprised of:

	As of June 30,	
	2018	2017
Diagnostic equipment	$24,296,957	$22,356,565
Research, development and demonstration equipment	2,987,531	2,749,753
Machinery and equipment	2,069,055	2,069,055
Furniture and fixtures	3,036,539	3,000,316
Leasehold improvements	7,165,035	6,601,480
Building	939,614	939,614
	40,494,731	37,716,783
Less: Accumulated depreciation and amortization	24,002,453	21,254,279
	$16,492,278	$16,462,504

Depreciation and amortization of property and equipment for the years ended June 30, 2018, 2017 and 2016 was $2,748,174, $2,303,554 and $2,042,211, respectively.

During the year ended June 30, 2017, the Company has retired assets that were fully depreciated with a cost and accumulated depreciation basis of $1,849,409.

NOTE 7 - OTHER INTANGIBLE ASSETS

Other intangible assets, net of accumulated amortization, at June 30, 2018 and 2017 are comprised of:

	As of June 30,	
	2018	2017
Capitalized software development costs	$7,004,847	$7,004,847
Patents and copyrights	4,835,806	4,726,977
Non-competition agreements	4,100,000	4,100,000
Customer relationships	3,800,000	3,800,000
	19,740,653	19,631,824
Less: Accumulated amortization	14,138,997	12,987,320
	$5,601,656	$6,644,504

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FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018, 2017 and 2016

NOTE 7 - OTHER INTANGIBLE ASSETS (Continued)

Information related to the above intangible assets for the years ended June 30, 2018, 2017 and 2016 is as follows:

	As of June 30,		
	2018	2017	2016
Balance – Beginning of Year	$6,644,504	$7,719,358	$8,950,160
Amounts capitalized	108,829	155,156	113,072
Software or patents written off	—	—	(88,796)
Amortization	(1,151,677)	(1,230,010)	(1,255,078)
Balance – End of Year	$5,601,656	$6,644,504	$7,719,358

Amortization of patents and copyrights for the years ended June 30, 2018, 2017 and 2016 amounted to $202,630, $194,296 and $187,553, respectively.

Amortization of capitalized software development costs for the years ended June 30, 2018, 2017 and 2016 was $173,333, $260,000 and $291,810, respectively.

Amortization of non-competition agreements for the years ended June 30, 2018, 2017 and 2016 amounted to $585,714, $585,714 and $585,714, respectively.

Amortization of customer relationships for the years ended June 30, 2018, 2017 and 2016 amounted to $190,000, $190,000 and $190,000, respectively.

The estimated amortization of other intangible assets for the five years ending June 30, 2023 and thereafter is as follows:

For the Years Ending June 30,	Total	Patents and Copyrights	Non-competition	Customer Relationships
2019	$980,284	$204,570	$585,714	$190,000
2020	783,072	202,595	390,477	190,000
2021	393,102	203,102	—	190,000
2022	391,713	201,713	—	190,000
2023	387,103	197,103	—	190,000
Thereafter	2,666,382	829,715	—	1,836,667
	$5,601,656	$1,838,798	$976,191	$2,786,667

The weighted average amortization period for other intangible assets is 11.1 years and they have no expected residual value.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018, 2017 and 2016

NOTE 8 - CAPITAL STOCK

Common Stock

Cash dividends payable on the common stock shall, in all cases, be on a per share basis, one hundred twenty percent (120%) of the cash dividend payable on shares of Class B common stock and three hundred sixty percent (360%) of the cash dividend payable on a share of Class C common stock.

Class B Common Stock

Class B common stock is convertible into shares of common stock on a one-for-one basis. Class B common stock has 10 votes per share. There were 146 of such shares outstanding at June 30, 2018, 2017 and 2016, respectively.

Class C Common Stock

On April 3, 1995, the stockholders ratified a proposal creating a new Class C common stock and authorized the exchange offering of three shares of Class C common stock for each share of the Company's outstanding Class B common stock. The Class C common stock has 25 votes per share, as compared to 10 votes per share for the Class B common stock and one vote per share for the common stock. The Class C common stock was offered on a three-for-one basis to the holders of the Class B common stock. Although having greater voting power, each share of Class C common stock has only one-third of the rights of a share of Class B common stock to dividends and distributions. Class C common stock is convertible into shares of common stock on a three-for-one basis.

Class A Non-Voting Preferred Stock

On April 3, 1995, the stockholders ratified a proposal consisting of the creation of a new class of Class A non-voting preferred stock with special dividend rights and the declaration of a stock dividend on the Company's common stock consisting of one share of Class A non-voting preferred stock for every five shares of common stock. The stock dividend was payable to holders of common stock on October 20, 1995. Class A non-voting preferred stock issued pursuant to such stock dividend approximates 313,000 shares.

