FONAR CORP
Form 10-Q
May 15, 2013

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended **MARCH 31, 2013**

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

SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____________ to _____________

Commission file number 0-10248

FONAR CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE (State or other jurisdiction of Incorporation or organization)	11-2464137 (I.R.S. Employer Identification No.)
110 Marcus Drive Melville, New York (Address of principal executive offices)	11747 (Zip Code)

Registrant's telephone number, including area code: (631) 694-2929

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 ___

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

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

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

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FONAR CORPORATION AND SUBSIDIARIES

(Continued from First Page)

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

Class	Outstanding at April 30, 2013
Common Stock, par value $.0001	5,969,132
Class B Common Stock, par value $.0001	158
Class C Common Stock, par value $.0001	382,513
Class A Preferred Stock, par value $.0001	313,438

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FONAR CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(000's OMITTED, except shares and per share data)

(UNAUDITED)

ASSETS

Current Assets:	March 31, 2013	June 30, 2012 *
Cash and cash equivalents	$9,243	$12,032
Accounts receivable – net	4,993	5,095
Accounts receivable - related party	30	—
Medical receivables – net	4,513	—
Management and other fees receivable – net	14,820	3,782
Management and other fees receivable – related medical practices – net	2,396	1,311
Costs and estimated earnings in excess of billings on uncompleted contracts	488	1,129
Inventories	2,284	2,195
Current portion of notes receivable – net	118	116
Prepaid expenses and other current assets	837	206
Total Current Assets	39,722	25,866
Property and equipment – net	17,713	3,173
Notes receivable	192	276
Goodwill	1,667	—
Other intangible assets – net	12,796	3,835
Other assets	1,191	465
Total Assets	$73,281	$33,615

*Condensed from audited financial statements.

See accompanying notes to condensed consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(000's OMITTED, except shares and per share data)

(UNAUDITED)

LIABILITIES AND STOCKHOLDERS' EQUITY

	March 31,	June 30,
Current Liabilities:	2013	2012*
Current portion of long-term debt and capital leases	$2,517	$1,854
Accounts payable	2,639	2,077
Other current liabilities	8,680	7,693
Unearned revenue on service contracts	5,681	5,475
Unearned revenue on service contracts - related party	28	—
Customer advances	4,763	3,881
Income tax payable	—	100
Total Current Liabilities	24,308	21,080
Long-Term Liabilities:		
Accounts payable, non current	—	47
Due to related medical practices	231	229
Long-term debt and capital leases, less current portion	13,404	777
Other liabilities	362	401
Total Long-Term Liabilities	13,997	1,454
Total Liabilities	38,305	22,534

*Condensed from audited financial statements.

See accompanying notes to condensed consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(000's OMITTED, except shares and per share data)

(UNAUDITED)

LIABILITIES AND STOCKHOLDERS' EQUITY (Continued)

LIABILITIES AND STOCKHOLDERS' EQUITY	March 31, 2013	June 30, 2012*
STOCKHOLDERS' EQUITY:		
Class A non-voting preferred stock $.0001 par value; 453,000 shares authorized at March 31, 2013 and June 30, 2012, 313,438 issued and outstanding at March 31, 2013 and June 30, 2012	—	—
Preferred stock $.001 par value; 567,000 shares authorized at March 31, 2013 and June 30, 2012, issued and outstanding – none	—	—
Common Stock $.0001 par value; 8,500,000 shares authorized at March 31, 2013 and June 30, 2012, 5,977,905 and 5,912,905 issued at March 31, 2013 and June 30, 2012, respectively; 5,966,262 and 5,901,262 outstanding at March 31, 2013 and June 30, 2012, respectively	1	1
Class B Common Stock (10 votes per share) $ .0001 par value; 227,000 shares authorized at March 31, 2013 and June 30, 2012, 158 issued and outstanding at March 31, 2013 and June 30, 2012	—	—
Class C Common Stock (25 votes per share) $.0001 par value; 567,000 shares authorized at March 31, 2013 and June 30, 2012, 382,513 issued and outstanding at March 31, 2013 and June 30, 2012	—	—
Paid-in capital in excess of par value	174,478	174,084
Accumulated other comprehensive loss	(15)	(20)
Accumulated deficit	(164,457)	(168,334)
Notes receivable from employee stockholders	(57)	(71)
Treasury stock, at cost - 11,643 shares of common stock at March 31, 2013 and June 30, 2012	(675)	(675)
Non controlling interests	25,701	6,096
Total Stockholders' Equity	34,976	11,081
Total Liabilities and Stockholders' Equity	$73,281	$33,615

*Condensed from audited financial statements.

See accompanying notes to condensed consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(000's OMITTED, except shares and per share data)

	FOR THE THREE MONTHS ENDED MARCH 31,	
REVENUES	2013	2012
Product sales – net	$416	$1,309
Service and repair fees – net	2,867	3,008
Service and repair fees – related parties - net	27	27
Patient revenue – net	965	—
Management and other fees – net	5,402	3,601
Management and other fees – related medical practices – net	1,965	1,571
Total Revenues – Net	11,642	9,516
COSTS AND EXPENSES		
Costs related to product sales	498	962
Costs related to service and repair fees	819	891
Costs related to service and repair fees – related parties	8	8
Costs related to patient revenue	791	—
Costs related to management and other fees	2,606	2,390
Costs related to management and other fees – related medical practices	900	953
Research and development	381	315
Selling, general and administrative	3,774	2,224
Provision for bad debts	235	170
Total Costs and Expenses	10,012	7,913
Income From Operations	1,630	1,603
Interest Expense	(79)	(103)
Investment Income	55	53
Income Before Provision for Income Taxes	1,606	1,553
Provision for Income Taxes	25	—
Net Income	1,581	1,553
Net Income - Non Controlling Interests	505	261
Net Income - Controlling Interests	$1,076	$1,292
Net Income Available to Common Stockholders	$1,005	$1,206
Net Income Available to Class A Non-Voting Preferred Stockholders	$53	$64
Net Income Available to Class C Common Stockholders	$18	$22
Basic Net Income Per Common Share Available to Common Stockholders	$0.17	$0.21
Diluted Net Income Per Common Share Available to Common Stockholders	$0.17	$0.20
Basic and Diluted Income Per Share - Common C	$0.05	$0.06
Weighted Average Basic Shares Outstanding	5,937,096	5,836,229
Weighted Average Diluted Shares Outstanding	6,064,600	5,963,733
Weighted Average Basic Shares Outstanding – Class C Common	382,513	382,513
Weighted Average Diluted Shares Outstanding – Class C Common	382,513	382,513

See accompanying notes to condensed consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(000's OMITTED, except shares and per share data)

