FONAR CORP
Form 10-Q
November 14, 2008

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

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

For the quarterly period ended SEPTEMBER 30, 2008

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the transition period from ____________ to _____________

Commission file number 0-10248

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

DELAWARE	11-2464137
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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

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

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

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

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

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

Class	Outstanding at October 31, 2008
Common Stock, par value $.0001	4,904,275
Class B Common Stock, par value $.0001	158
Class C Common Stock, par value $.0001	382,513
Class A Preferred Stock, par value $.0001	313,451

FONAR CORPORATION AND SUBSIDIARIES
INDEX

PART I - FINANCIAL INFORMATION PAGE

Item 1. Financial Statements

Condensed Consolidated Balance Sheets - September 30, 2008 (Unaudited) and June 30, 2008

Condensed Consolidated Statements of Operations for the Three Months Ended September 30, 2008 and September 30, 2007 (Unaudited)

Condensed Consolidated Statements of Comprehensive Loss for the Three Months Ended September 30, 2008 and September 30, 2007 (Unaudited)

Condensed Consolidated Statements of Cash Flows for the Three Months Ended September 30, 2008 and September 30, 2007 (Unaudited)

Notes to Condensed Consolidated Financial Statements (Unaudited)

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Item 4. Controls and Procedures

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

Item 2. Changes in Securities

Item 3. Defaults Upon Senior Securities

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

Item 5. Other Information

Item 6. Exhibits

Signatures

FONAR CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(000's OMITTED)

ASSETS	September 30, 2008 (UNAUDITED)	June 30, 2008
Current Assets:		
Cash and cash equivalents	$ 4,391	$ 1,326
Marketable securities	24	1,068

Accounts receivable - net	4,331	4,689
Accounts receivable - related parties -net	845	469
Medical receivables - net	1,111	1,228
Management fee receivable - net	3,893	5,040
Management fee receivable - related medical practices - net	1,348	1,372
Costs and estimated earnings in excess of billings on uncompleted contracts	-	6
Inventories	3,202	3,256
Current portion of advances and notes to related medical practices	188	214
Current portion of notes receivable less discount for below market interest	490	2,508
Prepaid expenses and other current assets	755	811
Total Current Assets	20,578	21,987
Property and equipment - net	3,667	3,933
Advances and notes to related medical practices - net	222	263
Notes receivable less discount for below market interest	2,171	2,297
Other intangible assets - net	4,849	4,810
Other assets	1,912	1,936
Total Assets	$ 33,399	$ 35,226

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

FONAR CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(000's OMITTED)

LIABILITIES AND STOCKHOLDERS' DEFICIENCY	September 30, 2008 (UNAUDITED)	June 30, 2008
Current Liabilities:		
Current portion of long-term debt and capital leases	$ 212	$ 373
Accounts payable	4,238	4,020
Other current liabilities	8,038	8,316
Unearned revenue on service contracts	4,019	4,732
Unearned revenue on service contracts - related parties	725	462
Customer advances	11,784	12,804
Customer advance - related party	1,472	1,472

Billings in excess of costs and estimated earnings on uncompleted contracts	6,118	5,773
Total Current Liabilities	36,606	37,952
Long-Term Liabilities:		
Due to related medical practices	93	98
Long-term debt and capital leases, less current portion	813	757
Other liabilities	461	497
Total Long-Term Liabilities	1,367	1,352
Total Liabilities	37,973	39,304
Minority interest	64	167

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

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

LIABILITIES AND STOCKHOLDERS' DEFICIENCY (continued)	September 30, 2008 (UNAUDITED)	June 30, 2008
STOCKHOLDERS' DEFICIENCY:		
Class A non-voting preferred stock $.0001 par value; 1,600,000 authorized, 313,451 issued and outstanding at September 30, 2008 and June 30, 2008	-	-
Common Stock $.0001 par value; 30,000,000 shares authorized at September 30, 2008 and June 30, 2008, 4,915,918 issued at September 30, 2008 and June 30, 2008 4,904,275 outstanding at September 30, 2008 and June 30, 2008	1	1
Class B Common Stock $.0001 par value; 800,000 shares authorized, (10 votes per share), 158 issued and outstanding at September 30, 2008 and June 30, 2008	-	-
Class C Common Stock $.0001 par value; 2,000,000 shares authorized, (25 votes per share), 382,513 issued and outstanding at September 30, 2008 and June 30, 2008	-	-
Paid-in capital in excess of par value	172,276	172,276
Accumulated other comprehensive loss	(17)	(73)
Accumulated deficit	(175,830)	(175,380)
Notes receivable from employee stockholders	(393)	(394)
Treasury stock, at cost - 11,643 shares of common stock at September 30, 2008 and June 30, 2008	(675)	(675)
Total Stockholders' Deficiency	(4,638)	(4,245)
Total Liabilities and Stockholders' Deficiency	$ 33,399	$ 35,226

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

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

	FOR THE THREE MONTHS ENDED SEPTEMBER 30,	
	2008	2007
REVENUES		
Product sales - net	$ 1,413	$ 2,589
Service and repair fees - net	2,331	2,465
Service and repair fees - related parties - net	269	254
Management and other fees - net	2,047	1,885
Management and other fees - related medical practices - net	724	1,476
Total Revenues - Net	6,784	8,669
COSTS AND EXPENSES		
Costs related to product sales	1,442	2,811
Costs related to service and repair fees	925	1,190
Costs related to service and repair fees - related parties	107	123
Costs related to management and other fees	1,203	1,089
Costs related to management and other fees - related medical practices	656	947
Research and development	880	1,163
Selling, general and administrative	3,265	5,287
Provision for bad debts	154	165
Total Costs and Expenses	8,632	12,775
Loss From Operations	(1,848)	(4,106)
Interest Expense	(79)	(102)
Investment Income	33	180
Interest Income - Related Parties	6	9
Other Income	1	6
Minority Interest in Income of Partnerships	(11)	(162)
Gain on Sale of Investment	-	571
Gain on Sale of Consolidated Subsidiary	1,448	3,395
NET LOSS	$ (450)	$(209)
Basic and Diluted Loss Per Common Share	$(.09)	$(0.04)
Weighted Average Number of Common Shares Outstanding	4,904,275	4,884,207

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

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

	FOR THE THREE MONTHS ENDED SEPTEMBER 30,	
	2008	2007
Net loss	$ (450)	$ (209)
Other comprehensive income (loss) net of tax:		
Unrealized gains (losses) on securities, net of tax	55	(2)
Total comprehensive loss	$ (395)	$ (211)