The Class A non-voting preferred stock is entitled to a special dividend equal to 3-1/4% of first $10 million, 4-1/2% of next $20 million and 5-1/2% on amounts in excess of $30 million of the amount of any cash awards or settlements

received by the Company in connection with the enforcement of five of the Company's patents in its patent lawsuits, less the revised special dividend payable on the common stock with respect to one of the Company's patents.

The Class A non-voting preferred stock participates on an equal per share basis with the common stock in any dividends declared and ranks equally with the common stock on distribution rights, liquidation rights and other rights and preferences (other than the voting rights).

Stock Bonus Plans

On April 23, 2010, the Board approved the 2010 Stock Bonus Plan. The plan entitles the Company to reserve 2,000,000 shares of common stock. On August 10, 2010, the Company filed Form S-8 to register the 2,000,000 shares. As of June 30, 2018, 716,876 shares of common stock of FONAR were available for future grant under this plan. For the years ended June 30, 2018, 2017 and 2016, 0, 193,461 and 146 shares were issued respectively.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018, 2017 and 2016

NOTE 8 - CAPITAL STOCK (Continued)

Options

The Company had stock option plans, which provide for the awarding of incentive and non-qualified stock options to employees, directors and consultants who may contribute to the success of the Company. The options granted vest either immediately or ratably over a period of time from the date of grant, typically three or four years, at a price determined by the Board of Directors or a committee of the Board of Directors, generally the fair value of the Company's common stock at the date of grant. The options must be exercised within ten years from the date of grant.

NOTE 9 – CONTROLLING AND NONCONTROLLING INTERESTS

On February 13, 2013 the Company entered into an agreement with outside investors to acquire a 50.5% controlling interest in a newly formed limited liability company, Health Diagnostics Management LLC (HDM). According to the February 13, 2013 LLC operating agreement of HDM there are two classes of members; Class A members and one Class B member. The Class A members have an ownership interest of 49.5% of HDM. The Class B member (HMCA) has an ownership of 50.5% of HDM. On all matters on which members may vote every member is entitled to cast the percentage of votes equal to their percentage of ownership interest. Profits and losses on all items of income, gain or loss, deductions or other allocations of the Company will be allocated among the members in the same proportions as their membership interests in the Company bear to all the Class A and Class B membership interests of the Company in the aggregate outstanding. All of the depreciation and amortization of the assets of the Company will be allocated solely to the Class A members, unless and until their interests have been redeemed by the Company in full pursuant to the provisions of the operating agreement. The Company contributed $20,200,000 to HDM and the group of outside investors contributed $19,800,000 for its non-controlling membership interest.

On March 5, 2013 HDM purchased from Health Diagnostics, LLC (“HD”) and certain of its subsidiaries, a business managing twelve (12) Stand-Up MRI Centers and two (2) other scanning centers located in the States of New York and Florida for a total purchase price (including consideration of $1.5 million to outside investors) aggregating $35.9 million. Concurrently with the acquisition, HDM entered into several consulting and non-competition agreements for a consideration of $4.1 million. The acquisition was accounted for using the purchase method in accordance with ASC 805, “Business Combinations”. The Company recognized and measured goodwill as of the acquisition date, as the excess of the fair value of the consideration paid over the fair value of the identified net assets acquired.

On January 8, 2015, the Company purchased 20% of the Class A members ownership interest at a cost of $4,971,094. The Company has a 60.4% ownership interest in HDM after this transaction.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018, 2017 and 2016

NOTE 9 – CONTROLLING AND NONCONTROLLNG INTERESTS (Continued)

Amount of each class of HDM members' equity as of June 30, 2018, 2017 and 2016

	June 30, 2018		June 30, 2017		June 30, 2016	
	Class A Members	Class B Member	Class A Members	Class B Member	Class A Members	Class B Member
Opening Members' Equity	$5,472,799	$27,988,982	$8,396,575	$23,314,842	$10,752,169	$22,043,621
Share of Net Income	4,221,383	18,101,940	4,058,177	16,947,624	2,886,006	13,229,621
Distributions	(6,135,000)	(14,315,000)	(6,981,953)	(12,273,484)	(5,241,600)	(11,958,400)
Ending Members' Equity	$3,559,182	$31,775,922	$5,472,799	$27,988,982	$8,396,575	$23,314,842

On May 2, 2011, the Company completed a private placement of equity and succeeded in raising $6,000,000. The offering consisted of Preferred Class A membership interests in a newly formed limited liability company, Imperial Management Services, LLC ("Imperial"). The Class B membership interests in Imperial, all of which were retained by the Company's subsidiary, HMCA, hold a 75% equity interest in Imperial. The Class A membership interests are entitled to receive a dividend of 18% per annum of their cash capital contribution of $6,000,000. HMCA contributed all of its assets, together with its liabilities, to Imperial as HMCA's capital contribution. The Imperial operating agreement provides for the Class A members to receive priority distributions until their original capital contributions are returned. Dividends are payable quarterly beginning August 1, 2011. On May 2, 2016, May 1, 2015 and on May 1, 2014, the Company returned a portion of the Class A Members capital contribution in the amount of $1,125,000, $1,125,000 and $1,125,100, respectively. As of June 30, 2016, the Company's subsidiary, HMCA, now owns approximately 100% interest in Imperial Management Services.