	FOR THE NINE MONTHS ENDED MARCH 31, 2013	2012
REVENUES		
Product sales – net	$2,536	$4,699
Service and repair fees – net	8,341	8,720
Service and repair fees – related parties - net	83	83
Patient revenue – net	965	—
Management and other fees – net	12,946	10,238
Management and other fees – related medical practices – net	5,895	4,712
Total Revenues – Net	30,766	28,452
COSTS AND EXPENSES		
Costs related to product sales	2,457	3,608
Costs related to service and repair fees	2,579	2,572
Costs related to service and repair fees – related parties	26	24
Costs related to patient revenue	791	—
Costs related to management and other fees	7,013	6,462
Costs related to management and other fees – related medical practices	2,568	2,673
Research and development	1,031	938
Selling, general and administrative	8,338	6,261
Provision for bad debts	735	655
Total Costs and Expenses	25,538	23,193
Income From Operations	5,228	5,259
Interest Expense	(258)	(333)
Investment Income	174	178
Other (Expense) Income	(13)	55
Income Before Provision for Income Taxes	5,131	5,159
Provision for Income Taxes	152	21
Net Income	4,979	5,138
Net Income - Non Controlling Interests	1,103	796
Net Income - Controlling Interests	$3,876	$4,342
Net Income Available to Common Stockholders	$3,621	$4,051
Net Income Available to Class A Non-voting Preferred Stockholders	$190	$217
Net Income Available to Class C Common Stockholders	$65	$74
Basic Net Income Per Common Share Available to Common Stockholders	$0.61	$0.71
Diluted Net Income Per Common Share Available to Common Stockholders	$0.60	$0.69
Basic and Diluted Income Per Share-Common C	$0.17	$0.19
Weighted Average Basic Shares Outstanding	5,921,540	5,744,506
Weighted Average Diluted Shares Outstanding	6,049,044	5,872,010
Weighted Average Basic Shares Outstanding – Class C Common	382,513	382,513

Weighted Average Diluted Shares Outstanding – Class C Common	382,513	382,513

See accompanying notes to condensed consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(UNAUDITED)

(Amounts in Thousands)

	FOR THE THREE MONTHS ENDED MARCH 31,	
	2013	2012
Net income	$1,581	$1,553
Other comprehensive income, net of tax: Unrealized gains on marketable securities, net of tax	5	3
Total comprehensive income	$1,586	$1,556
Comprehensive income-non controlling interests	505	261
Comprehensive income-controlling interests	$1,081	$1,295

See accompanying notes to condensed consolidated financial statements.

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FONAR CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(UNAUDITED)

(Amounts in Thousands)

	FOR THE NINE MONTHS ENDED MARCH 31,	
	2013	2012
Net income	$4,979	$5,138
Other comprehensive income, net of tax: Unrealized gains (losses) on marketable securities, net of tax	5	(1)
Total comprehensive income	$4,984	$5,137
Comprehensive income-non controlling interests	1,103	796
Comprehensive income-controlling interests	$3,881	$4,341

See accompanying notes to condensed consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in Thousands)

(UNAUDITED)

	FOR THE NINE MONTHS ENDED MARCH 31	
	2013	2012
Cash Flows from Operating Activities:		
Net income	$4,979	$5,138
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,489	1,629
Provision for bad debts	735	655
Stock issued for costs and expenses	—	384
Compensatory element of stock issuances	395	49
(Increase) decrease in operating assets, net:		
Accounts, management fee and medical receivables	(3,552)	(1,430)
Notes receivable	82	57
Costs and estimated earnings in excess of billings on uncompleted contracts	640	(1,003)
Inventories	(89)	(936)
Prepaid expenses and other current assets	(615)	129
Other assets	(183)	106
Increase (decrease) in operating liabilities, net:		
Accounts payable	515	(164)
Other current liabilities	1,214	550
Customer advances	882	(1,537)
Billings in excess of costs and estimated earnings on uncompleted contracts	—	800
Other liabilities	(39)	(18)
Due to related medical practices	2	(7)
Income tax payable	(100)	(75)
Net cash provided by operating activities	6,355	4,327
Cash Flows from Investing Activities:		
Purchases of property and equipment	(568)	(606)
Cost of HDM acquisition	(40,000)	—
Cost of patents	(109)	(94)
Proceeds from non controlling interests	19,800	16
Sale to non controlling interest	—	10
Net cash used in investing activities	(20,877)	(674)
Cash Flows from Financing Activities:		
Repayment of borrowings and capital lease obligations	(983)	(1,096)
Distributions to non controlling interests	(1,298)	(848)
Proceeds from long-term debt	14,000	—
Repayment of notes receivable from employee stockholders	14	43
Net cash provided by (used in) financing activities	11,733	(1,901)
Net (Decrease) Increase in Cash and Cash Equivalents	(2,789)	1,752
Cash and Cash Equivalents – Beginning of Period	12,032	9,251

Cash and Cash Equivalents - End of Period	$9,243	$11,003

See accompanying notes to condensed consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2013 and 2012

(UNAUDITED)

NOTE 1 - BASIS OF PRESENTATION & LIQUIDITY & CAPITAL RESOURCES

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended March 31, 2013, are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2013. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K filed on September 28, 2012 for the fiscal year ended June 30, 2012.

On March 5, 2013, the Company acquired a majority interest in a newly formed limited liability company, Health Diagnostics Management LLC (HDM), a business managing 12 Stand-Up MRI centers and 2 other scanning centers located in Florida and New York for a total cost of $40 million. See Note 9

Liquidity

At March 31, 2013, the Company had working capital of $15.4 million as compared to working capital of $4.8 million at June 30, 2012, and stockholders’ equity of $35.0 million at March 31, 2013 as compared to stockholders’ equity of $11.1 million at June 30, 2012. For the nine months ended March 31, 2013, we realized a net income of $5.0 million.

The Company believes that its business plan has been responsible for the past two consecutive fiscal years of profitability (fiscal 2012 and fiscal 2011) and that its capital resources will be adequate to support operations at current levels through March 31, 2014. In fiscal 2010 and prior years, however, the Company also experienced losses and periods of working capital deficits. The future effects on our business of healthcare reform legislation, the Deficit

Reduction Act, the tax on sales of medical equipment and the general economic and business climate are not known at the present time. Nevertheless, there is a possibility of adverse consequences to our business operations from these causes.

In order to promote sales, the Company is continuing to focus on marketing campaigns to strengthen the demand for our products and services. Management anticipates that the Company's capital resources will continue to improve if the Company's MRI scanner products gain wider market recognition and acceptance resulting in both increased product sales and scan volumes. If the Company is not successful with our marketing efforts to increase sales, the Company will experience a shortfall in cash, and it will be necessary to reduce operating expenses or obtain funds through equity or debt financing.

If the Company is unable to meet expenditures with revenues or financing then it will be necessary to reduce expenses further, or seek other sources of funds through the issuance of debt or equity financing in order to conduct operations as now conducted subsequent to fiscal 2013.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2013 and 2012

(UNAUDITED)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

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

Goodwill and Other Intangible Assets

Goodwill is the excess of purchase price over the fair value of identified net assets of businesses acquired. Goodwill deemed to have indefinite lives is not amortized but is subject to annual impairment tests. In addition to the annual impairment test for goodwill, the Company tests for impairment at any point where indicators of impairment exist.

The Company’s intangible assets deemed to have definite lives are amortized over their estimated useful lives, on a straight-line basis as follows:

Non compete	7 years
Customer relationships	20 years
Developed software	5 years

Income Per Share

Basic earnings per share ("EPS") is computed based on weighted average shares outstanding and excludes any potential dilution. 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 three and nine months ended March 31, 2013 and March 31, 2012.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2013 and 2012

(UNAUDITED)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Per Share (Continued)

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 three and nine months ended March 31, 2013 and March 31, 2012, the number of common shares potentially issuable upon the exercise of certain options of 6,610 and 16,205; respectively, have not been included in the computation of diluted EPS since the effect would be antidilutive.

	Three months ended March 31, 2013 (000's omitted, except per share data)			Three months ended March 31, 2012		
Basic	Total	Stock	Class C Common Stock	Total	Common Stock	Class C Common Stock
Numerator:						
Net income Available to common stockholders	$1,076	$1,005	$18	$1,292	$1,206	$22
Denominator:						
Weighted average shares outstanding	5,937	5,937	383	5,836	5,836	383
Basic income per common share	$0.18	$0.17	$0.05	$0.22	$0.21	$0.06
Diluted						
Denominator:						
Weighted average shares outstanding		5,937	383		5,836	383
Stock options		—	—		—	—
		128	—		128	—

Convertible Class C Stock				
Total Denominator for diluted earnings per share	6,065	383	5,964	383
Diluted income per common share	$0.17	$0.05	$0.20	$0.06

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FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2013 and 2012

(UNAUDITED)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Per Share (Continued)

	Nine months ended March 31, 2013 (000's omitted, except per share data)			Nine months ended March 31, 2012		
Basic	Total	Stock	Class C Common Stock	Total	Common Stock	Class C Common Stock
Numerator:						
Net income Available to common stockholders	$3,876	$3,621	$65	$4,342	$4,051	$74
Denominator:						
Weighted average shares outstanding	5,921	5,921	383	5,744	5,744	383
Basic income per common share	$0.65	$0.61	$0.17	$0.76	$0.71	$0.19
Diluted						
Denominator:						
Weighted average shares outstanding		5,921	383		5,744	383
Stock options		—	—		—	—
Convertible Class C Stock		128	—		128	—
Total Denominator for diluted earnings per share		6,049	383		5,872	383
Diluted income per common share		$0.60	$0.17		$0.69	$0.19

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FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2013 and 2012

(UNAUDITED)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements

In July 2012, the Financial Accounting Standards Board ("FASB")issued Accounting Standards Update ("ASU") No. 2012-02, Intangibles-Goodwill and Other (Topic 350) Testing Indefinite-Lived Intangible Assets for Impairment. This ASU simplifies how entities test indefinite-lived intangible assets for impairment which improve consistency in impairment testing requirements among long-lived asset categories. These amended standards permit an assessment of qualitative factors to determine whether it is more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying value. For assets in which this assessment concludes it is more likely than not that the fair value is more than its carrying value, these amended standards eliminate the requirement to perform quantitative impairment testing as outlined in previously issued standards. The guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, early adoption is permitted. The adoption of this standard is not expected to have a material impact on the Company's condensed consolidated financial position and results of operations.

FASB, the Emerging Issues Task Force and the SEC have issued certain other accounting standards, updates, and regulations as of March 31, 2013 that will become effective in subsequent periods; however, management does not believe that any of those pronouncements will have a significant impact on our condensed 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 reclassifcations did not have any effect on reported consolidated net income for any periods presented.

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FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2013 and 2012

(UNAUDITED)

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

Receivables, net is comprised of the following at March 31, 2013:

(000’s Omitted)

	Gross Receivable	Allowance for Doubtful accounts	Net
Receivables from equipment sales and service contracts	$ 6,854	$ 1,861	$4,993
Receivables from equipment sales and service contracts – related party	$ 30	—	$30
Medical receivables	$ 6,635	$ 2,122	$4,513
Management and other fees Receivables	$ 23,003	$ 8,183	$14,820
Management and other fees receivables from related medical practices ("PC’s")	$ 2,799	$ 403	$2,396

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

The Company recognizes patient revenue as imaging services are provided. Revenue is reported at the estimated net realizable amount from insurance companies, third-party payors, hospitals, patients and others for services rendered. These services are typically billed to insurance companies, hospitals, patients, or the patient’s legal counsel. Substantially all the revenue relates to patients residing in Florida. The carrying amount of the medical receivable may be reduced by an allowance that reflects management’s best estimate of the amounts that will not be collected. The Company determines allowances for contractual adjustments and uncollectible accounts based on specific agings and payor classifications at each center.

The Company's receivables from the related and non-related professional corporations (PC's) substantially consist of fees outstanding under management agreements. Payment of the outstanding fees is dependent on collection by the

PC's of fees from third party medical reimbursement organizations, principally insurance companies and health management organizations.

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 47% and 61% of the PC's net revenues for the nine months ended March 31, 2013 and 2012, respectively, were derived from no-fault and personal injury protection claims. The Company considers the aging of its accounts receivable in determining the amount of allowance for doubtful accounts. The Company generally takes all legally available steps to collect its receivables. Credit losses associated with the receivables are provided for in the condensed consolidated financial statements and have historically been within management's expectations.

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FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2013 and 2012

(UNAUDITED)

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

Net revenues from management and other fees charged to the related PCs accounted for approximately 19.2% and 16.6% of the consolidated net revenues for the nine months ended March 31, 2013 and 2012, respectively.

Tallahassee Magnetic Resonance Imaging, PA, Stand Up MRI of Boca Raton, PA and Stand Up MRI & Diagnostic Center, PA (all related 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.

NOTE 4 - INVENTORIES

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

(000's omitted)

	March 31, 2013	June 30, 2012
Purchased parts, components and supplies	$1,665	$1,673
Work-in-process	619	522
Total Inventories	$2,284	$2,195

NOTE 5 - COSTS & ESTIMATED EARNINGS ON UNCOMPLETED CONTRACTS

1) Information relating to uncompleted contracts as of March 31, 2013 is as follows:

(000's omitted)

Costs incurred on uncompleted contracts	$1,374
Estimated earnings	1,208
	2,582
Less: Billings to date	2,094
Total Costs and estimated earnings on uncompleted contracts	$488

Included in the accompanying condensed consolidated balance sheet at March 31, 2013 under the following captions:

Costs and estimated earnings in excess of billings on uncompleted contracts	$488
Less: Billings in excess of costs and estimated earnings on uncompleted contracts	—
Total costs and estimated earnings on uncompleted contracts	$488

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2013 and 2012

(UNAUDITED)

NOTE 5 - COSTS & ESTIMATED EARNINGS ON UNCOMPLETED CONTRACTS (Continued)

2) Customer advances consist of the following as of March 31, 2013:

	Total
Total Advances	$6,857
Less: Advances on contracts under construction	2,094
Total Customer Advances	$4,763

NOTE 6 – OTHER INTANGIBLE ASSETS

Other intangible assets, net of accumulated amortization, in the accompanying condensed consolidated balance sheet consist of the following:

	March 31, 2013	June 30, 2012
Capitalized software development costs	$7,669	$6,369
Patents and copyrights	4,210	4,101
Management agreement	513	513
Non-compete	4,100	—
Customer relationships	4,000	—
Gross other intangible assets	20,492	10,983
Less: Accumulated amortization	7,696	7,148
Other intangible assets	$12,796	$3,835

Amortization of patents and copyrights for the three months ended March 31, 2013 and 2012 amounted to $42 and $39 and amounted to $125 and $112 for the nine months ended March 31, 2013 and 2012, respectively.

Amortization of capitalized software development costs for the three months ended March 31, 2013 and 2012 amounted to $53 and $89 and amounted to $204 and $271 for the nine months ended March 31, 2013 and 2012, respectively.

Amortization of management agreement for the three months ended March 31, 2013 and 2012 amounted to $28 and $9 and amounted to $83 and $28 for the nine months ended March 31, 2013 and 2012, respectively.

Amortization of non-compete for the three months and nine months ended March 31, 2013 and 2012 amounted to $68 and $0, respectively.

NOTE 7 – STOCKHOLDERS EQUITY

Common Stock

During the nine months ended March 31, 2013, the Company issued 65,000 shares of common stock to employees and consultants as compensation valued at $394,500 under a stock bonus plan.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2013 and 2012

(UNAUDITED)

NOTE 8 – OTHER CURRENT LIABILITIES

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

(000's omitted)

	March 31, 2013	June 30, 2012
Accrued salaries, commissions and payroll taxes	$803	$570
Accrued interest	121	191
Litigation accruals	493	493
Sales tax payable	2,989	2,764
Legal and other professional fees	501	577
Accounting fees	231	345
Insurance premiums	49	13
Interest and penalty - sales tax	2,269	2,116
Penalty - 401k plan (see Note 12)	250	250
Rent	152	208
Other	822	166
Total other current liabilities	$8,680	$7,693

NOTE 9 - ACQUISITION

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). During March 2013 the Company contributed $20,200,000 to HDM and the group of outside investors contributed $19,800,000 for its non-controlling membership interest.

To fund its capital contribution the Company borrowed a total of $14 million from a bank in the form of a term loan aggregating $11 Million and a revolving credit loan aggregating $3 million. The term loan is payable in 60 consecutive monthly installments, commencing September 1, 2013. The term loan bears interest at 4.75% per annum and is payable monthly. The revolving credit loan is due March 5, 2016. The Company can prepay the loan in whole or in part in multiples of $100,000 at any time without penalty. The revolving credit note bears interest at a rate of 4% per annum and is payable monthly. All borrowings under the loan agreements are collateralized by substantially all of the Company's assets. The loan agreements also contain certain financial covenants that must be met on a periodic basis.

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 accompanying condensed consolidated financial statements include the operations of HDM from the date of acquisition.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2013 and 2012

(UNAUDITED)

NOTE 9 - ACQUISITION (Continued)

The following table summarizes the estimated fair values of the assets and liabilities assumed at the acquisition date:

Management fee receivable	$9,234,462
Medical receivables	4,512,740
Prepaid expenses and other current assets	10,262
Property and equipment	14,912,650
Intangible assets	9,400,000
Goodwill	1,667,108
Other assets	542,949
Other current liabilities	(6,323)
Long term debt	(273,848)
Net assets acquired	$40,000,000

The purchase price was allocated to the tangible and intangible assets and liabilities assumed based on estimates of their respective fair values at the date of acquisition with the remaining unallocated purchase price recorded as goodwill. Management is responsible for the valuation of net assets acquired and considered a number of factors, including valuations and appraisals, when estimating the fair values and estimated useful lives of acquired assets and liabilities. The intangible assets, excluding goodwill, are being amortized on a straight-line basis over their weighted average lives as follows:

Fair Value

Non compete	$4,100,000	7 years
Customer relationships	4,000,000	20 years
Developed software	1,300,000	5 years
Total intangible assets	$9,400,000	

The HDM acquisition operating results have been included within the Company's condensed consolidated financial statements since the date of acquisition. The following unaudited pro forma information assumes that the acquisition had been completed as of July 1, 2012:

	For The Three Months Ended March 31, 2013	For The Nine Months Ended March 31, 2013
Total Revenues – Net	$15,115	$51,049
Net Income – Controlling Interests	1,446	5,356
Net Income Available to Common Stockholders	1,351	5,003
Net Income Available to Class A Non-Voting Preferred Stockholders	71	263
Net Income Available to Class C Common Stockholders	24	90
Basis Net Income Per Common Share Available to Common Stockholders	$0.23	0.84
Diluted Net Income Per Common Share Available to Common Stockholders	0.22	0.83
Basic and Diluted Income Per Share – Common C	0.06	0.23
Weighted Average Basic Shares Outstanding	5,937,096	5,921,540
Weighted Average Diluted Shares Outstanding	6,064,600	6,049,044
Weighted Average Basic and Diluted Shares Outstanding – Class C Common	382,513	382,513

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2013 and 2012

(UNAUDITED)

NOTE 10 - SEGMENT AND RELATED INFORMATION

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

The accounting policies of the segments are the same as those described in the summary of significant accounting policies as disclosed in the Company's 10-K as of June 30, 2012. All inter-segment sales are market-based. The Company evaluates performance based on income or loss from operations.

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

(000's omitted)

	Medical Equipment	Management of Diagnostic Imaging Centers	Totals
For the three months ended March 31, 2013*			
Net revenues from external customers	$ 3,310	$ 8,332	$11,642
Inter-segment net revenues	$ 300	$ 141	$441
(Loss) income from operations	$ (286)	$ 1,916	$1,630
Depreciation and amortization	$ 126	$ 553	$679
Capital expenditures	$ 58	$ 281	$339
For the three months ended March 31, 2012			
Net revenues from external customers	$ 4,344	$ 5,172	$9,516
Inter-segment net revenues	$ 202	$ —	$202
Income from operations	$ 736	$ 867	$1,603
Depreciation and amortization	$ 173	$ 407	$580
Capital expenditures	$ 22	$ 223	$245

For the nine months ended March 31, 2013*			
Net revenues from external customers	$ 10,960	$ 19,806	$30,766
Inter-segment net revenues	$ 705	$ 141	$846
Income from operations	$ 182	$ 5,046	$5,228
Depreciation and amortization	$ 421	$ 1,068	$1,489
Capital expenditures	$ 166	$ 511	$677
For the nine months ended March 31, 2012			
Net revenues from external customers	$ 13,502	$ 14,950	$28,452
Inter-segment net revenues	$ 607	$ —	$607
Income from operations	$ 2,278	$ 2,981	$5,259
Depreciation and amortization	$ 518	$ 1,111	$1,629
Capital expenditures	$ 97	$ 603	$700

* includes HDM transactions as of March 5, 2013

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FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2013 and 2012

(UNAUDITED)

NOTE 11– SUPPLEMENTAL CASH FLOW INFORMATION

During the nine months ended March 31, 2013 and March 31, 2012, the Company paid $198,000 and $122,000 for interest, respectively.

During the nine months ended March 31, 2013 and March 31, 2012, the Company paid $252,000 and $0 for income taxes, respectively.

NOTE 12 – COMMITMENTS AND CONTINGENCIES

Litigation

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

There were no material changes in litigation from that reported in our Form 10-K for the fiscal year ended June 30, 2012.

Other Matters

The Company is also delinquent in filing sales tax returns for certain states, in which the Company has transacted business. As of March 31, 2013, the Company has recorded tax obligations of approximately $2,644,000 plus interest and penalties of approximately $2,269,000. The Company is in the process of determining the regulatory requirements in order to become compliant.

The Company has determined they may not be in compliance with the Department of Labor and Internal Revenue Service regulations concerning the requirements to file Form 5500 to report activity of its 401(k) Employee Benefit Plan. The filings do not require the Company to pay tax, however they may be subject to penalty for non-compliance. The Company has recorded provisions for any potential penalties totaling $250,000. The amount was the Company's best estimate of potential penalties. Management is unable to determine the outcome of this uncertainty. The Company has engaged outside counsel to handle such matters to determine the necessary requirements to ensure compliance. On August 31, 2011, the Company submitted with the Internal Revenue Service a request for a compliance statement and a determination letter for our 401K plan. On December 9, 2011, the Internal Revenue Service issued a favorable determination letter on our 401K plan. The Company is still working with outside counsel to complete and file forms with the US Department of Labor.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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(UNAUDITED)

NOTE 13 - INCOME TAXES

Effective January 1, 2007, the Company adopted the provisions of ASC topic 740 (formerly FASB Interpretation No. 48/FASB Statement No. 109, "Accounting for Uncertainty in 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.

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 2007.

The adoption of the provisions of ASC topic 740 did not have a material impact on the Company's consolidated financial position and results of operations. Upon the adoption and as of March 31, 2013, no liability for unrecognized tax benefits was required to be recorded. The Company does not expect its unrecognized tax benefit position to change during the next 12 months.

The Company recognized a deferred tax asset of $462,000, net of valuation allowance and a deferred tax liability of $462,000 as of March 31, 2013, primarily relating to net operating loss carryforwards of approximately $149,765,000 available to offset future taxable income through 2029. The net operating losses begin to expire in 2012 for federal and state income tax purposes.

The ultimate realization of deferred tax assets is dependent on the generation of future taxable income during the periods in which those temporary differences become deductible. The Company considers projected future taxable income and tax planning strategies in making this assessment. At present, the Company does not have a sufficient history of income or knowledge of future effects on our business of healthcare reform legislation, the Deficit Reduction Act, the tax on sales of medical equipment and the general economic and business climate to conclude that it is more-likely-than-not that the Company will be able to realize all of its tax benefits in the near future and therefore a valuation allowance was established for the full value of the deferred tax asset.

A valuation allowance will be maintained until sufficient positive evidence exists to support the reversal of any portion or all of the valuation. Should the Company become profitable in future periods with supportable trends, the valuation allowance will be reversed accordingly.

FONAR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2013 and 2012

(UNAUDITED)

NOTE 14 – SUBSEQUENT EVENTS

On May 1, 2013, the Company repaid a portion of the Class A Stockholders capital contribution in the amount of $1.2 million. The Company's subsidiary, HMCA, now owns an 85% interest in Imperial Management Services.

During the period from April 1, 2013 through April 30, 2013, the Company issued 2,870 shares of common stock to consultants as compensation valued at $20,521 under the 2010 Stock Bonus Plan.

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

For the nine month period ended March 31, 2013, we reported a net income of $5.0 million on revenues of $30.8 million as compared to net income of $5.1 million on revenues of $28.5 million for the nine month period ended March 31, 2012. We recognized an operating income of $5.2 million for the nine month period ended March 31, 2013 compared to an operating income of $5.3 million for the nine month period ended March 31, 2012.

For the three month period ended March 31, 2013, we reported net income of $1.6 million on revenues of $11.6 million as compared to net income of $1.6 million on revenues of $9.5 million for the three month period ended March 31, 2012.

Overall, our revenues increased 8.1% from $28.5 million for the first nine months of fiscal 2012 to $30.8 million for the first nine months of fiscal 2013. Although management fees increased by 26% from $15.0 million for the first nine months of fiscal 2012 to $18.8 million for the first nine months of fiscal 2013, service and repair fees decreased 4.3% from $8.8 million for the first nine months of fiscal 2012 to $8.4 million for the first nine months of fiscal 2013, and revenues from product sales decreased 46%, from $4.7 million for the first nine months of 2012 to $2.5 million for the first nine months of fiscal 2013.

The increase in our revenues was offset by a larger increase in our costs and expenses, and consequently we recognized decreased operating income for the nine months ended March 31, 2013 of $5.2 million as compared to an operating income of $5.3 million for the nine months ended March 31, 2012. The increase in costs and expenses of 10.1% from $23.2 million in the first nine months of fiscal 2012 to $25.5 million in the first nine months of fiscal 2013, exceeded the increase in revenues of 8.1%, from $28.5 million in the first nine months of fiscal 2012 to $30.8 million in the first nine months of fiscal 2013.

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). During March 2013 the Company contributed $20,200,000 to HDM and the group of outside investors contributed $19,800,000 for its non-controlling membership interest.

To fund its capital contribution the Company borrowed a total of $14 million from a bank in the form of a term loan aggregating $11 million and a revolving credit loan aggregating $3 million. The term loan is payable in 60 consecutive monthly installments, commencing September 1, 2013. The term loan bears interest at 4.75% per annum and is payable monthly. The revolving credit loan is due March 5, 2016. The Company can prepay the loan in whole or in part in multiples of $100,000 at any time without penalty. The revolving credit note bears interest at a rate of 4% per annum and is payable monthly. All borrowings under the loan agreements are collateralized by substantially all of the Company’s assets. The loan agreements also contain certain financial covenants that must be met on a periodic basis.

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.

Our revenues, costs and expenses for the nine month and three month periods ended March 31, 2013 attributable to the acquisition include only those from March 5, 2013 through March 31, 2013. The revenues were $2.8 million and the combined expenses were $2.4 million.

We have continued our efforts to control costs and increase our management fees, including those of the scanning centers acquired by HDM, which we expect will be responsible for our continuing profitability.

Forward Looking Statements

Certain statements made in this Quarterly Report on Form 10-Q are "forward-looking statements" (within the meaning of the Private Securities Litigation Reform Act of 1995) regarding the plans and objectives of Management for future operations. Such statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. The forward-looking statements included herein are based on current expectations that involve numerous risks and uncertainties. Our plans and objectives are based, in part, on assumptions involving the expansion of business. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Although we believe that our assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this Report will prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statement included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives and plans will be achieved.

Results of Operations

We operate in two industry segments: the manufacture and servicing of medical (MRI) equipment, our traditional business which is conducted directly by Fonar, and diagnostic facilities management services, which is conducted through Fonar’s wholly-owned subsidiary, Health Management Corporation of America, which we also refer to as HMCA.

Effective May 2, 2011, HMCA contributed all of its assets, liabilities and business to Imperial Management Services, LLC, which is controlled but not wholly-owned by HMCA. Imperial is continuing the business of HMCA utilizing the same facilities, equipment and personnel as HMCA. This transaction did not result in a change of control or policy, but was solely a means to raise capital. To avoid confusion in making comparisons and to show the continuity of the business, our physician management and diagnostic services segment is sometimes referred to as “HMCA-IMPERIAL” for both periods before and after May 2, 2011.

Effective March 5, 2013, HMCA-IMPERIAL, through its 50.5% interest in HDM, acquired twelve (12) Stand-Up® MRI Centers and two (2) other scanning centers. The contribution of these new scanning centers to the operating results of the Company are included for the period of March 5, 2013 through March 31, 2013.

Trends in the first nine months of fiscal 2013 include an increase in management and other fee revenues, and a decline in product sales revenues, and product service and repair fees. Also costs related to product sales decreased 31.9% from $3.6 million for the first nine months of fiscal 2012 to

$2.5 million for the first nine months of fiscal 2013, which corresponds to the decrease in product sales. We will continue to focus on our marketing efforts to improve sales performance and increase patient volume at the MRI facilities managed by HMCA-IMPERIAL in fiscal 2013. In addition, we will monitor our cost control program and will continue to reduce costs as necessary.

For the three month period ended March 31, 2013, as compared to the three month period ended March 31, 2012 overall revenues from MRI product sales decreased 68.2% ($416,000 compared to $1.3 million), and for the nine month period ended March 31, 2013 as compared to the nine month period ended March 31, 2012 overall revenues from MRI product sales decreased 46% ($2.5 million compared to $4.7 million). Continuing tight credit and world-wide economic uncertainty have depressed the market for our MRI products, which in the overwhelming majority of cases are purchased on credit.

Service revenues for the three month period ended March 31, 2013 as compared to the three month period ended March 31, 2012 decreased 4.6% ($2.9 million compared to $3.0 million). Unrelated party service and repair fees decreased 4.6% ($2.9 million compared to $3.0 million) and related party service and repair fees remained constant at $27,000 for the three month period ended March 31, 2012 and the three month period ended March 31, 2013. We anticipate that there will be increases in service revenues as warranties on installed scanners expire over time.

Service revenues for the nine month period ended March 31, 2013 as compared to the nine month period ended March 31, 2012 decreased 4.3% ($8.4 million compared to $8.8 million). Unrelated party service and repair fees decreased 4.3% ($8.3 million compared to $8.7 million) and related party service and repair fees remained constant at $83,000 for the nine months ended March 31, 2013 and for the nine months ended March, 31, 2012.

There were approximately $782,000 in foreign revenues for the first nine months of fiscal 2013 as compared to approximately $2.2 million in foreign revenues for the first nine months of fiscal 2012, representing a decrease in foreign revenues of 59.9%. We do not regard this as a material trend, but as part of a normal variation resulting from low volumes of foreign sales.

Overall, for the first nine months of fiscal 2013, revenues for the medical equipment segment decreased by 18.8% to $11 million from $13.5 million for the first nine months of fiscal 2012. The revenues generated by HMCA-IMPERIAL increased by 26%, to $18.8 million for the first nine months of fiscal 2013 as compared to $15.0 million for the first nine months of fiscal 2012. This trend reflects an increase in the percentage of our revenues derived from our diagnostic facilities management segment relative to our revenues derived from our medical equipment segment (61.2% for the first nine months of fiscal 2013 compared to 52.5% for the first nine months of fiscal 2012). The increase in HMCA-IMPERIAL revenues was the result of increased marketing efforts for the scanning centers and the opening of a new center.

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

Costs related to product sales decreased by 48.2% from $962,000 in the third quarter of fiscal 2012 to $498,000 in the third quarter of 2013, resulting from a decrease in the manufacturing activity. Cost related to product sales also decreased by 31.9% from $3.6 million in the first nine months of fiscal 2012 to $2.5 million in the first nine months of fiscal 2013.

Costs related to providing service for the third quarter decreased by 8% from $899,000 in the third quarter of fiscal 2012 to $827,000 in fiscal 2013, notwithstanding a decrease in service revenues of only 4.6%, from $3.0 million in the third quarter of fiscal 2012 to $2.9 million in the third quarter of fiscal 2013. Certain of the costs of providing service (employee salaries and overhead, for example) are not directly tied to revenue. Notwithstanding the foregoing, we believe that an important factor in controlling our service costs is our ability to monitor the performance of customers' scanners from our facilities in Melville, New York on a daily basis, and to detect and repair any irregularities before more serious problems result.

Overall, the operating results for our medical equipment segment decreased to an operating loss of $286,000 for the third quarter of fiscal 2013 as compared to an operating income of $736,000 for the third quarter of 2012. Also our operating income for our medical equipment segment decreased from $2.3 million for the first nine months of 2012 to $182,000 for the first nine months of fiscal 2013.

HMCA-IMPERIAL revenues increased in the third quarter of fiscal 2013 by 61.1% to $8.3 million from $5.2 million for the third quarter of fiscal 2012, primarily due to increased revenues from our New York locations. Contributing to the increase in revenue was the increase in management and other fees resulting from renegotiating our annual management contracts with the professional corporations we manage. Also included are the revenues for approximately one month from the facilities acquired by HDM.

We now manage twenty-five sites, twenty-three of which are equipped with FONAR UPRIGHT® MRI scanners. HMCA-IMPERIAL experienced an operating income of $5 million for the first nine months of fiscal 2013 compared to operating income of $3.0 million for the first nine months of fiscal 2012. The greater operating income was due primarily to an increase in management and other fees.

HMCA-IMPERIAL cost of revenues for the first nine months of fiscal 2013 as compared to the first nine months of fiscal 2012 increased slightly by 13.5% from $9.1 million to $10.4 million. HMCA's cost of revenues includes expenditures we have been making to improve HMCA revenues through our marketing efforts, which focus on the unique capability of our Upright® MRI Scanners to scan patients in different positions.

The increase in our consolidated net revenues of 22.3% from $9.5 million in the third quarter of fiscal 2012 to $11.6 million in the third quarter of fiscal 2013 was coupled with a increase of 26.5% in total costs and expenses from $7.9 million in the third quarter of fiscal 2012 compared to $10 million in the third quarter of fiscal 2013. As a result, our income from operations remained constant at $1.6 million in the third quarter of fiscal 2012 and the third quarter of fiscal 2013.

For the first nine months of 2013 our consolidated revenues increased by 8.1% to $30.8 million from $28.5 million for the first nine months of fiscal 2012 while total costs and expenses increased by 10.1% to $25.5 million for the for first nine months of fiscal 2013 from $23.2 million for the first nine months of fiscal 2012. Our operating income of $5.3 million in the first nine months of fiscal 2012 decreased to $5.2 million in the first nine months of fiscal 2013.

Selling, general and administrative expenses increased by 33.2% to $8.3 million in the first nine months of fiscal 2013 from $6.2 million in the first nine months of fiscal 2012. The compensatory element of stock issuances, which is included in selling, general and administrative expenses, was $394,500 for the first nine months of fiscal 2013 and $49,000 for the first nine months of fiscal 2012.

Research and development expenses increased by 9.9% to $1.0 million for the first nine months of fiscal 2013 as compared to $938,000 for the first nine months of fiscal 2012.

Interest expense in the first nine months of fiscal 2013 decreased by 22.5% to $258,000 from $333,000 in the first nine months of fiscal 2012.

Inventories increased slightly to $2.3 million at March 31, 2013 from $2.2 million at June 30, 2012. This represents our purchase of raw materials and components which have not yet been used to fill orders.

Management fee and medical receivables increased by 326% to $21.7 million at March 31, 2013 from $5.1 million at June 30, 2012. This increase is primarily the result of the receivables acquired by HDM in connection with the purchase of the businesses managing the twelve (12) scanning centers from HD, together with renegotiated management fee contracts with an unrelated party and decreased collections of outstanding receivables, in part due to Hurricane Sandy.

The overall trends reflected in the results of operations for the first nine months of fiscal 2013 are an increase in revenues from management and other fees, as compared to the first nine months of fiscal 2012 ($18.8 million for the first nine months of fiscal 2013 as compared to $15.0 million for the first nine months of fiscal 2012), and a decrease in MRI equipment segment revenues both absolutely ($11 million as compared to $13.5 million) and as compared to HMCA-IMPERIAL revenues. Revenues were $11 million or 35.6% from the MRI equipment segment as compared to $19.8 million or 64.4% from HMCA-IMPERIAL, for the first nine months of fiscal 2013, as compared to $13.5 million or 47.5% from the MRI equipment segment and $15.0 million or 52.5%, from HMCA-IMPERIAL, for the first nine months of fiscal 2012.

On March 23, 2010, President Obama signed into law healthcare reform legislation in the form of the Patient Protection and Affordable Care Act (PPACA). The implementation of this law could have a profound impact on the healthcare industry. Many of the most substantive provisions of PPACA are in the process of being implemented. Many provisions require the federal government and individual state governments to interpret and implement the new requirements and adopt appropriate regulations. Although PPACA remains the subject of significant debate, the Act has been held constitutional by the United States Supreme Court, and there is no indication that the Act will be repealed or substantially modified in the foreseeable future. We are unable to predict how many of the legislative mandates contained in PPACA will be implemented or how they will affect our MRI equipment segment or HMCA-IMPERIAL in practice.

We are committed to improving the operating results we experienced in the first nine months in fiscal 2013. Nevertheless, factors beyond our control, such as the timing and rate of market growth which depend on economic conditions, including the availability of credit, payor reimbursement rates and policies, and unexpected expenditures or the timing of such expenditures, make it problematical to forecast future operating results. We believe we are pursuing the correct policies which should prove successful in improving the Company's operating results.

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

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

Fonar has announced a major diagnostic breakthrough in multiple sclerosis achieved with advanced UPRIGHT® MRI. Medical researchers at FONAR published a paper reporting a diagnostic breakthrough in multiple sclerosis (MS), based on observations made possible by the Company’s unique FONAR UPRIGHT® Multi-Position™ MRI scanner. The findings reveal that the cause of multiple sclerosis may be biomechanical and related to earlier trauma to the neck, which can result in obstruction of the flow of cerebrospinal fluid (CSF), which is produced and stored in the central anatomic structures of the brain known as the ventricles. Since the ventricles produce a large volume of CSF each day (500 cc), the obstruction can result in a build up of pressure within the ventricles, resulting in leakage of the CSF into the surrounding brain tissue. This leakage could be responsible for generating the brain lesions of multiple sclerosis.

The paper, titled “The Possible Role of Cranio-Cervical Trauma and Abnormal CSF Hydrodynamics in the Genesis of Multiple Sclerosis," appears in the journal “Physiological Chemistry and Physics and Medical NMR” (Sept. 20, 2011, 41: 1-17).

This capability of 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, because the brain stem descends and is compressed 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. Conventional lie-down MRI scanners cannot make an adequate evaluation of the pathology since the patient's pathology is most visible and the symptoms most acute when the patient is scanned in the upright weight-bearing position.

Most recently a combined study of 1,200 neck pain patients published in “Brain Injury” (July 2010: 24(7-8): 988-944) by 8 university medical centers reported that cerebellar tonsil ectopia (CTE) 1mm or greater was found and visualized 2.5 times (250%) more frequently when patients who had sustained MVA whiplash injuries were scanned upright rather than lying down (recumbent).

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 which allows the patient to stand during the MRI exam. Fonar has developed an 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 recent 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. The UPRIGHT® MRI examination of scoliosis enables the needed imaging evaluation of the degree of spine scoliosis without exposing the patient to the risk of breast cancer from x-radiation. Currently scoliosis affects more than 3,000,000 American women.

In addition, the University of California, Los Angeles (UCLA) reported their results of their study of 1,302 patients utilizing the FONAR UPRIGHT® Multi-Position™ MRI at the 22nd Annual Meeting of the North American Spine Society on October 23, 2007. The UCLA study showed the superior ability of the FONAR UPRIGHT® MRI to detect spine pathology, including spondylolisthesis, disc herniations and disc degneration, as compared to visualizations of the spine produced by traditional single position static MRIs.

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

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

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

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

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

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In the future, we expect the Fonar 360™ to function as an interventional MRI. The enlarged room sized magnet and 360º access to the patient afforded by the Fonar 360™ permits surgeons to walk into the magnet and perform surgical interventions on the patient under direct MR image guidance. Most importantly the exceptional quality of the MRI image and its capacity to exhibit tissue detail on the image, can then be obtained real time during the procedure to guide the interventionalist. Thus surgical instruments, needles, catheters, endoscopes and the like could be introduced directly into the human body and guided directly to a malignant lesion using the MRI image. The number of inoperable lesions could be significantly reduced by the availability of this new FONAR technology. Most importantly treatment can be carried directly to the target tissue.

The first Fonar 360™ MRI scanner, installed at the Oxford-Nuffield Orthopedic Center in Oxford, United Kingdom, is now carrying a full diagnostic imaging caseload. In addition, development of the work in progress Fonar 360™ MRI image guided interventional technology is actively progressing. Fonar software engineers have completed and installed their 2nd generation tracking software at Oxford-Nuffield which is designed to enable the surgeons to insert needles into the patient and accurately advance them, under direct visual image guidance, to the target tissue, such as a tumor, so that therapeutic agents can be injected.

The Company expects marked demand for its most commanding MRI products, the FONAR UPRIGHT® MRI and the Fonar 360™ because of their exceptional features in patient diagnosis and treatment. These scanners additionally provide improved image quality and higher imaging speed because of their higher field strength of .6 Tesla. The geometry of the FONAR UPRIGHT® MRI magnet and its transverse magnetic field enables the use of two detector rf coils operating in quadrature which increases the FONAR UPRIGHT® MRI signal to noise ratio by 40%, providing a signal to noise ratio equal to a .84T recumbent only MRI scanner.

Liquidity and Capital Resources

Cash and cash equivalents decreased by 23.2% from $12.0 million at June 30, 2012 to $9.2 million at March 31, 2013, primarily as a result of providing part of the financing of the acquisition of fourteen (14) scanning centers by HDM.

Cash provided by operating activities for the first nine months of fiscal 2013 was $6.4 million. Cash provided by operating activities was attributable to net income of $5 million, an increase of other current liabilities of $1.2 million, depreciation and amortization of $1.5 million, provision for bad debt of $735,000, an increase in accounts payable of $515,000 offset by a decrease in prepaid expenses and other current assets of $615,000 and an increase in accounts, management fee and medical receivables of $3.6 million.

Cash used in investing activities for the first nine months of fiscal 2013 was $20.9 million. The principal uses of cash used in investing activities during the first nine months of fiscal 2013 consisted of patent costs of $109,000, and the purchase of property and equipment of $568,000. The cost of the HDM acquisition of $40 million was offset by proceeds from non-controlling interests of $19.8 million.

Cash provided by financing activities for the first nine months of fiscal 2013 was $11.7 million. The principal uses of cash in financing activities during the first nine months of fiscal 2013 were the repayment of principal on long-term debt and capital lease obligations of $983,000, along with distributions to non-controlling interests of $1.3 million offset by the cash provided by proceeds from debt of $14.0 million.

Total liabilities increased by 70% to $38.3 million at March 31, 2013 from $22.5 million at June 30, 2012, reflecting the assumption of liabilities associated with the acquisition by HDM of the fourteen (14) scanning centers. Other current liabilities increased from $7.7 million at June 30, 2012 to $8.7 million at March 31, 2013 along with an increase in long-term debt and capital leases from $777,000 at June 30, 2012 to $13.4 million at March 31, 2013, an increase in the current portion of our long term debt from $1.8 million at June 30, 2012 to $2.5 million at March 31, 2013 and an increase in customer advances from $3.9 million at June 30, 2012 to $4.8 million at March 31, 2013. Unearned revenue on service contracts increased to $5.7 million at March 31, 2013 as compared to $5.5 million at June 30, 2012.

As of March 31, 2013, the total of $8.7 million in other current liabilities included accrued salaries and payroll taxes of $803,000, accrued interest and penalties of $2.3 million and sales taxes of $3 million.

Our working capital increased to $15.4 million at March 31, 2013 from $4.8 million at June 30, 2012. This resulted from an increase in current assets ($25.9 million at June 30, 2012 as compared to $39.7 million at March 31, 2013), slightly offset by an increase in current liabilities from $21.1 million at June 30, 2012 to $24.3 million at March 31, 2013.

Fonar has committed to making capital expenditures for the construction on a new scanning center to be located on Long Island, NY during the remainder of the 2013 fiscal year. The total cost of this project has not yet been determined.

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

Critical to our business plan are improvement and expansion of the MRI facilities managed by our subsidiary HMCA-IMPERIAL, and increasing the number of scans performed at those facilities. In addition, our business plan calls for a continuing emphasis on providing our customers with enhanced equipment service and maintenance capabilities and delivering state-of-the-art, innovative and high quality equipment and upgrades at competitive prices.

The Company continues to focus its efforts on increased marketing campaigns to strengthen the demand for its products and services. Management is seeking to promote wider market recognition of Fonar’s scanner products, and increase demand for Upright® scanning at the facilities HMCA-IMPERIAL manages. Given the liquidity and credit constraints in the markets, the sale of medical equipment has and may continue to suffer. There can be no assurance that the Company would be able to secure additional funds in the event such funds are needed on terms and conditions acceptable to the Company. In such case, reduction in operating expenses might need to be implemented in order for the Company to generate positive cash flow to sustain the operations of the Company.

Management anticipates that Fonar's capital resources will improve if (1) Fonar's MRI scanner products gain wider market recognition and acceptance resulting in increased product sales, (2) service and maintenance revenues increase as the warranties on scanners expire and (3) HMCA-IMPERIAL revenues can be increased through the Company's vigorous marketing efforts, the installation of more HMCA-IMPERIAL managed Upright® MRI scanners and HDM's acquisition of fourteen (14) additional scanning centers. If our marketing efforts to increase revenues fail, and we are unable to raise debt or equity capital, we will experience a shortfall in cash, and it will be necessary to reduce operating expenses to attempt to avoid the need to curtail our operations. Current economic, credit and political conditions have contributed to a challenging business environment for our company. The precise impact of these conditions can not be fully predicted. There can be no assurance that we would be able to secure additional funds if needed.

The Company believes that its business plan has been responsible for the past two consecutive fiscal years of profitability (fiscal 2012 and fiscal 2011) and that its capital resources will be adequate to support operations at current levels through March 31, 2014. The Company also has experienced, however, periods of working capital deficits and prior to fiscal 2011, losses. The future effects on our business of healthcare reform legislation, the Deficit Reduction Act, the tax on sales of medical equipment, and the general economic and business climate are not known at the present time. Nevertheless, there is a possibility of adverse consequences to our business operations from these causes.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company maintains its funds in liquid accounts. None of our investments are in fixed rate instruments. All of our revenue, expense and capital purchasing activities are transacted in United States dollars.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

Disclosure controls and procedures (as defined in Rule 13(a)-15(e)) are designed to ensure that information required to be disclosed by a public company in the reports that it files or submits under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a public company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow for timely decisions regarding required disclosure. Disclosure controls and procedures include many aspects of internal control over financial reporting.

In connection with the preparation of this Quarterly Report on Form 10-Q for the nine months ended March 31, 2013, management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Exchange Act and have determined that such controls and procedures were effective as of March 31, 2013.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal controls or in other factors that could significantly affect these controls, during the quarter ended March 31, 2013, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II – OTHER INFORMATION

Item 1 – Legal Proceedings: There were no material changes in litigation from that reported in our Form 10-K for the fiscal year ended June 30, 2012. In the Golden Triangle Company v. Fonar Corporation et al case (U.S. District Court for the Eastern District of New York CV10-2932), the Company made a motion to dismiss the plaintiff's amended complaint, which was granted, leaving only the cause of action for breach of contract. The claims against the individual officers and employees were also dismissed. Fonar filed its answer to the complaint, together with a counterclaim alleging the plaintiff, by attempting to overcharge the end customer has damaged Fonar's reputation and ability to sell in Kuwait. The plaintiff, in turn, has answered our counterclaim. The trial is scheduled to take place in June 2013.

In the Matt Malek Madison v. Fonar case (U.S. District Court, Northern District of California), Fonar appealed the judgment against it, but the U.S. Court of Appeals for 9th Circuit affirmed the judgment of the District Court on January 31, 2012, awarding the plaintiff the $300,000 deposit with prejudgment interest from July 1, 2006. The $300,000 plus interest of $72,000 has been accrued as of December 31, 2012. Although we asked the Court of Appeals to reconsider its decision in an en banc (larger panel of judges) proceeding, our request was not granted. Notwithstanding the outstanding judgment, the plaintiff has not to our knowledge taken any steps to enforce the judgment against us.

In the Bonutti Research v. Fonar et al case (U.S. District Court, Eastern District of New York),

Bonutti Research filed an action on December 2, 2011 alleging that Fonar's Upright® MRI scanners infringe plaintiff's patent, which relates to the moving of a patient into the scanner. Fonar believes plaintiff's claims are without merit and further, that the patent is invalid. Bonutti has answered our counterclaims and discovery has commenced. At this point we are unable to assess the amount in controversy as no damages were specified. The patent has expired.

Item 1A – Risk Factors: Not required. We are a smaller reporting company.

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

Item 3 - Defaults Upon Senior Securities: None

Item 4 - Mine Safety Disclosure: None

Item 5 - Other Information: None

Item 6 - Exhibits and Reports on Form 8-K:

a) Exhibit 31.1 Certification. See Exhibits

b) Exhibit 32.1 Certification. See Exhibits

c) Report on Form 8-K filed on February 14, 2013, Item 2.02: Results of

Operations and Financial Condition for the fiscal quarter ended December 31, 2012.

SIGNATURES

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

FONAR CORPORATION

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

Dated: May 15, 2013