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

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

	FOR THE THREE MONTHS ENDED SEPTEMBER 30,	
	2008	2007
Cash Flows from Operating Activities		
Net loss	$ (450)	$ (209)
Adjustments to reconcile net loss to net used in operating activities:		
Minority interest in income of partnerships	11	162
Depreciation and amortization	435	558
Gain on sale of consolidated subsidiary	(1,448)	(3,395)
Gain on sale of investment	-	(571)
Provision for bad debts	154	165
Stock issued for costs and expenses	-	135
(Increase) decrease in operating assets, net:		
Accounts, management fee and medical receivable(s)	198	(1,363)
Notes receivable	144	130
Costs and estimated earnings in excess of billings on uncompleted contracts	6	(31)
Inventories	54	(310)
Prepaid expenses and other current assets	56	(255)
Other assets	(9)	(20)
Advances and notes to related medical practices	68	19
Increase (decrease) in operating liabilities, net:		
Accounts payable	234	(625)
Other current liabilities	(728)	(373)
Customer advances	(1,020)	1,080
Billings in excess of costs and estimated earnings on uncompleted contracts	345	1,425
Other liabilities	(36)	(20)
Due to related medical practices	(5)	-
Net used in operating activities	(1,991)	(3,498)

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

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

	FOR THE THREE MONTHS ENDED SEPTEMBER 30,	
	2008	2007
Cash Flows from Investing Activities:		
Sales of marketable securities	1,099	50
Purchases of marketable securities	-	(765)
Purchases of property and equipment	(1)	(51)
Costs of capitalized software development	(149)	(187)
Cost of patents	(60)	(88)
Proceeds from note receivable	2,000	-
Proceeds from sale of investment	-	571
Proceeds from sale of consolidated subsidiary	2,293	4,142
Net cash provided by investing activities	5,182	3,672
Cash Flows from Financing Activities:		
Distributions to holders of minority interest	(23)	(95)
Repayment of borrowings and capital lease obligations	(104)	(56)
Repayment of notes receivable from employee stockholders	1	2
Net cash used in financing activities	(126)	(149)
Net Increase in Cash and Cash Equivalents	3,065	25
Cash and Cash Equivalents - Beginning of Period	1,326	1,470
Cash and Cash Equivalents - End of Period	$ 4,391	$ 1,495

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

FONAR CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2008
(UNAUDITED)

NOTE 1 - BASIS OF PRESENTATION & LIQUIDITY & CAPITAL RESOURCES

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered

necessary for a fair presentation have been included. Operating results for the three months ended September 30, 2008 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2009. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K filed on October 7, 2008 for the fiscal year ended June 30, 2008.

Liquidity and Capital Resources

In September 2008, the Company sold its 92.3% interest (to a related party) in an entity that provided management services to a scanning center in Bensonhurst, New York and received net cash proceeds of approximately $2.3 million.

In August 2008, the Company signed a modification agreement with regards to the asset purchase agreement with Health Plus. The Company received a $2,000,000 payment on the note issued by Health Plus.

At September 30, 2008, the Company had a working capital deficit of approximately $16.0 million and a stockholders' deficiency of approximately $4.6 million. For the three months ended September 30, 2008, the Company incurred a net loss of approximately $450,000, which included non-cash charges of approximately $589,000. The Company has funded its cash flow deficit for the three months ended September 30, 2008 through cash provided by the sale of marketable securities and other assets. In addition, during June 2008, the Company implemented a restructuring program, including a reduction of its workforce, across the board salary reductions, elimination of manufacturing facilities and restructuring of its diagnostic imaging management service business. Management estimates that the annualized savings related to these cost-cutting measures approximates $5,000,000.

FONAR CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2008
(UNAUDITED)

NOTE 1 - BASIS OF PRESENTATION & LIQUIDITY & CAPITAL RESOURCES (Continued)

Liquidity and Capital Resources (Continued)

Although sales levels remained weak in fiscal 2008, the Company continues to focus its efforts on increased advertising and marketing campaigns, and distribution programs to strengthen the demand for its products and services. Management anticipates that its capital resources will improve if Fonar's MRI scanner products gain wider market recognition and acceptance resulting in increased product sales. If the Company is not successful with its marketing efforts to increase sales and weak demand continues, the Company will experience a shortfall in cash and it will be necessary to further reduce operating expenses or obtain funds through equity or debt financing in sufficient amounts to avoid the need to curtail operations subsequent to September 30, 2009. Current economic credit conditions have contributed to a slowing business environment. Given such liquidity and credit constraints in the markets, the business may suffer, should the credit markets not improve in the near future. The direct impact of these conditions is not fully known. However, there can be no assurance that the Company would be able to secure additional funds if needed and that if such funds were available, whether the terms or conditions would be acceptable to the Company. In such case, the further reduction in operating expenses might need to be substantial in order for the Company to generate positive cash flow to sustain the operations of the Company.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

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

Earnings (Loss) Per Share

Basic earnings (loss) per share ("EPS") is computed based on weighted average shares outstanding and excludes any potential dilution. In accordance with EITF 03-6, "Participating Securities and the Two-Class method under FASB Statement No. 128" ("EITF 03-6"), the Company's participating convertible securities, which include Class B common stock and Class C common stock, are not included in the computation of basic EPS for the three months ended September 30, 2008 and 2007, because the participating securities do not have a contractual obligation to share in the losses of the Company.

Diluted EPS reflects the potential dilution from the exercise or conversion of all dilutive securities into common stock based on the average market price of common shares outstanding during the period. The number of common shares potentially issuable upon the exercise of certain options and warrants or conversion of the participating convertible securities that were excluded from the diluted EPS calculation was approximately 267,000 and 279,000 because they were antidilutive as a result of net losses for the three month periods ended September 30, 2008 and 2007, respectively.

FONAR CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2008
(UNAUDITED)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standard Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements," ("SFAS 157"). This statement provides a single definition of fair value, a framework for measuring fair value, and expanded disclosures concerning fair value. Previously, different definitions of fair value were contained in various accounting pronouncements creating inconsistencies in measurement and disclosures. SFAS 157 applies under those previously issued pronouncements that prescribe fair value as the relevant measure of value, except SFAS No. 123 (revised 2004), "Share-Based Payment", and related interpretations and pronouncements that require or permit measurement similar to fair value but are not intended to measure fair value. The Company adopted SFAS 157 on July 1, 2008, as required for its financial assets and financial liabilities. However, the FASB deferred the effective date of SFAS 157 for one year as it relates to fair value measurement requirements for nonfinancial assets and nonfinancial liabilities that are not recognized or disclosed at fair value on a recurring basis. The adoption of SFAS 157 for the Company's financial assets and financial liabilities did not have a material impact on its condensed consolidated financial statements. The Company is evaluating the effect the implementation of SFAS 157 for its nonfinancial assets and nonfinancial liabilities will have on

the Company's condensed consolidated financial statements.

Effective January 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48, "Accounting of Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a corporate tax return. For those benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by taxing authorities. Differences between tax positions taken or expected to be taken in a tax return and the benefit recognized and measured pursuant to the interpretation are referred to as "unrecognized benefits". A liability is recognized (or amount of net operating loss carry forward or amount of tax refundable is reduced) for an unrecognized tax benefit because it represents an enterprise's potential future obligation to the taxing authority for a tax position that was not recognized as a result of applying the provisions of FIN 48. In accordance with FIN 48, interest costs related to unrecognized tax benefits are required to be calculated (if applicable) and would be classified as "Interest expense, net". Penalties if incurred would be recognized as a component of "General and administrative" expenses. The Company files corporate income tax returns in the United States (federal) and in various state and local jurisdictions. In most instances, the Company is no longer subject to federal, state and local income tax examinations by tax authorities for years prior to 2004. The adoption of the provisions of FIN 48 did not have a material impact on the Company's consolidated financial position and results of operations. As of September 30, 2008, no liability for unrecognized tax benefits was required to be recorded. The Company recognized a deferred tax asset of approximately $76 million as of September 30, 2008, primarily related to net operating loss carryforwards of approximately $167 million, available to offset future taxable income through 2028.

FONAR CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2008
(UNAUDITED)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Recent Accounting Pronouncements (Continued)

On February 15, 2007, the FASB issued SFAS No. 159, entitled ``The Fair Value Option for Financial Assets and Financial Liabilities,'' ("SFAS 159"). The guidance in SFAS 159 ``allows'' reporting entities to ``choose'' to measure many financial instruments and certain other items at fair value. The objective underlying the development of this literature is to improve financial reporting by providing reporting entities with the opportunity to reduce volatility in reported earnings that results from measuring related assets and liabilities differently without having to apply complex hedge accounting provisions, using the guidance in SFAS No. 133, as amended, entitled ``Accounting for Derivative Instruments and Hedging Activities.'' The provisions of SFAS No. 159 are applicable to all reporting entities and are effective as of the beginning of the first fiscal year that begins subsequent to November 15, 2007. The Company adopted SFAS 159 effective July 1, 2008. Upon adoption, the Company did not elect the fair value option for any items within the scope of SFAS 159 and, therefore, the adoption of SFAS 159 did not have an impact on the Company's condensed consolidated financial statements.

In March 2007, the FASB ratified the Emerging Issues Task Force ("EITF") consensus on EITF Issue No. 06-10. "Accounting for Collateral Assignment Split

Dollar Life Insurance". This EITF indicates that an employer should recognize a liability for postretirement benefits related to collateral assignment split-dollar life insurance arrangements. In addition, the EITF provides guidance for the recognition of an asset related to a collateral assignment split-dollar life insurance arrangement. The EITF is effective for fiscal years beginning after December 15, 2007. The Company will adopt the EITF as required and management does not expect it to have any impact on the Company's results of operations, financial condition and liquidity.

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

FONAR CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2008
(UNAUDITED)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Recent Accounting Pronouncements (Continued)

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements - An Amendment of ARB No. 51" ("SFAS 160"). SFAS 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary (previously referred to as minority interests). SFAS 160 also requires that a retained noncontrolling interest upon the deconsolidation of a subsidiary be initially measured at its fair value. Upon adoption of SFAS 160, the Company will be required to report its noncontrolling interests as a separate component of stockholders' equity. The Company will also be required to present net income allocable to the noncontrolling interest and net income attributable to the stockholders of the Company separately in its consolidated statements of income. Currently, minority interests are reported as a liability in the Company's consolidated balance sheets and the related income attributable to the minority interests is reflected as an expense in arriving at net loss. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. SFAS 160 requires retroactive adoption of the presentation and disclosure requirements for existing minority interests. All other requirements of SFAS 160 shall be applied prospectively.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities-an amendment of FASB Statement No 133" ("SFAS No. 161"). SFAS No. 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and (c) how derivative instruments and related hedged item affect an entity's financial position, financial performance

and cash flows. The guidance in SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. This Statement encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The Company does not believe that the implementation of SFAS No. 161 will have any impact on the Company's consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles". SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. It is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles". The adoption of this statement in not expected to have a material effect on the Company's consolidated financial statements.

FONAR CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2008
(UNAUDITED)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Recent Accounting Pronouncements (Continued)

In October 2008, the FASB issued FASB Staff Position No. FAS 157-3, "Determining the Fair Value of a Financial Asset in a Market That Is Not Active" ("FSP 157-3"), which clarifies the application of SFAS 157 when the market for a financial asset is inactive. Specifically, FSP 157-3 clarifies how (1) management's internal assumptions should be considered in measuring fair value when observable data are not present, (2) observable market information from an inactive market should be taken into account, and (3) the use of broker quotes or pricing services should be considered in assessing the relevance of observable and unobservable data to measure fair value. The guidance in FSP 157-3 is effective immediately and did not have a material impact on the Company's condensed consolidated financial statements.

Reclassifications

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

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

Medical Receivables

The Company was assigned medical receivables valued at $11,775,000, in connection with the satisfaction of the management fees and termination fees related to a Termination and Replacement Agreement dated May 23, 2005. The balance of the net medical receivables as of September 30, 2008 was $1,111,000. As of September 30, 2008 and June 30, 2008, the Company recorded an allowance for doubtful accounts of $789,500 and $769,000, respectively, on these receivables.

Accounts Receivable and Management Fee Receivable

Receivables, net is comprised of the following at September 30, 2008:

(000's Omitted)

	Gross Receivable	Allowance for doubtful accounts	Net
Receivables from equipment sales and service contracts	$ 5,663	$ 1,332	$ 4,331
Receivables from equipment sales and service contracts - related parties	$ 1,464	$ 619	$ 845
Management fee receivables	$ 7,961	$ 4,068	$ 3,893
Management fee receivables from related medical practices ("PC's")	$ 3,726	$ 2,378	$ 1,348

FONAR CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2008
(UNAUDITED)

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

Medical Receivables (Continued)

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

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

As of June 22, 2007, an unrelated third party purchased the stock of the professional corporations owning the eight New York sites managed by the Company, previously owned by Dr. Raymond V. Damadian, the President, Chairman of the Board and principal stockholder of Fonar. In connection with the sale, new management agreements were substituted for the existing management agreements, providing, however, for the same management services. The fees starting in fiscal 2008, however, are currently fixed monthly fees in amounts ranging from $45,000 to $125,000 per month. Dr. Damadian still owns the four MRI facilities in Georgia and Florida managed by the Company. No MRI facilities or other medical facilities are owned by the Company.

Collection by the Company of its management fee receivables may be impaired by the uncollectibility of the PC's medical fees from third party payors, particularly insurance carriers covering automobile no-fault and workers compensation claims due to longer payment cycles and rigorous informational requirements and certain other disallowed claims. Approximately 49% and 40% of the PC's net revenues for both the three months ended September 30, 2008 and 2007, respectively, were derived from no-fault and personal injury protection claims. The Company considers the aging of its accounts receivable in determining the amount of allowance for doubtful accounts and contractual allowances. The Company generally takes all legally available steps to collect

its receivables. Credit losses associated with the receivables are provided for in the condensed consolidated financial statements and have historically been within management's expectations.

Net revenues from management and other fees charged to the related P.C.'s accounted for approximately 10.7% and 17.0% of the consolidated net revenues for the three months ended September 30, 2008 and 2007, respectively. Product sales and service repair fees from related parties amounted to approximately 4.0% and 2.9% of consolidated net revenues for the three months ended September 30, 2008 and 2007 respectively.

FONAR CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2008
(UNAUDITED)

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

Medical Receivables (Continued)

HMCA entered into a management agreement in September 2007 with Integrity Healthcare Management Inc ("Integrity"). Under the terms of the agreement, Integrity provided the billings and collections for HMCA's facilities as well as assist in the management of the facilities. Integrity was to receive as compensation an annual fee equal to one-half of the increase in the consolidated cash flow of HMCA and the facilities over the period from July 1, 2006 through June 30, 2007. The original term of the agreement was one year with an automatic year to year renewal, but may be terminated by either party without cause at the end of any year. During June 2008, HMCA terminated the agreement and no management fees were earned by Integrity. Integrity is a subsidiary of Health Diagnostics, LLC. The director of Health Diagnostics, LLC, Timothy Damadian, is a son of the President and Chief Executive Officer of Fonar, Dr. Raymond Damadian. Commencing with June 2008, however, the Company hired Health Diagnostics, LLC, the parent company of Integrity, to perform all billing and collection procedures on its behalf. The Company has agreed to pay 6% of all adjusted deposits for these services. Amounts charged to HMCA during the quarter ended September 30, 2008 under this agreement totaled $308,586.

Unaudited Financial Information of Unconsolidated Managed Medical Practices

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

Summarized statement of operations data for the three months ended September 30, 2008 and 2007 related to the unconsolidated medical practices managed by the Company is as follows:

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

For the three months ended September 30,

	2008	2007
Patient Revenue - Net	$4,181	$4,369
Income (Loss) from Operations	$ 16	$(327)

Net Loss	$(7)	$(472)

FONAR CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2008
(UNAUDITED)

NOTE 4 - INVENTORIES

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

(000's omitted)

	September 30, 2008	June 30, 2008
Purchased parts, components and supplies	$ 1,884	$ 1,847
Work-in-process	1,318	1,409
	$ 3,202	$ 3,256

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

1) Information relating to uncompleted contracts as of September 30, 2008 is as follows:

(000's omitted)

Costs incurred on uncompleted contracts	$ 3,677
Estimated earnings	1,483
	5,160
Less: Billings to date	11,278
	$(6,118)

Included in the accompanying condensed consolidated balance sheet at September 30, 2008 under the following captions:

Costs and estimated earnings in excess of billings on uncompleted contracts	$ -
Less: Billings in excess of costs and estimated earnings on uncompleted contracts	6,118
	$(6,118)

2) Customer advances consist of the following as of September 30, 2008:

	Total	Related Party	Other
Total Advances	$ 24,534	$ 1,472	$ 23,062
Less: Advances			

on contracts under construction	11,278	-	11,278
	$ 13,256	$ 1,472	$ 11,784

FONAR CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2008
(UNAUDITED)

NOTE 6 - OTHER CURRENT LIABILITIES

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

(000's omitted)

	September 30, 2008	June 30, 2008
Royalties	$ 623	$ 623
Accrued salaries, commissions and payroll taxes	1,114	901
Accrued interest	829	876
Litigation accruals	193	193
Sales tax payable	2,577	2,544
Legal and other professional fees	521	634
Accounting fees	262	503
Insurance premiums	389	410
Penalty - Sales tax	632	632
Penalty - 401k plan (see Note 11)	250	250
Other	648	750
	$ 8,038	$ 8,316

NOTE 7 - SALE OF CONSOLIDATED SUBSIDIARY AND INVESTMENT

Sale of Consolidated Subsidiary

On September 30, 2008, the Company sold its 92.3% interest (to a related party) in an entity that provided management services to a diagnostic center in Bensonhurst, NY. The Company continues to manage other diagnostic centers in the New York region.

The related third party purchased all assets and assumed all liabilities of the diagnostic center which included cash, the management fee receivable, furniture and fixtures and other miscellaneous assets. The purchase price for the 92.3% interest was $2,307,500 all of which was paid in cash at the time of closing.

The following is the calculation of the gain on sale of the 92.3% interest in a consolidated subsidiary:

(000's omitted)

Selling Price - Net cash paid:	$ 2,307
Assets and liabilities sold:	
Cash	$ 14
Management fee receivable - net	917
Property and equipment - net	1

Other assets	34
Accounts payable	(16)
Minority interest	(91)
Subtotal	859
Gain on sale of consolidated subsidiary	$ 1,448
	=======

FONAR CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2008
(UNAUDITED)

NOTE 7 - SALE OF CONSOLIDATED SUBSIDIARY AND SALE OF INVESTMENT (CONTINUED)

Sale of Consolidated Subsidiary (Continued)

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

The unrelated third party purchased all assets and assumed all liabilities of the diagnostic center which included cash, the management fee receivable, furniture and fixtures and other miscellaneous assets. The purchase price for the 50% interest was $4,500,000 and after closing costs the amount received was $4,257,000.