Amount of each class of Imperial members' equity as of June 30, 2016

	June 30, 2016	
	Class A Members	Class B Member
Opening Members' Equity	$1,279,446	$15,000,446
Share of Net Income	—	—
Distributions	(202,500)	—
Buyout	48,054	
Redemption	(1,125,000)	—
Ending Members' Equity	$—	$15,000,446

The Company has a 50% controlling interest in an entity which the Company consolidates, that provides management services to a diagnostic center in the New York Metropolitan area. The center began operations during January 2012. On June 30, 2016, the Company purchased the remaining 50% interest in the entity making it a wholly owned subsidiary for the Company. The Company paid $1,780,000 to acquire this additional ownership interest.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018, 2017 and 2016

NOTE 10 - LONG-TERM DEBT, NOTES PAYABLE AND CAPITAL LEASES

Long-term debt, notes payable and capital leases consist of the following:

	2018	2017
Note payable requiring monthly payments of interest at a rate of 7% until May 2009 followed by 240 monthly payments of $4,472 through October 2026. The loan is collateralized by a building with a net book value of $515,834 as of June 30, 2018.	$336,781	$365,406
The revolving credit note was extended to September 2018. The Company can prepay the loan in whole or part in multiples of $100,000 at any time without penalty. The note bears interest at a rate of 4% per annum and is payable monthly. The loan is collateralized by substantially all of the Company's assets. The loan also contains certain financial covenants that must be met on a periodic basis. The note was paid in full September 2, 2014. The Company still has the ability to draw down on the line.	—	—
Note payable requiring 12 consecutive interest only payments commencing at the inception of the loan followed by 48 consecutive monthly payments, commencing May 1, 2014. The note bears interest at a rate of 4.75% per annum and is payable monthly. The loan is collateralized by substantially all of the Company's assets. The loan also contains certain financial covenants that must be met on a periodic basis.	—	143,676
Other (including capital leases for property and equipment).	7,586	7,769
	344,367	516,851
Less: Current portion	38,332	180,090
	$306,035	$336,761

The maturities of long-term debt over the next five years and thereafter are as follows:

Years Ending June 30,	
2019	$38,332
2020	32,944
2021	35,416

2022	38,013
2023	40,820
Thereafter	158,842
	$344,367

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018, 2017 and 2016

NOTE 11 - INCOME TAXES

ASC topic 740 prescribes a recognition threshold and a 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 carryforward 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 ASC topic 740. The Company believes there are no uncertain tax positions in prior years tax filings and therefore it has not recorded a liability for unrecognized tax benefits.

In accordance with ASC topic 740, 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 "Selling, general and administrative" expenses.

The Company files corporate income tax returns in the United States (federal) 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 2014.

The Company has recorded a deferred tax asset of $22,689,011 and a deferred tax liability of $239,011 as of June 30, 2018, primarily relating to its net operating loss carryforwards of approximately $82,662,000 available to offset future taxable income through 2030. The net operating losses begin to expire in 2021 for federal tax and state income tax purposes.

Future ownership changes as determined under Section 382 of the Internal Revenue code could further limit the utilization of net operating loss carryforwards. As of June 30, 2018, no such changes in ownership have occurred.

The ultimate realization of deferred tax assets is dependent on the generation of future taxable income during the periods in which temporary differences become deductible or when such net operating losses can be utilized. The Company considers projected future taxable income, the regulatory environment of the industry, and tax planning strategies in making this assessment. At present, the Company believes that it is more likely than not that the benefits from certain deferred tax asset carryforwards, will not all be fully realized. In recognition of this inherent risk, a valuation allowance was established for the partial value of the deferred tax asset, (principally related to research and development tax credits and allowance for doubtful accounts).

A valuation allowance will be maintained until sufficient positive evidence exists to support the reversal of the remainder of the valuation.

The valuation allowance for deferred tax assets decreased during the year ended June 30, 2018, by approximately $27,600,000, of which $16,000,000 was the result of the revalued deferred tax assets due to the Tax Cuts and Jobs Act

and the benefits expected to be realized from the usage of net operating losses given the Company's current and projected profitable operations. The valuation allowance decreased by approximately $11,131,000 during the year ended June 30, 2017.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2018, 2017 and 2016

NOTE 11 - INCOME TAXES (Continued)

Components of the benefit for income taxes are as follows: