

Apollo Medical Holdings, Inc.  
Form 10-Q  
August 19, 2015

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

*(Mark One)*

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

For the quarterly period ended **June 30, 2015**

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

**Commission File No.**

**000-25809**

**Apollo Medical Holdings, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**                      **46-3837784**  
State of Incorporation IRS Employer Identification No.

**700 North Brand Blvd., Suite 220**

**Glendale, California 91203**

(Address of principal executive offices)

**(818) 396-8050**

(Issuer's telephone number)

(Former name, former address and former fiscal year, if changed since last report)

Securities Registered Pursuant to Section 12(b) of the Act:

| Title of each Class | Name of each Exchange on which Registered |
|---------------------|---|
|                     | None                                      |

Securities Registered Pursuant to Section 12(g) of the Act:

Common Stock, \$.001 Par Value

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

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

As of August 14, 2015, there were 4,863,455 shares of common stock, \$.001 par value per share, issued and outstanding.

**APOLLO MEDICAL HOLDINGS, INC.**

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**PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****APOLLO MEDICAL HOLDINGS, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(UNAUDITED)**

|   | <b>June 30,<br/>2015</b> | <b>March 31,<br/>2015</b> |
|---|--------------------------|---------------------------|
| <b>ASSETS</b>   |                          |                           |
| <b>CURRENT ASSETS</b>   |                          |                           |
| Cash and cash equivalents   | \$3,890,477              | \$5,014,242               |
| Accounts receivable, net  | 3,692,757                | 3,801,584                 |
| Other receivables   | 328,439                  | 208,288                   |
| Due from affiliates   | 30,615                   | 36,397                    |
| Prepaid expenses  | 258,224                  | 278,922                   |
| Deferred financing costs, net, current                            | -                        | 513,646                   |
| Total current assets  | 8,200,512                | 9,853,079                 |
| Deferred financing costs, net, non-current                        | 235,093                  | 264,708                   |
| Property and equipment, net                                       | 577,273                  | 582,470                   |
| Restricted cash   | 530,000                  | 530,000                   |
| Intangible assets, net  | 1,339,235                | 1,377,257                 |
| Goodwill  | 2,168,833                | 2,168,833                 |
| Other assets  | 212,146                  | 218,716                   |
| <b>TOTAL ASSETS</b>   | <b>\$13,263,092</b>      | <b>\$14,995,063</b>       |
| <b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>                      |                          |                           |
| <b>CURRENT LIABILITIES</b>  |                          |                           |
| Accounts payable and accrued liabilities                          | \$4,142,819              | \$3,352,204               |
| Medical liabilities   | 1,147,645                | 1,260,549                 |
| Note and line of credit payable, net of discount, current portion | 6,624,548                | 327,141                   |
| Convertible notes payable, net of discount, current portion       | 2,597,438                | 1,037,818                 |
| Warrant liability   | 2,308,620                | -                         |
| Total current liabilities   | 16,821,070               | 5,977,712                 |
| Notes payable, net of discount, non-current portion               | -                        | 6,234,721                 |

|  |            |            |
|--|------------|------------|
| Convertible notes payable, net of discount | -          | 1,457,103  |
| Warrant liability                          | -          | 2,144,496  |
| Deferred tax liability                     | 174,280    | 171,215    |
| Total liabilities                          | 16,995,350 | 15,985,247 |

**COMMITMENTS AND CONTINGENCIES (NOTE 10)****STOCKHOLDERS' DEFICIT**

|   |                      |                      |
|---|----------------------|----------------------|
| Preferred stock, par value \$0.001;<br>5,000,000 shares authorized; none issued   | -                    | -                    |
| Common Stock, par value \$0.001; 100,000,000 shares authorized, 4,863,389 shares<br>issued and outstanding as of June 30, 2015 and March 31, 2015 | 4,863                | 4,863                |
| Additional paid-in-capital  | 16,601,833           | 16,517,985           |
| Accumulated deficit   | (21,822,887)         | (19,340,521)         |
| Stockholders' deficit attributable to Apollo Medical Holdings, Inc.   | (5,216,191 )         | (2,817,673 )         |
| Non-controlling interest  | 1,483,933            | 1,827,489            |
| Total stockholders' deficit   | (3,732,258 )         | (990,184 )           |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT</b>  | <b>\$ 13,263,092</b> | <b>\$ 14,995,063</b> |

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

**APOLLO MEDICAL HOLDINGS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS****(UNAUDITED)**

|  | <b>Three Months Ended June 30,</b> |                   |
|--|------------------------------------|-------------------|
|  | <b>2015</b>                        | <b>2014</b>       |
| Net revenues   | \$ 10,204,125                      | \$ 4,094,486      |
| Costs and expenses   |                                    |                   |
| Cost of services   | 7,567,868                          | 3,259,839         |
| General and administrative                                       | 4,237,203                          | 2,009,332         |
| Depreciation and amortization                                    | 63,751                             | 11,899            |
| Total costs and expenses   | 11,868,822                         | 5,281,070         |
| Loss from operations   | (1,664,697 )                       | (1,186,584 )      |
| Other (expense) income   |                                    |                   |
| Interest expense   | (360,402 )                         | (276,867 )        |
| Change in fair value of warrant and conversion feature liability | (213,718 )                         | (30,005 )         |
| Other  | 101,004                            | (2,476 )          |
| Total other expense  | (473,116 )                         | (309,348 )        |
| Loss before provision for income taxes                           | (2,137,813 )                       | (1,495,932 )      |
| Provision for income taxes                                       | 92,691                             | 11,602            |
| Net loss   | (2,230,504 )                       | (1,507,534 )      |
| Net income attributable to non-controlling interests             | (251,862 )                         | (170,207 )        |
| Net loss attributable to Apollo Medical Holdings, Inc.           | \$ (2,482,366 )                    | \$ (1,677,741 )   |
| Other comprehensive loss:  |                                    |                   |
| Unrealized change in value of marketable securities              | -                                  | 18,589            |
| Comprehensive loss   | \$ (2,482,366 )                    | \$ (1,659,152 )   |
| <b>NET LOSS PER SHARE:</b>                                       |                                    |                   |
| <b>BASIC AND DILUTED</b>   | <b>\$ (0.51 )</b>                  | <b>\$ (0.34 )</b> |
| <b>WEIGHTED AVERAGE SHARES OF COMMON STOCK OUTSTANDING:</b>      |                                    |                   |
| <b>BASIC AND DILUTED</b>   | <b>4,863,389</b>                   | <b>4,913,455</b>  |

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



**APOLLO MEDICAL HOLDINGS, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(UNAUDITED)**

|   | <b>Three Months Ended June 30,</b> |                     |
|---|------------------------------------|---------------------|
|   | <b>2015</b>                        | <b>2014</b>         |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                |                                    |                     |
| Net loss  | \$ (2,230,504 )                    | \$ (1,507,534 )     |
| Adjustments to reconcile net loss to net cash used in operating activities: |                                    |                     |
| Depreciation and amortization expense                                       | 63,751                             | 11,899              |
| Deferred income tax   | 3,065                              | -                   |
| Stock-based compensation expense  | 83,848                             | 119,139             |
| Amortization of financing costs   | 29,914                             | 28,308              |
| Amortization of debt discount   | 115,609                            | 79,381              |
| Change in fair value of warrant and conversion feature liability            | 213,718                            | 30,005              |
| Changes in assets and liabilities:  |                                    |                     |
| Accounts receivable   | 108,827                            | 4,273               |
| Other receivables   | (120,151 )                         | -                   |
| Due from affiliates   | (14,748 )                          | (20,482 )           |
| Prepaid expenses and advances   | 20,698                             | (5,267 )            |
| Deferred financing costs  | 513,347                            | -                   |
| Other assets  | 6,570                              | 2,955               |
| Accounts payable and accrued liabilities                                    | 790,613                            | (4,797 )            |
| Medical liabilities   | (112,904 )                         | 163,677             |
| Net cash used in operating activities                                       | (528,347 )                         | (1,098,443 )        |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                |                                    |                     |
| Acquisition, net of cash and cash equivalents acquired                      | -                                  | 216,361             |
| Property and equipment acquired   | -                                  | (11,973 )           |
| Net cash provided by investing activities                                   | -                                  | 204,388             |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                |                                    |                     |
| Principal payments on term note payable                                     | -                                  | (175,000 )          |
| Distributions to non-controlling interest shareholder                       | (595,418 )                         | -                   |
| Net cash used in financing activities                                       | (595,418 )                         | (175,000 )          |
| <b>NET DECREASE IN CASH &amp; CASH EQUIVALENTS</b>                          | <b>(1,123,765 )</b>                | <b>(1,069,055 )</b> |
| <b>CASH &amp; CASH EQUIVALENTS, BEGINNING OF PERIOD</b>                     | <b>5,014,242</b>                   | <b>6,831,478</b>    |
| <b>CASH &amp; CASH EQUIVALENTS, END OF PERIOD</b>                           | <b>\$ 3,890,477</b>                | <b>\$ 5,762,423</b> |
| <b>SUPPLEMENTARY DISCLOSURES OF CASH FLOW INFORMATION:</b>                  |                                    |                     |

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|                                |            |            |
|--------------------------------|------------|------------|
| Interest paid                  | \$ 100,959 | \$ 150,486 |
| Income taxes paid              | \$ 32,197  | \$ 11,129  |
| Non-Cash Financing Activities: |            |            |
| Holdback liability             | \$ -       | \$ 136,822 |

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

APOLLO MEDICAL HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

## 1. Description of Business

Apollo Medical Holdings, Inc. (the “Company” or “ApolloMed”) and its affiliated physician groups are a patient-centered, physician-centric integrated healthcare delivery company working to provide coordinated, outcomes-based medical care in a cost-effective manner. ApolloMed has built a company and culture that is focused on physicians providing high quality care, population management and care coordination for patients, particularly for senior patients and patients with multiple chronic conditions.

ApolloMed serves Medicare, Medicaid and HMO patients and uninsured patients in California. We primarily provide services to patients that are covered by private or public insurance, although we do derive a small portion of our revenue from non-insured patients. We provide care coordination services to each major constituent of the healthcare delivery system, including patients, families, primary care physicians, specialists, acute care hospitals, alternative sites of inpatient care, physician groups and health plans.

ApolloMed’s physician network consists of hospitalists, primary care physicians and specialist physicians primarily through ApolloMed’s owned and affiliated physician groups. ApolloMed operates through the following subsidiaries: Apollo Medical Management, Inc. (“AMM”), Pulmonary Critical Care Management, Inc. (“PCCM”), Verdugo Medical Management, Inc. (“VMM”), and ApolloMed Accountable Care Organization, Inc. (“ApolloMed ACO”). Through its wholly-owned subsidiary, AMM, ApolloMed manages affiliated medical groups, which consist of ApolloMed Hospitalists (“AMH”), a hospitalist company, ApolloMed Care Clinic (“ACC”), Maverick Medical Group, Inc. (“MMG”), AKM Medical Group, Inc. (“AKM”), Southern California Heart Centers (“SCHC”) and Bay Area Hospitalist Associates, A Medical Corporation (“BAHA”). Through its wholly-owned subsidiary, PCCM, ApolloMed manages Los Angeles Lung Center (“LALC”), and through its wholly-owned subsidiary VMM, ApolloMed manages Eli Hendel, M.D., Inc. (“Hendel”). ApolloMed also has a controlling interest in ApolloMed Palliative Services, LLC (“ApolloMed Palliative”), which owns two Los Angeles-based companies, Best Choice Hospice Care LLC (“BCHC”) and Holistic Health Home Health Care Inc. (“HCHHA”). AMM, PCCM and VMM each operate as a physician practice management company and are in the business of providing management services to physician practice corporations under long-term management service agreements, pursuant to which AMM, PCCM or VMM, as applicable, manages all non-medical services for the affiliated medical group and has exclusive authority over all non-medical decision making related to ongoing business operations. ApolloMed ACO participates in the Medicare Shared Savings Program (“MSSP”), the goal of which is to improve the quality of patient care and outcomes through more efficient and coordinated approach among providers. Revenues earned by ApolloMed ACO are uncertain, and, if such amounts are payable, they will be paid on an annual basis significantly after the time earned, and will be contingent on various factors, including achievement of the minimum savings rate as determined by MSSP for the relevant period. If MSSP determines that ApolloMed ACO

did not achieve the necessary minimum savings rate for 2014, then no ACO payment will be received by ApolloMed ACO in fiscal year 2016.

## **Liquidity, Capital Resources and Going Concern**

The condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and have been prepared on a going concern basis, which contemplates the realization of assets and settlement of liabilities in the normal course of business.

The Company has a history of operating losses and as of June 30, 2015 has an accumulated deficit of \$21,822,887, and during the three months ended June 30, 2015 net cash used in operating activities was \$528,347.

The primary sources of liquidity as of June 30, 2015 include cash on hand of \$3,890,477. Management has established a business plan, which they believe will result in future profitability. Additionally the Company is highly dependent on MSSP revenue, which is contingent upon the realization of program savings as determined by the Centers for Medicare & Medicaid Services (“MSSP”). Non receipt of amounts from the MSSP could adversely impact the liquidity of the Company. The Company may also require additional funding to meet certain obligations until sufficient cash flows are generated from anticipated operations.

Management is uncertain that ongoing requirements for working capital, debt service and covenants compliance and planned capital expenditures will be adequately funded from current sources for at least the next twelve months. The Company currently has a waiver for debt covenant noncompliance through the end of the current quarter (see Part II, Item 5). If the Company cannot obtain a further waiver and/or amendment from NNA of Nevada, Inc., an affiliate of Fresenius Medical Care Holdings, Inc., to waive and/or amend certain covenants, management does not believe it will be able to meet its future debt service requirements and maintain covenant compliance. Furthermore, if available funds are not adequate and/or the Company does not receive any ACO payments during the current year, the Company will need to obtain additional funds or reduce costs of operations. There is no assurance that the Company will be successful in doing so. Accordingly there is substantial doubt as to the ability of the Company to continue as a going concern.

## **2. Summary of Significant Accounting Policies**

### **Accounting Principles**

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These condensed consolidated statements reflect all adjustments, consisting of normal recurring adjustments, which, in management's opinion, are necessary, and should be read in conjunction with the Company's Annual Report on Form 10-K/A for the fiscal year ended March 31, 2015 as filed with the SEC on July 29, 2015.

## **Principles of Consolidation**

The Company's consolidated financial statements include the accounts of (1) Apollo Medical Holdings, Inc. and its wholly owned subsidiaries AMM, PCCM, and VMM, (2) the Company's controlling interest in ApolloMed ACO, and ApolloMed Palliative, a newly formed entity which provides home health and hospice medical services and owns BCHC and HCHHA and in which a non-controlling interest in ApolloMed Palliative contributed \$586,111 in cash; and (3) physician practice corporations ("PPCs") managed under long-term management service agreements including AMH, MMG, ACC, LALC, Hendel, AKM, SCHC and BAHA. Some states have laws that prohibit business entities, such as ApolloMed, from practicing medicine, employing physicians to practice medicine, exercising control over medical decisions by physicians (collectively known as the corporate practice of medicine), or engaging in certain arrangements with physicians, such as fee-splitting. In California, the Company operates by maintaining long-term management service agreements with the PPCs, which are each owned and operated by physicians, and which employ or contract with additional physicians to provide hospitalist services. Under the management agreements, the Company provides and performs all non-medical management and administrative services, including financial management, information systems, marketing, risk management and administrative support. Each management agreement typically has a term from 10 to 20 years unless terminated by either party for cause. The management agreements are not terminable by the PPCs, except in the case of material breach or bankruptcy of the respective PPM.

Through the management agreements and the Company's relationship with the stockholders of the PPCs, the Company has exclusive authority over all non-medical decision making related to the ongoing business operations of the PPCs. Consequently, the Company consolidates the revenue and expenses of each PPC from the date of execution of the applicable management agreement.

All intercompany balances and transactions have been eliminated in consolidation.

## **Business Combinations**

The Company uses the acquisition method of accounting for all business combinations, which requires assets and liabilities of the acquiree to be recorded at fair value (with limited exceptions), to measure the fair value of the consideration transferred, including contingent consideration, to be determined on the acquisition date, and to account for acquisition related costs separately from the business combination.

## **Reportable Segments**

The Company operates as one reportable segment, the healthcare delivery segment, and implements and operates innovative health care models to create a patient-centered, physician-centric experience. The Company reports its consolidated financial statements in the aggregate, including all activities in one reportable segment.

## **Revenue Recognition**

Revenue consists of contracted, fee-for-service, and capitation revenue. Revenue is recorded in the period in which services are rendered. Revenue is principally derived from the provision of healthcare staffing services to patients within healthcare facilities. The form of billing and related risk of collection for such services may vary by customer. The following is a summary of the principal forms of the Company's billing arrangements and how net revenue is recognized for each.

### *Contracted revenue*

Contracted revenue represents revenue generated under contracts for which the Company provides physician and other healthcare staffing and administrative services in return for a contractually negotiated fee. Contract revenue consists primarily of billings based on hours of healthcare staffing provided at agreed-to hourly rates. Revenue in such cases is recognized as the hours are worked by the Company's staff and contractors. Additionally, contract revenue also includes supplemental revenue from hospitals where the Company may have a fee-for-service contract arrangement or provide physician advisory services to the medical staff at a specific facility. Contract revenue for the supplemental billing in such cases is recognized based on the terms of each individual contract. Such contract terms generally either provides for a fixed monthly dollar amount or a variable amount based upon measurable monthly activity, such as hours staffed, patient visits or collections per visit compared to a minimum activity threshold. Such supplemental revenues based on variable arrangements are usually contractually fixed on a monthly, quarterly or annual calculation basis considering the variable factors negotiated in each such arrangement. Such supplemental revenues are recognized as revenue in the period when such amounts are determined to be fixed and therefore contractually obligated as payable by the customer under the terms of the respective agreement. Additionally, the Company derives a portion of the Company's revenue as a contractual bonus from collections received by the Company's partners and such revenue is contingent upon the collection of third-party billings. These revenues are not considered earned and therefore not recognized as revenue until actual cash collections are achieved in accordance with the contractual arrangements for such services.

*Fee-for-service revenue*

Fee-for-service revenue represents revenue earned under contracts in which the Company bills and collects the professional component of charges for medical services rendered by the Company's contracted physicians. Under the fee-for-service arrangements, the Company bills patients for services provided and receives payment from patients or their third-party payors. Fee-for-service revenue is reported net of contractual allowances and policy discounts. All services provided are expected to result in cash flows and are therefore reflected as net revenue in the financial statements. Fee-for-service revenue is recognized in the period in which the services are rendered to specific patients and reduced immediately for the estimated impact of contractual allowances in the case of those patients having third-party payor coverage. The recognition of net revenue (gross charges less contractual allowances) from such visits is dependent on such factors as proper completion of medical charts following a patient visit, the forwarding of such charts to the Company's billing center for medical coding and entering into the Company's billing system and the verification of each patient's submission or representation at the time services are rendered as to the payor(s) responsible for payment of such services. Revenue is recorded based on the information known at the time of entering of such information into the Company's billing systems as well as an estimate of the revenue associated with medical services.

*Capitation revenue*

Capitation revenue (net of capitation withheld to fund risk share deficits) is recognized in the month in which the Company is obligated to provide services. Minor ongoing adjustments to prior months' capitation, primarily arising from contracted health maintenance organizations (each, an "HMO") finalizing of monthly patient eligibility data for additions or subtractions of enrollees, are recognized in the month they are communicated to the Company. Managed care revenues of the Company consist primarily of capitated fees for medical services provided by the Company under a provider service agreement ("PSA") or capitated arrangements directly made with various managed care providers including HMO's and management service organizations ("MSOs"). Capitation revenue under the PSA and HMO contracts is prepaid monthly to the Company based on the number of enrollees electing the Company as their healthcare provider. Additionally, Medicare pays capitation using a "Risk Adjustment model," which compensates managed care organizations and providers based on the health status (acuity) of each individual enrollee. Health plans and providers with higher acuity enrollees will receive more and those with lower acuity enrollees will receive less. Under Risk Adjustment, capitation is determined based on health severity, measured using patient encounter data. Capitation is paid on an interim basis based on data submitted for the enrollee for the preceding year and is adjusted in subsequent periods after the final data is compiled. Positive or negative capitation adjustments are made for Medicare enrollees with conditions requiring more or less healthcare services than assumed in the interim payments. Since the Company cannot reliably predict these adjustments, periodic changes in capitation amounts earned as a result of Risk Adjustment are recognized when those changes are communicated by the health plans to the Company.

HMO contracts also include provisions to share in the risk for enrollee hospitalization, whereby the Company can earn additional incentive revenue or incur penalties based upon the utilization of hospital services. Typically, any shared risk deficits are not payable until and unless the Company generates future risk sharing surpluses, or if the HMO



withholds a portion of the capitation revenue to fund any risk share deficits. At the termination of the HMO contract, any accumulated risk share deficit is typically extinguished. Due to the lack of access to information necessary to estimate the related costs, shared-risk amounts receivable from the HMOs are only recorded when such amounts are known. Risk pools for the prior contract years are generally final settled in the third or fourth quarter of the following fiscal year.

In addition to risk-sharing revenues, the Company also receives incentives under “pay-for-performance” programs for quality medical care, based on various criteria. These incentives, which are included in other revenues, are generally recorded in the third and fourth quarters of the fiscal year and are recorded when such amounts are known.

Under full risk capitation contracts, an affiliated hospital enters into agreements with several HMOs, pursuant to which, the affiliated hospital provides hospital, medical, and other healthcare services to enrollees under a fixed capitation arrangement (“Capitation Arrangement”). Under the risk pool sharing agreement, the affiliated hospital and medical group agree to establish a Hospital Control Program to serve the enrollees, pursuant to which, the medical group is allocated a percentage of the profit or loss, after deductions for costs to affiliated hospitals. The Company participates in full risk programs under the terms of the PSA, with health plans whereby the Company is wholly liable for the deficits allocated to the medical group under the arrangement. The related liability is included in medical liabilities in the accompanying consolidated balance sheets at June 30, 2015 and March 31, 2015 (see "Medical Liabilities" in this Note 2, below).

### *Medicare Shared Savings Program Revenue*

The Company through its subsidiary, ApolloMed ACO, participates in the MSSP sponsored by the Centers for Medicare & Medicaid Services (“CMS”). The MSSP allows ACO participants to share in cost savings it generates in connection with rendering medical services to Medicare patients. Payments to ACO participants, if any, will be calculated annually by CMS on cost savings generated by the ACO participant relative to the ACO participants’ CMS benchmark. The MSSP is a relatively new program managed by CMS that has an evolving payment methodology. The Company considers revenue, if any, under the MSSP, as contingent upon the realization of program savings as determined by CMS, and are not considered earned and therefore are not recognized as revenue until notice from CMS that cash payments are to be imminently received.

### **Cash and Cash Equivalents**

Cash and cash equivalents consists of highly liquid investments with an initial maturity of three months or less at date of purchase to be cash equivalents.

### **Restricted Cash**

Restricted cash primarily consists of cash held as collateral to secure standby letters of credits as required by certain contracts. The certificates have an interest rate of 0.15%.

### **Goodwill and Intangible Assets**

Under FASB ASC 350, *Intangibles – Goodwill and Other* (“ASC 350”), goodwill and indefinite-lived intangible assets are reviewed at least annually for impairment. Acquired intangible assets with definite lives are amortized over their individual useful lives.

At least annually, management assesses whether there has been any impairment in the value of goodwill by first comparing the fair value to the net carrying value. If the carrying value exceeds its estimated fair value, a second step is performed to compute the amount of the impairment. An impairment loss is recognized if the implied fair value of the asset being tested is less than its carrying value. In this event, the asset is written down accordingly. The fair values of goodwill are determined using valuation techniques based on estimates, judgments and assumptions

management believes are appropriate in the circumstances. The fair value is evaluated based on market capitalization determined using average share prices within a reasonable period of time near the selected testing date (i.e., fiscal year-end).

At least annually, indefinite-lived intangible assets are tested for impairment. Impairment for intangible assets with indefinite lives exists if the carrying value of the intangible asset exceeds its fair value. The fair values of indefinite-lived intangible assets are determined using valuation techniques based on estimates, judgments and assumptions management believes are appropriate in the circumstances.

### **Accounts Receivable and Allowance for Doubtful Accounts**

Accounts receivable primarily consists of amounts due from third-party payors, including government sponsored Medicare and Medicaid programs, insurance companies, and amounts due from hospitals and patients. Accounts receivable are recorded and stated at the amount expected to be collected.

The Company maintains reserves for potential credit losses on accounts receivable. Management reviews the composition of accounts receivable and analyzes historical bad debts, customer concentrations, customer credit worthiness, current economic trends and changes in customer payment patterns to evaluate the adequacy of these reserves. The Company also regularly analyses the ultimate collectability of accounts receivable after certain stages of the collection cycle using a look-back analysis to determine the amount of receivables subsequently collected and adjustments are recorded when necessary. Reserves are recorded primarily on a specific identification basis.

### **Concentrations**

The Company had major payors that contributed the following percentage of net revenue:

|                   | Three Months<br>Ended June<br>30, 2015 |   | Three Months<br>Ended June 30,<br>2014 |
|-------------------|--|---|--|
| Medicare/Medi-Cal | 31.1                                   | % | 14.0%                                  |
| L.A Care          | 13.9                                   | % | 15.0%                                  |
| Healthnet         | 12.4                                   | % | 15.2%                                  |

Receivables from one payor amounted to the following percentage of total accounts receivable:

|                   | June 30, 2015 |   | June 30, 2014 |   |
|-------------------|---------------|---|---------------|---|
| Medicare/Medi-Cal | 25.1          | % | 21.4          | % |

### Medical Liabilities

The Company is responsible for integrated care that the associated physicians and contracted hospitals provide to its enrollees under risk-pool arrangements. The Company provides integrated care to health plan enrollees through a network of contracted providers under sub-capitation and direct patient service arrangements, company-operated clinics and staff physicians. Medical costs for professional and institutional services rendered by contracted providers are recorded as cost of services in the accompanying condensed consolidated statements of operations and comprehensive loss. Costs for operating medical clinics, including the salaries of medical personnel, are also recorded in cost of services, while non-medical personnel and support costs are included in general and administrative expense.

An estimate of amounts due to contracted physicians, hospitals, and other professional providers is included in medical liabilities in the accompanying condensed consolidated balance sheets. Medical liabilities include claims reported as of the balance sheet date and estimates of incurred but not reported claims (“IBNR”). Such estimates are developed using actuarial methods and are based on many variables, including the utilization of health care services, historical payment patterns, cost trends, product mix, seasonality, changes in membership, and other factors. The estimation methods and the resulting reserves are periodically reviewed and updated. Many of the medical contracts are complex in nature and may be subject to differing interpretations regarding amounts due for the provision of various services. Such differing interpretations may not come to light until a substantial period of time has passed following the contract implementation. The Company has a \$20,000 per member professional stop-loss, none on institutional risk pools. Any adjustments to reserves are reflected in current operations.

The Company’s medical liabilities were as follows:

|   | Three Months<br>Ended June<br>30, 2015 | Year Ended<br>March 31,<br>2015 |
|---|--|---------------------------------|
| Balance, beginning of period              | \$ 1,260,549                           | \$ 552,561                      |
| Incurred health care costs:               |  |                                 |
| Current year                              | 1,458,088                              | 4,211,231                       |
| Acquired medical liabilities (see Note 3) | -                                      | 458,378                         |

|   |              |              |
|---|--------------|--------------|
| Claims paid:  |              |              |
| Current year  | (712,039 )   | (3,245,283)  |
| Prior years   | (851,217 )   | (90,367 )    |
| Total claims paid   | (1,563,256 ) | (3,335,650)  |
| Risk pool settlement  | -            | (384,869 )   |
| Accrual for net deficit from full risk capitation contracts | 82,541       | 544,041      |
| Adjustments   | (90,277 )    | (785,143 )   |
| Balance at June 30, 2015                                    | \$ 1,147,645 | \$ 1,260,549 |

### Deferred Financing Costs

Costs relating to debt issuance have been deferred and are amortized over the lives of the respective loans, using the effective interest method (see Note 6).

At March 31, 2015, there was approximately \$514,000 of deferred financing costs related to the Company's anticipated upcoming public offering which was anticipated to close during the second quarter of fiscal 2016. During the three months ended June 30, 2015, it was determined the offering may be postponed more than 90 days and these costs, which included legal, accounting and regulatory fees, were expensed.

## **Income Taxes**

Federal and state income taxes are computed at currently enacted tax rates less tax credits using the asset and liability method. Deferred taxes are adjusted both for items that do not have tax consequences and for the cumulative effect of any changes in tax rates from those previously used to determine deferred tax assets or liabilities. Tax provisions include amounts that are currently payable, changes in deferred tax assets and liabilities that arise because of temporary differences between the timing of when items of income and expense are recognized for financial reporting and income tax purposes, changes in the recognition of tax positions and any changes in the valuation allowance caused by a change in judgment about the realizability of the related deferred tax assets. A valuation allowance is established when necessary to reduce deferred tax assets to amounts expected to be realized.

The Company uses a recognition threshold of more-likely-than-not and a measurement attribute on all tax positions taken or expected to be taken in a tax return in order to be recognized in the financial statements. Once the recognition threshold is met, the tax position is then measured to determine the actual amount of benefit to recognize in the financial statements.

## **Stock-Based Compensation**

The Company maintains a stock-based compensation program for employees, non-employees, directors and consultants, which is more fully described in Note 9. The value of stock-based awards so measured is recognized as compensation expense on a cumulative straight-line basis over the vesting terms of the awards, adjusted for expected forfeitures. The Company sells certain of its restricted common stock to its employees, directors and consultants with a right (but not obligation) of repurchase feature that lapses based on performance of services in the future.

The Company accounts for share-based awards granted to persons other than employees and directors under ASC 505-50 *Equity-Based Payments to Non-Employees*. As such the fair value of such shares is periodically re-measured using an appropriate valuation model and income or expense is recognized over the vesting period.

## **Fair Value of Financial Instruments**

The Company's accounting for Fair Value Measurement and Disclosures defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. This topic also establishes a fair value hierarchy which requires classification based on observable and unobservable inputs

when measuring fair value. The fair value hierarchy distinguishes between assumptions based on market data (observable inputs) and an entity's own assumptions (unobservable inputs). The hierarchy consists of three levels:

Level one — Quoted market prices in active markets for identical assets or liabilities;

Level two — Inputs other than level one inputs that are either directly or indirectly observable; and

Level three — Unobservable inputs developed using estimates and assumptions, which are developed by the reporting entity and reflect those assumptions that a market participant would use.

Determining which category an asset or liability falls within the hierarchy requires significant judgment. The Company evaluates its hierarchy disclosures each quarter.

The fair values of the Company's financial instruments are measured on a recurring basis. The carrying amount reported in the accompanying condensed consolidated balance sheets for cash and cash equivalents, accounts receivable, accounts payable and accrued expenses approximates fair value because of the short-term maturity of those instruments. The carrying amount for borrowings under the NNA Term Loan and the Convertible Notes approximates fair value which is determined by using interest rates that are available for similar debt obligations with similar terms at the balance sheet date.

#### *Warrant liability*

The fair value of the warrant liability of \$2,308,620 at June 30, 2015 issued in connection with the 2014 NNA financing was estimated at June 30, 2015 using the Monte Carlo valuation model which used the following inputs: term of 5.7 years, risk free rate of 1.83%, no dividends, volatility of 57.6%, share price of \$6.90 per share based on the trading price of the Company's common stock adjusted for a marketability discount, and a 100% probability of down-round financing. The fair value of the warrant liability of \$2,144,496 at March 31, 2015 was estimated at March 31, 2015 using the Monte Carlo valuation model which used the following inputs: term of 6.0 years, risk free rate of 1.53%, no dividends, volatility of 57.4%, share price of \$5.00 per share based on the trading price of the Company's common stock adjusted for a marketability discount, and a 100% probability of down-round financing.

*Conversion feature liability*

The fair value of the \$491,952 conversion feature liability (included in convertible note payable) at June 30, 2015 issued in connection with the 2014 NNA financing 8% Convertible Note was estimated using the Monte Carlo valuation model which used the following inputs: term of 3.7 years, risk free rate of 1.3%, no dividends, volatility of 48.6%, share price of \$6.90 per share based on the trading price of the Company's common stock adjusted for a marketability discount, and a 100% probability that the Company will participate in a "down-round" financing at price per share lower than the initial NNA Financing 8% Convertible Note conversion price of \$10.00 per share. The fair value of the \$442,358 conversion feature liability (included in convertible note payable) at March 31, 2015 issued in connection with the 2014 NNA financing 8% Convertible Note was estimated using the Monte Carlo valuation model which used the following inputs: term of 4.0 years, risk free rate of 1.1%, no dividends, volatility of 47.6%, share price of \$5.00 per share based on the trading price of the Company's common stock adjusted for a marketability discount, and a 100% probability that the Company will participate in a "down-round" financing at price per share lower than the initial NNA Financing 8% Convertible Note conversion price of \$10.00 per share.

The carrying amounts and fair values of the Company's financial instruments are presented below as of:

June 30, 2015

|                              | Fair Value Measurements |         |              | Total        |
|------------------------------|-------------------------|---------|--------------|--------------|
|                              | Level 1                 | Level 2 | Level 3      |              |
| Liabilities:                 |                         |         |              |              |
| Warrant liability            | \$ -                    | \$ -    | \$ 2,308,620 | \$ 2,308,620 |
| Conversion feature liability | -                       | -       | 491,952      | 491,952      |
|                              | \$ -                    | \$ -    | \$ 2,800,572 | \$ 2,800,572 |

March 31, 2015

|                              | Fair Value Measurements |         |              | Total        |
|------------------------------|-------------------------|---------|--------------|--------------|
|                              | Level 1                 | Level 2 | Level 3      |              |
| Liabilities:                 |                         |         |              |              |
| Warrant liability            | \$ -                    | \$ -    | \$ 2,144,496 | \$ 2,144,496 |
| Conversion feature liability | -                       | -       | 442,358      | 442,358      |
|                              | \$ -                    | \$ -    | \$ 2,586,854 | \$ 2,586,854 |



The following summarizes the activity of Level 3 inputs measured on a recurring basis for the three ended June 30, 2015:

|  | <b>Warrant Liability</b> | Conversion<br>Feature<br>Liability | <b>Total</b> |
|--|--------------------------|------------------------------------|--------------|
| Balance at March 31, 2015  | \$ 2,144,496             | \$ 442,358                         | \$2,586,854  |
| Loss on change in fair value of warrant and conversion feature liability | 164,124                  | 49,594                             | 213,718      |
| Balance at June 30, 2015   | \$ 2,308,620             | \$ 491,952                         | \$2,800,572  |

The change in fair value of the warrant and conversion feature liability of \$213,718 and \$30,005 for the three months ended June 30, 2015 and 2014, respectively, is included in the accompanying condensed consolidated statements of operations and comprehensive loss. The fair value of the conversion feature liability is reflected in the accompanying consolidated balance sheet together with the carrying value of the convertible notes.

### **Non-Controlling Interests**

The non-controlling interests recorded in the Company's condensed consolidated financial statements includes the pre-acquisition equity of those PPC's in which the Company has determined that it has a controlling financial interest and for which consolidation is required as a result of management contracts entered into with these entities owned by third-party physicians. The nature of these contracts provide the Company with a monthly management fee to provide the services described above, and as such, the adjustments to non-controlling interests in any period subsequent to initial consolidation would relate to either capital contributions or distributions by the non-controlling parties as well as income or losses attributable to certain non-controlling interests. Non-controlling interests also represent third-party minority equity ownership interests which are majority owned by the Company.

## Basic and Diluted Earnings per Share

Basic net income (loss) per share is calculated using the weighted average number of shares of the Company's common stock issued and outstanding during a certain period, and is calculated by dividing net income (loss) by the weighted average number of shares of the Company's common stock issued and outstanding during such period. Diluted net income (loss) per share is calculated using the weighted average number of common and potentially dilutive common shares outstanding during the period, using the as-if converted method for secured convertible notes, and the treasury stock method for options and warrants.

The following table sets forth the number of shares excluded from the computation of diluted earnings per share, as their inclusion would be anti-dilutive:

|                   | <b>Three Months Ended June 30,</b> |             |
|-------------------|------------------------------------|-------------|
|                   | <b>2015</b>                        | <b>2014</b> |
| Options           | 387,031                            | 409,092     |
| Warrants          | 19,251                             | 145,107     |
| Convertible Notes | 50,967                             | -           |
|                   | 457,249                            | 554,199     |

## New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") amended the FASB Accounting Standards Codification and created a new Topic ASC 606, "*Revenue from Contracts with Customers*" ("ASC 606"). This amendment prescribes that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The amendment supersedes the revenue recognition requirements in Topic 605, "*Revenue Recognition*," and most industry-specific guidance throughout the Industry Topics of the Codification. For annual and interim reporting periods the mandatory adoption date of ASC 606 is January 1, 2017, and there will be two methods of adoption allowed, either a full retrospective adoption or a modified retrospective adoption. The FASB recently issued ASU 2015-14 to defer the effective date of the new revenue recognition standard by one year. As such, it now takes effect for public entities in fiscal years beginning after December 15, 2017. Accordingly the revised mandatory adoption date of ASC 606 is April 1, 2018. The Company is currently evaluating the impact of ASC 606, but at the current time does not know what impact the new standard will have on revenue recognized and other accounting decisions in future periods, if any, nor what method of adoption will be selected if the impact is material.

In August 2014, the FASB amended the FASB Accounting Standards Codification and amended Subtopic 205-40, “*Presentation of Financial Statements – Going Concern.*” This amendment prescribes that an entity should evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity’s ability to continue as a going concern within one year after the date that the financial statements are issued. The amendments will become effective for the Company’s annual and interim reporting periods beginning April 1, 2017. The Company will begin evaluating going concern disclosures based on this guidance upon adoption.

In January 2015, the FASB issued ASU No. 2015-01, *Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items*. This standard update eliminates the concept of extraordinary items from generally accepted accounting principles in the United States (U.S. GAAP) as part of an initiative to reduce complexity in accounting standards while maintaining or improving the usefulness of the information provided to the users of the financial statements. The presentation and disclosure guidance for items that are unusual in nature or occur infrequently will be retained and expanded to include items that are both unusual in nature and infrequent in occurrence. This standard update is effective for fiscal years beginning after December 15, 2015; however, earlier adoption is permitted. The adoption of this standard update is not expected to have a significant impact on our consolidated financial statements.

In February 2015, the FASB issued ASU No. 2015-02, *Amendments to the Consolidation Analysis*, which is included in ASC 810, Consolidation. This update changes the guidance with respect to the analyses that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. All legal entities are subject to reevaluation under the revised consolidation model. The new guidance affects the following areas: (1) limited partnerships and similar legal entities, (2) evaluating fees paid to a decision maker or a service provider as a variable interest, (3) the effect of fee arrangements on the primary beneficiary determination, (4) the effect of related parties on the primary beneficiary determination, and (5) certain investment funds. The guidance will be effective for the Company’s interim and annual reporting periods beginning April 1, 2016. The standard allows the Company to transition to the new model using either a full or modified retrospective approach, and early adoption is permitted. The Company is currently evaluating the impact this standard will have on its business practices, financial condition, results of operations, and disclosures.

In April 2015, the FASB issued ASU 2015-03, *Interest – Imputation of Interest (Subtopic 835-30)*. This ASU requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by this ASU. The amendments in this ASU are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those years. Early adoption is permitted for financial statements that have not been previously issued and retrospective application is required for each balance sheet presented. The adoption of this standard update is not expected to have a significant impact on the Company’s consolidated financial statements.

## Use of Estimates

The preparation of financial statements in conformity with United States GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ materially from these estimates under different assumptions or conditions.

## 3. Acquisitions

### *Apollo Palliative Services LLC and Affiliates Acquisitions*

On October 27, 2014, AMM made an initial capital contribution of \$613,889 (the “Initial Contribution”) to ApolloMed Palliative (“APS”) in exchange for 51% of the membership interests of ApolloMed Palliative. ApolloMed Palliative used the Initial Contribution, in conjunction with funds contributed by other investors in ApolloMed Palliative, to finance the closing payments for the acquisitions described immediately below. In connection with this arrangement, the Company entered into a consulting agreement with one of ApolloMed Palliative’s members. The consulting agreement has a 6 year term, and provides for the member to receive \$15,000 in cash per month, and for the member to be eligible to receive stock-based awards under the Company’s 2013 Equity Incentive Plan as determined by the Company’s Board of Directors. Immediately prior to closing the transactions described below, and as condition precedent to ApolloMed Palliative closing the transactions, the selling equity owners in each transaction described below contributed specific equity interests to ApolloMed Palliative in return for interests in ApolloMed Palliative pursuant to contribution agreements.

### *Best Choice Hospice Care LLC*

Subject to the terms and conditions of that certain Membership Interest Purchase Agreement (the “BCHC Agreement”), dated October 27, 2014, by and among ApolloMed Palliative, the Company, the members of BCHC, and BCHC, ApolloMed Palliative agreed to purchase all of the remaining membership interests in BCHC for \$900,000 in cash and \$230,862 of equity consideration in APS, subject to reduction if BCHC’s working capital was less than \$145,000 as of the closing of the transaction. APS agreed to pay a contingent payment of up to a further \$400,000 (the “BCHC Contingent Payment”) to one seller and one employee of BCHC. The BCHC Contingent Payment will be paid in two installments of \$100,000 to each of the seller and the employee within sixty days of each of the first and second anniversaries of the transaction, and is contingent upon, as of each applicable date, the seller’s and the employee’s employment, as applicable, continuing or having been terminated without cause and, for the employee, meeting certain productivity targets. The Company absolutely, unconditionally and irrevocably guaranteed payment of the BCHC Contingent Payment if ApolloMed Palliative fails to make any payment. The contingent payments were

accounted for as post-combination compensation consideration and will be accrued ratably over two years. As of March 31, 2015, \$109,848 had been expensed and included in accounts payable and accrued liabilities. As of June 30, 2015, a total of \$173,631 had been expensed and is included in accounts payable and accrued liabilities.

The results of BCHC's operations have been included in the Company's condensed consolidated financial statements since October 27, 2014.

*Holistic Health Home Health Care Inc.*

Subject to the terms and conditions of that certain Stock Purchase Agreement (the "HCHHA Agreement"), dated October 27, 2014, by and among ApolloMed Palliative, the sole shareholder of HCHHA, and HCHHA, ApolloMed Palliative agreed to purchase all of the remaining shares of HCHHA for \$300,000 in cash and \$43,286 of equity consideration in APS, subject to reduction if HCHHA's working capital was less than \$50,000 as of the closing of the transaction. ApolloMed Palliative agreed to pay a contingent payment of up to a further \$150,000 (the "HCHHA Contingent Payment"). The HCHHA Contingent Payment will be paid in two installments of \$75,000 to the seller within sixty days of each of the first and second anniversaries of the transaction, and is contingent upon, as of each applicable date, the seller's employment continuing or having been terminated without cause and the seller meeting certain productivity targets. The contingent payments were accounted for as compensation consideration and will be accrued ratably over two years. As of March 31, 2015, \$41,245 had been expensed and included in accounts payable and accrued liabilities. As of June 30, 2015, a total of \$65,194 had been expensed and included in accounts payable and accrued liabilities.

The results of HCHHA's operations have been included in the Company's condensed consolidated financial statements since October 27, 2014.

*SCHC*

On July 22, 2014, pursuant to a Stock Purchase Agreement dated as of July 21, 2014 (the "Purchase Agreement") by and among SCHC, a Medical Corporation that provides professional medical services in Los Angeles County, California, the shareholders of SCHC (the "Sellers") and a Company affiliate, SCHC Acquisition, A Medical Corporation (the "Affiliate"), solely owned by Dr. Warren Hosseinon as physician shareholder and the Chief Executive Officer of the Company, the Affiliate acquired all of the outstanding shares of capital stock of SCHC from the Sellers. The purchase price for the shares was (i) \$2,000,000 in cash, (ii) \$428,391 to pay off and discharge certain indebtedness of SCHC (iii) warrants to purchase up to 100,000 shares of the Company's common stock at an exercise price of \$10.00 per share and (iv) a contingent amount of up to \$1,000,000 payable, if at all, in cash. The acquisition was funded by an intercompany loan from AMM, which also provided an indemnity in favor of one of the Sellers relating to certain indebtedness of SCHC that remained outstanding following the closing of the acquisition. Following the acquisition of SCHC, the Affiliate was merged with and into SCHC, with SCHC being the surviving corporation. The indebtedness of SCHC was paid off following the acquisition and did not remain outstanding as of December 31, 2014.

In connection with the acquisition of SCHC, AMM entered into a management services agreement with the Affiliate on July 21, 2014. As a result of the Affiliate's merger with and into SCHC, SCHC is now the counterparty to this management services agreement and bound by its terms. Pursuant to the management services agreement, AMM will manage all non-medical services for SCHC, will have exclusive authority over all non-medical decision making related to the ongoing business operations of SCHC, and is the primary beneficiary of SCHC, and the financial statements of SCHC have been consolidated as a variable interest entity with those of the Company from July 21, 2014.

The Company accounted for the acquisition as a business combination using the acquisition method of accounting which requires, among other things, that assets acquired and liabilities assumed be recognized at their fair values as of the purchase date and be recorded on the balance sheet.

A contingent payment obligation of \$1,000,000 was considered a post-combination transaction and therefore it will be recorded as post-combination compensation expense over the term of the arrangement and not as purchase consideration. The compensation expense will be accrued in each reporting period based upon achievement of certain physician productivity measures through June 30, 2016. As of March 31, 2015, \$375,000 had been expensed and included in accounts payable and accrued liabilities. As of June 30, 2015, a total of \$575,000 had been expensed and is included in accounts payable and accrued liabilities.

The results of SCH's operations have been included in the Company's condensed consolidated financial statements since July 22, 2014.

#### *AKM*

In May 2014, AMM entered into a management services agreement with AKM Acquisition Corp, Inc. ("AKMA"), a newly-formed provider of physician services and an affiliate of the Company owned by Dr. Warren Hosseinion as a physician shareholder, to manage all non-medical services for AKMA. AMM has exclusive authority over all non-medical decision making related to the ongoing business operations of AKMA and is the primary beneficiary; consequently, AMM consolidated the revenue and expenses of AKMA from the date of execution of the management services agreements. On May 30, 2014, AKMA entered into a stock purchase agreement (the "AKM Purchase Agreement") with the shareholders of AKM Medical Group, Inc. ("AKM"), a Los Angeles, CA-based independent practice association. Immediately following the closing, AKMA merged with and into AKM, with AKM being the surviving entity and assuming the rights and obligations under the management services agreement. Under the AKM Purchase Agreement all of the issued and outstanding shares of capital stock of AKM were acquired for approximately \$280,000.

Under the AKM Purchase Agreement, former shareholders of AKM were entitled to be paid the Holdback Amount of up to approximately \$376,000 plus the difference between the actual cash position of AKM and the target amount of \$461,104 within 6 months of the Closing Date. During the year ended March 31, 2015, it was determined that AKM's cash position exceeded the target amount. Accordingly, in March 2015, the Company remitted a total of \$419,981 to the former shareholders and settled this liability in full.



The results of AKM's operations have been included in the Company's condensed consolidated financial statements since July 22, 2014.

#### 4. Intangible Assets

Intangible assets, net consisted of the following:

| June 30, 2015                | Gross Amounts | Accumulated<br>Amortization | Net          |
|------------------------------|---------------|-----------------------------|--------------|
| Indefinite-lived assets:     |               |                             |              |
| Medicare license             | \$ 704,000    | \$ -                        | \$704,000    |
| Amortized intangible assets: |               |                             |              |
| Exclusivity                  | 40,000        | (18,440)                    | ) 21,560     |
| Non-compete                  | 185,400       | (55,445)                    | ) 129,955    |
| Payor relationships          | 107,000       | (21,400)                    | ) 85,600     |
| Network relationships        | 220,000       | (40,333)                    | ) 179,667    |
| Trade name                   | 257,000       | (38,547)                    | ) 218,453    |
| Totals                       | \$ 1,513,400  | \$ (174,165)                | )\$1,339,235 |

| March 31, 2015               | Gross Amounts | Accumulated<br>Amortization | Net           |
|------------------------------|---------------|-----------------------------|---------------|
| Indefinite-lived assets:     |               |                             |               |
| Medicare license             | \$ 704,000    | \$ -                        | \$704,000     |
| Amortized intangible assets: |               |                             |               |
| Exclusivity                  | 40,000        | (15,940)                    | ) 24,060      |
| Non-compete                  | 185,400       | (41,428)                    | ) 143,972     |
| Payor relationships          | 107,000       | (16,050)                    | ) 90,950      |
| Network relationships        | 220,000       | (29,333)                    | ) 190,667     |
| Trade name                   | 257,000       | (33,392)                    | ) 223,608     |
| Totals                       | \$ 1,513,400  | \$ (136,143)                | ) \$1,377,257 |

The amortization expense for the three months ended June 30, 2015 and June 30, 2014 was approximately \$38,022 and \$4,200, respectively.

#### 5. Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities consisted of the following:

|                           | June 30,<br>2015 | March 31,<br>2015 |
|---------------------------|------------------|-------------------|
| Accounts payable          | \$1,654,860      | \$1,377,817       |
| Physician share of MSSP   | 62,000           | 62,000            |
| Accrued compensation      | 1,552,124        | 1,469,132         |
| Income taxes payable      | 253,077          | 185,051           |
| Accrued interest          | 169,749          | 55,529            |
| Accrued professional fees | 450,725          | 202,675           |
|                           | \$4,142,819      | \$3,352,204       |

## 6. Notes and Lines of Credit Payable

Notes and lines of credit payable consist of the following:

|   | June 30,<br>2015 | March 31,<br>2015 |
|---|------------------|-------------------|
| Term loan payable to NNA due March 28, 2019, net of debt discount of \$995,363 (June 30, 2015) and \$1,060,401 (March 31, 2015) | \$5,532,137      | \$5,467,098       |
| Line of credit payable to NNA due March 28, 2019  | 1,000,000        | 1,000,000         |
| Unsecured revolving line of credit due to financial institution due June 5, 2016  | 94,764           | 94,764            |
|   | \$6,624,548      | \$6,561,862       |

### *NNA Credit Agreements*

On October 15, 2013, the Company entered into a \$2.0 million secured revolving credit facility (the “Revolving Credit Agreement”) with NNA of Nevada, Inc., (“NNA”), an affiliate of Fresenius Medical Care Holdings, Inc.. On December 20, 2013 the Company entered into the First Amendment to the Credit Agreement (the “Amended Credit Agreement”), which increased the revolving credit facility from \$2 million to \$4 million. The proceeds of the Amended Credit Agreement were used by the Company to repay the \$500,000 Note to SpaGus Apollo, LLC, and were used to pay or repay certain of the Company’s 10% Notes (see Note 7), to refinance certain other indebtedness of the Company, and for working capital and for general corporate purposes. The Amended Credit Agreement was refinanced on March 28, 2014 in connection with 2014 NNA financing.

### *2014 NNA Financing*

On March 28, 2014, the Company entered into a Credit Agreement (the “Credit Agreement”) pursuant to which NNA, extended to the Company (i) a \$1,000,000 revolving line of credit (the “Revolving Loan”) and (ii) a \$7,000,000 term loan (the “Term Loan”). The Company drew down the full amount of the Revolving Loan on October 23, 2014. The Term Loan and Revolving Loan mature on March 28, 2019, subject to NNA’s right to accelerate payment on the occurrence of certain events. The Term Loan may be prepaid at any time without penalty or premium. The loans extended under the Credit Agreement are secured by substantially all of the Company’s assets, and are guaranteed by the Company’s subsidiaries and consolidated medical corporations. The guarantees of these subsidiaries and consolidated entities are in turn secured by substantially all of the assets of the subsidiaries and consolidated entities providing the guaranty.

Concurrently with the Credit Agreement, the Company entered into a Pledge and Security Agreement with NNA (the “Pledge and Security Agreement”), whereby all of the issued and outstanding shares, interests or other equivalents of capital stock of a direct subsidiary of the Company (not including any entity that carries on the practice of medicine) are considered pledged interests. Pledged interests as of the date of the Pledge and Security Agreement include 100% of AMM, PCCM, VMM common stock and 72.77% of ApolloMed ACO common stock.

Concurrently with the Credit Agreement, the Company entered into an Investment Agreement with NNA (the “Investment Agreement”), pursuant to which it issued to NNA an 8% Convertible Note in the original principal amount of \$2,000,000 (the “Convertible Note”). The Company drew down the full principal amount of the Convertible Note on July 30, 2014 (see Note 7). The Convertible Note matures on March 28, 2019, subject to NNA’s right to accelerate payment on the occurrence of certain events. The Company may redeem amounts outstanding under the Convertible Note on 60 days’ prior notice to NNA. Amounts outstanding under the Convertible Note are convertible at NNA’s sole election into shares of the Company’s common stock at an initial conversion price of \$10.00 per share. The Company’s obligations under the Convertible Note are guaranteed by its subsidiaries and consolidated medical corporations.

On February 6, 2015, the Company entered into a First Amendment and Acknowledgement (the “Acknowledgement”) with NNA, Warren Hosseinion, M.D., and Adrian Vazquez, M.D. The Acknowledgement amended some provisions of, and/or provided waivers in connection with, each of (i) the Registration Rights Agreement between the Company and NNA, dated March 28, 2014 (the “Registration Rights Agreement”), (ii) the Investment Agreement, (iii) the NNA Convertible Note, and (iv) the NNA Warrants. The amendments to the Registration Rights Agreement included amendments with respect to the timing of the filing deadline for a resale registration statement for the benefit of NNA.

Under the Investment Agreement, the Company issued to NNA warrants to purchase up to 300,000 shares of the Company’s common stock at an initial exercise price of \$10.00 per share and warrants to purchase up to 200,000 shares of the Company’s common stock at an initial exercise price of \$20.00 per share (collectively, the “Warrants”).

The Company determined the fair value of the proceeds of \$9.0 million in part based on the following inputs for the warrant liability: term of 7 years, risk free rate of 2.31%, no dividends, volatility of 71.4%, share price of \$4.50 per share and a 50% probability of down-round financing. The common stock issuance was recorded at \$899,739 (a discount of \$1,100,261 to the face amount), the Term Loan was recorded at \$5,745,637 (a discount of \$1,254,363 to the face amount), and a corresponding warrant liability of \$2,354,624 was recorded.

The Term Loan accrues interest at a rate of 8.0% per annum. A portion of the principal amount of the Term Loan is repaid on the last business day of each calendar quarter, which provides for quarterly payments of \$87,500 in the first year, \$122,500 in the second year, \$122,500 in the third year, \$175,000 in the fourth year, and \$210,000 in the fifth year. The Term Loan reflected an original issue discount of \$1,305,435 associated with the issuance of 300,000 warrants to acquire the Company's common stock (see Note 9) and payment of a fee to NNA of \$80,000 of which \$51,072 was considered a debt discount, \$7,998 was recorded to equity, and \$20,930 allocated to warrant liability was immediately recorded as interest expense. The discount will be amortized to interest expense over the expected term of the loan using the effective interest method.

The Revolving Loan bears interest at the rate of three month LIBOR plus 6.0% per annum. The Company had borrowed \$1,000,000 under the Revolving Loan at June 30, 2015 and March 31, 2015. As of June 30, 2015, there are no remaining amounts available to be borrowed under the Revolving Loan. The Term Loan and Revolving Loan mature on March 28, 2019.

The Company incurred \$235,119 in third party costs related to the 2014 NNA financing, which were allocated to the related debt and equity instruments based on their relative fair values, of which \$150,101 was classified as deferred financing costs which will be deferred and amortized over the life of the loan using the effective interest method.

The Credit Agreement and the Convertible Note provide for certain financial covenants. On February 16, 2015, the Company and NNA agreed to amend the tangible net worth covenant computation.

In addition, the Credit Agreement and the Convertible Note include: (1) certain negative covenants that, subject to exceptions, limit the Company's ability to, among other things incur additional indebtedness, engage in future mergers, consolidations, liquidations and dissolutions, sell assets, pay dividends and distributions on or repurchase capital stock, and enter into or amend other material agreements; and (2) certain customary representations and warranties, affirmative covenants and events of default, which are set forth in more detail in the 2014 NNA financing credit agreement and Convertible Note.

On July 7, 2015, the Company entered into an Amendment to First Amendment and Acknowledgement (the "New Amendment") with NNA of Nevada, Inc., an affiliate of Fresenius Medical Care Holdings, Inc.. The New Amendment amended the First amendment and Acknowledgement, dated as of February 6, 2015 (as amended by the Amendment, the "Acknowledgement"), among the Company, NNA, Warren Hosseinion, M.D., and Adrian Vazquez, M.D. and included an extension until October 15, 2015 of a deadline previously contemplated by the Acknowledgement, for the Company to file a registration statement covering the sale of NNA's registrable securities. If the registration statement is not filed with the SEC on or prior to the filing deadline, the Company must pay to NNA an amount in common stock based upon its then fair market value, as liquidated damages equal to 1.50% of the aggregate purchase price paid by NNA. The Acknowledgement was filed as an exhibit to the Company's Current Report on Form 8-K on July 10, 2015.

*Unsecured revolving line of credit*

Included in “Notes and lines of credit payable” in the accompanying consolidated balance sheet is a \$100,000 revolving line of credit with a financial institution of which \$94,764 was outstanding at June 30, 2015 and March 31, 2015. Borrowings under the line of credit bear interest at the prime rate (as defined) plus 4.50% (7.75% per annum at June 30, 2015 and at March 31, 2015), interest only is payable monthly, and the line of credit matures June 5, 2016. The line of credit is unsecured.

*Other lines of credit*

LALC has a line of credit of \$230,000 as of June 30, 2015. The Company has borrowed zero under this line of credit as of June 30, 2015 and March 31, 2015.

BAHA has a line of credit of \$150,000 as of June 30, 2015. The Company has borrowed zero under this line of credit as of June 30, 2015 and March 31, 2015. The line of credit is subject to renewal on April 27, 2016.

Interest expense associated with the notes and lines of credit payable consisted of the following:

|  | <b>Three Months Ended</b> |                   |
|--|---------------------------|-------------------|
|  | <b>June 30,</b>           |                   |
|  | <b>2015</b>               | <b>2014</b>       |
| Interest expense                       | \$ 149,709                | \$ 144,153        |
| Amortization of loan fees and discount | 74,573                    | 71,251            |
|  | <b>\$ 224,282</b>         | <b>\$ 215,404</b> |

## 7. Convertible Notes Payable

Convertible notes payable consist of the following:

|   | June 30,<br>2015 | March 31,<br>2015 |
|---|------------------|-------------------|
| 9% Senior Subordinated Convertible Notes due February 15, 2016, net of debt discount of \$43,472 (June 30, 2015) and \$62,182 (March 31, 2015)              | \$1,056,527      | \$1,037,818       |
| 8% Senior Subordinated Convertible Note Payable to NNA due March 28, 2019, net of debt discount of \$951,040 (June 30, 2015) and \$985,255 (March 31, 2015) | 1,048,959        | 1,014,745         |
| Conversion feature liability  | 491,952          | 442,358           |
|   | \$2,597,438      | \$2,494,921       |

### *9% Senior Subordinated Callable Convertible Promissory Notes due February 15, 2016*

The 9% Notes, issued January 31, 2013, bear interest at a rate of 9% per annum, payable semi-annually on August 15 and February 15, and mature February 15, 2016, and are subordinated. The principal of the 9% Notes plus any accrued yet unpaid interest is convertible at any time by the holder at a conversion price of \$4.00 per share of the Company's common stock, subject to adjustment for stock splits, stock dividends and reverse stock splits. On 60 days' prior notice, 9% Notes are callable in full or in part by the Company at any time after January 31, 2015. If the Average Daily Value of Trades ("ADVT") during the prior 90 days as reported by Bloomberg is greater than \$100,000, the 9% Notes are callable at a price of 105% of the 9% Notes' par value, and if the ADVT is less than \$100,000, the 9% Notes are callable at a price of 110% of the 9% Notes' par value.

In connection with the issuance of the 9% Notes, the holders of the 9% Notes received warrants to purchase 66,000 shares of the Company's common stock at an exercise price of \$4.50 per share, subject to adjustment for stock splits, reverse stock splits and stock dividends, and which are exercisable at any date prior to January 31, 2018, and were classified in equity. The \$186,897 fair value of the 9% Notes warrants was based on the Company's closing stock price at the transaction date and inputs to the Black-Scholes option pricing model: term of 5.0 years, risk free rate of 0.70%, and volatility of 36.7%.

### *8% Convertible Note Payable to NNA*

The NNA 8% Convertible Note commitment provided for the Company to borrow up to \$2,000,000. On July 31, 2014, the Company exercised its option to borrow \$2,000,000, received \$2,000,000 of proceeds and recorded a debt discount of \$1,065,775 related to the fair value of a conversion feature liability and a warrant liability discussed below. Borrowings bear interest at the rate of 8.0 % per annum payable semi-annually, are due March 28, 2019, and are convertible into shares of the Company's common stock initially at \$10.00 per share. The conversion price will be subject to adjustment in the event of subsequent down-round equity financings, if any, by the Company. The conversion feature included a non-standard anti-dilution feature that has been bifurcated and recorded as a conversion feature liability at the issuance date of \$578,155. The fair value of the conversion feature liability issued in connection with 2014 NNA financing 8% Convertible Note at June 30, 2015 was estimated using the Monte Carlo valuation model which used the following inputs: term of 3.7 years, risk free rate of 1.3%, no dividends, volatility of 48.6%, share price of \$6.90 per share based on the trading price of the Company's common stock adjusted for a marketability discount, and a 100% probability of down-round financing. In addition the Company was required to issue 100,000 warrants to NNA with an exercise price of \$10.00 per share. The fair value of the warrant liability related to 100,000 common shares issuable in connection with NNA 8% Convertible Note as of June 30, 2015 was estimated using the Monte Carlo valuation model which used the following inputs: term of 5.7 years, risk free rate of 1.8%, no dividends, volatility of 57.6%, share price of \$6.90 per share based on the trading price of the Company's common stock adjusted for a marketability discount, and a 100% probability of down-round financing.

Interest expense associated with the convertible notes payable consisted of the following:

|  | <b>Three Months Ended</b> |             |
|--|---------------------------|-------------|
|  | <b>June 30,</b>           |             |
|  | <b>2015</b>               | <b>2014</b> |
| Interest expense                       | \$ 65,469                 | \$ 25,025   |
| Amortization of loan fees and discount | 70,651                    | 36,438      |
|  | \$ 136,120                | \$ 61,463   |



## 8. Income Taxes

Deferred income taxes are provided on a liability method whereby deferred tax assets and liabilities are recognized for temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. Significant management judgment is required in determining the Company's provision for income taxes and the recoverability of the Company's deferred tax assets. Such determination is based primarily on the Company's historical taxable income, with some consideration given to the Company's estimates of future taxable income by jurisdictions in which the Company operates and the period over which the Company's deferred tax assets will be recoverable. Due to overall cumulative losses incurred in recent years, the Company maintained a full valuation allowance against its deferred tax assets as of June 30, 2015 and March 31, 2015. The Company is subject to U.S. federal income tax, as well as income tax of multiple state tax jurisdictions.

ASC No. 740 addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under ASC No. 740, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities based on the technical merits of the position. The tax benefits recognized in the financial statements from such position should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. ASC No. 740 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosure requirements. The Company and its subsidiaries are currently open to audit under the statute of limitations by the Internal Revenue Service for the years ended December 31, 2011 and later. The Company's state income tax returns are open to audit under the statute of limitations for the years ended December 31, 2010 and later. The Company does not anticipate any material unrecognized tax benefits within the next twelve months.

## 9. Stockholders' Equity

### Common Stock Placement

On March 28, 2014, the Company entered into an equity and debt investment for up to \$12.0 million with NNA. As part of the investment, the Company entered into the Investment Agreement with NNA, pursuant to which the Company sold NNA 200,000 shares of the Company's common stock (the "Purchased Shares") at a purchase price of \$10.00 per share. In addition with the issuance of common shares, the Company issued to NNA 100,000 warrants to purchase the Company's common stock for \$10.00 per share. The Company used the Monte Carlo Method to value the warrants, which used the following inputs: term of 7 years, risk free rate of 2.31%, no dividends, volatility of 71.4%, share price of \$4.50 per share and a 50% probability of down-round financing. The Company determined that the fair

value of the shares issued was approximately \$900,000, or \$868,236 after the relative fair value adjustment, which approximates \$4.50 per share. The Company also entered into a registration rights agreement (“RRA”) with NNA, which the Company and NNA amended on February 6, 2015, which requires the Company to file a registration statement to register its shares with the SEC no later than June 26, 2015. Effective July 7, 2015, the Company amended the First Amendment to extend the previous registration statement deadline to October 15, 2015. The RRA requires the Company to use commercially reasonable best efforts to cause the RRA to be declared effective by the SEC. If the Initial Registration Statement is not filed with the SEC on or prior to the filing deadline, the Company must pay to NNA an amount in common stock based upon its then fair market value, as liquidated damages equal to 1.50% of the aggregate purchase price paid by NNA.

### **Equity Incentive Plans**

The Company’s amended 2010 Equity Incentive Plan (the “2010 Plan”) allowed the Board to grant up to 1,200,000 shares of the Company’s common stock, and provided for awards including incentive stock options, non-qualified options, restricted common stock, and stock appreciation rights. As of June 30, 2015, there were no shares available for grant.

On April 29, 2013 the Company’s Board of Directors approved the Company’s 2013 Equity Incentive Plan (the “2013 Plan”), pursuant to which 500,000 shares of the Company’s common stock were reserved for issuance thereunder. The Company received approval of the 2013 Plan from the Company’s stockholders on May 19, 2013. The Company issues new shares to satisfy stock option and warrant exercises under the 2013 Plan. As of June 30, 2015 there were approximately 48,600 shares available for future grants under the 2013 Plan.

## Share Issuances

A summary of the Company's restricted stock sold to employees, directors and consultants with a right of repurchase of unexpired or unvested shares is as follows:

|  | Shares  | Weighted<br>Average<br>Remaining<br>Vesting<br>Life<br>(In years) | Weighted<br>Average<br>Per Share<br>Intrinsic<br>Value | Weighted-<br>average<br>Per Share<br>Grant Date<br>Fair Value |
|--|---------|---|--|---|
| Unvested or unexpired shares at March 31, 2015 | 12,222  | 0.3   | \$ 0.50  | \$ 4.10   |
| Granted  | -       |   |  |   |
| Vested / lapsed                                | (6,111) | -   |  |   |
| Forfeited                                      | -       |   |  |   |
| Unvested or unexpired shares at June 30, 2015  | 6,111   | 0.3   | 0.81   | 4.10  |

## Options

Stock option activity for the three months ended June 30, 2015 is summarized below:

|                                       | Shares  | Weighted<br>Average<br>Per Share<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Life<br>(Years) | Weighted<br>Average<br>Per Share<br>Intrinsic<br>Value |
|---------------------------------------|---------|---|---|--|
| Balance, March 31, 2015               | 776,500 | \$ 4.69   | 7.4   | \$ 1.50  |
| Granted                               | -       |   |   |  |
| Cancelled                             | -       |   |   |  |
| Exercised                             | -       |   |   |  |
| Expired                               | -       |   |   |  |
| Forfeited                             | -       |   |   |  |
| Balance, June 30, 2015                | 776,500 | \$ 4.69   | 7.2   | 6.16   |
| Vested and exercisable, June 30, 2015 | 675,431 | \$ 2.39   | 5.0   | 4.67   |

## ApolloMed ACO 2012 Equity Incentive Plan

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On October 18, 2012 ApolloMed ACO's Board of Directors adopted the ApolloMed Accountable Care Organization, Inc. 2012 Equity Incentive Plan (the "ACO Plan") and reserved 9,000,000 shares of ApolloMed ACO's common stock for issuance thereunder. The purpose of the ACO Plan is to encourage selected employees, directors, consultants and advisers to improve operations and increase the profitability of ApolloMed ACO and encourage selected employees, directors, consultants and advisers to accept or continue employment or association with ApolloMed ACO.

The following table summarizes the restricted stock award in the ACO Plan during the three months ended June 30, 2015:

|                                       | <b>Shares</b> | <b>Weighted<br/>Average<br/>Remaining<br/>Vesting<br/>Life<br/>(Years)</b> | <b>Weighted<br/>Average<br/>Per Share<br/>Intrinsic<br/>Value</b> | <b>Weighted<br/>Average<br/>Per Share<br/>Fair Value</b> |
|---------------------------------------|---------------|--|---|--|
| Balance, March 31, 2015               | 3,752,004     | 0.1  | \$ 0.70   | \$ 0.07  |
| Granted                               | -             | -  | -   | -  |
| Released                              | -             | -  | -   | -  |
| Balance, June 30, 2015                | 3,752,004     | -  | \$ 0.70   | \$ 0.07  |
| Vested and exercisable, end of period | 3,651,675     |  |   |  |

Awards of restricted stock under the ACO Plan vest (i) one-third on the date of grant; (ii) one-third on the first anniversary of the date of grant, if the grantee has remained in service continuously until that date; and (iii) one-third on the second anniversary of the date of grant if the grantee has remained in service continuously until that date.

As of June 30, 2015, total unrecognized compensation costs related to non-vested stock-based compensation arrangements granted under the Company's 2010 and 2013 Equity Plans, and the ACO Plan's and the weighted-average period of years expected to recognize those costs are as follows:

|                           | Unrecognized<br>Stock<br>Compensation<br>Cost | Weighted<br>Average<br>Remaining<br>Vesting Period<br>(Years) |
|---------------------------|---|---|
| Common stock options      | \$ 214,977                                    | 1.5   |
| Restricted stock          | \$ 40,940                                     | 0.02  |
| ACO Plan restricted stock | \$ 7,275                                      | 0.01  |

Stock-based compensation expense related to common stock and common stock option awards is recognized over their respective vesting periods and was included in the accompanying condensed consolidated statement of operations as follows:

|                                   | <b>Three Months Ended</b> |             |
|-----------------------------------|---------------------------|-------------|
|                                   | <b>June 30,</b>           |             |
|                                   | <b>2015</b>               | <b>2014</b> |
| Stock-based compensation expense: |                           |             |
| Cost of services                  | \$ 1,227                  | \$ 28,743   |
| General and administrative        | 82,621                    | 90,396      |
|                                   | \$ 83,848                 | \$ 119,139  |

## Warrants

Warrants consisted of the following for the three months ended June 30, 2015:

|                               | <b>Weighted<br/>Average<br/>Per Share<br/>Intrinsic<br/>Value</b> | <b>Number of<br/>Warrants</b> |
|-------------------------------|---|-------------------------------|
| Outstanding at March 31, 2015 | \$ 0.46   | 9,145,000                     |
| Granted                       | -   | -                             |
| Exercised                     | -   | -                             |
| Cancelled                     | -   | -                             |
| Outstanding at June 30, 2015  | \$ 0.31   | 9,145,000                     |

| Exercise Price Per<br>Share | Warrants<br>Outstanding | Weighted<br>Average Remaining<br>Contractual Life | Warrants<br>Exercisable | Weighted<br>Average<br>Exercise Price Per<br>Share |
|-----------------------------|-------------------------|---|-------------------------|--|
| \$ 1.15                     | 125,000                 | 1.1   | 125,000                 | \$ 1.15  |
| 1.15                        | 25,000                  | 1.1   | 25,000                  | 1.15   |
| 4.50                        | 50,000                  | 1.1   | 50,000                  | 4.50   |
| 5.00                        | 10,000                  | 2.3   | 10,000                  | 5.00   |
| 4.50                        | 82,500                  | 2.6   | 82,500                  | 4.50   |
| 4.00                        | 22,000                  | 2.6   | 22,000                  | 4.00   |
| 10.00                       | 200,000                 | 5.7   | -                       | 10.00  |
| 20.00                       | 200,000                 | 5.7   | -                       | 20.00  |
| 10.00                       | 100,000                 | 5.7   | -                       | 10.00  |
| 10.00                       | 100,000                 | 3.1   | 100,000                 | 10.00  |
|                             | 914,500                 | 3.1   | 414,500                 | 4.60   |

In connection with the 2014 NNA financing, NNA received warrants to purchase up to 300,000 shares of the Company's common stock at an exercise price of \$10.00 per share and up to 200,000 shares at an exercise price of \$20.00 per share, subject to adjustment for stock splits, reverse stock splits and stock dividends, and are exercisable after March 28, 2017 and before March 28, 2021. The warrants also contained down-round protection under which the exercise price of the warrants is subject to adjustment in the event the Company issues future common shares at a price below \$9.00 per share. The Company determined that the warrants should be classified as liabilities under ASC 815-40, which requires the Company to determine the fair value of the warrants at the transaction date and at each subsequent reporting date (see Notes 2 and 6). On July 21, 2014, in connection with the SCHC acquisition, the Company issued warrants to purchase up to 100,000 shares of the Company's common stock at an exercise price of \$10.00 per share. The warrants are exercisable at any date prior to July 21, 2018.

### Authorized stock

At June 30, 2015 the Company was authorized to issue up to 100,000,000 shares of common stock. The Company is required to reserve and keep available out of the authorized but unissued shares of common stock such number of shares sufficient to effect the conversion of all outstanding shares of the 9% Senior Subordinated Callable Notes, the exercise of all outstanding warrants exercisable into shares of common stock, and shares granted and available for grant under the Company's 2013 Plan. The number of shares of common stock reserved for these purposes is as follows at June 30, 2015:

|  |           |
|--|-----------|
| Common stock issued and outstanding                        | 4,863,455 |
| Conversion of 9% Notes                                     | 275,000   |
| Conversion of 8% Notes                                     | 200,000   |
| Warrants outstanding                                       | 914,500   |
| Stock options outstanding                                  | 776,500   |
| Remaining shares issuable under 2013 Equity Incentive Plan | 90,000    |
|  | 7,119,455 |

## 10. Commitments and Contingencies

### *Regulatory Matters*

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs. The Company believes that it is in compliance with all applicable laws and regulations.

*Legal*

On May 16, 2014, Lakeside Medical Group, Inc. and Regal Medical Group, Inc., two independent physician associations who compete with the Company in the greater Los Angeles area, filed an action against the Company and two affiliates of the Company, MMG and AMEH, in Los Angeles County Superior Court. The complaint alleged that the Company and its two affiliates made misrepresentations and engaged in other acts in order to improperly solicit physicians and patient-enrollees from Plaintiffs. The Complaint sought compensatory and punitive damages. On June 30, 2014, the Company and its affiliates filed a motion requesting the Court to stay the court proceeding and order the parties to arbitrate this dispute subject to existing arbitration agreements. On August 11, 2014, the Plaintiffs filed a request for dismissal without prejudice of the action. On August 12, 2014, the Plaintiffs served the Company and its affiliates with Demands for Arbitration before Judicial Arbitration Mediation Services in Los Angeles. The Company is currently examining the merits of the claims to be arbitrated, and it is too early to state whether the likelihood of an unfavorable outcome is probable or remote, or to estimate the potential loss if the outcome should be negative. The Company is aware that punitive damages previously sought in the court proceeding are not available in arbitration. The Company and its affiliates are preparing a defense to the allegations and the Company intends to vigorously defend the action.

On August 28, 2014, Lakeside Medical Group, Inc. and Regal Medical Group, Inc., filed a similar lawsuit against Warren Hosseinion, the Company's Chief Executive Officer. Dr. Hosseinion is defending the action and is currently being indemnified by the Company subject to the terms of an indemnification agreement and the Company's charter. The Company has an existing Directors and Officers insurance policy. On September 9, 2014, Dr. Hosseinion filed a motion requesting the Court to stay the court proceeding and, pursuant to existing arbitration agreements, order the parties to arbitrate the dispute as part of the pending arbitration proceedings before JAMS (as discussed above). On October 29, 2014, the Plaintiffs filed a request for dismissal without prejudice of the action. On November 13, 2014, Plaintiffs served Dr. Hosseinion with Demands for Arbitration before JAMS in Los Angeles, and on November 19, 2014, the parties agreed to consolidate the two proceedings against Dr. Hosseinion with the two existing proceedings against the Company and its affiliates. The Company continues to examine the merits of the claims to be arbitrated against Dr. Hosseinion, and it is too early to state whether the likelihood of an unfavorable outcome is probable or remote, or to estimate the potential loss if the outcome should be negative. The Company is aware that punitive damages previously sought in the court proceeding against Dr. Hosseinion are not available in arbitration.

The parties involved in the proceedings described above are currently in mediation.



In the ordinary course of the Company's business, the Company becomes involved in pending and threatened legal actions and proceedings, most of which involve claims of medical malpractice related to medical services provided by the Company's affiliated hospitalists. The Company may also become subject to other lawsuits which could involve significant claims and/or significant defense costs. The Company believes, based upon the Company's review of pending actions and proceedings, that the outcome of such legal actions and proceedings will not have a material adverse effect on the Company's business, financial condition, results of operations, or cash flows. The outcome of such actions and proceedings, however, cannot be predicted with certainty and an unfavorable resolution of one or more of them could have a material adverse effect on the Company's business, financial condition, results of operations, or cash flows in a future period.

#### *Liability Insurance*

The Company believes that the Company's insurance coverage is appropriate based upon the Company's claims experience and the nature and risks of the Company's business. In addition to the known incidents that have resulted in the assertion of claims, the Company cannot be certain that the Company's insurance coverage will be adequate to cover liabilities arising out of claims asserted against the Company, the Company's affiliated professional organizations or the Company's affiliated hospitalists in the future where the outcomes of such claims are unfavorable. The Company believes that the ultimate resolution of all pending claims, including liabilities in excess of the Company's insurance coverage, will not have a material adverse effect on the Company's financial position, results of operations or cash flows; however, there can be no assurance that future claims will not have such a material adverse effect on the Company's business.

Although the Company currently maintains liability insurance policies on a claims-made basis, which are intended to cover malpractice liability and certain other claims, the coverage must be renewed annually, and may not continue to be available to the Company in future years at acceptable costs, and on favorable terms. The Company believes its malpractice coverage is adequate and is the standard for the industry.

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*The following management's discussion and analysis should be read in conjunction with the unaudited condensed consolidated financial statements and the notes thereto included in this Quarterly Report. In addition, reference is made to our audited consolidated financial statements and notes thereto and related Management's Discussion and Analysis of Financial Condition and Results of Operations included in our most recent Annual Report on Form 10-K/A for the year ended March 31, 2015, filed with the SEC on July 29, 2015.*

*In this Quarterly Report, unless otherwise expressly stated or the context otherwise requires, "ApolloMed," "we," "us" and "our" refer to Apollo Medical Holdings, Inc., a Delaware corporation, its subsidiaries and its consolidated affiliates. Our affiliated professional organizations are separate legal entities that provide physician services primarily in California and with which we have management agreements. For financial reporting purposes we consolidate the revenues and expenses of all our practice groups that we own or manage because we have a controlling financial interest in these practices based on applicable accounting rules and as described in our accompanying financial statements. References to "practices" or "practice groups" refer to our subsidiary-management company and the affiliated professional organizations of Apollo that provide medical services, unless otherwise expressly stated or the context otherwise requires.*

*The following discussion contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 regarding future events and the future results of Apollo that are based on management's current expectations, estimates, projections, and assumptions about our business. Words such as "may," "will," "could," "should," "target," "potential," "project," "expects," "anticipates," "intends," "plans," "believes," "sees," "estimates" and variations and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements due to numerous factors, including, but not limited to, those discussed in our most recent Annual Report on Form 10-K/A, including the section entitled "Risk Factors", as well as those discussed from time to time in the Company's other SEC filings and reports. In addition, such statements could be affected by general industry and market conditions. Such forward-looking statements speak only as of the date of this Report or, in the case of any document incorporated by reference, the date of that document, and we do not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date of this Report, or for changes made to this document by wire services or Internet service providers. If we update or correct one or more forward-looking statements, investors and others should not conclude that we will make additional updates or corrections with respect to other forward-looking statements.*

### **Overview**

We are a patient-centered, physician-centric integrated healthcare delivery company with a management team with over a decade of experience working at providing coordinated, outcomes-based medical care in a cost-effective manner. We have built a company and culture that is focused on physicians providing high quality care, population management and care coordination for patients, particularly for senior patients and patients with multiple chronic conditions. We believe that we are well-positioned to take advantage of changes in the U.S. healthcare industry as there is a growing national movement towards more results-oriented healthcare centered on the triple aim of patient satisfaction, high-quality care and cost efficiency.

We operate in one reportable segment, the healthcare delivery segment, and implement and operate innovative health care models to create a patient-centered, physician-centric experience. Accordingly, we report our consolidated financial statements in the aggregate, including all of our activities in one reportable segment. We have the following integrated, synergistic operations:

- Hospitalists, which includes our contracted physicians who focus on the delivery of comprehensive medical care to hospitalized patients;

- An ACO, which focuses on the provision of high-quality and cost-efficient care to Medicare FFS patients;

- Two IPAs, which contract with physicians and provide care to Medicare, Medicaid, commercial and dual eligible patients on fee-for-service or risk and value based fee bases;

- Clinics, which provide primary care and specialty care in the Greater Los Angeles area; and

- Palliative care, home health and hospice services, which include, our at-home, pain management and final stages of life services.

Our revenue streams are diversified among our various operations and contract types, and include:

- Traditional fee-for-service reimbursement, which is the primary revenue source for our clinics; and

- Risk and value-based contracts with health plans, IPAs, hospitals and the CMS's MSSP, which are the primary revenue sources for our hospitalists, ACO, IPAs and palliative care operations.

We serve Medicare, Medicaid, HMO and uninsured patients primarily in California, as well as in Mississippi and Ohio (where our ACO has recently begun operations). We primarily provide services to patients that are covered by private or public insurance, although we do derive a small portion of our revenue from non-insured patients. We provide care coordination services to each major constituent of the healthcare delivery system, including patients, families, primary care physicians, specialists, acute care hospitals, alternative sites of inpatient care, physician groups and health plans.

Our mission is to transform the delivery of healthcare services in the communities we serve by implementing innovative population health models and creating a patient-centered, physician-centric experience in a high performance environment of integrated care.

The original business owned by ApolloMed was ApolloMed Hospitalists ("AMH"), a hospitalist company, which was incorporated in California in June, 2001 and which began operations at Glendale Memorial Hospital. Through a reverse merger, ApolloMed became a publicly held company in June 2008. ApolloMed was initially organized around the admission and care of patients at inpatient facilities such as hospitals. We have grown our inpatient strategy in a competitive market by providing high-quality care and innovative solutions for our hospital and managed care clients. In 2012, we formed an ACO, ApolloMed ACO, and an IPA, MMG, and in 2013 we expanded our service offering to include integrated inpatient and outpatient services through MMG. In 2014, we added several complementary operations by acquiring an IPA and outpatient primary care and specialty clinics, as well as hospice/palliative care and home health entities.

Our physician network consists of hospitalists, primary care physicians and specialist physicians primarily through our owned and affiliated physician groups. We operate through the following subsidiaries: AMM, PCCM, VMM and ApolloMed ACO. Through our wholly-owned subsidiary, AMM, we manage affiliated medical groups, which consist of AMH, ACC, MMG, AKM, SCHC, and Bay Area Hospitalist Associates, A Medical Corporation ("BAHA"). Through our wholly-owned subsidiary, PCCM, we manage LALC, and through our wholly-owned subsidiary VMM, we manage Hendel. We also have a controlling interest in ApolloMed Palliative, which owns two Los Angeles-based companies, Best Choice Hospice Care LLC and Holistic Health Home Health Care Inc. AMM, PCCM and VMM each operate as a physician practice management company and are in the business of providing management services to physician practice corporations under long-term management service agreements. Our ACO participates in the MSSP, the goal of which is to improve the quality of patient care and outcomes through more efficient and

coordinated approach among providers. Revenues earned by ApolloMed ACO are uncertain, and, if such amounts are payable, they will be paid on an annual basis significantly after the time earned, and will be contingent on various factors, including achievement of the minimum savings rate as determined by MSSP for the relevant period. If MSSP determines that ApolloMed ACO did not achieve the necessary minimum savings rate for 2014, then no ACO payment will be received by ApolloMed ACO in fiscal year 2016.

Our recent financial highlights, as more fully discussed below, include that for the three months ended June 30, 2015 (unaudited), we had:

Net revenue of \$10.2 million, an increase of 149% from \$4.1 million for the three months ended June 30, 2014 which net revenue consisted of approximately \$4.0 million from our hospitalists, approximately \$3.0 million from our IPAs, approximately \$1.6 million from our clinics, and \$1.6 million from our palliative care services; and

Generated loss from operations of \$1.7 million, an increase of 40% compared to a loss from operations of \$1.2 million in the comparable period of 2014.

## Recent Developments

### NNA Amendments

On May 13, 2015, we entered into an Amendment to First Amendment and Acknowledgement (the “Amendment”) with NNA of Nevada, Inc., an affiliate of Fresenius Medical Care Holdings, Inc. The Amendment amended the First amendment and Acknowledgement, dated as of February 6, 2015 (the “Acknowledgement”), among the Company, NNA, Warren Hosseinion, M.D., and Adrian Vazquez, M.D. and included an extension until June 12, 2015 of a deadline previously contemplated by the Acknowledgement, for the Company to file a registration statement covering the sale of NNA’s registrable securities.

On July 7, 2015, we entered into an Amendment to First Amendment and Acknowledgement (the “New Amendment”) with NNA of Nevada, Inc., an affiliate of Fresenius Medical Care Holdings, Inc. The New Amendment amended the First amendment and Acknowledgement, dated as of February 6, 2015 (as amended by the Amendment, the “Acknowledgement”), among the Company, NNA, Warren Hosseinion, M.D., and Adrian Vazquez, M.D. and included an extension until October 15, 2015 of a deadline previously contemplated by the Acknowledgement, for the Company to file a registration statement covering the sale of NNA’s registrable securities. If the registration statement is not filed with the SEC on or prior to the filing deadline, the Company must pay to NNA an amount in common stock based upon its then fair market value, as liquidated damages equal to 1.50% of the aggregate purchase price paid by NNA. The Acknowledgement was filed as an exhibit to our Current Report on Form 8-K on July 10, 2015.

## Results of Operations

The following is a detailed discussion of our results of operations for the periods presented:

|                               | <b>Three Months Ended June 30,</b> |         |             |         |
|-------------------------------|------------------------------------|---------|-------------|---------|
|                               | <b>2015</b>                        |         | <b>2014</b> |         |
| Net revenues                  | \$10,204,125                       | 100.0%  | \$4,094,486 | 100.0%  |
| Costs and expenses            |                                    |         |             |         |
| Cost of services              | 7,567,868                          | 74.2 %  | 3,259,839   | 79.6 %  |
| General and administrative    | 4,237,203                          | 41.5 %  | 2,009,332   | 49.1 %  |
| Depreciation and amortization | 63,751                             | 0.6 %   | 11,899      | 0.1 %   |
| Total costs and expenses      | 11,868,822                         | 116.3%  | 5,281,070   | 129.0%  |
| Loss from operations          | (1,664,697 )                       | -16.3 % | (1,186,584) | -29.0 % |

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|  |                |         |                |         |  |
|--|----------------|---------|----------------|---------|--|
| Other (expense) income   |                |         |                |         |  |
| Interest expense   | (360,402 )     | -3.5 %  | (276,867 )     | -6.8 %  |  |
| Loss on change in fair value of warrant and conversion feature liabilities | (213,718 )     | -2.1 %  | (30,005 )      | -0.7 %  |  |
| Other  | 101,004        | 1.0 %   | (2,476 )       | -0.1 %  |  |
| Total other expense  | (473,116 )     | -4.6 %  | (309,348 )     | -7.6 %  |  |
| Loss before provision for income taxes                                     | (2,137,813 )   | -21.0 % | (1,495,932 )   | -36.5 % |  |
| Income tax provision   | 92,691         | 0.9 %   | 11,602         | 0.3 %   |  |
| Net loss   | (2,230,504 )   | -21.9 % | (1,507,534 )   | -36.8 % |  |
| Net income attributable to non-controlling interest                        | (251,862 )     | -2.5 %  | (170,207 )     | -4.2 %  |  |
| Net loss attributable to Apollo Medical Holdings, Inc.                     | \$(2,482,366 ) | -24.3 % | \$(1,677,741 ) | -41.0 % |  |

*Three Months Ended June 30, 2015 Compared to Three Months Ended June 30, 2014*

*Net revenues*

Net revenues for the three months ended June 30, 2015 increased by approximately \$6.1 million, or 149.2%, as compared to the same period of 2014. The increase in revenue was primarily due to an increase of \$1.7 million in incremental revenue from the acquisitions of AKM and SCHC, an increase of \$1.5 million in incremental revenue from the acquisitions of BCHC and HCHHA and an increase of \$1.2 million in revenue from consolidating BAHA as a variable interest entity. Revenues from LALC and Hendel increased \$0.2 million and furthermore, MMG revenues increased \$1.5 million from the three months ended June 30, 2014, due to an increase in patient lives.

*Cost of services*

Cost of services for the three months ended June 30, 2015 increased by approximately \$4.3 million, or 132.2%, as compared to the same period of 2014. Cost of services increased approximately \$2.2 million primarily due to the incremental costs associated with the Company's acquisitions during fiscal 2015, of which \$1.4 million resulted from the acquisitions of AKM and SCHC and \$0.8 million resulted from the acquisitions of BCHC and HCHHA. Consolidating BAHA as a variable interest entity added \$0.9 million of additional cost of services. The remaining increase was primarily due to a \$1.3 million increase in MMG claim costs due to the increase in patient lives.

*General and administrative*

General and administrative costs for the three months ended June 30, 2015 increased by approximately \$2.2 million, or 110.9%, as compared to the same period of 2014. Approximately \$1.3 million of the increase was due to the acquisitions of AKM and SCHC and BCHC and HCHHA which added costs of \$0.5 million and \$0.8 million, respectively and \$0.3 million was attributable to the consolidation of BAHA. Also, during the first quarter of fiscal 2016, there was an increase of \$0.8 million in legal and professional fees that were incurred related to the Lakeside litigation and other corporate initiatives offset by a \$0.1 million decrease in stock compensation expense and a \$0.1 million decrease in other expenses.

*Depreciation and amortization*



Depreciation and amortization increased by approximately \$52,000, or 435.8%, as compared to the same period of 2014. This increase was primarily due to the acquisitions of BCHC, HCHHA, AKM and SCHC, which added additional depreciation expense of approximately \$16,000 and additional amortization expense of approximately \$34,000 related to the intangible assets acquired during fiscal year 2015.

*Interest expense*

Interest expense increased by approximately \$0.1 million, or 30.2%, as compared to the same period of 2014. This increase was primarily due to the higher interest expense attributable to the increase in borrowings primarily related to the 2014 NNA financing.

*Loss on change in fair value of warrant and conversion feature liabilities*

The loss on change in fair value of warrant and conversion feature liabilities increased by approximately \$0.2 million, or 558.0%, as compared to the same period of 2014. This increase resulted from the change in the fair value measurement of the Company's warrant and conversion feature liabilities, which consider among other things, expected term, the volatility of the Company's share price, interest rates, and the probability of additional financing of the underlying NNA Term Loan and NNA 8% Convertible Note.

*Other*

Other income increased by approximately \$0.1 million, or 4,179.3%, as compared to the same period of 2014 primarily due to the \$96,000 Affordable Care Act incentive received by AKM during the three months ended June 30, 2015.

*Income tax provision*

Income tax provision increased approximately \$0.1 million, or 698.9%, as compared to the same period of 2014. For the three months ended June 30, 2015 the effective tax rate was (4.2)% compared to (0.8)% for the three months ended June 30, 2014; and the change in the effective rate was primarily driven by the additions of AKM (acquired May 2014), HCHHA (acquired October 2014) and BAHA (consolidated as a variable interest entity).

*Net income attributable to non-controlling interests*

Net income attributable to non-controlling interests increased approximately \$82,000, or 48.2%, as compared to the same period of 2014. The increase was primarily due to the net income attributable to BAHA which we began consolidating as a variable interest entity on February 17, 2015.

*Liquidity and Capital Resources*

At June 30, 2015, the Company had cash equivalents of approximately \$3.9 million compared to cash and cash equivalents of approximately \$5.0 million at March 31, 2015. At June 30, 2015, the Company had borrowings totaling \$8.7 million compared to borrowings at March 31, 2015 of \$8.6 million.

To date, we have funded our operations from internally generated cash flow and external sources, including the proceeds from the issuance of debt and equity securities, which have provided funds for near-term operations and growth.

We have a history of operating losses and as of June 30, 2015 we have an accumulated deficit of \$21.8 million, and during the three months ended June 30, 2015 we used net cash of \$0.5 million for our operating activities. Furthermore, during the three months ended June 30, 2015, we incurred a loss from operations of \$0.5 million.

The primary sources of liquidity as of June 30, 2015 include cash on hand of \$3.9 million and availability under lines of credit of approximately \$380,000. Management has established a business plan, which they believe will result in future profitability. Additionally, we are highly dependent on MSSP revenue, which is contingent upon the realization of program savings as determined by the Centers for Medicare & Medicaid Services ("MSSP"). Non receipt of amounts from the MSSP could adversely impact our liquidity. However, we may also require additional funding to meet certain obligations until sufficient cash flows are generated from anticipated operations. Management believes that ongoing requirements for working capital, debt service and covenants compliance and planned capital expenditures will be adequately funded from current sources for at least the next twelve months. If available funds are not adequate and/or we do not receive any MSSP funds, we may need to obtain additional sources of funds or reduce operations; however, there is no assurance that we will be successful in doing so.

For the three months ended June 30, 2015, cash used in operating activities was approximately \$0.5 million. This was the result of net loss of \$2.3 million offset by cash provided by non-cash expenses of \$0.5 million and the change in working capital of \$1.2 million. Non-cash expenses primarily include depreciation and amortization expense, issuance stock-based compensation expense, amortization of financing costs, accretion of debt discount, change in the fair value of the warrant and conversion feature liabilities and the write-off of deferred financing costs. Cash provided by working capital was primarily due to the \$0.8 million increase in accounts payable and accrued liabilities and the \$0.5 million decrease in deferred financing costs. Deferred financing costs decreased as a result of the write-off of the expenses associated with our expected public offering (see Note 2 to the condensed consolidated financial statements).

For the three months ended June 30, 2015, no cash was used in or provided by investing activities.

For the three months ended June 30, 2015, net cash used in financing activities was \$0.6 million which was the distribution to a non-controlling interest physician practice.

### *Concentration of Payors*

Receivables from one payor (Medicare/MediCal) amounted to 25.1% and 21.4% of total accounts receivable as of June 30, 2015 and June 30, 2014, respectively. The Company anticipates that Medicare/MediCal will continue to be a significant payor.

### *Intercompany Loans*

Each of AMH, ACC, MMG, AKM and SCHC has entered into an Intercompany Loan Agreement with AMM under which AMM has agreed to provide a revolving loan commitment to each of the affiliated entities in an amount set forth in each Intercompany Loan Agreement. Each Intercompany Loan Agreement provides that AMM's obligation to make any advances automatically terminates concurrently with the termination of the Management Agreement with the applicable affiliated entity. In addition, each Intercompany Loan Agreement provides that (i) any material breach by Dr. Hosseinion of the applicable Physician Shareholder Agreement or (ii) the termination of the Management Agreement with the applicable affiliated entity constitutes an event of default under the Intercompany Loan Agreement. The following tables summarize the various intercompany loan agreements for the three months ended June 30, 2015 and for the year ended March 31, 2015.

| Entity | Facility     | Expiration | Interest Rate<br>per Annum | Three Months Ended June 30, 2015       |                |                                    |                                   |
|--------|--------------|------------|----------------------------|--|----------------|------------------------------------|-----------------------------------|
|        |              |            |                            | Maximum<br>Balance<br>During<br>Period | Ending Balance | Principal<br>Paid During<br>Period | Interest<br>Paid During<br>Period |
| AMH    | \$10,000,000 | 30-Sep-18  | 10                         | % \$ 1,698,058                         | \$ 1,698,058   | \$ -                               | \$ -                              |
| ACC    | 1,000,000    | 31-Jul-18  | 10                         | % 1,213,276                            | 1,213,276      | -                                  | -                                 |
| MMG    | 5,000,000    | 30-May-19  | 10                         | % 832,646                              | 832,646        | -                                  | -                                 |
| AKM    | 5,000,000    | 30-May-19  | 10                         | % 124,683                              | 124,683        | -                                  | -                                 |
| SCHC   | 5,000,000    | 21-Jul-19  | 10                         | % 3,181,168                            | 3,181,168      | -                                  | -                                 |
| Total  | \$26,000,000 |            |                            | \$ 7,049,831                           | \$ 7,049,831   | \$ -                               | \$ -                              |

| Entity | Facility | Expiration | Interest Rate<br>per Annum | Year Ended March 31, 2015              |                |                                    |                                   |
|--------|----------|------------|----------------------------|--|----------------|------------------------------------|-----------------------------------|
|        |          |            |                            | Maximum<br>Balance<br>During<br>Period | Ending Balance | Principal<br>Paid During<br>Period | Interest<br>Paid During<br>Period |

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|       |              |           |    |   |             |              |    |   |    |   |
|-------|--------------|-----------|----|---|-------------|--------------|----|---|----|---|
| AMH   | \$10,000,000 | 30-Sep-18 | 10 | % | \$1,681,735 | \$ 1,681,735 | \$ | - | \$ | - |
| ACC   | 1,000,000    | 31-Jul-18 | 10 | % | 1,156,966   | 1,156,966    | -  | - | -  | - |
| MMG   | 5,000,000    | 30-May-19 | 10 | % | 700,151     | 700,151      | -  | - | -  | - |
| AKM   | 5,000,000    | 30-May-19 | 10 | % | 126,729     | 126,729      | -  | - | -  | - |
| SCHC  | 5,000,000    | 21-Jul-19 | 10 | % | 3,175,593   | 3,175,593    | -  | - | -  | - |
| Total | \$26,000,000 |           |    |   | \$6,841,174 | \$ 6,841,174 | \$ | - | \$ | - |

**Critical Accounting Policies**

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and potentially result in materially different results under different assumptions and conditions. We believe that our critical accounting policies are limited to those described in the Critical Accounting Policies section of Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K/A for the fiscal year ended March 31, 2015.

## Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) amended the FASB Accounting Standards Codification and created a new Topic ASC 606, “*Revenue from Contracts with Customers*” (“ASC 606”). This amendment prescribes that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The amendment supersedes the revenue recognition requirements in Topic 605, “*Revenue Recognition*,” and most industry-specific guidance throughout the Industry Topics of the Codification. For annual and interim reporting periods the mandatory adoption date of ASC 606 is January 1, 2017, and there will be two methods of adoption allowed, either a full retrospective adoption or a modified retrospective adoption. The FASB recently issued ASU 2015-14 to defer the effective date of the new revenue recognition standard by one year. As such, it now takes effect for public entities in fiscal years beginning after December 15, 2017. Accordingly the revised mandatory adoption date of ASC 606 is April 1, 2018. The Company is currently evaluating the impact of ASC 606, but at the current time does not know what impact the new standard will have on revenue recognized and other accounting decisions in future periods, if any, nor what method of adoption will be selected if the impact is material.

In August 2014, the FASB amended the FASB Accounting Standards Codification and amended Subtopic 205-40, “*Presentation of Financial Statements – Going Concern*.” This amendment prescribes that an entity should evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity’s ability to continue as a going concern within one year after the date that the financial statements are issued. The amendments will become effective for the Company’s annual and interim reporting periods beginning April 1, 2017. The Company will begin evaluating going concern disclosures based on this guidance upon adoption.

In January 2015, the FASB issued ASU No. 2015-01, *Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items*. This standard update eliminates the concept of extraordinary items from generally accepted accounting principles in the United States (U.S. GAAP) as part of an initiative to reduce complexity in accounting standards while maintaining or improving the usefulness of the information provided to the users of the financial statements. The presentation and disclosure guidance for items that are unusual in nature or occur infrequently will be retained and expanded to include items that are both unusual in nature and infrequent in occurrence. This standard update is effective for fiscal years beginning after December 15, 2015; however, earlier adoption is permitted. The adoption of this standard update is not expected to have a significant impact on our consolidated financial statements.

In February 2015, the FASB issued ASU No. 2015-02, *Amendments to the Consolidation Analysis*, which is included in ASC 810, Consolidation. This update changes the guidance with respect to the analyses that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. All legal entities are subject to reevaluation under the revised consolidation model. The new guidance affects the following areas: (1) limited partnerships and similar legal entities, (2) evaluating fees paid to a decision maker or a service provider as a variable interest, (3) the effect of fee arrangements on the primary beneficiary determination, (4) the effect of related parties on the primary beneficiary determination, and (5) certain investment funds. The guidance will be effective for the

Company's interim and annual reporting periods beginning April 1, 2016. The standard allows the Company to transition to the new model using either a full or modified retrospective approach, and early adoption is permitted. The Company is currently evaluating the impact this standard will have on its business practices, financial condition, results of operations, and disclosures.

In April 2015, the FASB issued ASU 2015-03, *Interest – Imputation of Interest (Subtopic 835-30)*. This ASU requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by this ASU. The amendments in this ASU are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those years. Early adoption is permitted for financial statements that have not been previously issued and retrospective application is required for each balance sheet presented. The adoption of this standard update is not expected to have a significant impact on the Company's consolidated financial statements.

### **Off Balance Sheet Arrangements**

As of June 30, 2015, the Company had no off-balance sheet arrangements.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

### ITEM 4. CONTROLS AND PROCEDURES

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

In connection with the preparation of this Quarterly Report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Principal Financial and Accounting Officer, of the effectiveness of our disclosure controls and procedures, as of June 30, 2015, in accordance with Rules 13a-15(b) and 15d-15(b) of the Exchange Act.

Based on that evaluation, our Chief Executive Officer and Principal Financial and Accounting Officer have concluded that our disclosure controls and procedures were not effective as of June 30, 2015.

We have identified the following three material weaknesses in our disclosure controls and procedures:

1. We do not have written documentation of our internal control policies and procedures. Written documentation of key internal controls over financial reporting is a requirement of Section 404 of the Sarbanes-Oxley Act. Management evaluated the impact of our failure to have written documentation of our internal controls and procedures on our assessment of our disclosure controls and procedures, and concluded that the control deficiency that resulted represented a material weakness.
2. We do not have sufficient segregation of duties within accounting functions, which is a basic internal control. Due to our size and nature, segregation of all conflicting duties may not always be possible and may not be economically feasible. Management evaluated the impact of our failure to have segregation of duties on our assessment of our disclosure controls and procedures, and concluded that the control deficiency that resulted represented a material weakness.



3. We do not have adequate review and supervision procedures for financial reporting functions. The review and supervision function of internal control relates to the accuracy of financial information reported. The failure to adequately review and supervise could allow the reporting of inaccurate or incomplete financial information. Due to our size and nature, review and supervision may not always be possible or economically feasible.

Based on the foregoing material weaknesses, we have determined that, as of June 30, 2015, our internal controls over our financial reporting are not effective. The Company is taking remediating steps to address each material weakness. We continue to add employees and consultants to address these issues and we will continue to broaden the scope of our accounting and billing capabilities and realign responsibilities in our financial and accounting review functions.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable and not absolute assurance that the objectives of the system are met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of certain events. Because of these and other inherent limitations of control systems, there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

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

There has been no change in our internal control over financial reporting during the three month period ended June 30, 2015 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II – OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

In the ordinary course of our business, we become involved in pending and threatened legal actions and proceedings, most of which involve claims of medical malpractice related to medical services that are provided by our affiliated hospitalists. We may also become subject to other lawsuits which could involve significant claims and/or significant defense costs. We have become involved in the following two legal matters:

On May 16, 2014, Lakeside Medical Group, Inc. and Regal Medical Group, Inc., two independent physician associations who compete with us in the greater Los Angeles area, filed an action against us and two of our affiliates, MMG and AMEH in Los Angeles County Superior Court. The complaint alleged that we and our two affiliates made misrepresentations and engaged in other acts in order to improperly solicit physicians and patient-enrollees from

Plaintiffs. The Complaint sought compensatory and punitive damages. On June 30, 2014, we filed a motion requesting the Court to stay the court proceeding and order the parties to arbitrate this dispute subject to existing arbitration agreements. On August 11, 2014, the Plaintiffs filed a request for dismissal without prejudice of the action. On August 12, 2014, the Plaintiffs served us and our affiliates with Demands for Arbitration before Judicial Arbitration Mediation Services (JAMS) in Los Angeles. We are currently examining the merits of the claims to be arbitrated, and it is too early to state whether the likelihood of an unfavorable outcome is probable or remote, or to estimate the potential loss if the outcome should be negative. We are aware that punitive damages previously sought in the court proceeding are not available in arbitration. We are preparing a defense to the allegations and we intend to vigorously defend the action.

On August 28, 2014, Lakeside Medical Group, Inc. and Regal Medical Group, Inc., filed a similar lawsuit against Warren Hosseinion, our Chief Executive Officer. Dr. Hosseinion is defending the action and is currently being indemnified by us subject to the terms of an indemnification agreement and our charter. We have an existing Directors and Officers insurance policy. On September 9, 2014, Dr. Hosseinion filed a motion requesting the Court to stay the court proceeding and, pursuant to existing arbitration agreements, order the parties to arbitrate the dispute as part of the pending arbitration proceedings before JAMS (as discussed above). On October 29, 2014, the Plaintiffs filed a request for dismissal without prejudice of the action. On November 13, 2014, Plaintiffs served Dr. Hosseinion with Demands for Arbitration before JAMS in Los Angeles, and on November 19, 2014, we agreed to consolidate the two proceedings against Dr. Hosseinion with the two existing proceedings against us and our other affiliates. We continue to examine the merits of the claims to be arbitrated against Dr. Hosseinion, and it is too early to state whether the likelihood of an unfavorable outcome is probable or remote, or to estimate the potential loss if the outcome should be negative. We are aware that punitive damages previously sought in the court proceeding against Dr. Hosseinion are not available in arbitration.

The parties involved in both arbitration proceedings described above are currently in mediation.

Other than the two specific items disclosed above, the merits of which we continue to examine and analyze, we believe, based upon our review of pending actions and proceedings, that the outcome of such legal actions and proceedings will not have a material adverse effect on our business, financial condition, results of operations, or cash flows. The outcome of such actions and proceedings, however, cannot be predicted with certainty and an unfavorable resolution of one or more of them could have a material adverse effect on our business, financial condition, results of operations, or cash flows in a future period.

## **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

## **ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

## **ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

## ITEM 5. OTHER INFORMATION

On August 18, 2015, we entered into a Waiver and Consent (“Waiver”) with NNA of Nevada, Inc. (“NNA”), an affiliate of Fresenius Medical Care Holdings, Inc., whereby NNA waived and consented to certain provisions of the Credit Agreement, dated as of March 28, 2014, between us and NNA (the “Credit Agreement”) and the Convertible Note issued by us on March 28, 2014 to NNA (the “Convertible Note”). Under the terms of the Waiver, NNA (i) agreed to treat Bay Area Hospitalist Associates, a Medical Corporation (“BAHA”) as an “Immaterial Subsidiary” until October 15, 2015 such that until such date BAHA is not subject to most of the requirements of the Credit Agreement and Convertible Note, including the financial covenants contained therein, (ii) waived events of default which have occurred under the Credit Agreement and Convertible Note as a result of payments made by us to Adrian Vazquez, M.D. and Warren Hosseinion, M.D. in fiscal years 2014 and 2015, which were not permitted under the Credit Agreement or the Convertible Note, (iii) waived an event of default which has occurred under the Credit Agreement and Convertible Note as a result of our failure to satisfy a consolidated net worth covenant for the fiscal quarter ended June 2015, and (iv) waived an event of default which has occurred under the Credit Agreement and Convertible Note as a result of an outstanding principal balance under an Intercompany Loan Agreement which exceeded the permitted amount by \$213,276, with such waiver granted by NNA until October 15, 2015 and subject to a maximum excess loan balance of \$250,000 during such time.

**ITEM 6. EXHIBITS**

| <b>Exhibit No.</b> | <b>Description</b>  |
|--------------------|---|
| 2.1                | Stock Purchase Agreement dated July 21, 2014 by and between SCHC Acquisition, A Medical Corporation, the Shareholders of Southern California Heart Centers, A Medical Corporation and Southern California Heart Centers, A Medical Corporation (filed as an exhibit to a Quarterly Report on Form 10-Q on August 14, 2014, and incorporated herein by reference). |
| 3.1                | Restated Certificate of Incorporation (filed as an exhibit to a Current Report on Form 8-K on January 21, 2015, and incorporated herein by reference).  |
| 3.2                | Certificate of Amendment to Restated Certificate of Incorporation (filed as an exhibit to a Current Report on Form 8-K on April 27, 2015, and incorporated herein by reference).  |
| 3.3                | Restated Bylaws (filed as an exhibit to a Current Report on Form 8-K on January 21, 2015, and incorporated herein by reference).  |
| 10.46              | Board of Directors Agreement dated April 9, 2015 by and between Apollo Medical Holdings, Inc., and Lance Jon Kimmel (filed as an exhibit to a Current Report on Form 8-K on April 13, 2015, and incorporated herein by reference).  |
| 10.47              | Amendment to the First Amendment and Acknowledgement, dated as of May 13, 2015, among Apollo Medical Holdings, Inc., NNA of Nevada, Inc., Warren Hosseinion, M.D. and Adrian Vazquez, M.D. (filed as an exhibit to a Current Report on Form 8-K on May 15, 2015, and incorporated herein by reference).   |
| 10.48              | Amendment to the First Amendment and Acknowledgement, dated as of July 7, 2015, among Apollo Medical Holdings, Inc., NNA of Nevada, Inc., Warren Hosseinion, M.D. and Adrian Vazquez, M.D. (filed as an exhibit to a Current Report on Form 8-K on July 10, 2015, and incorporated herein by reference).  |
| 10.49+             | Waiver and Consent, dated as of August 18, 2015, among Apollo Medical Holdings, Inc. and NNA of Nevada, Inc.  |

**Exhibit 31 - Rule 13a-14(d)/15d-14(d) Certifications**

- 31.1+ Certification by Chief Executive Officer
- 31.2+ Certification by Chief Financial Officer

**Exhibit 32 - Section 1350 Certifications**

- 32.1+ Certification by Chief Executive Officer pursuant to 18 U.S.C. section 1350.
- 32.2+ Certification by Chief Financial Officer pursuant to 18 U.S.C. section 1350

+ Filed herewith.

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**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.

**APOLLO MEDICAL HOLDINGS, INC.**

Dated: August 19, 2015 By: /s/ Warren Hosseinion  
Warren Hosseinion  
Chief Executive Officer and Director

Dated: August 19, 2015 By: /s/ Mitchell R. Creem  
Mitchell R. Creem  
Chief Financial Officer and Director  
(Principal Financial and Accounting Officer)