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

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

Sale of Investment

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

The gain was calculated as follows:

(000's omitted)	
Selling Price:	$ 629
Less: Closing costs	(58)
Selling Price - Net cash paid	571
Cost Basis	-

Gain on sale of investment	$571
	======

FONAR CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2008
(UNAUDITED)

NOTE 8 - SEGMENT AND RELATED INFORMATION

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

The accounting policies of the segments are the same as those described in the summary of significant accounting policies as disclosed in the Company's 10-K as of June 30, 2008. All inter-segment sales are market-based. The Company evaluates performance based on income or loss from operations.

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

(000's omitted)

	Medical Equipment	Management of Diagnostic Imaging Centers	Totals
For the three months ended September 30, 2008:			
Net revenues from external customers	$ 4,013	$ 2,771	$ 6,784
Inter-segment net revenues	$ 272	$ -	$ 272
(Loss) Income from operations	$ (1,860)	$ 12	$(1,848)
Depreciation and amortization	$ 267	$ 168	$ 435
Capital expenditures	$ 210	$ -	$ 210
Identifiable assets	$ 18,245	$ 15,154	$33,399
For the three months ended September 30, 2007:			
Net revenues from external customers	$ 5,308	$ 3,361	$ 8,669
Inter-segment net revenues	$ 235	$ -	$ 235
(Loss) Income from operations	$ (4,185)	$ 79	$(4,106)
Depreciation and amortization	$ 330	$ 228	$ 558
Capital expenditures	$ 275	$ 51	$ 326
Identifiable assets - June 30, 2008	$ 19,203	$ 16,022	$35,226

NOTE 9 - SUPPLEMENTAL CASH FLOW INFORMATION

During the three months ended September 30, 2008 and September 30, 2007, the Company paid $127,000 and $62,000 for interest, respectively.

FONAR CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2008
(UNAUDITED)

NOTE 10 - COMMITMENTS AND CONTINGENCIES

Litigation

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

Other Matters

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

The Company is also delinquent in filing sales tax returns for certain states, for which the Company has transacted business. As of September 30, 2008, the Company has recorded tax obligations of approximately $1,940,000 plus interest and penalties of approximately $1,320,000. The Company is in the process of determining the regulatory requirements in order to become compliant.

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

NOTE 10 - COMMITMENTS AND CONTINGENCIES (Continued)

NASDAQ Notice of Non-compliance

On July 8, 2008, the Company received a letter from The NASDAQ Stock Market LLC indicating the Company was not in compliance with Marketplace Rules 4350(e) and 4350(g) due to the fact that it had not yet solicited proxies and held its annual meeting for the fiscal year ended June 30, 2007. As a result, the notice indicated that the Company's securities would be subject to delisting from The NASDAQ Capital Market unless the Company requested a hearing before a NASDAQ Listing Qualifications Panel. On July 15, 2008, the Company requested a hearing with the NASDAQ Listing Qualifications Panel. The request was granted. The hearing was held on August 28, 2008. At the hearing the Company's ability to

comply with NASDAQ's stockholders' equity requirement was raised and discussed. Subsequent to the hearing and after the filing of the Form 10-K for fiscal 2008, which showed a stockholder's deficiency, NASDAQ requested additional information concerning the Company's plan to regain compliance with the stockholder's equity requirement. An additional submission was made in writing on November 3, 2008. Although no decision has yet been rendered, the Company has solicited proxies and is scheduled to hold a joint two-year annual meeting on November 17, 2008.

The Company's stockholder's deficiency was $4.2 million as of June 30, 2008 and $4.6 million as of September 30, 2008. The Company is in the process of seeking equity financing in an amount which would be at least sufficient to meet NASDAQ's stockholder's equity requirement. In the Company's submission responding to NASDAQ's request for additional information relating to the Company's plan to require compliance with NASDAQ's stockholders' equity requirement, the Company requested an exception through January 15, 2009 to evidence compliance with the minimum stockholders' equity requirement for continued listing on the NASDAQ Capital Market. No decision has yet been rendered.

NOTE 11 - NOTES RECEIVABLE

On August 8, 2008, the Company signed a modification agreement with regards to the Asset Purchase Agreement with Health Plus. Under the modification agreement Health Plus made a $2,000,000 principal payment on the promissory note in exchange for a discount on the original note of $1,000,000.

The original promissory note ("Note") was modified to $2,378,130 payable in 60 consecutive months in equal installments of principal and interest of $47,090. The Note is secured by a first lien on all of the assets of Health Plus, including its accounts receivable and is subject to prepayment provisions to the extent Health Plus resells all or part of the assets and business or utilizes the assets sold as collateral in any debt financing. The note provides for interest at 7% per annum. The Company recorded a change to earnings representing the net discount on this note of $658,351 on this transaction during the quarter ended June 30, 2008.

FONAR CORPORATION AND SUBSIDIARIES

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

For the three month period ended September 30, 2008, we reported a net loss of $450,000 on revenues of $6.8 million as compared to net loss of $209,000 on revenues of $8.7 million for the three month period ended September 30, 2007.

Our revenues declined 22% from the first quarter of fiscal 2008 compared to the first quarter of fiscal 2009. The Company believes the reason for the reduction in revenues is in large measure the result of current economic circumstances where credit is difficult to obtain and customers may be concerned about the impact on their business of a possible recession.

Notwithstanding a decrease in our revenues and an increase of our net loss, our operating loss for the three months ended September 30, 2008 improved as compared to the three months ended September 30, 2007 ($1.8 million for the first three months of fiscal 2009 as compared to $4.1 million for the first three months of fiscal 2008). The decrease in the operating loss was principally due to a decrease in selling, general and administrative expenses. In order to reduce our net losses and demands on our cash and other liquid reserves, we instituted an aggressive program of cost cutting at the end of fiscal 2008 and the beginning of fiscal 2009. Overall, there was a reduction of our selling,

general and administrative costs of 38.2%, from $5.3 million in the first three months of fiscal 2008 to $3.3 million in the first three months of fiscal 2009, resulting directly from our aggressive program of cutting costs.

In addition to the success of our cost cutting programs in improving our operating performance, we also realized a gain on a sale in September 2008 of our 92.3% interest in a consolidated entity. We received proceeds of approximately $2.3 million and recognized a gain of approximately $1.4 million, which also improved our liquidity. The entity was engaged in the business of managing a MRI facility. The principal reason our net loss for the first quarter of fiscal 2009 ($450,000) was more than the net loss for the first quarter of fiscal 2008 ($209,000), notwithstanding the improvement in our operations, was because of we recognized gains on the sale of an investment ($571,000) and the sale of a consolidated subsidiary ($3.4 million) in the first quarter of fiscal 2008, which exceeded the improvement in our operations ($2.3 million) and the gain on the sale of a consolidated subsidiary ($1.4 million) in the first quarter of fiscal 2009.

