FONAR CORP
Form 10-K
October 02, 2007

SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934[Fee Required]
For the fiscal year ended June 30, 2007

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934 [No Fee Required]
For the transition period from _____ to _____

Commission File No. 0-10248

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

DELAWARE	11-2464137
(State of incorporation)	(IRS Employer Identification Number)
110 Marcus Drive, Melville,	11747
(Address of principal executive offices)	(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:
Common Stock, par value $.0001 per share (Title of Class)

Securities registered pursuant to Section 12(g) of the Act:
None

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

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

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

Indicate by check mark if disclosure of delinquent filers, pursuant to Item 405 of Regulation S-K, ss.229.405 of this Chapter, is not contained, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or

information statements incorporated by reference in Part III of this 10-K or any amendment to the Form 10-K. [X]

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

The aggregate market value of the shares of Common Stock held by non-affiliates as of December 29, 2006 based on the closing price of $7.00 per share on such date as reported on the NASDAQ System, was approximately $33.3 million. The other outstanding classes do not have a readily determinable market value. The number of shares and price per share have been retroactively adjusted to reflect the reverse stock split which was effective on April 16, 2007.

As of September 14, 2007, 4,894,207 shares of Common Stock, 158 shares of Class B Common Stock, 382,513 shares of Class C Common Stock and 313,451 shares of Class A Non-voting Preferred Stock of the registrant were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE
None

PART I
ITEM 1. BUSINESS
GENERAL

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

We conduct our business in two segments. The first, conducted directly through Fonar, is referred to as our medical equipment segment. The second, conducted through our wholly owned subsidiary Health Management Corporation of America, is referred to as the physician management and diagnostic services segment.

MEDICAL EQUIPMENT SEGMENT

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

Fonar's iron frame technology made Fonar the originator of "open" MRI scanners. We introduced the first "open" MRI in 1980. Since that time we have concentrated on further application of our "open" MRI, introducing most recently the Upright(TM) Multi-positional(TM) MRI scanner (also referred to as the "Upright(TM)" or "Stand-Up(TM)" MRI scanner) and the Fonar 360(TM) MRI scanner.

The product we are now most vigorously promoting is our Upright(TM) MRI. The Upright(TM) MRI is unique in the industry in that it allows patients to be

scanned in a fully weight-bearing condition, such as standing, sitting or bending in any position that causes symptoms. This means that an abnormality or injury, such as a slipped disk can be visualized where it may not be visualized with the patient lying down. We are introducing the name "Upright(TM)" as an alternative to "Stand-UP(TM)" because of the multiplicity of positions in which the patient may be scanned where the patient is not standing.

PHYSICIAN MANAGEMENT AND DIAGNOSTIC SERVICES SEGMENT

Health Management Corporation of America, which we sometimes refer to as "HMCA", was formed by Fonar in March 1997 as a wholly-owned subsidiary in order to enable us to expand into the business of providing comprehensive management services to medical providers. HMCA provides management services, administrative services, office space, equipment, repair, maintenance service and clerical and other non-medical personnel to medical providers. Since July 28, 2005, following the sale of HMCA's physical therapy and rehabilitation business, HMCA has elected to provide its services solely to diagnostic imaging centers.

See Note 21 to the Consolidated Financial Statements for separate financial information respecting our medical equipment and physician and diagnostic management services segments.

FORWARD LOOKING STATEMENTS.

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

RECENT DEVELOPMENTS AND OVERVIEW.

Our products and works-in-progress are intended to significantly improve our competitive position. Our current products are the Upright(TM) MRI and the Fonar 360(TM).

The Upright(TM) MRI permits, for the first time, MRI diagnoses to be made in the weight-bearing state. The Upright(TM) MRI is the only MRI scanner which allows patients to be scanned while standing, sitting or reclining, either horizontally or at an angle. This means that an abnormality or injury, such as a slipped disk, will be able to be scanned under full weight-bearing conditions and, more often than not, in the position in which the patient experiences pain. A patient handling system built into the floor brings the patients to the desired height in the scanner. An adjustable bed allows the patients to stand, sit or lie on their backs, sides or stomachs at any angle. The Upright(TM) MRI may also be useful for MRI guided interventional procedures.

More recently a new application of the Fonar Upright(TM) technology is in the evaluation and diagnosis of patients with the Arnold-Chiari syndrome believed to affect from 200,000 to 500,000 Americans. In this syndrome brain stem compression and entrapment of the brain 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. Classic symptoms of the Chiari syndrome include the "drop attack", where the erect patient unexpectedly experiences an explosive rush or nervous discharge at the base of the brain which rushes down the body to the extremities, causing the patient to collapse in a transient neuromuscular paralysis which then subsides when the patient is in a horizontal position.

The Fonar Upright(TM) MRI has recently demonstrated its key value on two patients with Chiari syndrome establishing that the conventional lie-down MRI scanners cannot make an adequate evaluation of their pathology since the patient's pathology is most visible and symptoms are most acute when the patient is upright. It is critical to have an image of the patient in an upright position so that the neurosurgeons can fully evaluate the extent of the brain stem compression which is occurring so they can choose the most appropriate surgical approach for the operative repair.

Another milestone in the sale and utilization of Fonar's Upright(TM) technology is the sale in September, 2006 of an Upright(TM) MRI scanner to the largest orthopedic hospital in the Netherlands, the St. Maartenskliniek. St. Maartenskliniek has over 300 in-patient beds and an extensive outpatient clinic program that diagnosis and treats 25,000 patients with orthopedic problems annually. In placing their order, St. Maartenskliniek announced from the point of view of their internationally recognized "Spine Center" that "once Fonar made available upright weight-bearing MRI imaging technology, owning one for the St. Maartenskliniek "Spine Center" was not optional but mandatory. For our hospital to continue to engage in spine surgery without it, once this new technology became available, was unacceptable. Once the means were available to make certain we were getting the complete picture of the patient's spine pathology before undertaking surgery, so that we could be certain we were not performing surgery based on a wrong diagnosis and running the risk of doing the wrong surgery, we did not regard the utilization of this new technology, from our patient's perspective as optional. It was mandatory."

We are vigorously promoting sales of the Upright(TM) MRI which we regard as our most promising product. The market for the Upright(TM) shows strong progress. Revenues recognized from the sale of Upright(TM) MRI scanners increased in fiscal 2007 by 5.6% over fiscal 2006 from approximately $10.5 million in fiscal 2006 to approximately $11.0 million in fiscal 2007 although revenues from the sale of Upright(TM) MRI scanners had decreased in 2006 by 85.4% from approximately $71.7 million in fiscal 2005. The following chart shows the revenues attributable to our different model scanners for the fiscal years ended June 30, 2005, June 30, 2006 and June 30, 2007. Note that we recognize revenue on a percentage of completion basis. Accordingly, revenue is recognized as each sub-assembly of a scanner is manufactured. Consequently the revenues for a fiscal period do not necessarily relate to orders placed in that period.

Model	Revenues Recognized		
	Fiscal 2005	Fiscal 2006	Fiscal 2007
Upright(TM)	$71,666,053	$10,452,069	$11,041,251
Fonar 360(TM)	$ 764,031	$ 383,589	$ 62,379
Other	$ 0	$ 0	$ 0

The Fonar 360(TM) includes the Open Sky(TM) MRI. We received our first order for a Fonar 360(TM) scanner in the first quarter of fiscal 2005. The magnet frame is incorporated into the floor, ceiling and sidewalls of the scan room and is open. Consequently, physicians and family members can walk inside the magnet to

approach the patient. The Open Sky(TM) version of the Fonar 360(TM) is decoratively designed so that it is incorporated into the panoramic landscape that decorates the walls of the scan room. The ability of the Fonar 360(TM) to give physicians direct 360 degree access to patients and the availability of MRI compatible interventional instruments such as needles, catheters, probes, scalpels and forceps, will also enable the Fonar 360(TM) to be used for image guided interventions. Our earlier primary product, the QUAD(TM) MR scanner, utilized a electromagnet and was accessible from four sides. The QUAD(TM) was the first "open" MRI scanner at high field.

Fonar's showcase installation of the first Fonar 360(TM) MRI scanner was completed at the Oxford Nuffield Orthopedic Center in Oxford, United Kingdom. Oxford-Nuffield had two objectives in the choice of the Fonar 360(TM) MRI. The first was to have an open mid-field MRI imaging scanner to meet their medical imaging needs. The second was to have an open scanner that would enable direct image guided surgical intervention. The Oxford-Nuffield scanner is carrying a full diagnostic imaging load daily.

Additionally, 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 software is now installed and being tested by Oxford-Nuffield's surgical teams. Proceeding to the next step of injecting test substances and therapeutic agents into target tissues is expected to commence in the near future.

Health Management Corporation of America ("HMCA"), a wholly-owned subsidiary of Fonar, currently is managing 12 diagnostic imaging centers located principally in New York and Florida. During the beginning of fiscal 2006 HMCA also managed six physical therapy and rehabilitation practices located in New York. HMCA sold the portion of its business engaged in the management of physical therapy and rehabilitation practices in July of 2005. MEDICAL EQUIPMENT SEGMENT

PRODUCTS

Fonar's principal products are the Upright(TM) MRI and the Fonar 360(TM).

The Upright(TM) MRI is a whole-body open MRI system that enables positional MRI (pMRI(TM)) applications, such as weight-bearing MRI studies. Operating at a magnetic field strength of 0.6 Tesla, the scanner is a powerful, diagnostically versatile and cost-effective open MRI that provides a broad range of clinical capabilities and a complete set of imaging protocols. Patients can be scanned standing, bending, sitting, upright at an intermediate angle or in any of the conventional recumbent positions. This multi-positional MRI system accommodates an unrestricted range of motion for flexion, extension, lateral bending, and rotation studies of the cervical (upper)and lumbar (lower) spine. Previously difficult patient scanning positions can be achieved using the system's MRI-compatible, three-dimensional, motorized patient handling system. Patients, lying horizontally, are placed into the magnet in the conventional manner. The system's lift and tilt functions then deliver the targeted anatomical region to the center of the magnet. The ceiling and floor are recessed to accommodate the full vertical travel of the table. True image orientation is assured, regardless of the rotation angle, via computer read-back of the table's position. Spines and extremities can be scanned in weight-bearing states; brains can be scanned with patients either standing or sitting.

Recently, this capability of the Fonar Upright(TM) 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(TM) MRI is exceptionally open, making it the most non-claustrophobic whole-body MRI scanner. Patients can walk into the magnet, stand or sit for their scans and then walk out. From the patient's point of view, the magnet's front-open and top-open design provides an unprecedented degree of comfort because the scanner allows the patient an unobstructed view of the scanner room from inside the magnet, and there is nothing in front of one's face or over one's head. The only thing in front of the patient's face during the scan is a very large (42") panoramic TV (included with the scanner) mounted on the wall. The bed is tilted back five degrees to stabilize a standing patient. Special coil fixtures, a patient seat, Velcro straps, and transpolar stabilizing bars are available to keep the patient comfortable and motionless throughout the scanning process.

Full-range-of-motion studies of the joints in virtually any direction will be possible, an especially promising feature for sports injuries. Full range of motion cines, or movies, of the lumbar spine will be achieved under full body weight.

The Upright(TM) MRI will also be useful for MRI guided interventional procedures as the physician would have unhindered access to the patient with no restrictions in the vertical direction.

This easy-entry, mid-field-strength scanner should be 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 our 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 360 degree access to the patient, and physicians and family members are able to enter the scanner and approach the patient.

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) capacity, the Fonar 360(TM) serves as an open patient-friendly scanner which allows 360 degree 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 Fonar's earlier QUAD(TM) MRI scanner, is 0.6 Tesla.

We also expect to enable the Fonar 360(TM) to function as an MRI guided interventional scanner, for the purpose of performing intra-operative, interventional and therapeutic procedures with MR compatible instrumentation. In this capacity, the enlarged room sized magnet and 360 degree access to the patient afforded by the Fonar 360(TM) would permit full-fledged support teams to walk into the magnet and perform MRI guided interventions on the patient inside the magnet. Most importantly, the exceptional quality of the MRI image and its exceptional capacity to exhibit tissue detail on the image, by virtue of the

nuclear resonance signal's extraordinary capacity to create image contrast, can then be obtained real time to guide the physician during the MRI guided intervention. Thus MRI compatible instruments, needles, catheters, endoscopes and the like can be introduced directly into the human body and guided to the malignant lesion or other pathology by means of the MRI image. Surgically inoperable lesions could be accessed through MRI guided catheters and needles making it possible to deliver the treatment agent directly to the targeted 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 software is now being tested by Oxford-Nuffield's surgical teams. Proceeding to the next step of injecting test substances and therapeutic agents into the target tissues is expected to commence in the near future.

With current treatment methods, therapy must always be restricted in the doses that can be applied to the malignant tissue because of the adverse effects on the healthy tissues. Thus chemotherapies must be limited at the first sign of toxic side effects. The same is the case with radiation therapy. Fonar expects that with the Fonar 360(TM) treatment agents may be administrated directly to the malignant tissue through small catheters or needles, thereby allowing much larger doses of chemotherapy, x-rays, laser ablation, microwave and other anti-neoplastic agents to be applied directly and exclusively to the malignant tissue with more effective results. Since the interventional procedure of introducing a treatment needle or catheter under image guidance will be minimally invasive, the procedure can be readily repeated should metastases occur elsewhere, with minimum impact on the patient beyond a straightforward needle injection. The presence of the MRI image during treatment will would enable the operator to make assessments during treatment whether the treatment is being effective.

In addition to the patient comfort and new applications, such as MRI directed interventions, made possible by our scanners' open design, the Upright(TM) and Fonar 360(TM) scanners are designed to maximize image quality through an optimal combination of signal-to-noise (S/N) and contrast-to-noise (C/N) ratios. The technical improvements realized in these scanners' design over their predecessors also include increased image-processing speed and diagnostic flexibility.

MRI directed interventions are made possible by the scanners' ability to supply images to a monitor positioned next to the patient, enabling the operator to view in process an interventional procedure from an unlimited number of angles. The openness of Fonar's scanners would enable a physician to perform a wide range of interventional procedures inside the magnet.

In the case of breast imaging the access by a physician permits an image guided biopsy to be performed easily which is essential once suspicious lesions are spotted by any diagnostic modality. In addition to being far superior to x-ray in detecting breast lesions because of the MRI's ability to create the soft tissue contrast needed to see them, where x-ray is deficient in its ability to generate the needed contrast between cancer and normal tissue, there is not the painful compression of the breast characteristic of X-ray mammography.

The Upright(TM) MRI and Fonar 360(TM) scanners share much of the same fundamental technology and offer the same speed, precision and image quality.

Fonar's scanners initiated the new market segment of high-field open MRI in which the Fonar Upright(TM) MRI is one of the market leaders. High-field open MRIs operate at significantly higher magnetic field strengths and, therefore, produce more of the MRI image-producing signal needed to make high-quality MRI images (measured by signal-to-noise ratios, S/N).

Like Fonar's previous principal product, the QUAD(TM) scanner, the Upright(TM) MRI and Fonar 360(TM) scanners utilize a 6000 gauss (0.6 Tesla field strength) iron core electromagnet. The QUAD(TM) was the first open MRI scanner at high field. The greater field strength of the 6000 gauss magnet, as compared to lower field open MRI scanners that operate at 3,000 gauss (0.3 Tesla) when enhanced by the electronics already utilized by Fonar's scanners, produces images of higher quality and clarity. Fonar's 0.6 Tesla open scanner magnets are among the highest field "open MRI" magnets in the industry.

The Upright(TM) MRI and Fonar 360(TM) scanners are designed to maximize image quality through an optimal combination of signal-to-noise (S/N) and contrast-to-noise (C/N) ratios. The technical improvements realized in the scanners' design over their lower field predecessors also include increased image-processing speed and diagnostic flexibility.

Several technological advances have been engineered into the Upright(TM) MRI and Fonar 360(TM) scanners for extra improvements in S/N, including: new high-S/N Organ Specific(TM) receiver coils; new advanced front-end electronics featuring high-speed, wide-dynamic-range analog-to-digital conversion and a miniaturized ultra-low-noise pre-amplifier; high-speed automatic tuning, bandwidth-optimized pulse sequences, multi-bandwidth sequences, and off-center FOV imaging capability.

In addition to the signal-to-noise ratio, however, the factor that must be considered when it comes to image quality is contrast, the quality that enables reading physicians to clearly distinguish adjacent, and sometimes minute, anatomical structures from their surroundings. This quality is measured by contrast-to-noise ratios (C/N). Unlike S/N, which increases with increasing field strength, relaxometry studies have shown that C/N peaks in the mid-field range and actually falls off precipitously at higher field strengths. The Upright(TM) MRI and Fonar 360(TM) scanners operate squarely in the optimum C/N range.

The Upright(TM) MRI and Fonar 360(TM) provide various features allowing for versatile diagnostic capability. For example, SMART(TM) scanning allows for same-scan customization of up to 63 slices, each slice with its own thickness, resolution, angle and position. This is an important feature for scanning parts of the body that include small-structure sub-regions requiring finer slice parameters. There is also Multi-Angle Oblique(TM) (MAO) imaging, and oblique imaging.

The console for these scanners includes a mouse-driven, multi-window interface for easy operation and a 19-inch, 1280 x 1024-pixel, 20-up, high-resolution image monitor with features such as electronic magnifying glass and real-time, continuous zoom and pan.

Prior to the introduction of the Upright(TM) MRI, Fonar 360(TM) and QUAD(TM) scanners, the Ultimate(TM) 7000 scanner, introduced in 1990, was the Company's principal product. The Ultimate(TM) scanner replaced the Company's traditional principal products, the Beta(TM) 3000 scanner (which utilized a permanent magnet) and the Beta(TM) 3000M scanner (which utilized an iron core electromagnet). All of the Company's current and earlier model scanners create cross-sectional images of the human body.

During fiscal 2007, sales of our Upright(TM) MRI scanners accounted for approximately 33.2% of our total revenues and 51.9% of our medical equipment

revenues, as compared to 31.6% of total revenues and 53.0% of medical equipment revenues in fiscal 2006 and 68.3% of total revenues and 88.2% of medical equipment revenues in fiscal 2005. These sales show the market penetration being achieved by the Upright(TM) MRI scanner.

During fiscal 2007, sales of our Fonar 360(TM) scanner accounted for 0.2% of total revenues and 0.3% of medical equipment revenues. During fiscal 2006 sales of our Fonar 360(TM) scanner accounted for 1.2% of total revenues and 1.9% of medical equipment revenues and during fiscal 2005 sales of our Fonar 360(TM) scanner accounted for 0.7% of total revenues and 0.9% of medical equipment revenues.

Our principal selling, marketing and advertising efforts have been focused on the Upright(TM) MRI, which we believe is a particularly unique product, being the only MRI scanner which is both open and allows for weight bearing imaging. Since we perceive that the Upright(TM) MRI is successfully penetrating the market and enabled us to achieve profitability in fiscal 2005, we expect to continue our focus on the Upright(TM) MRI in the immediate future, notwithstanding the losses incurred in fiscal 2006 and fiscal 2007. We are optimistic that the Fonar 360(TM) and our other products and works in progress will also contribute materially to increased product sales.

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

WORKS-IN-PROGRESS

All of our products and works-in-progress seek to bring to the public MRI products that are expected to provide important advances against serious disease.

MRI takes advantage of the nuclear resonance signal elicited from the body's tissues and the exceptional sensitivity of this signal for detecting disease. Much of the serious disease of the body occurs in the soft tissue of vital organs. The principal diagnostic modality currently in use for detecting disease, as in the case of x-ray mammography, are diagnostic x-rays. X-rays discriminate soft tissues, such as healthy breast tissue and cancerous tissue poorly, because the x-ray particle traverses the various soft tissues almost equally thereby causing target films to be nearly equally exposed by x-rays passing through adjacent soft tissues and creating healthy and cancerous shadows on the film that differ little in brightness. The image contrast between cancerous and healthy breast tissue is poor, making the detection of breast cancers by the x-ray mammogram less than optimal and forcing the mammogram to rely on the presence or absence of microscopic stones called "microcalcifications" instead of being able to "see" the breast cancer itself. If microcalcifications are not present to provide the missing contrast, then the breast cancer goes undetected. They frequently are not present. The maximum contrast available by x-ray with which to discriminate disease is 4%. Brain cancers differ from surrounding healthy brain by only 1.6% while the contrast in the brain by MRI is 25 times greater at 40%. X-ray contrasts among the body's soft tissues are maximally 4%. Their contrast by MRI is 32.5 times greater (130%).

On the other hand the soft tissue contrasts with which to distinguish cancers on images by MRI are up to 180%. In the case of cancer these contrasts can be even more marked making cancers readily visible and detectable anywhere in the body. This is because the nuclear resonance signals from the body's tissues differ so dramatically. Liver cancer and healthy liver signals differ by 180% for example. Thus there is some urgency to bring to market an MRI based breast scanner that can overcome the x-ray limitation and assure that mammograms do not miss serious

lesions. The added benefit of MRI mammography relative to x-ray mammography is the elimination of the need for the patient to disrobe and the painful compression of the breast typical of the x-ray mammogram. The patient is scanned in her street clothes in MRI mammography. Moreover MRI mammogram scans the entire chest wall including the axilla for the presence of nodes which the x-ray mammogram cannot reach.

We view our Upright(TM) MRI as having the potential for being an ideal breast examination machine as it permits the patient to be seated for the examination, which would allow easy access for an MRI guided breast biopsy when needed. The Fonar 360(TM) MRI scanner would also be ideal for breast examinations.

PRODUCT MARKETING

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

Fonar's internal sales force is approximately 19 persons. Our internal sales force handles the domestic market, although we also have two non-exclusive domestic independent sales representatives. We continue to use independent manufacturer's representatives and distributors for foreign markets. In addition to its internal domestic sales force, Fonar and General Electric Medical Systems, a division of General Electric Company, have entered into an arrangement pursuant to which General Electric Medical Systems is an independent manufacturer's representative for Fonar's Upright(TM) MRI scanner in the domestic market as well. Neither General Electric nor any of Fonar's other competitors, however, are entitled to make the Upright(TM) MRI scanner. Following the fiscal year end, in August 2007, Fonar engaged the services of a second independent sales representative to focus on spine surgeons or groups of spine surgeons pre-approved by Fonar who have a pre-existing relationship with the sales representative.

In addition, Fonar's website includes an interactive product information desk for reaching customers. We plan to commence a program for providing demonstrations of our products to potential customers on an international basis.

Fonar has exhibited its new products at the annual meeting of the Radiological Society of North America ("RSNA") in Chicago since November 1995 and plans to attend the RSNA meeting in November 2007 and future years. The RSNA meeting is attended by radiologists from all over the world. Most manufacturers of MRI scanners regularly exhibit at this meeting.

Fonar has targeted orthopedic surgeons and neurosurgeons, particularly spine surgeons, as important markets for the Upright(TM) MRI. Accordingly, Fonar has for several years now exhibited at the annual meetings of The American Academy of Orthopaedic Surgeons (AAOS); the North American Spine Society (NASS); the American Association of Neurological Surgeons (AANS); and the Congress of Neurological Surgeons (CNS). In addition, in 2007, Fonar attended the Global Health Care Expansion Congress and the Abu Dahabi International Surgical Conference abroad.

Fonar's success in targeting surgeons was most evident in the sale, in September 2006, of an Upright(TM) MRI scanner to the largest orthopedic hospital in the Netherlands, the St. Maartenskliniek in Nijmegen. In addition to being a key sale to a prestigious hospital, the medical conclusions reached and stated by the buyer and the buyer's intention to conduct research and publish articles concerning the Upright(TM) technology, are a vital component to Fonar's objective to prove to the medical community at large, insurers, governmental agencies and others the benefits, if not necessity of Upright(TM) scanning. A Director of St. Maartenskliniek and the Chairman of Spine Surgery stated that "We at St. Maartenskliniek, the biggest orthopedic hospital in the Netherlands, are very much looking forward to this new technology from Fonar which will

enable us to evaluate the spine anatomy in the fully weight bearing state and in multiple positions. We expect these new multi-position capabilities to lead to more accurate diagnosis and better surgery outcomes for patients. Once our active research program has discovered the benefits of this new Fonar technology for patients, we intend to publish the results in a lot of peer reviewed scientific journals." The Chairman stated further "that once Fonar made available upright weight-bearing MRI imaging technology, owning one for the St. Maartenskliniek "Spine Center" was not optional but mandatory. For our hospital to continue to engage in spine surgery without it, once this new technology became available, was unacceptable".

We have launched an exciting new advertising campaign, directed at physicians. It has already led to many inquires about purchase and to some sales of the Upright(TM) MRI scanner. In order to increase Fonar's presence in the medical market and to tell the story of the Upright(TM) MRI with its Multi-Position(TM) diagnostic capability well, the campaign features two-page color advertisements. The advertising is directed at three target audiences, and each of the three is being reached through the leading medical journals that are addressed to that audience.

1) Neurosurgeons and Orthopaedic Surgeons: These are the surgeons who can most benefit from the superior diagnostic benefits of the Fonar Upright(TM) MRI with its Multi-Position(TM) diagnostic ability. Advertisements to them currently appear in the journal Spine, The Journal of Neurosurgery, and the Journal of the American Academy of Orthopedic Surgery.

2) Radiologists: This segment of the campaign is aimed at the physicians who now have a wonderful new modality to offer their referring physicians. The advertisements are appearing in Radiology and Diagnostic Imaging.

3) All Physicians: This effort is to the total physician audience, so that the vast number of doctors who send patients for MRI's are aware of the diagnostic advantages of the Fonar Upright(TM) Multi-Position(TM) MRI. The advertisements appear in the Journal of the American Medical Association, which has a readership of over 350,000 physicians. This new advertising campaign has featured a series of compelling messages. One advertisement points out that the AMA book, Guides to the Evaluation of Permanent Impairment, indicates that diagnosis must be performed upright in flexion and extension. Another advertisement is educational and headlined, "Discover the power of Upright Imaging". Fonar realizes that peer-to-peer communications is the most powerful way to speak to physicians, so the campaign uses testimonials from surgeons and radiologists. The first such advertisement featured five surgeons and two radiologists, explaining the Multi-Position(TM) diagnostic benefits of the Fonar Upright(TM) MRI scanner to them. The latest advertisement features a leading radiologist, telling why he bought 12 Fonar Upright(TM) MRI scanners and plans to buy more.

In addition, we have an extensive advertising effort on Google and Yahoo Search Marketing. Enter relevant terms, such as "mri" or "mri for back pain", and an ad for Fonar will very likely appear in the paid search listings on the right side of the results page or along the top of it.

We are directing our MRI marketing efforts to meet the demand for high field open MRI scanners. Fonar plans to devote its principal efforts to marketing the Upright(TM) MRI, which is the only scanner in the industry that has the unique capability of scanning patients under weight-bearing conditions and in various positions of pain or other symptoms. In addition we will continue to market our Fonar 360(TM) MRI scanners. Utilizing a 6000 gauss (0.6 Tesla field strength) iron core electromagnet, the Upright(TM) MRI and Fonar 360(TM) scanner magnets are among the highest field "open MRI" scanners in the industry.

We also will seek to introduce new MRI applications for our scanners such as

MRI-directed interventions.

Our areas of operations are principally in the United States. During the fiscal year ended June 30, 2007, 7.3% of the Company's revenues were generated by foreign sales, as compared to 10.1% and 7.1% for fiscal 2006 and 2005, respectively.

We are seeking to promote foreign sales and have sold scanners in various foreign countries. Foreign sales, however, have not yet proved to be a significant source of revenue.

SERVICE AND UPGRADES FOR MRI SCANNERS

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

Income is generated from the installed base in two principal areas namely, service and upgrades. Service and maintenance revenues from our external installed base were approximately $5.8 million in fiscal 2005, $8.6 million in fiscal 2006 and $10.0 million in fiscal 2007. We expect service revenues to continue to increase as warranties expire on previously sold scanners, and the customers then enter into service contracts.

We also anticipate that our new scanners will result in upgrades income in future fiscal years. The potential for upgrades income, particularly in the form of new patient supporting upright imaging fixtures and receiver coils, originates in the versatility and productivity of the new Upright Imaging(TM) technology. New medical uses for MRI technology are constantly being discovered and are anticipated for the Upright Imaging(TM) technology as well. New features can often be added to the scanner by the implementation of little more than versatile new software packages. For example, software can be added to existing MRI angiography applications to synchronize angiograms with the cardiac cycle. By doing so the dynamics of blood vessel filling and emptying can be visualized with movies. Such enhancements are attractive to end users because they extend the useful life of the equipment and enable the user to avoid obsolescence and the expense of having to purchase new equipment. At the present time, however, upgrade revenue is not significant. We had approximately $40,000 upgrade revenue in fiscal 2005, and upgrade revenues of approximately $82,000 in fiscal 2006. We had no upgrade revenues in fiscal 2007.

Service and upgrade revenues are expected to increase as sales of scanners and the size of the customer base increases.

RESEARCH AND DEVELOPMENT

During the fiscal year ended June 30, 2007, we incurred expenditures of $6,328,265, $636,167 of which was capitalized, on research and development, as compared to $7,581,898 $714,253 of which was capitalized and $6,752,755, $745,994 of which was capitalized, during the fiscal years ended June 30, 2006 and June 30, 2005, respectively.

Research and development activities have focused principally, on the development and enhancement of the Upright(TM) and Fonar 360(TM) MRI scanners. The Upright(TM) MRI and Fonar 360(TM) involve significant software and hardware development as the new products represent entirely new hardware designs and architecture requiring a new operating software. Our research activity includes developing a multitude of new features for upright scanning made possible by the high speed processing power of its scanners. In addition, the Company's research and development efforts include the development of new software, such as its Sympulse(TM) software and hardware upgrade and the designing and continuing introduction of new receiver surface coils for the Upright(TM) MRI.

BACKLOG

Our backlog of unfilled orders at September 28, 2007 was approximately $49.2 million, as compared to $26.1 million at September 28, 2006. It is expected that a substantial portion of the existing backlog of orders will be filled within the 2008 fiscal year. Our contracts generally provide that if a customer cancels an order, the customer's initial down payment for the MRI scanner is nonrefundable.

PATENTS AND LICENSES

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

Dr. Damadian granted Fonar an exclusive world-wide license, to make, use and sell apparatus covered by certain domestic and foreign patents in his name relating to MRI technology. No patents covered by this license are in effect any longer.

One of the patents, issued in the name of Dr. Damadian and covered by said license, was United States patent No. 3,789,832, Apparatus and Method for Detecting Cancer in Tissue, also referred to as the "1974 Patent". The development of the Beta(TM) 3000 was based upon the 1974 Patent, and we believe that the 1974 Patent was the first of its kind to utilize MR to scan the human body and to detect cancer. The 1974 Patent was extended beyond its original 17-year term and expired in February, 1992.

We have significantly enhanced our patent position within the industry and now possesses a substantial patent portfolio which provides us, under the aegis of United States patent law, "the exclusive right to make, use and sell" many of the scanner features which Fonar pioneered and which are now incorporated in most MRI scanners sold by the industry. The Company has 134 patents issued and approximately 90 patents pending. A number of Fonar's existing patents specifically relate to protecting Fonar's position in the high-field iron frame open MRI market. The patents further enhance Dr. Damadian's pioneer patent, the 1974 Patent, that initiated the MRI industry and provided the original invention of MRI scanning. The 134 issued patents extend to various times up to 2025.

We have a license agreement granting us a license to utilize the MRI technology covered by the existing patent portfolio of a patent holding company. We also have patent cross-licensing agreements with other MRI manufacturers.

PRODUCT COMPETITION

MRI SCANNERS

A majority of the MRI scanners in use in hospitals and outpatient facilities and at mobile sites in the United States are based on high field air core magnet technology while the balance are based on open iron frame magnet technology. Fonar's open iron frame MRI scanners are competing principally with high-field air core scanners. Fonar's open MRI scanners, however, utilizing a 6,000 gauss or 0.6 Tesla field strength, iron core electromagnet, were the first "open" MR scanners at high field strength.

Fonar believes that its MRI scanners have significant advantages as compared to the high-field air core scanners of its competitors. These advantages include:

1. There is no expansive fringe magnetic field. High field air core scanners require a more expensive shielded room than is required for the iron frame scanners. The shielded room required for the iron frame scanners is intended to prevent interference from external radio frequencies.

2. They are more open and quiet.

3. They can scan the trauma victim, the cardiac arrest patient, the respirator-supported patient, and premature and newborn babies. This is not possible with high- field air core scanners because their magnetic field interferes with conventional life-support equipment.

The principal competitive disadvantage of our products is that they are not "high field strength", 1.0 Tesla +, magnets. As a general principle, the higher field strength can produce a faster scan. In some parts of the body a faster scan can be traded for a clearer picture. Although we believe that the benefits of "openness" provided by our scanners compensate for the lower field strength, certain customers will still prefer the higher field strength.

Fonar faces competition within the MRI industry from such firms as General Electric Company, Philips N.V., Toshiba Corporation, Hitachi Corporation and Siemens A.G. Most competitors have marketing and financial resources more substantial than those available to us. They have in the past, and may in the future, heavily discount the sales price of their scanners. Such competitors sell both high field air core and iron frame products. Based on the Frost and Sullivan data contained in their publication, Fonar had a 10% market share in the low-field segment of the 2005 market in the United States. It should be noted that although Frost and Sullivan define .6 Tela (the field strength of Fonar's magnets) as "low-field", the market place generally and Fonar define it as "mid-field" and in the category of open MRI scanners, Fonar's .6 Tesla magnets are among the highest field strength open magnets. Fonar introduced the first "Open MRI" in 1980. "Open MRI" was made possible by Fonar's introduction of an MRI magnet built on an iron frame. Thus the magnetic flux generating apparatus of the magnet, magnet coils or permanent magnet bricks, was built into a frame of steel. The steel frame provided a return path for the magnetic lines of force and thereby kept the magnetic lines of force contained within the magnet. This enabled Fonar, from 1980 on, to show that the Fonar magnet was the only magnet that allowed the patients to stretch out their arms, the only "open" MRI.

The iron frame, because it could control the magnetic lines of force and place them where wanted and remove them from where not wanted, such as in the Fonar 360(TM) where physicians and staff are standing, provide a much more versatile magnet design than is possible with air core magnets. Air core magnets contain no iron but consist entirely of turns of current carrying wire.

For an 11 year period from 1983-1994, Fonar's large competitors, with one exception, generally rejected Fonar's "open" design but by now all have added the iron frame "open" magnet to their MRI product lines. One reason for this market shift, in addition to patient claustrophobia, is the awareness that the open magnet designs permit access to the patient to perform MRI guided procedures, a field which is now growing rapidly and is called "interventional MRI."

The Fonar 360(TM) scanner explicitly addresses this growing market reception of MRI guided interventions, and the first of these scanners was sold to a hospital in England. Fonar's Upright(TM) magnet also addresses the growing market reception of MRI guided interventions. Although not enabling a full interventional theater as the Fonar 360(TM) does, the iron frame Upright(TM) MRI design permits ready access to the patient and enables a wide range of interventional procedures such as biopsies and needle or catheter delivered therapies to be performed under MRI image guidance. The "tunnel" air core superconductive scanners do not permit access to the patient while the patient is inside the scanner.

Fonar expects to be a leader in domestic open MRI market for several reasons. In

MRI, scanning speed and image quality is controlled by the strength of the magnetic field. Fonar's Upright(TM) and Fonar 360(TM) scanners operate at 0.6 Tesla, which make them among the highest field strength open MRI scanners. Furthermore, the Upright(TM) MRI is the only MRI which allows patients to be scanned under weight-bearing conditions. High field MRI manufacturers convinced the marketplace for Fonar, and the marketplace accepts, that higher field strength translates directly into superior image quality and faster scanning speeds. No companies possess the Upright(TM) MRI or Fonar 360(TM) scanners, and Fonar possesses the pioneer patents on "open MRI" technology.

OTHER IMAGING MODALITIES

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

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

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

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

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

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

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

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

produced by those other methodologies.

GOVERNMENT REGULATION

FDA Regulation

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

Classes of Products

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

Fonar's products are Class II devices. Class I devices are subject to the least regulatory control. They present minimal potential for harm to the user and are often simpler in design than Class II or Class III devices. Class I devices are subject to "General Controls" as are Class II and Class III devices. General Controls include:

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

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

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

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

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

Class II devices are those for which general controls alone are insufficient to assure safety and effectiveness, and existing methods are available to provide such assurances. In addition to complying with general controls, Class II devices are also subject to special controls. Special controls may include special labeling requirements, guidance documents, mandatory performance standards and post-market surveillance.

We received approval to market our Beta(TM) 3000 and Beta(TM) 3000M scanners as Class III devices on September 26, 1984 and November 12, 1985. On July 28, 1988, the Magnetic Resonance Diagnostic Device which includes MR Imaging and MR Spectroscopy was reclassified by the FDA to Class II status. Consequently, Fonar's products are now classified as Class II products. On July 26, 1991, Fonar received FDA clearance to market the Ultimate(TM) Magnetic Resonance Imaging Scanner as a Class II device. Fonar received FDA clearance to market the

QUAD(TM) 7000 in April 1995 and the QUAD(TM) 12000 in November 1995. On March 16, 2000, Fonar received FDA clearance to market the Fonar 360(TM) for diagnostic imaging, the Open Sky(TM) version, and on October 3, 2000 received FDA clearance for the Upright(TM) MRI.

Premarketing Submission

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

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

The 510(k) is essentially a brief statement and description of the product. As Fonar's scanner products are Class II products, there are no pre-market data requirements and the process is neither lengthy nor expensive.

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

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

Quality System Regulation

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

Medical Device Reporting Regulation

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

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

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

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

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

- provide for timely and effective identification, communication and evaluation of adverse events;
- provide a standardized review process and procedures for determining whether or not an event is reportable; and
- provide procedures to insure the timely transmission of complete reports.

These procedures also include documentation and record keeping requirements for:

- information that was evaluated to determine if an event was reportable;
- all medical device reports and information submitted to the FDA;
- any information that was evaluated during preparation of annual certification reports; and
- systems that ensure access to information that facilitates timely follow up and inspection by FDA.

FDA Enforcement

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

FDA-Initiated or Voluntary Recalls

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

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

Class I

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

Class II

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

Class III

Is a situation in which use of, or exposure to, a violative product is not

likely to cause adverse health consequences.

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

Civil Money Penalties

The FDA, after an appropriate hearing, may impose civil money penalties for violations of the FD&C Act that relate to medical devices. In determining the amount of a civil penalty, FDA will take into account the nature, circumstances, extent, and gravity of the violations, the violator's ability to pay, the effect on the violator's ability to continue to do business, and any history of prior violations. The civil money penalty may not exceed $15,000 for each violation and may not exceed $1,000,000 for all violations adjudicated in a single proceeding, per person.

Warning Letters

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

Seizure

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

Citation

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

Injunction

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

Prosecution

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

Foreign and Export Regulation

We obtain approvals as necessary in connection with the sales of our products in foreign countries. In some cases, FDA approval has been sufficient for foreign

sales as well. Our standard practice has been to require either the distributor or the customer to obtain any such foreign approvals or licenses which may be required.

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

Foreign governments have differing requirements concerning the import of medical devices into their respective jurisdictions. The European Union, also referred to as EU, made up of 27 individual countries, has some essential requirements described in the EU's Medical Device Directive, also referred to as MDD. In order to export to one of these countries, we must meet the essential requirements of the MDD and any additional requirements of the importing country. The essential requirements are similar to some of the requirements mandated by the FDA. In addition the MDD requires that we enlist a Notified Body to examine and assess our documentation, a Technical Construction File, and verify that the product has been manufactured in conformity with the documentation. The notified body must carry out or arrange for the inspections and tests necessary to verify that the product complies with the essential requirements of the MDD, including safety performance and Electromagnetic Compatibility, also referred to as EMC. Also required is a Quality System, ISO-9001, assessment by the Notified Body. We were approved for ISO 9001 certification for its Quality Management System in April, 1999.

We received clearance to sell the QUAD(TM) scanners in the EU in May, 1999. Clearances for the Fonar 360(TM) and Upright(TM) MRI scanners were obtained in May, 2002.

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

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

Because our export sales are not material at this point, foreign regulation does not have a material effect on us. In any case, we do not believe that foreign regulation will deter its efforts to penetrate foreign markets.

Reimbursement to Medical Providers for MRI Scans

Effective November 22, 1985, the Department of Health and Human Services authorized reimbursement of MRI scans under the Federal Medicare program. In addition, most private insurance companies have authorized reimbursement for MRI scans.

Anti-Kickback and Self-Referral Legislation

Proposed and enacted legislation at the State and Federal levels has restricted referrals by physicians to medical and diagnostic centers in which they or their family members have an interest. In addition, regulations have been adopted by the Secretary of Health and Human Services which provide limited "safe harbors" under the Medicare Anti-Kickback Statute. These safe harbors describe payments and transactions which are permitted between an entity receiving reimbursement under the Medicare program and those having an interest in or dealings with the entity. Although the Company cannot predict the overall effect of the adoption of these regulations on the medical equipment industry, the use and continuation

of limited partnerships, where investors may be referring physicians, to own and operate MRI scanners could be greatly diminished.

HEALTH MANAGEMENT CORPORATION OF AMERICA
PHYSICIAN AND DIAGNOSTIC SERVICES MANAGEMENT BUSINESS

Health Management Corporation of America, formed under the name U.S. Health Management Corporation and referred to as "HMCA", was organized by us in March 1997. HMCA is a wholly-owned subsidiary which engages in the business of providing comprehensive management services to imaging facilities. The services we provide include development, administration, leasing of office space, facilities and medical equipment, provision of supplies, staffing and supervision of non-medical personnel, legal services, accounting, billing and collection and the development and implementation of practice growth and marketing strategies.

HMCA currently manages 12 MRI facilities. In April 2003, HMCA sold the portion of its business which managed primary care medical practices, and in July 2005, HMCA sold the portion of its business engaged in the management of physical therapy and rehabilitation practices. This was the result of HMCA's decision to focus on management of MRI facilities, the business in which HMCA is most experienced. For the 2007 fiscal year, the revenues HMCA recognized from the MRI facilities were $11.9 million. No revenues were recognized from physical therapy and rehabilitation practices. For the 2006 fiscal year, the revenues HMCA recognized from the MRI facilities were $12.7 million and the revenues recognized from the physical therapy and rehabilitation practices were $648,000 for total revenues of $13.3 million. For the fiscal 2005 year, the revenues HMCA recognized from the MRI facilities were $14.0 million and the revenues recognized from the physical and rehabilitation practices were $9.7 million, for total revenues of $23.7 million.

HMCA GROWTH STRATEGY

HMCA's growth strategy focuses on upgrading and expanding the existing facilities it manages and expanding the number of facilities it manages for its clients. Our most important effort in this regard has been to promote and facilitate the replacement of existing MRI scanners with new Fonar Upright(TM) MRI scanners. Presently, we have Upright(TM) MRI scanners at all of the MRI facilities we manage with the exception of the one in Garden City, New York and the one in Dublin, Georgia.

In connection with its focus on managing MRI facilities, HMCA decided to sell its business of managing physical therapy and rehabilitation practices. The sale was completed on July 28, 2005, at the beginning of the 2006 fiscal year.

The sale was made pursuant to an asset purchase agreement. The assets sold consisted principally of the management agreements with the physical therapy and rehabilitation facilities, the assignment of other agreements and rights utilized in our physical therapy and rehabilitation facility management business, the physical therapy equipment, a portion of the accounts receivable and office furnishings and equipment we provided to the physical therapy and rehabilitation facilities.

The sale was made to Health Plus Management Services, L.L.C. There is no material relationship between Health Plus and Fonar, HMCA, or any of their respective subsidiaries, directors or officers or associates of any such person. The two principals of Health Plus were employed by HMCA up to the time of the closing of the transaction. In consideration for the termination of their employment agreements, these two individuals each became entitled to receive $800,000. In addition, each became entitled to receive $200,000 for billing and collection services to be provided on behalf of HMCA with respect to a portion of the accounts receivable of certain physical therapy and rehabilitation

facilities which arose during the period when we were engaged in the management of those facilities. The $1,000,000 payable was paid in shares of Fonar common stock.

The purchase price under the asset purchase agreement was $6.6 million, payable pursuant to a promissory note in 120 monthly installments commencing on August 28, 2005. The first twelve installments are interest only and the remaining 108 payments will consist of equal installments of principal and interest in the amount of $76,014 each. The note 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.

PHYSICIAN AND DIAGNOSTIC MANAGEMENT SERVICES

HMCA's services to the facilities it manages encompass substantially all of their business operations. Each facility is controlled, however, by the physician owner, not HMCA, and all medical services are performed by the physicians and other medical personnel under the physician owner's supervision. HMCA is the management company and performs services of a non-professional nature. These services include:

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

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

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

4. Billing and Collections. HMCA is responsible for the billing and collection of revenues from third-party payors including those governed by no-fault and workers' compensation statutes.

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

6. Diagnostic Imaging and Ancillary Services. HMCA can offer access to diagnostic imaging equipment through diagnostic imaging facilities it manages. The Company may expand the ancillary services offered in its network to include CT-scans and x-rays, if it is determined that such additions may be useful to clients.

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

8. Expansion Plans. HMCA assists the clients in developing expansion plans

including the opening of new or replacement facilities where appropriate.

HMCA advises clients on all aspects of their businesses, including expansion where it is a reasonable objective, on a continuous basis. HMCA's objective is to free physicians from as many non-medical duties as is practicable. Practices can treat patients more efficiently if the physicians can spend less time on business and administrative matters and more time practicing medicine.

HMCA provides its services pursuant to negotiated contracts with its clients. While HMCA believes it can provide the greatest value to its clients by furnishing the full range of services appropriate to that client, HMCA would also be willing to enter into contracts providing for a more limited spectrum of management services.

The facilities enter into contracts with third party payors, including managed care companies. Neither HMCA's clients nor HMCA participate in any capitated plans or other risk sharing arrangements. Capitated plans are those HMO programs where the provider is paid a flat monthly fee per patient.

In the case of contracts with the MRI facilities, fees were charged by HMCA during fiscal 2007 based on the number of procedures performed. In the case of the physical therapy and rehabilitation practices we previously managed, flat fees were charged on a monthly basis. Fees are subject to adjustment on an annual basis, but must be based on mutual agreement. The per procedure charges to the MRI facilities during fiscal 2007 ranged from $275 to $500 per MRI scan. Commencing in fiscal 2008, however, eight of the MRI facilities will be charged a flat fee, pursuant to the new contracts entered into by HMCA following the sale of said MRI facilities at the end of fiscal 2007 by Dr. Raymond Damadian to Dr. Robert Diamond. Dr. Diamond has been reading scans for HMCA managed facilities for more than seven years.

As of June 22, 2007, Dr. Robert Diamond purchased the stock of the professional corporations owning the eight New York sites managed by HMCA, previously owned by Dr. Raymond V. Damadian, the President, Chairman of the Board and principal stockholder of Fonar. In connection with the sale, new management agreements were substituted for the existing management agreements, providing, however, for the same management services. The fees in fiscal 2008, however, will be flat monthly fees in the aggregate amount of $732,250 per month.

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

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., also referred to as "Integrity", which is owned by an unrelated party. Under the terms of the agreement, Integrity will supervise and direct HMCA and the management of the facilities. The existing management agreements between the facilities and HMCA will remain in place. Integrity will receive as compensation an annual fee equal to one-half of the increase in the consolidated cash flow of HMCA and the facilities over the period from July 1, 2006 through June 30, 2007. The term of the agreement is on an automatically renewable year to year basis, but may be terminated by either party without cause at the end of any year.

HMCA MARKETING

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

DIAGNOSTIC IMAGING FACILITIES AND OTHER ANCILLIARY SERVICES

Diagnostic imaging facilities managed by HMCA provide diagnostic imaging services to patients referred by physicians who are either in private practice or affiliated with managed care providers or other payor groups. The facilities are operated in a manner which eliminates the admission and other administrative inconveniences of in-hospital diagnostic imaging services. Imaging services are performed in an outpatient setting by trained medical technologists under the direction of physicians. Following diagnostic procedures, the images are reviewed by the interpreting physicians who prepare a report of these tests and their findings. These reports are transcribed by HMCA personnel and then delivered to the referring physician.

HMCA develops marketing programs in an effort to establish and maintain profitable referring physician relationships and to maximize reimbursement yields. These marketing approaches identify and target selected market segments consisting of area physicians with certain desirable medical specialties and reimbursement yields. Corporate and facility managers determine these market segments based upon an analysis of competition, imaging demand, medical specialty and payor mix of each referral from the local market. HMCA also directs marketing efforts at managed care providers.

Managed care providers have become an important factor in the diagnostic imaging industry. To further its position, HMCA will seek to expand the imaging modalities offered at its managed diagnostic imaging facilities.

HMCA COMPETITION

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

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

GOVERNMENT REGULATION APPLICABLE TO HMCA

FEDERAL REGULATION

Stark Law

Under the federal Self-Referral Law, also referred to as the "Stark Law", which is applicable to Medicare and Medicaid patients, and the self-referral laws of various States, certain health practitioners, including physicians, chiropractors and podiatrists, are prohibited from referring their patients for the provision of designated health services, including diagnostic imaging and physical therapy services, to any entity with which they or their immediate family members have a financial relationship, unless the referral fits within one of the specific exceptions in the statutes or regulations. Statutory exceptions under the Stark Law include, among others, direct physician services, in-office ancillary services rendered within a group practice, space and

equipment rental and services rendered to enrollees of certain prepaid health plans. Some of these exceptions are also available under the State self-referral laws. HMCA believes that it and its clients are in compliance with these laws.

Anti-kickback Regulation

Under the federal Anti-kickback statute, which is applicable to Medicare and Medicaid, it is illegal, among other things, for a provider of MRI services to pay or offer money or other consideration to induce the referral of MRI scans. Neither HMCA nor its clients engage in this practice.

In fiscal 2007, approximately 20.1% of the revenues of HMCA's clients were attributable to Medicare and 1.6% were attributable to Medicaid. In fiscal 2006, approximately 18.2% of the revenues of HMCA's clients were attributable to Medicare and 1.1% were attributable to Medicaid. In fiscal 2005, approximately 9.9% of HMCA's revenues were attributable to Medicare and 0.5% were attributable to Medicaid.

State Regulation

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

Various States prohibit business corporations from practicing medicine. Various States also prohibit the sharing of professional fees or fee splitting. Consequently, HMCA leases space and equipment to clients and provides clients with a range of non-medical administrative and managerial services for agreed upon fees. HMCA does not engage in the practice of medicine or establish standards of medical practice or policies for its clients in any State even where permitted.

HMCA's clients generate revenue from patients covered by no-fault insurance and workers' compensation programs. For the fiscal year ended June 30, 2007 approximately 33.1% of our clients' receipts were from patients covered by no-fault insurance and approximately 4.8% of our client's receipts were from patients covered by worker's compensation programs. For the fiscal year ended June 30, 2006, approximately 43% of HMCA's clients' receipts were from patients covered by no-fault insurance and approximately 4.1% of HMCA's clients' receipts were from patients covered by workers compensation programs. For the fiscal year ended June 30, 2005 approximately 59.3% of HMCA's clients' receipts were from patients covered by no-fault insurance and approximately 6.2% of HMCA's clients' receipts were from patients covered by workers compensation programs. In the event that changes in these laws alter the fee structures or methods of providing service, or impose additional or different requirements, HMCA could be required to modify its business practices and services in ways that could be more costly to HMCA or in ways that decrease the revenues which HMCA receives from its clients.

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

EMPLOYEES

As of July 1, 2007, we employed 370 persons on a full-time and part-time basis. Of such employees, 41 were engaged in marketing and sales, 48 in research and development, 70 in production, 53 in customer support services, 158 in administration, including 65 on site at facilities and offices managed by HMCA and 49 performing billing, collection and transcription services for those

facilities.

ITEM 1A. RISK FACTORS

An investment in Fonar is highly speculative and subject to a high degree of risk. Therefore, you should carefully consider the risks discussed below and other information contained in this annual report before deciding to invest in shares of our common stock.

1. In the past we have experienced significant losses and may in the future incur losses.

For the fiscal years ended June 30, 2007 and June 30, 2006, we experienced net losses of $25.5 million and $30.0 million respectively and losses from operations of $25.5 million and $29.7 million, respectively.

As of June 30, 2007, our consolidated balance sheet reflected $1.5 million in cash and cash equivalents and $2.0 million in marketable securities out of total current assets of $23.0 million as compared to $4.6 million in cash and cash equivalents and $4.9 million in marketable securities out of total current assets of $38.9 million as of June 30, 2006, reflecting a decrease in cash, cash equivalents and marketable securities. As of June 30, 2007, we had a working capital deficit of $7.6 million as compared to a working capital surplus of $14.2 million as of June 30, 2006. We believe that we will be able to reduce our operating loss and generate operating income by continuing the marketing of our new MRI scanners, particularly our Upright(TM) MRI scanners.

2. Fonar is dependant on the success of its new products to become profitable.

Our ability to generate future operating profits will depend on our ability to market and sell our MRI products. The Upright(TM) MRI and Fonar 360 MRI scanners have been introduced into the market. Although we are optimistic that these scanners' features will make them competitive, and we perceive that the Upright(TM) MRI is successfully penetrating the market, notwithstanding lower sales in fiscal 2007 and 2006, there can be no assurance as to the degree, timing or continuation of market acceptance of these products. The product we are promoting most vigorously is the Upright(TM) MRI. We believe the Upright(TM) MRI is the most promising because it enables scans to be performed on patients in weight bearing positions, such as sitting, standing or lying at an intermediate angle or in any of the conventional recumbent positions. We sold on Fonar 360 MRI scanner in fiscal 2005.

3. We must compete in a highly competitive market against competitors with greater financial resources than we have.

The medical equipment industry is highly competitive and characterized by rapidly changing technology and extensive research and development. The market demand for a continuing supply of new and improved products requires that we be engaged continuously in research and development. New products also require continuous retooling or at least modifications to our manufacturing facilities, and our sales and marketing force must continuously adjust to new products and product features. This is highly expensive and companies with substantially greater financial resources than we have engage in the marketing of magnetic resonance imaging scanners which compete with the Company's scanners. Competitors include large, multinational companies or their affiliates such as General Electric Company, Siemens A.G., Philips N.V., Toshiba Corporation and Hitachi Corporation. There can be no assurance that Fonar's products will be able to successfully compete with products of its competitors.

4. HMCA's profitability depends on its ability to successfully perform billing and collection services for its clients.

HMCA performs billing and collection services for the facilities it manages. The viability of HMCA's clients and their ability to remit management fees to HMCA depends on HMCA's ability to collect the clients' receivables. Collectibility of these receivables can be adversely affected by the longer payment cycles and rigorous informational requirements of some insurance companies or other third party payors. Proper authorizations, referrals and confirmation of coverage for patients, as well as issues of medical necessity, need to be addressed prior to the rendering of service to assure prompt payment of claims. HMCA believes it is properly addressing billing and collection requirements and issues for its clients and that its collection rates are good. Nevertheless, the regulations and requirements applicable to medical billing and collections could change in the future and result in reduced or delayed collections.

5. The profitability of HMCA could be adversely affected if medical insurance reimbursement rates change.

All HMCA's revenue is now generated from providers of MRI services. Consequently, HMCA would be indirectly affected by changes in medical insurance reimbursement policies, referral patterns, no-fault and workers compensation reimbursement levels and other factors affecting the profitability of an MRI facility. There are currently 12 MRI facilities served by HMCA located in New York, Florida and Georgia. Approximately 33.1% of HMCA's clients' revenues in fiscal 2007, 43% of HMCA's clients' revenues in fiscal 2006 and 59.3% in fiscal 2005 were generated from no-fault claims. Approximately 4.8% of HMCA's clients' revenues were from workers' compensation claims in fiscal 2007 as compared to 4.1% in fiscal 2006 and 6.2% in fiscal 2005. In addition, in fiscal 2007, approximately 20.1% of the revenues of HMCA's clients were attributable to Medicare and 1.6% were attributable to Medicaid. In fiscal 2006, approximately 18.2% of the revenues of HMCA's clients were attributable to Medicare and 1.1% were attributable to Medicaid. In fiscal 2005, approximately 9.9% of the revenues of HMCA's clients were attributable to Medicare and 0.5% were attributable to Medicaid. The Deficit Reduction Act has had a negative but not material effect on the Medicare receipts of HMCA's clients. Future changes in the reimbursement levels for MRI, workers compensation, no fault reimbursement or Medicare, or changes in utilization policies for MRI also could adversely affect the ability of HMCA's clients to pay HMCA's fees. In addition, HMCA depends on the ability of its clients to attract and retain physicians and other professional staff.

6. Professional liability claims against HMCA or its clients may exceed insurance coverage levels.

Although HMCA does not provide medical services, it is possible that a patient suing one of HMCA's MRI facilities would also sue HMCA. All of HMCA's 12 currently managed MRI facilities carry professional liability insurance. In addition, physicians working for HMCA's clients, are required to maintain professional liability insurance in the minimum amount of $1,000,000/$3,000,000. Such insurance would not cover HMCA, which is not insured, and claims in excess of insurance coverage might also have to be satisfied by HMCA if it were named as a defendant.

7. We are dependent upon the services of Dr. Damadian.

Our success is greatly dependent upon the continued participation of Dr. Raymond V. Damadian, Fonar's founder, Chairman of the Board and President. Dr. Damadian has acted as our CEO since 1978 and will continue to do so for the foreseeable future. In addition to providing general supervision and direction, he provides active direction, supervision and management of our sales, marketing and research and development efforts. Loss of the services of Dr. Damadian would have a material adverse effect on our business. We do not have an employment or noncompetition agreement with Dr. Damadian. We do not currently carry "key man"

life insurance on Dr. Damadian.

8. Dr. Raymond V. Damadian has voting control of Fonar; the management cannot be changed or the Company sold without his agreement.

Dr. Raymond V. Damadian, the President, Chairman of the Board and principal stockholder of Fonar is and will continue to be in control of Fonar and in a position to elect all of the directors of Fonar. As of September 14, 2007, there were outstanding 4,894,207 shares of common stock, having one vote per share, 158 shares of Class B common stock, having ten votes per share and 382,513 shares of Class C common stock, having 25 votes per share. Of these totals Dr. Damadian owns 120,302 shares of common stock and 382,447 shares of Class C common stock, giving him approximately 67% of the voting power of Fonar's voting stock. This means that the holders of the common stock other than Dr. Damadian will not be able to control decisions concerning any merger or sale of Fonar, the election of directors or the determination of business and management policy.

ITEM 1B. UNRESOLVED STAFF COMMENTS. None

ITEM 2. PROPERTIES

Fonar leases approximately 135,240 square feet of office and plant space at its principal offices in Melville, New York and at two other locations in Melville and Farmingdale, New York at a current aggregate annual rental rate of $1,125,158, excluding utilities, taxes and other related expenses. The term of one of the leases includes options to renew up through 2008 and the terms of the other leases extend to 2013. Management believes that these premises are adequate for its current needs. HMCA leases approximately 16,850 square feet for its headquarters in Melville, New York at a current annual rental rate of $467,356. The term of the lease extends through September, 2009. In addition, HMCA maintains leased office premises for its clients having an aggregate annual rental rate of approximately $744,000 under leases having various terms.

ITEM 3. LEGAL PROCEEDINGS

There is no material litigation pending, or to its knowledge, threatened against the Company.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

On April 16, 2007, we held our annual meeting of stockholders. The matters before the meeting were 1. the election of directors, 2. to consider and act upon a proposal to grant the Board of Directors the authority to amend our certificate of incorporation to effect a reverse stock split of our issued and outstanding Common Stock, Class B Common Stock, Class C Common Stock and Class A Nonvoting Preferred Stock at a specific ratio to be determined by our Board of Directors within a range of one for ten and one for twenty-five, 3. to consider and act upon a proposal to grant the Board of Directors the authority to amend our certificate of incorporation to effect a reverse stock split of our authorized number of shares of Common Stock, Class B Common Stock, Class C Common Stock, Preferred Stock and Class A Nonvoting Preferred Stock at a specific ratio to be determined by our Board of Directors within a range of one for three and one for ten, 4. to ratify the selection of Marcum & Kliegman LLP as the Company's auditors for the fiscal year ended June 30, 2007, 5. to consider and act upon a stockholder proposal to limit certain management compensation, and 6. to transact such other business as may properly come before the meeting.

Following the meeting, effective April 16, 2007 we effected a reverse split of 1:25 for the issued and outstanding shares of all classes of our stock

outstanding, and reduced the number of authorized shares of each class at the ratio of 1:5.

The table below lists the votes cast for, against or withheld, as well as abstentions and broker non-votes.

(1) Election of Directors:

	FOR	WITHHELD
Raymond V. Damadian	337,203,493	9,170,994
Claudette J.V. Chan	338,765,981	7,608,506
Robert J. Janoff	339,918,359	6,456,128
Charles N. O'Data	340,619,481	5,755,007
Robert Djerejian	340,609,356	5,765,131

(2) To grant the Board of Directors the authority to amend our certificate of incorporation to effect a reverse stock split of our issued and outstanding Common Stock, Class B Common Stock, Class C Common Stock and Class A Preferred Stock

FOR	AGAINST	ABSTAIN	BROKER NON-VOTES
252,564,221	7,501,483	39,498,471	86,269,284

(3) To grant the Board of Directors the authority to amend our certificate of incorporation to effect a reverse stock split of our authorized number of shares of Common Stock, Class B Common Stock, Class C Common Stock and Class A Non-voting Preferred Stock

FOR	AGAINST	ABSTAIN	BROKER NON-VOTES
253,091,115	6,973,109	40,979,203	86,269,284

(4) Ratification of Auditors Marcum & Kliegman LLP

FOR	AGAINST	ABSTAIN	BROKER NON-VOTES
342,809,546	2,898,567	66,374,437	0

(5) To limit certain management compensation

FOR	AGAINST	ABSTAIN	BROKER NON-VOTES
10,033,145	249,320,533	751,525	86,269,284

(6) To transact such other business as may properly come before the meeting

FOR	AGAINST	ABSTAIN	BROKER NON-VOTES
333,610,996	10,964,067	1,799,424	0

Part II

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

Our Common Stock is traded in the Nasdaq SmallCap market under the National Association of Securities Dealers Automated Quotation System, also referred to as "NASDAQ", symbol FONR. The following table sets forth the high and low trades reported in NASDAQ System for the periods shown. The per share high and low bids have been adjusted to take effect of the reverse stock split effective April 16, 2007 for periods prior to that time.

Fiscal Quarter				High	Low
January	-	March	2005	44.50	29.75
April	-	June	2005	35.50	28.50
July	-	September	2005	32.25	25.25
October	-	December	2005	28.00	16.75
January	-	March	2006	21.25	14.25
April	-	June	2006	20.00	6.50
July	-	September	2006	15.50	8.25
October	-	December	2006	12.50	9.50
January	-	March	2007	8.75	5.00
April	-	June	2007	7.50	4.01
July	-	September 21	2007	10.00	4.20

On August 30, 2007, we had approximately 4,470 stockholders of record of our Common Stock, 12 stockholders of record of our Class B Common Stock, 4 stockholders of record of our Class C Common Stock and 3,882 stockholders of record of our Class A Non-voting Preferred Stock.

At the present time, the only class of our securities for which there is a market is the Common Stock.

During fiscal 2006 we received notices from NASDAQ that our common stock would be delisted unless the market price recovered and increased for at least ten consecutive trading days to $1.00 per share. Originally the date by which this was required to occur was June 20, 2006, but since Fonar was then in compliance with NASDAQ's other continuing listing requirements, an extension of six months to December 20, 2006 was granted.

Since the market price of Fonar's Common Stock did not recover by said time, Fonar proposed to implement a reverse split of its Common Stock. A hearing was held in February 2007 which resulted in the NASDAQ Hearing Panel's approval of Fonar's plan, which was then presented to Fonar's stockholders at its Annual Meeting. Since the reverse split of all classes of Fonar's stock was effective, Fonar's Common Stock has regained compliance with NASDAQ's minimum price bid requirement. Fonar's Common Stock is the only class of its securities which is listed on NASDAQ.

We paid cash dividends in fiscal 1998 and the first three quarters of fiscal 1999 on monies we received from the enforcement of our patents. Except for these dividends, we have not paid any cash dividends. Except for these dividends, we expect that we will retain earnings to finance the development and expansion of our business.

Item 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data has been extracted from our consolidated financial statements for the five years ended June 30, 2007. This consolidated selected financial data should be read in conjunction with our consolidated financial statements and the related notes included in Item 8 of this form.

	As of and For the Periods Ended June 30,				
	2007	2006	2005	2004	2003
STATEMENT OF OPERATIONS					

Revenues	$33,212,000	$33,076,000	$104,899,000	$71,609,000	$52,892,000
Cost of revenues	$26,660,000	$26,950,000	$ 67,331,000	$44,945,000	$32,894,000
Research and Development Expenses	$ 5,692,000	$6,868,000	$6,007,000	$5,491,000	$5,164,000
Net (Loss) Income from continuing operations	$(25,453,000)	$(29,963,000)	$1,014,000	($9,494,000)	($15,201,000)
Net Gain (Loss) from discontinued operations	$ ---	$ ---	$ ---	$ ---	$ 194,000
Basic and Diluted Net Income (Loss) per common share-continuing operations	$ (5.29)	$ (6.78)	$ .23	$ (2.61)	$ (5.01)
Basic and Diluted Net Gain (Loss) per common share-discontinued operations	$ ---	$ ---	$ ---	$ ---	$ ---
Basic Weighted average number of shares outstanding	4,830,652	4,416,125	4,063,680	3,641,118	3,032,679
Diluted Weighted average number of shares outstanding	4,830,652	4,416,125	4,220,228	3,641,118	3,032,679
BALANCE SHEET DATA					
Working capital (1)	$(7,566,000)	$14,237,000	$36,224,000	$22,593,000	$13,517,000
Total Assets	$41,210,000	$57,230,000	$76,094,000	$77,201,000	$58,749,000
Long-term debt and obligations under capital leases (1)	$ 1,213,000	$ 1,406,000	$ 1,392,000	$ 6,702,000	$ 1,930,000
Stock holder's equity	$8,898,000	$30,419,000	$51,869,000	$43,154,000	$32,379,000

(1) Amounts as of and for the year ended June 30, 2003 have been adjusted for

the reclassification of discontinued operations.

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

INTRODUCTION.

Fonar was formed in 1978 to engage in the business of designing, manufacturing and selling MRI scanners. In 1997, we formed a wholly-owned subsidiary, Health Management Corporation of America, also referred to as "HMCA", formerly known as U.S. Health Management Corporation, in order to expand into the physician and diagnostic management services business.

Fonar's principal MRI products are its Stand-Up(TM)/Upright(TM) MRI and Fonar 360(TM) MRI scanners. The Stand-Up(TM) MRI allows patients to be scanned for the first time under weight-bearing conditions. The Company has been aggressively seeking new sales. The Stand-Up(TM) MRI is the only MRI capable of producing images in the weight bearing state.

In fiscal 2005, we received our first order for a 360(TM) MRI scanner, bringing the total number of orders for our MRI scanners to 31 in fiscal 2005.

At 0.6 Tesla field strength, the Upright(TM) MRI and Fonar 360(TM) magnets are among the highest field open MRI scanners in the industry, offering non-claustrophobic MRI together with high-field image quality. Fonar's open MRI scanners were the first high field strength MRI scanners in the industry.

HMCA commenced operations in July, 1997 and generates revenues from providing comprehensive management services, including development, administration, accounting, billing and collection services, together with office space, medical equipment, supplies and non-medical personnel to its clients. Revenues are in the form of fees which are earned under contracts with MRI facilities and physical rehabilitation practices. Since April 2003, HMCA has not engaged in the management of primary care medical practices. Since July 2005, HMCA has engaged only in the management of MRI facilities, having sold the portion of its business engaged in the management of physical therapy and rehabilitation practices.

For the fiscal years ended June 30, 2007, June 30, 2006, 100% and 95.2%, respectively, of HMCA's revenues were derived from contracts with facilities and practices owned by Dr. Raymond V. Damadian, the President of Fonar and HMCA and principal stockholder of Fonar. The agreements with the MRI facilities are for one-year terms which renew automatically on an annual basis, unless terminated. The fees are based on the number of procedures performed and currently range from $275 to $500 per MRI scan. The fees are reviewed and if appropriate, adjusted on an annual basis by mutual agreement. Commencing with fiscal 2008, the MRI facilities will be charged a flat fee, pursuant to new contracts executed in connection with the sale of the MRI facilities by Dr. Raymond Damadian to Dr. Robert Diamond at the end of fiscal 2007.

Effective as of June 1, 2005 agreements were entered into with new practices with the new owners of the physical therapy and rehabilitation practices who had no affiliation with Dr. Damadian, Fonar or HMCA. These agreements were assigned in connection with the sale of the portion of HMCA's business managing physical therapy and rehabilitation practices. Historically, adjustments were made on the basis of changes in HMCA's costs, plus a percentage of costs. The monthly fees under these contracts with the physical rehabilitation practices ranged from approximately $110,000 to $205,000.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to investments, intangible assets, income taxes, contingencies and litigation. We base our estimates on historical experience and on various assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

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

We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. As of June 30, 2007, we recorded a valuation allowance which reduced our deferred tax assets to equal our deferred tax liability.

We amortize our intangible assets, including patents, purchased management agreements and capitalized software development costs, over the shorter of the contractual/legal life or the estimated economic life. Our amortization life for patents, purchased management agreements and capitalized software development costs is 15 to 17 years, 20 years and 5 years, respectively.

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

RESULTS OF OPERATIONS. FISCAL 2007 COMPARED TO FISCAL 2006

In fiscal 2007, we experienced a net loss of $25.5 million on revenues of $33.2 million, as compared to a net loss of $30.0 million on revenues of $33.1 million for fiscal 2006. This represents an increase in revenues of 0.4%. This was due mostly to increased unrelated party sales and service revenues, which increased by 36.1% and 19.8% respectively. Related party product sales and management fees decreased by 94.9% and 10.7% respectively. In addition, total cost and expenses decreased by 6.6%. We have been reluctant to make drastic cuts to date because we anticipate that our sales results will improve and we will need to have maintained our current capacity. Our consolidated operating results improved by $4.2 million to an operating loss of $25.5 million for fiscal 2007 as compared to an operating loss of $29.7 million for fiscal 2006.

Discussion of Operating Results of Medical Equipment Segment
Fiscal 2007 Compared to Fiscal 2006

Revenues attributable to our medical equipment segment increased by 7.9% to

$21.3 million in fiscal 2007 from $19.7 million in fiscal 2006, reflecting an increase in product sales revenues of 1.0%, from $11.1 million in fiscal 2006 to $11.3 million in fiscal 2007, and an increase in service revenue of 16.9%, from $8.6 million in fiscal 2006 to $10.0 million in fiscal 2007. This increase in revenues was attributable to an increase in sales of our Upright(TM) MRI to unrelated parties and increased service revenues. Notwithstanding the decrease in related party sales. We attribute the lower sales volumes in fiscal 2006 and 2007 primarily to a concern on the part of potential customers about MRI scan reimbursements from medical insurance, no-fault insurance, worker's compensation and Federal and State programs, most significantly Medicare and Medicaid. Even in our own management of MRI facilities by HMCA, we have noticed an increasing resistance to paying claims by insurers. Also of concern is the Deficit Reduction Act which is reducing Medicare funding available for MRI imaging.

We anticipate an improvement in our Upright(TM) MRI sales because the Upright(TM) MRI is unique in that it permits MRI scans to be performed on patients upright in the weight-bearing state and in multiple positions that correlate with symptoms. An important event in our ongoing effort to educate both the medical community and payors about the benefits, if not necessity, of utilizing Upright(TM) MRI scanning, occurred subsequent to the end of fiscal 2006 when we sold an Upright(TM) MRI scanner to the largest orthopedic hospital in the Netherlands, St. Maartenskliniek. Upon placing the order, the Chairman of Spine Surgery at St. Maartenskliniek expressed the view that for their hospital to continue to engage in spine surgery without Fonar's Upright(TM) MRI technology, now that it was available was "unacceptable" and that owning the scanner "was not optional, but mandatory". He further stated that "[o]nce our active research program has discovered the benefits of this new Fonar technology for patients, we intend to publish the results in a lot of peer reviewed scientific journals".

In addition, significant progress is being made in developing the Fonar 360(TM) MRI scanner so that it can be used in interventional procedures. At the Oxford-Nuffield site in the United Kingdom, where we installed the first Fonar 360(TM) MRI, Fonar software engineers have completed and installed our 2nd generation tracking software, 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, in order to inject therapeutic agents directly into the tissue.

The increase in service revenue is a result primarily of our increase scanner base, as scanners sold in previous years become service customers after the warranty period expires.

Product sales to unrelated parties increased by 36.1% in fiscal 2007 from $8.2 million in fiscal 2006 to $11.1 million in fiscal 2007. Product sales to related parties decreased by 94.9% in fiscal 2007 from $3.0 million in fiscal 2006 to $152,000 in fiscal 2007.

We believe that one of our principal challenges in achieving greater market penetration is attributable to the better name recognition and larger sales forces of our larger competitors such as General Electric, Siemens, Hitachi, Philips and Toshiba and the ability of some of our competitors to offer attractive financing terms through affiliates, such as G.E. Capital. Nevertheless, no other competitor offers a whole body weight bearing MRI scanner such as the Upright(TM) MRI, and the General Electric Medical Systems division of General Electric acts as a manufacturer's representative for the Stand-Up(TM) MRI.

We believe that our aggregate product sales to unrelated parties of Upright(TM) Scanners shows that we are successfully meeting that challenge.

The operating results for the medical equipment segment improved by $2.5 million

from a loss of $24.7 million in fiscal 2006 to a loss of $22.2 million in fiscal 2007. This improvement is attributable most significantly to an increase in service revenue and to an increase in our scanner sales.

We recognized revenues of $11.0 million from the sale of our Upright(TM) MRI scanners in fiscal 2007. In fiscal 2006, we recognized revenues of $10.5 million from the sale of Upright(TM) MRI scanners and $383,589 from the balance due on the sale of our first Fonar 360(TM) MRI scanner in fiscal 2005.

Sales of MRI scanners to related parties, consisting of professional corporations and other entities in which Dr. Damadian or members of his family have an interest, represented approximately 0.5%, or $152,000, of our revenues in fiscal 2007, as compared to 9.0%, or $3.0 million, of our revenues in fiscal 2006. We believe concerns about payor reimbursements adversely affected these sales as well as sales to unrelated parties.

We had no license and royalty revenue in fiscal 2007 or in fiscal 2006.

Research and development expenses, net of capitalized costs, decreased by 17.1% to $5.7 million in fiscal 2007 as compared to $6.9 million in fiscal 2006. Our expenses for fiscal 2007 represented continued research and development of Fonar's scanners, Fonar's new hardware and software product, Sympulse(TM) and new surface coils to be used with the Stand-Up(TM) MRI scanner.

Discussion of Operating Results of Physician and Diagnostic Services Management Segment.
Fiscal 2007 Compared to Fiscal 2006

Revenues attributable to the Company's physician and diagnostic services management segment, HMCA, decreased by 10.7% to $11.9 million in fiscal 2007 from $13.4 million in fiscal 2006. The decrease in revenues reflected decreases resulting from sale of HMCA's physical therapy and rehabilitation facility management business and delayed collections. HMCA manages only MRI facilities. Presently, ten of the 12 MRI facilities managed by HMCA have Upright(TM) MRI scanners and additional upgrades are planned.

Cost of revenues as a percentage of the related revenues for our physician and diagnostic services management segment increased from $9.4 million or 70.4% of related revenues for the year ended June 30, 2006 to $9.0 million, or 75.2% of related revenue for the year ended June 30, 2007. This resulted from our inability to benefit from reduced costs per scanner that would have resulted if there had been a higher volume of sales in fiscal 2007.

Operating results of this segment declined from an operating loss of $5.0 million in fiscal 2006 to operating loss of $3.2 million in fiscal 2007. We attribute the decline to HMCA's sale of its physical therapy and rehabilitation facility management business.

Discussion of Certain Consolidated Results of Operations
Fiscal 2007 Compared to Fiscal 2006

Interest income and interest expense remained fairly constant in 2007 compared to 2006. We recognized interest income of $819,637 in 2007 as compared to $809,691 in fiscal 2006, representing an increase of 1.2%.

Interest expense of $279,912 was recognized in fiscal 2007, as compared to $281,903 in fiscal 2006, representing a decrease of 0.7%.

Notwithstanding that revenue increased by .4%, selling, general and administrative expenses, exclusive of compensatory element of stock issuances,

increased by .9% to $24.2 million in fiscal 2007 from $24.0 million in fiscal 2006.

The decrease in compensatory element of stock issuances from approximately $1.9 million in fiscal 2006 to $121,000 in fiscal 2007 reflected the highly reduced use of Fonar's stock bonus plans to pay certain highly compensated employees and others in stock rather than in cash.

The higher provision for bad debt of $2.0 million in fiscal 2007 as compared to $1.5 million in fiscal 2006, reflected an increase in reserves of certain indebtedness by our physician and diagnostic services management segment.

We are enthusiastic about the future of our Upright(TM) MRI and Fonar 360(TM) scanners which bring a new plateau of openness to diagnostic MRI and are expected to bring a new frontier in performing MRI guided intervention. We believe our new products have begun to successfully penetrate the market, as reflected in the dramatic increase in product sales from approximately $6.1 million in fiscal 2001 to $11.6 million in fiscal 2002, to $24.9 million in fiscal 2003, to $43.0 million in fiscal 2004 and to $73.1 million in fiscal 2005, notwithstanding lower revenues of 11.1 million in fiscal 2006 and $11.3 million in fiscal 2007. In addition to our success with our Upright(TM) MRI, we received an order for our first Fonar 360(TM) in the first quarter of fiscal 2005.

Service and repair fees also have steadily increased, as reflected by the increase in service and repair fees from $2.2 million in fiscal 2002 to $2.5 million in fiscal 2003 to $3.2 million in fiscal 2004 to $5.8 million in fiscal 2005 to $8.6 million in fiscal 2006 and to $10.0 million in fiscal 2007.

Continuing our trad