**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**Form 10-Q**

**(Mark one)**

|  |  |  |
| --- | --- | --- |
|  | **[X]** | **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** |

**For the quarterly period ended June 30, 2019**

**or**

|  |  |  |
| --- | --- | --- |
|  | **[  ]** | **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** |

**For the transition period from               to**

**Commission File Number 001-36529**

**MTBC, Inc.**

*(Exact name of registrant as specified in its charter)*

|  |  |  |
| --- | --- | --- |
| **Delaware** |  | **22-3832302** |
| *(State or other jurisdiction of*  *incorporation or organization)* |  | *(I.R.S. Employer*  *Identification Number)* |

|  |  |  |
| --- | --- | --- |
| **7 Clyde Road**  **Somerset, New Jersey** |  | **08873** |
| *(Address of principal executive offices)* |  | *(Zip Code)* |

**(732) 873-5133**

*(Registrant’s telephone number, including area code)*

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes [X] No [  ]

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

|  |  |
| --- | --- |
| Large accelerated filer [  ] | Accelerated filer [  ] |
| Non-Accelerated filer [  ] | Smaller reporting company [X] |
|  | Emerging growth company [X] |

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

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

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Title of each class |  | Trading Symbol(s) |  | Name of each exchange on which registered |
| Common Stock, par value $0.001 per share |  | MTBC |  | Nasdaq Global Market |
| Series A Preferred Stock, par value $0.001 per share |  | MTBCP |  | Nasdaq Global Market |

At August 1, 2019, the registrant had 12,033,242 shares of common stock, par value $0.001 per share, outstanding.

|  |
| --- |
|  |

|  |
| --- |
|  |

**INDEX**

|  |  |  |
| --- | --- | --- |
|  |  | Page |
|  |  |  |
| [Forward-Looking Statements](#b_001) | | 2 |
|  |  |  |
|  | [**PART I. FINANCIAL INFORMATION**](#b_002) |  |
|  |  |  |
| Item 1. | [Condensed Consolidated Financial Statements (Unaudited)](#b_003) | 3 |
|  | [Condensed Consolidated Balance Sheets at June 30, 2019 and December 31, 2018](#b_004) | 3 |
|  | [Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2019 and 2018](#b_005) | 4 |
|  | [Condensed Consolidated Statements of Comprehensive Loss for the three and six months ended June 30, 2019 and 2018](#b_006) | 5 |
|  | [Condensed Consolidated Statements of Shareholders’ Equity for the three and six months ended June 30, 2019 and 2018](#b_007) | 6 |
|  | [Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2019 and 2018](#b_008) | 7 |
|  | [Notes to Condensed Consolidated Financial Statements](#c_012) | 8 |
| Item 2. | [Management’s Discussion and Analysis of Financial Condition and Results of Operations](#k_001) | 24 |
| Item 3. | [Quantitative and Qualitative Disclosures About Market Risk](#c_001) | 34 |
| Item 4. | [Controls and Procedures](#c_002) | 35 |
|  |  |  |
|  | [**PART II. OTHER INFORMATION**](#c_003) |  |
|  |  |  |
| Item 1. | [Legal Proceedings](#c_004) | 36 |
| Item 1A. | [Risk Factors](#c_005) | 36 |
| Item 2. | [Unregistered Sales of Equity Securities and Use of Proceeds](#c_006) | 36 |
| Item 3. | [Defaults Upon Senior Securities](#c_007) | 36 |
| Item 4. | [Mine Safety Disclosures](#c_008) | 36 |
| Item 5. | [Other Information](#c_009) | 36 |
| Item 6. | [Exhibits](#c_010) | 37 |
|  |  |  |
| [Signatures](#c_011) | | 38 |

|  |  |  |
| --- | --- | --- |
|  | 1 |  |

|  |
| --- |
|  |

**Forward-Looking Statements**

*Certain statements that we make from time to time, including statements contained in this Quarterly Report on Form 10-Q, constitute “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. All statements other than statements of historical fact contained in this Quarterly Report on Form 10-Q are forward-looking statements. These statements relate to anticipated future events, future results of operations or future financial performance. In some cases, you can identify forward-looking statements by terminology such as “may,” “might,” “will,” “should,” “intends,” “expects,” “plans,” “goals,” “projects,” “anticipates,” “believes,” “estimates,” “predicts,” “potential,” or “continue” or the negative of these terms or other comparable terminology. Our operations involve risks and uncertainties, many of which are outside of our control, and any one of which, or a combination of which, could materially affect our results of operations and whether the forward-looking statements ultimately prove to be correct. Forward-looking statements in this Quarterly Report on Form 10-Q include, without limitation, statements reflecting management’s expectations for future financial performance and operating expenditures (including our ability to continue as a going concern, to raise additional capital and to succeed in our future operations), expected growth, profitability and business outlook, increased sales and marketing expenses, and the expected results from the integration of our acquisitions.*

*Forward-looking statements are only predictions, are uncertain and involve substantial known and unknown risks, uncertainties, and other factors which may cause our (or our industry’s) actual results, levels of activity or performance to be materially different from any future results, levels of activity or performance expressed or implied by these forward-looking statements. These factors include, among other things, the unknown risks and uncertainties that we believe could cause actual results to differ from these forward-looking statements as set forth under the heading “Risk Factors” in our Annual Report on Form 10-K filed with the SEC on March 20, 2019. New risks and uncertainties emerge from time to time, and it is not possible for us to predict all of the risks and uncertainties that could have an impact on the forward-looking statements, including without limitation, risks and uncertainties relating to:*

|  |  |  |
| --- | --- | --- |
|  | ● | our ability to manage our growth, including acquiring, partnering with, and effectively integrating recent acquisitions and other acquired businesses into our infrastructure and avoiding legal exposure and liabilities associated with acquired companies and assets; |
|  |  |  |
|  | ● | our ability to retain our clients and revenue levels, including effectively migrating new clients and maintaining or growing the revenue levels of our new and existing clients; |
|  |  |  |
|  | ● | our ability to maintain operations in Pakistan and Sri Lanka in a manner that continues to enable us to offer competitively priced products and services; |
|  |  |  |
|  | ● | our ability to keep pace with a rapidly changing healthcare industry; |
|  |  |  |
|  | ● | our ability to consistently achieve and maintain compliance with a myriad of federal, state, foreign, local, payor and industry requirements, regulations, rules, laws and contracts; |
|  |  |  |
|  | ● | our ability to maintain and protect the privacy of confidential and protected Company, client and patient information; |
|  |  |  |
|  | ● | our ability to protect and enforce intellectual property rights; |
|  |  |  |
|  | ● | our ability to attract and retain key officers and employees, and the continued involvement of Mahmud Haq as executive chairman, all of which are critical to our ongoing operations, growing our business and integrating of our newly acquired businesses; |
|  |  |  |
|  | ● | our ability to comply with covenants contained in our credit agreement with our senior secured lender, Silicon Valley Bank and other future debt facilities; |
|  |  |  |
|  | ● | our ability to pay our monthly preferred dividends to the holders of our Series A Preferred Stock; |
|  |  |  |
|  | ● | our ability to compete with other companies developing products and selling services competitive with ours, and who may have greater resources and name recognition than we have; and |
|  |  |  |
|  | ● | our ability to keep and increase market acceptance of our products and services. |

*We cannot guarantee future results, levels of activity or performance. Except as required by law, we are under no duty to update or revise any of such forward-looking statements, whether as a result of new information, future events, or otherwise, after the date of this Quarterly Report on Form 10-Q.*

*You should read this Quarterly Report on Form 10-Q with the understanding that our actual future results, levels of activity, performance and events and circumstances may be materially different from what we expect.*

|  |  |  |
| --- | --- | --- |
|  | 2 |  |

|  |
| --- |
|  |

**PART I. FINANCIAL INFORMATION**

**Item 1. Condensed Consolidated Financial Statements (Unaudited)**

**MTBC, INC.**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **June 30, 2019** | |  |  | **December 31, 2018** | |  |
|  |  | **(Unaudited)** | |  |  |  | |  |
| ASSETS |  |  |  |  |  |  |  |  |
| CURRENT ASSETS: |  |  |  |  |  |  |  |  |
| Cash |  | $ | 10,583,026 |  |  | $ | 14,472,483 |  |
| Accounts receivable - net of allowance for doubtful accounts of $194,000 and $189,000 at June 30, 2019 and December 31, 2018, respectively |  |  | 7,518,940 |  |  |  | 7,331,474 |  |
| Contract asset |  |  | 2,473,671 |  |  |  | 2,608,631 |  |
| Inventory |  |  | 402,570 |  |  |  | 444,437 |  |
| Current assets - related party |  |  | 13,200 |  |  |  | 25,203 |  |
| Prepaid expenses and other current assets |  |  | 843,428 |  |  |  | 1,191,445 |  |
| Total current assets |  |  | 21,834,835 |  |  |  | 26,073,673 |  |
| Property and equipment - net |  |  | 2,031,246 |  |  |  | 1,832,187 |  |
| Operating lease right-of-use assets |  |  | 4,860,780 |  |  |  | - |  |
| Intangible assets - net |  |  | 6,507,149 |  |  |  | 6,634,003 |  |
| Goodwill |  |  | 12,633,696 |  |  |  | 12,593,795 |  |
| Other assets |  |  | 412,101 |  |  |  | 489,703 |  |
| TOTAL ASSETS |  | $ | 48,279,807 |  |  | $ | 47,623,361 |  |
| LIABILITIES AND SHAREHOLDERS’ EQUITY |  |  |  |  |  |  |  |  |
| CURRENT LIABILITIES: |  |  |  |  |  |  |  |  |
| Accounts payable |  | $ | 2,442,211 |  |  | $ | 2,438,267 |  |
| Accrued compensation |  |  | 2,181,733 |  |  |  | 1,731,063 |  |
| Accrued expenses |  |  | 2,031,007 |  |  |  | 1,589,009 |  |
| Deferred rent (current portion) |  |  | - |  |  |  | 90,657 |  |
| Operating lease liability (current portion) |  |  | 2,077,030 |  |  |  | - |  |
| Deferred revenue (current portion) |  |  | 16,225 |  |  |  | 25,355 |  |
| Accrued liability to related party |  |  | 663 |  |  |  | 10,663 |  |
| Notes payable (current portion) |  |  | 152,830 |  |  |  | 277,776 |  |
| Contingent consideration |  |  | 279,565 |  |  |  | 526,432 |  |
| Dividend payable |  |  | 1,486,708 |  |  |  | 1,468,724 |  |
| Total current liabilities |  |  | 10,667,972 |  |  |  | 8,157,946 |  |
| Notes payable |  |  | 158,874 |  |  |  | 222,400 |  |
| Deferred rent |  |  | - |  |  |  | 189,366 |  |
| Operating lease liability |  |  | 2,876,232 |  |  |  | - |  |
| Deferred revenue |  |  | 18,360 |  |  |  | 18,949 |  |
| Deferred tax liability |  |  | 149,166 |  |  |  | 164,346 |  |
| Total liabilities |  |  | 13,870,604 |  |  |  | 8,753,007 |  |
| COMMITMENTS AND CONTINGENCIES (Note 8) |  |  |  |  |  |  |  |  |
| SHAREHOLDERS’ EQUITY: |  |  |  |  |  |  |  |  |
| Preferred stock, $0.001 par value - authorized 7,000,000 and 4,000,000 shares at June 30, 2019 and December 31, 2018, respectively; issued and outstanding 2,162,449 and 2,136,289 shares at June 30, 2019 and December 31, 2018, respectively |  |  | 2,162 |  |  |  | 2,136 |  |
| Common stock, $0.001 par value - authorized 29,000,000 and 19,000,000 shares at June 30, 2019 and December 31, 2018, respectively; issued 12,769,041 and 12,570,557 shares at June 30, 2019 and December 31, 2018, respectively; outstanding, 12,028,242 and 11,829,758 shares at June 30, 2019 and December 31, 2018, respectively |  |  | 12,769 |  |  |  | 12,571 |  |
| Additional paid-in capital |  |  | 62,300,966 |  |  |  | 65,142,460 |  |
| Accumulated deficit |  |  | (25,270,408 | ) |  |  | (24,203,745 | ) |
| Accumulated other comprehensive loss |  |  | (1,974,286 | ) |  |  | (1,421,068 | ) |
| Less: 740,799 common shares held in treasury, at cost at June 30, 2019 and December 31, 2018 |  |  | (662,000 | ) |  |  | (662,000 | ) |
| Total shareholders’ equity |  |  | 34,409,203 |  |  |  | 38,870,354 |  |
| TOTAL LIABILITIES AND SHAREHOLDERS’ EQUITY |  | $ | 48,279,807 |  |  | $ | 47,623,361 |  |

See notes to condensed consolidated financial statements.

|  |  |  |
| --- | --- | --- |
|  | 3 |  |

|  |
| --- |
|  |

**MTBC, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended** | | | | | |  |  | **Six Months Ended** | | | | | |  |
|  |  | **June 30,** | | | | | |  |  | **June 30,** | | | | | |  |
|  |  | **2019** | |  |  | **2018** | |  |  | **2019** | |  |  | **2018** | |  |
| NET REVENUE |  | $ | 16,749,499 |  |  | $ | 8,682,937 |  |  | $ | 31,829,710 |  |  | $ | 16,990,262 |  |
| OPERATING EXPENSES: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Direct operating costs |  |  | 11,396,395 |  |  |  | 4,333,573 |  |  |  | 21,243,935 |  |  |  | 8,817,628 |  |
| Selling and marketing |  |  | 382,557 |  |  |  | 403,057 |  |  |  | 743,956 |  |  |  | 708,071 |  |
| General and administrative |  |  | 5,143,754 |  |  |  | 3,054,205 |  |  |  | 9,305,830 |  |  |  | 5,654,939 |  |
| Research and development |  |  | 218,408 |  |  |  | 248,921 |  |  |  | 473,064 |  |  |  | 504,800 |  |
| Change in contingent consideration |  |  | - |  |  |  | 11,030 |  |  |  | (64,203 | ) |  |  | 42,780 |  |
| Depreciation and amortization |  |  | 836,161 |  |  |  | 559,696 |  |  |  | 1,592,901 |  |  |  | 1,150,467 |  |
| Total operating expenses |  |  | 17,977,275 |  |  |  | 8,610,482 |  |  |  | 33,295,483 |  |  |  | 16,878,685 |  |
| OPERATING (LOSS) INCOME |  |  | (1,227,776 | ) |  |  | 72,455 |  |  |  | (1,465,773 | ) |  |  | 111,577 |  |
| OTHER: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest income |  |  | 67,497 |  |  |  | 29,939 |  |  |  | 145,697 |  |  |  | 35,224 |  |
| Interest expense |  |  | (100,562 | ) |  |  | (74,167 | ) |  |  | (195,958 | ) |  |  | (148,248 | ) |
| Other income - net |  |  | 545,221 |  |  |  | 218,589 |  |  |  | 464,191 |  |  |  | 369,963 |  |
| (LOSS) INCOME BEFORE INCOME TAXES |  |  | (715,620 | ) |  |  | 246,816 |  |  |  | (1,051,843 | ) |  |  | 368,516 |  |
| Income tax provision |  |  | 55,352 |  |  |  | 51,536 |  |  |  | 14,820 |  |  |  | 98,200 |  |
| NET (LOSS) INCOME |  | $ | (770,972 | ) |  | $ | 195,280 |  |  | $ | (1,066,663 | ) |  | $ | 270,316 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Preferred stock dividend |  |  | 1,486,706 |  |  |  | 1,248,717 |  |  |  | 2,979,406 |  |  |  | 2,024,049 |  |
| NET LOSS ATTRIBUTABLE TO COMMON SHAREHOLDERS |  | $ | (2,257,678 | ) |  | $ | (1,053,437 | ) |  | $ | (4,046,069 | ) |  | $ | (1,753,733 | ) |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net loss per common share: basic and diluted |  | $ | (0.19 | ) |  | $ | (0.09 | ) |  | $ | (0.34 | ) |  | $ | (0.15 | ) |
| Weighted-average common shares used to compute basic and diluted loss per share |  |  | 12,022,143 |  |  |  | 11,665,174 |  |  |  | 11,984,284 |  |  |  | 11,641,190 |  |

See notes to condensed consolidated financial statements.

|  |  |  |
| --- | --- | --- |
|  | 4 |  |

|  |
| --- |
|  |

**MTBC, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS (UNAUDITED)**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended** | | | | | |  |  | **Six Months Ended** | | | | | |  |
|  |  | **June 30,** | | | | | |  |  | **June 30,** | | | | | |  |
|  |  | **2019** | |  |  | **2018** | |  |  | **2019** | |  |  | **2018** | |  |
| NET (LOSS) INCOME |  | $ | (770,972 | ) |  | $ | 195,280 |  |  | $ | (1,066,663 | ) |  | $ | 270,316 |  |
| OTHER COMPREHENSIVE LOSS, NET OF TAX |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Foreign currency translation adjustment (a) |  |  | (762,563 | ) |  |  | (227,258 | ) |  |  | (553,218 | ) |  |  | (430,404 | ) |
| COMPREHENSIVE LOSS |  | $ | (1,533,535 | ) |  | $ | (31,978 | ) |  | $ | (1,619,881 | ) |  | $ | (160,088 | ) |

(a) No tax effect has been recorded as the Company recorded a valuation allowance against the tax benefit from its foreign currency translation adjustments.

See notes to condensed consolidated financial statements.

|  |  |  |
| --- | --- | --- |
|  | 5 |  |

|  |
| --- |
|  |

**MTBC, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS’ EQUITY (UNAUDITED)**

**FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2019 AND JUNE 30, 2018**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Preferred Stock** | | | | | |  |  | **Common Stock** | | | | | |  |  | **Additional Paid-in** | |  |  | **Accumulated** | |  |  | **Accumulated Other Comprehensive** | |  |  | **Treasury (Common)** | |  |  | **Total Shareholders’** | |  |
|  |  |  | **Shares** |  |  |  | **Amount** |  |  |  | **Shares** |  |  |  | **Amount** |  |  |  | **Capital** |  |  |  | **Deficit** |  |  |  | **Loss** |  |  |  | **Stock** |  |  |  | **Equity** |  |
| Balance- December 31, 2018 |  |  | 2,136,289 |  |  | $ | 2,136 |  |  |  | 12,570,557 |  |  | $ | 12,571 |  |  | $ | 65,142,460 |  |  | $ | (24,203,745 | ) |  | $ | (1,421,068 | ) |  | $ | (662,000 | ) |  | $ | 38,870,354 |  |
| Net loss |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | (295,691 | ) |  |  | - |  |  |  | - |  |  |  | (295,691 | ) |
| Foreign currency translation adjustment |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | 209,345 |  |  |  | - |  |  |  | 209,345 |  |
| Issuance of stock under the Amended and Restated Equity Incentive Plan |  |  | 26,160 |  |  |  | 26 |  |  |  | 179,984 |  |  |  | 180 |  |  |  | (206 | ) |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |
| Stock-based compensation, net of cash settlements |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | 523,556 |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | 523,556 |  |
| Tax withholding obligations on stock issued to employees |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | (800,271 | ) |  |  | - |  |  |  | - |  |  |  | - |  |  |  | (800,271 | ) |
| Preferred stock dividends |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | (1,492,700 | ) |  |  | - |  |  |  | - |  |  |  | - |  |  |  | (1,492,700 | ) |
| Balance - March 31, 2019 |  |  | 2,162,449 |  |  | $ | 2,162 |  |  |  | 12,750,541 |  |  | $ | 12,751 |  |  | $ | 63,372,839 |  |  | $ | (24,499,436 | ) |  | $ | (1,211,723 | ) |  | $ | (662,000 | ) |  | $ | 37,014,593 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Balance- April 1, 2019 |  |  | 2,162,449 |  |  | $ | 2,162 |  |  |  | 12,750,541 |  |  | $ | 12,751 |  |  | $ | 63,372,839 |  |  | $ | (24,499,436 | ) |  | $ | (1,211,723 | ) |  | $ | (662,000 | ) |  | $ | 37,014,593 |  |
| Net loss |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | (770,972 | ) |  |  | - |  |  |  | - |  |  |  | (770,972 | ) |
| Foreign currency translation adjustment |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | (762,563 | ) |  |  | - |  |  |  | (762,563 | ) |
| Issuance of stock under the Amended and Restated Equity Incentive Plan |  |  | - |  |  |  | - |  |  |  | 18,500 |  |  |  | 18 |  |  |  | (18 | ) |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |
| Stock-based compensation, net of cash settlements |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | 473,387 |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | 473,387 |  |
| Tax withholding obligations on stock issued to employees |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | (58,536 | ) |  |  | - |  |  |  | - |  |  |  | - |  |  |  | (58,536 | ) |
| Preferred stock dividends |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | (1,486,706 | ) |  |  | - |  |  |  | - |  |  |  | - |  |  |  | (1,486,706 | ) |
| Balance - June 30, 2019 |  |  | 2,162,449 |  |  | $ | 2,162 |  |  |  | 12,769,041 |  |  | $ | 12,769 |  |  | $ | 62,300,966 |  |  | $ | (25,270,408 | ) |  | $ | (1,974,286 | ) |  | $ | (662,000 | ) |  | $ | 34,409,203 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Balance- December 31, 2017 before adoption |  |  | 1,086,739 |  |  | $ | 1,087 |  |  |  | 12,271,390 |  |  | $ | 12,272 |  |  | $ | 45,129,517 |  |  | $ | (23,509,386 | ) |  | $ | (721,070 | ) |  | $ | (662,000 | ) |  | $ | 20,250,420 |  |
| Cumulative effect of adopting ASC 606 |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | 1,444,121 |  |  |  | - |  |  |  | - |  |  |  | 1,444,121 |  |
| Balance- January 1, 2018 after adoption |  |  | 1,086,739 |  |  | $ | 1,087 |  |  |  | 12,271,390 |  |  | $ | 12,272 |  |  | $ | 45,129,517 |  |  | $ | (22,065,265 | ) |  | $ | (721,070 | ) |  | $ | (662,000 | ) |  | $ | 21,694,541 |  |
| Net income |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | 75,036 |  |  |  | - |  |  |  | - |  |  |  | 75,036 |  |
| Foreign currency translation adjustment |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | (203,146 | ) |  |  | - |  |  |  | (203,146 | ) |
| Issuance of stock under the Amended and Restated Equity Incentive Plan |  |  | 29,550 |  |  |  | 29 |  |  |  | 134,583 |  |  |  | 134 |  |  |  | (163 | ) |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |
| Stock-based compensation, net of cash settlements |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | 112,090 |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | 112,090 |  |
| Tax withholding obligations on stock issued to employees |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | (226,250 | ) |  |  | - |  |  |  | - |  |  |  | - |  |  |  | (226,250 | ) |
| Preferred stock dividends |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | (775,332 | ) |  |  | - |  |  |  | - |  |  |  | - |  |  |  | (775,332 | ) |
| Balance - March 31, 2018 |  |  | 1,116,289 |  |  | $ | 1,116 |  |  |  | 12,405,973 |  |  | $ | 12,406 |  |  | $ | 44,239,862 |  |  | $ | (21,990,229 | ) |  | $ | (924,216 | ) |  | $ | (662,000 | ) |  | $ | 20,676,939 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Balance- April 1, 2018 |  |  | 1,116,289 |  |  | $ | 1,116 |  |  |  | 12,405,973 |  |  | $ | 12,406 |  |  | $ | 44,239,862 |  |  | $ | (21,990,229 | ) |  | $ | (924,216 | ) |  | $ | (662,000 | ) |  | $ | 20,676,939 |  |
| Net income |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | 195,280 |  |  |  | - |  |  |  | - |  |  |  | 195,280 |  |
| Foreign currency translation adjustment |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | (227,258 | ) |  |  | - |  |  |  | (227,258 | ) |
| Stock-based compensation, net of cash settlements |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | 364,710 |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | 364,710 |  |
| Issuance of preferred stock, net of fees and expenses |  |  | 420,000 |  |  |  | 420 |  |  |  | - |  |  |  | - |  |  |  | 9,354,490 |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | 9,354,910 |  |
| Preferred stock dividends |  |  | - |  |  |  | - |  |  |  | - |  |  |  | - |  |  |  | (1,248,717 | ) |  |  | - |  |  |  | - |  |  |  | - |  |  |  | (1,248,717 | ) |
| Balance - June 30, 2018 |  |  | 1,536,289 |  |  | $ | 1,536 |  |  |  | 12,405,973 |  |  | $ | 12,406 |  |  | $ | 52,710,345 |  |  | $ | (21,794,949 | ) |  | $ | (1,151,474 | ) |  | $ | (662,000 | ) |  | $ | 29,115,864 |  |

For all periods presented, the preferred stock dividends were paid monthly at the rate of $2.75 per share per annum.

**See notes to condensed consolidated financial statements.**

|  |  |  |
| --- | --- | --- |
|  | 6 |  |

|  |
| --- |
|  |

**MTBC, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

**FOR THE SIX MONTHS ENDED JUNE 30, 2019 AND 2018**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **2019** | |  |  | **2018** | |  |
| OPERATING ACTIVITIES: |  |  |  |  |  |  |  |  |
| Net (loss) income |  | $ | (1,066,663 | ) |  | $ | 270,316 |  |
| Adjustments to reconcile net (loss) income to net cash provided by operating activities: |  |  |  |  |  |  |  |  |
| Depreciation and amortization |  |  | 1,627,296 |  |  |  | 1,176,939 |  |
| Deferred rent |  |  | - |  |  |  | (36,022 | ) |
| Lease amortization |  |  | 943,028 |  |  |  | - |  |
| Deferred revenue |  |  | (9,719 | ) |  |  | (34,832 | ) |
| Provision for doubtful accounts |  |  | 92,061 |  |  |  | 112,406 |  |
| (Benefit) provision for deferred income taxes |  |  | (15,180 | ) |  |  | 78,000 |  |
| Foreign exchange gain |  |  | (295,487 | ) |  |  | (332,100 | ) |
| Interest accretion |  |  | 258,735 |  |  |  | 95,604 |  |
| Gain on sale of assets |  |  | (26,213 | ) |  |  | - |  |
| Stock-based compensation expense |  |  | 1,550,188 |  |  |  | 537,402 |  |
| Change in contingent consideration |  |  | (64,203 | ) |  |  | 42,780 |  |
| Changes in operating assets and liabilities, net of businesses acquired: |  |  |  |  |  |  |  |  |
| Accounts receivable |  |  | 267,850 |  |  |  | 2,576 |  |
| Contract asset |  |  | 274,129 |  |  |  | 326,631 |  |
| Inventory |  |  | 41,867 |  |  |  | - |  |
| Other assets |  |  | 571,468 |  |  |  | (91,643 | ) |
| Accounts payable and other liabilities |  |  | (836,228 | ) |  |  | (180,452 | ) |
| Net cash provided by operating activities |  |  | 3,312,929 |  |  |  | 1,967,605 |  |
| INVESTING ACTIVITIES: |  |  |  |  |  |  |  |  |
| Capital expenditures, net |  |  | (904,220 | ) |  |  | (376,430 | ) |
| Cash paid for acquisitions |  |  | (1,600,000 | ) |  |  | (1,000,000 | ) |
| Net cash used in investing activities |  |  | (2,504,220 | ) |  |  | (1,376,430 | ) |
| FINANCING ACTIVITIES: |  |  |  |  |  |  |  |  |
| Proceeds from issuance of preferred stock, net of fees and expenses |  |  | - |  |  |  | 9,415,000 |  |
| Preferred stock dividends paid |  |  | (2,961,422 | ) |  |  | (1,714,979 | ) |