We anticipate improvements in our operating results in part from reduced apprehension on the part of FONAR UPRIGHT(R), Multi-Position(TM) MRI ("FONAR UPRIGHT(R) MRI") customers regarding the anticipated negative impact of the Deficit Reduction Act (DRA) on scanner income and the magnitude of the impact. We believe from experience by FONAR UPRIGHT(R) MRI customers and MRI facilities managed by our subsidiary, Health Management Corporation of America ("HMCA"), that the DRA's revenue impact has been largely offset by the growth in demand for FONAR UPRIGHT(R) MRI scans.

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

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

In order to reduce our net losses and demands on our cash and other liquid reserves, we instituted an aggressive program of cost cutting at the end of fiscal 2008 and beginning of fiscal 2009. These measures include consolidating HMCA's office space with Fonar's office space, reductions in the size of our workforce, compensation and benefits, as well as across the board reduction of expenses. These cost reductions are intended to enable us to withstand periods of low volumes of MRI scanner sales, such as we have experienced in fiscal 2007 and 2008, by keeping expenditures at levels which, if necessary, can be supported by service revenues and HMCA revenues.

Forward Looking Statements

Certain statements made in this Quarterly Report on Form 10-Q are "forward-looking statements" (within the meaning of the Private Securities Litigation Reform Act of 1995) regarding the plans and objectives of Management for future operations. Such statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. The forward-looking statements included herein are based on current expectations that involve numerous risks and uncertainties. Our plans and objectives are based, in part, on assumptions involving the expansion of business. Assumptions relating to the foregoing involve judgments with respect to, among other things,

future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Although we believe that our assumptions underlying the forward- looking statements are reasonable, any of the assumptions could prove inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this Report will prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statement included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives and plans will be achieved.

Results of Operations

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

Trends in the first quarter of fiscal 2009 include a decrease in product sales revenues, service and repair fees, and management fees, as well as a decrease in our total costs and expenses, in particular in our selling, general and administrative expenses. We will continue to focus on our marketing efforts, including advertising, and adding additional distributors and sales personnel, where appropriate, to improve sales performance in fiscal 2009. In addition, we will continue to monitor our cost cutting program and will continue to reduce costs as necessary.

For the three month period ended September 30, 2008, as compared to the three month period ended September 30, 2007, overall revenues from MRI product sales decreased 45.4% ($1.4 million compared to $2.6 million). Unrelated party scanner sales ($1.4 million compared to $2.6 million) decreased at a rate of 45.4%. There were no related party scanner sales for the three month periods ended September 30, 2008 and 2007.

Service revenues for the three month period ended September 30, 2008, as compared to the three month period ended September 30, 2007 decreased by 4.4% ($2.6 million compared to $2.7 million). Unrelated party service and repair fees decreased by 5.4% ($2.3 million compared to $2.5 million) and related party service and repair fees increased by 5.9% ($269,000 compared to $254,000). We anticipate that there will be increases in service revenues as warranties on installed scanners expire over time.

There were approximately $189,000 in foreign revenues for the first three months of fiscal 2009 as compared to approximately $198,000 in foreign revenues for the first three months of fiscal 2008, representing a decrease in foreign revenues of 4.5%. The Company is making a concerted effort to increase foreign sales, most recently through its foreign distributors.

Overall, for the first quarter of fiscal 2009, revenues for the medical equipment segment decreased by 24.4% to $4.0 million from $5.3 million for the first quarter of fiscal 2008. The revenues generated by HMCA decreased, by 17.6% to $2.8 million for the first quarter of fiscal 2009 as compared to $3.4 million for the first quarter of fiscal 2008.

We recognize MRI scanner sales revenues on the "percentage of completion" basis, which means the revenues are recognized as the scanner is manufactured. Revenues recognized in a particular quarter do not necessarily reflect new orders or progress payments made by customers in that quarter. We build the scanner as the customer meets certain benchmarks in its site preparation in order to minimize the time lag between incurring costs of manufacturing and our receipt of the cash progress payments from the customer which are due upon

delivery. Consequently, there can be a disparity between the revenues recognized in a fiscal period and the number of product sales. Generally, the recognized revenue results from revenues from a scanner sale are recognized in a fiscal quarter or quarters following the quarter in which the sale was made.

Costs related to product sales decreased by 48.7% from $2.8 million in the first quarter of fiscal 2008 to $1.4 million in the first quarter of 2009, reflecting the corresponding decrease in product sales revenues. Costs related to providing service decreased by 21.4% from $1.3 million in the first quarter of fiscal 2008 to $1.0 million and fiscal 2009.

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

Overall, our operating loss for our medical equipment segment was $1.9 million for the first three months of fiscal 2009 as compared to an operating loss of $4.2 million for the first three months of fiscal 2008 resulting from an a decrease in cost related to product sales, research and development and, most significantly, selling, general and administrative expenses.

HMCA revenues decreased in the first quarter of fiscal 2009, by 17.6% to $2.8 million from $3.4 million for the first quarter of fiscal 2008, primarily because of the sale of its 50% interest of a previously consolidated entity in July 2007. We now manage ten sites, nine of which are equipped with FONAR UPRIGHT(R) MRI scanners. HMCA experienced an operating income of $12,000 for the first three months of fiscal 2009 compared to operating income of $79,000 for the first three months of fiscal 2008.

HMCA cost of revenues decreased to $1.9 million for the first quarter of fiscal 2009 as compared to $2.0 million for the first quarter of fiscal 2008.

As of June 22, 2007, an unrelated third party purchased the stock of the professional corporations owning the eight New York sites managed by HMCA, previously owned by Dr. Raymond V. Damadian, the President, Chairman of the Board, Chief Executive Officer and principal stockholder of Fonar. In connection with the sale, new management agreements were substituted for the existing management agreements, providing, however, for the same management services. The fees in fiscal 2009 are currently flat monthly fees in the aggregate amount of $682,500 per month. Dr. Damadian still owns the four MRI facilities in Georgia and Florida managed by the Company. No MRI facilities or other medical facilities are owned by the Company.

For the purpose of improving the performance of HMCA and the facilities, HMCA entered into an agreement in September, 2007 with Integrity Healthcare Management, Inc. ("Integrity"), which is a wholly-owned subsidiary of Health Diagnostics, LLC. Under the terms of the agreement, Integrity supervised and directed HMCA and the management of the facilities including the performance of billing and collections services. The existing management agreements between the facilities and HMCA remained in place. Integrity was entitled to compensation of an annual fee equal to one-half of the increase in the consolidated cash flow of HMCA and the facilities over the period from July 1, 2006 through June 30, 2007. This agreement was terminated as of the end of June 2008.

Nevertheless, commencing upon the termination of this agreement, we hired Health Diagnostics, LLC, the parent company of Integrity, to perform all billing and collection procedures for HMCA's clients on HMCA's behalf. HMCA has agreed

to pay 6% of all adjusted deposits for these services.

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

We believe that the effect of the DRA on our scanning center management business has not been material because of our payor mix and that any negative effect has been countered by an increase in the scan volume of the centers we manage.

The decrease in our total net revenues of 21.7% from $8.7 million in the first quarter of fiscal 2008 to $6.8 million in the first quarter of fiscal 2009, was accompanied by a decrease of 32.4% in total costs and expenses from $12.8 million in the first quarter of fiscal 2008 compared to $8.6 million in the first quarter of fiscal 2009. As a result, our operating loss improved from ($4,106,000) in the first quarter of fiscal 2008 to ($1,848,000) in the first quarter of fiscal 2009 notwithstanding the greater net loss in the first fiscal quarter of 2009 ($450,000) compared to ($209,000) in the first quarter of fiscal 2008.

Selling, general and administrative expenses decreased by 38.2% to $3.3 million in the first three months of fiscal 2009 from $5.3 million in the first three months of fiscal 2008, largely as a result of our aggressive cost cutting measures. There was no compensatory element of stock issuances, which is now included in selling, general and administrative expenses, in the first three months of fiscal 2009 or 2008.

Research and development expenses decreased by 24.3% to $880,000 for the first three months of fiscal 2009 as compared to $1.2 million for the first three months of fiscal 2008.

Interest expense in the first three months of fiscal 2009 decreased by 22.5% to $79,000 from $102,000 for the first three months of fiscal 2008 because of the repayment of existing debt.

Inventories decreased by 1.7% to $3.2 million at September 30, 2008 as compared to $3.3 million at June 30, 2008 representing our use of raw materials and components in our inventory to fill orders.

Management fee and medical receivables decreased by 16.9% to $6.4 million at September 30, 2008 from $7.6 million at June 30, 2008, primarily due to collections on the Company's management fee receivables and the sale of a 92.3% interest of a consolidated entity, which included the receivables of such entity.

The overall trends reflected in the results of operations for the first three months of fiscal 2009 are an decrease in revenues from product sales, as compared to the first three months of fiscal 2008 ($1.4 million for the first

three months of fiscal 2009 as compared to $2.6 million for the first three months of fiscal 2008), and a decrease in MRI equipment segment revenues relative to HMCA revenues ($4.0 million or 59.2% from the MRI equipment segment as compared to $2.8 million or 40.8% from HMCA, for the first three months of fiscal 2009, as compared to $5.3 million or 61% from the MRI equipment segment and $3.4 million or 39%, from HMCA, for the first three months of fiscal 2008). In addition, we experienced a decrease in unrelated party sales relative to related party sales in our medical equipment product sales ($1.4 million or 100% to unrelated parties for the first three months of fiscal 2009 as compared to $2.6 million, or 100% to unrelated parties).

We are committed to continuing the improvement in our operating results we experienced in the first three months in fiscal 2009. Nevertheless, factors beyond our control, such as the timing and rate of market growth which depend on economic conditions, including the availability of credit, payor reimbursement rates and policies, and unexpected expenditures or the timing of such expenditures, make it impossible to forecast future operating results. We believe we are pursuing the correct policies which should prove successful in improving the Company's operating results.

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

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

Recently, this capability of the FONAR UPRIGHT(R) technology has demonstrated its key value on patients with the Arnold-Chiari syndrome, which is believed to affect 200,000 to 500,000 Americans. In this syndrome, brain stem compression and subsequent severe neurological symptoms occur in these patients, when because of weakness in the support tissues within the skull, the brain stem descends and is compressed at the base of the skull in the foramen magnum, which is the circular bony opening at the base of the skull where the spinal cord exits the skull. Conventional lie-down MRI scanners cannot make an adequate evaluation of the pathology since the patient's pathology is most visible and the symptoms most acute when the patient is scanned in the upright weight-bearing position.

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

In addition, the University of California, Los Angeles (UCLA) reported

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

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

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

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

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

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

In the future, we expect the Fonar 360(TM) to function as an interventional MRI. The enlarged room sized magnet and 360 access to the patient afforded by

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

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

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

Liquidity and Capital Resources

Cash, cash equivalents and marketable securities increased from $2.4 million at June 30, 2008 to $4.4 million at September 30, 2008. Marketable securities approximated $24,000 as of September 30, 2008, as compared to $1.1 million at June 30, 2008.

Cash used in operating activities for the first three months of fiscal 2009 was $2.0 million. Cash used in operating activities was attributable to a decrease in customer advances of $1.0 million, a decrease in other current liabilities of $728,000 and the net loss of $450,000, offset by a decrease in accounts, management fee and medical receivables of $198,000.

Cash provided by investing activities for the first three months of fiscal 2009 was $5.2 million. The principal source of cash from investing activities during the first three months of fiscal 2009 consisted of proceeds from the sale of consolidated subsidiary of $2.3 million, proceeds of $2.0 million from the prepayment of a portion of a note receivable and sale of marketable securities of $1.1 million, offset by capitalized software and patent costs of $209,000.

Cash used in financing activities for the first three months of fiscal 2009 was $126,000. The principal uses of cash in financing activities during the first three months of fiscal 2009 consisted of repayment of principal on long-term debt and capital lease obligations of $104,000 and distributions to holders of minority interests of $23,000.

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

(000's OMITTED)

Contractual Obligation	Total	Due in less Than 1 year	Due in 2-3 years	Due in 4-5 years	Due after 5 years
Long-term debt	$ 633	$ 104	$ -	$ -	$ 529
Capital lease Obligations	392	108	247	37	-
Operating leases	5,485	1,619	1,751	1,581	534
Total cash Obligations	$ 6,510	$ 1,831	$ 1,998	$ 1,618	$ 1,063

Total liabilities decreased by 3.4% to $38.0 million at September 30, 2008 from $39.3 million at June 30, 2008. We experienced a increase in long-term debt and capital leases from $757,000 at June 30, 2008 to $813,000 at September 30, 2008 and an increase in accounts payable from $4.0 million at June 30, 2008 to $4.2 million at September 30, 2008, along with an increase in billings in excess of costs and estimated earnings on uncompleted contracts from $5.8 million at June 30, 2008 to $6.1 million at September 30, 2008, and a decrease in customer advances from $14.3 million at June 30, 2008 to $13.3 million at September 30, 2008. Unearned revenue on service contracts decreased from $5.2 million at June 30, 2008 to $4.7 million at September 30, 2008.

As of September 30, 2008, the total of $8.0 million in other current liabilities included primarily accrued salaries and payroll taxes of $1.1 million, accrued interest of $829,000, accrued royalties of $623,000 and excise and sales taxes of $2.6 million.

Our working capital deficit remained constant at $16.0 million as of September 30, 2008 and June 30, 2008. This resulted from an increase in current liabilities ($38.0 million at June 30, 2008 as compared to $36.6 million at September 30, 2008, particularly a decrease in customer advances of $1.0 million ($14.3 million at June 30, 2008 as compared to $13.3 million at September 30, 2008), and a decrease of unearned revenue on service contracts of $500,000 ($5.2 million at June 30, 2008 as compared to $4.7 million at September 30, 2008), notwithstanding a decrease in current assets ($22.0 million at June 30, 2008 compared to $20.6 million at September 30, 2008) resulting primarily from a decrease in management fee receivable of $1.2 million ($6.4 million at June 30, 2008 compared to $5.2 million at September 30, 2008) along with an increase in cash and cash equivalents and marketable securities of $2.0 million ($2.4 million at June 30, 2008 as compared to $4.4 million at September 30, 2008) and a decrease in inventories of approximately $100,000 ($3.3 million at June 30, 2008 as compared to $3.2 million at September 30, 2008).

With respect to current liabilities, the current portion of long-term debt decreased from $373,000 at June 30, 2008 to $212,000 at September 30, 2008, and billings in excess of costs and estimated earnings on uncompleted contracts increased from $5.8 million at June 30, 2008 to $6.1 million at September 30, 2008. Customer advances decreased from $14.3 million at June 30, 2008 to $13.3 million at September 30, 2008 and accounts payable increased from $4.0 million at June 30, 2008 to $4.2 million at September 30, 2008.

Inventories decreased by approximately $100,000 ($3.3 million at June 30, 2008 as compared to $3.2 million at September 30, 2008) resulting from the use of raw materials and components in our inventory to fill our backlog of orders.

Fonar has not committed to making additional capital expenditures in the 2009 fiscal year other than to continue research and development expenditures at current levels.

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

Our principal source of liquidity has been derived from revenues, as well as by the sale of marketable securities and cash provided by previous debt and equity financing. We currently expect this to continue. Also, in September 2008, the Company sold its 92.3% interest in a consolidated subsidiary and to a related third party and received proceeds of approximately $2.3 million. At September 30, 2008, we had a working capital deficit of $16.0 million. For the three months ended September 30, 2008, we incurred a net loss of $450,000 which included non-cash charges of $589,000.

On July 8, 2008, the Company received a letter from The NASDAQ Stock Market LLC indicating the Company was not in compliance with Marketplace Rules 4350(e) and 4350(g) due to the fact that it had not yet solicited proxies and held its annual meeting for the fiscal year ended June 30, 2007. As a result, the notice indicated that the Company's securities would be subject to delisting from The NASDAQ Capital Market unless the Company requested a hearing before a NASDAQ Listing Qualifications Panel. On July 15, 2008, the Company requested a hearing with the NASDAQ Listing Qualifications Panel. The request was granted. The hearing was held on August 28, 2008. At the hearing the Company's ability to comply with NASDAQ's stockholders' equity requirement was raised and discussed. Subsequent to the hearing and after the filing of the Form 10-K for fiscal 2008, which showed a stockholder's deficiency, NASDAQ requested additional information concerning the Company's plan to regain compliance with the stockholder's equity requirement. An additional submission was made in writing on November 3, 2008. Although no decision has yet been rendered, the Company has solicited proxies and is scheduled to hold a joint two-year annual meeting on November 17, 2008.

The Company's stockholder's deficiency was $4.2 million as of June 30, 2008 and $4.6 million as of September 30, 2008. The Company is in the process of seeking equity financing in an amount which would be at least sufficient to meet NASDAQ's stockholder's equity requirement. In the Company's submission responding to NASDAQ's request for additional information relating to the Company's plan to require compliance with NASDAQ's stockholders' equity requirement, the Company requested an exception through January 15, 2009 to evidence compliance with the minimum stockholders' equity requirement for continued listing on the NASDAQ Capital Market. No decision has yet been rendered.

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

Although sales levels remained weak in fiscal 2008, we are continuing to focus our efforts on increased advertising and marketing campaigns, and distribution programs to strengthen the demand for our products and services. Management anticipates that Fonar's capital resources will improve if Fonar's MRI scanner products gain wider market recognition and acceptance resulting in increased product sales. If we are not successful with our marketing efforts to increase sales and weak demand continues, we will experience a shortfall in

cash, and it will be necessary to further reduce operating expenses or obtain funds through equity or debt financing in sufficient amounts to avoid the need to curtail our operations subsequent to September 30, 2009. Current economic credit conditions have contributed to a slowing business environment. Given such liquidity and credit constraints in the markets, the business may suffer, should the credit markets not improve in the near future. The direct impact of these conditions is not fully known. However, there can be no assurance that we would be able to secure additional funds if needed and that if such funds were available, whether the terms or conditions would be acceptable to us. In such case, the reduction in operating expenses might need to be substantial in order for us to generate positive cash flow to sustain our operations.

If we are unable to meet expenditures with revenues or financing then it will be necessary to reduce expenses further, or seek other sources of funds through the issuance of debt or equity financing in order to conduct operations as now conducted subsequent to September 30, 2009.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company maintains its funds in liquid accounts. None of our investments are in fixed rate instruments.

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

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures.

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

(b) Change in internal controls.

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

PART II - OTHER INFORMATION

Item 1 - Legal Proceedings:There were no material changes in litigation for the first three months of fiscal 2009.

Item 1A - Risk Factors: There were no material changes in risk factors in the first three months of fiscal 2009 from those disclosed in our most recent Form 10-K.

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

Item 3 - Defaults Upon Senior Securities: None

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

Item 5 - Other Information: None

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

Exhibit 32.1 Certification See Exhibits

SIGNATURES

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

FONAR CORPORATION
(Registrant)

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

Dated: November 13, 2008