| Settlement of tax withholding obligations on stock issued to employees |  |  | (932,465 | ) |  |  | (213,675 | ) |
| Repayments of notes payable, net |  |  | (181,457 | ) |  |  | (139,485 | ) |
| Contingent consideration payments |  |  | (182,664 | ) |  |  | (82,725 | ) |
| Other financing activities |  |  | - |  |  |  | (60,090 | ) |
| Net cash (used in) provided by financing activities |  |  | (4,258,008 | ) |  |  | 7,204,046 |  |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH |  |  | (440,158 | ) |  |  | (434,834 | ) |
| NET (DECREASE) INCREASE IN CASH |  |  | (3,889,457 | ) |  |  | 7,360,387 |  |
| CASH - beginning of the period |  |  | 14,472,483 |  |  |  | 4,362,232 |  |
| CASH - end of the period |  | $ | 10,583,026 |  |  | $ | 11,722,619 |  |
| SUPPLEMENTAL NONCASH INVESTING AND FINANCING ACTIVITIES: |  |  |  |  |  |  |  |  |
| Vehicle financing obtained |  | $ | 24,909 |  |  | $ | 75,372 |  |
| Dividends declared, not paid |  | $ | 1,486,708 |  |  | $ | 1,056,217 |  |
| SUPPLEMENTAL INFORMATION - Cash paid during the period for: |  |  |  |  |  |  |  |  |
| Income taxes |  | $ | 35,862 |  |  | $ | 29,673 |  |
| Interest |  | $ | 28,085 |  |  | $ | 20,221 |  |

See notes to condensed consolidated financial statements.

|  |  |  |
| --- | --- | --- |
|  | 7 |  |

|  |
| --- |
|  |

**MTBC, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**AS OF AND FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2019 AND 2018 (UNAUDITED)**

**1. Organization and Business**

MTBC, Inc., (and together with its consolidated subsidiaries “MTBC” or the “Company”) is a healthcare information technology company that offers an integrated suite of proprietary cloud-based electronic health records and practice management solutions, together with related business services, to healthcare providers. The Company’s integrated services are designed to help customers increase revenues, streamline workflows and make better business and clinical decisions, while reducing administrative burdens and operating costs. The Company’s services include full-scale revenue cycle management, electronic health records, and other technology-driven practice management services for private and hospital-employed healthcare providers. MTBC has its corporate offices in Somerset, New Jersey and maintains client support teams throughout the U.S., Pakistan and Sri Lanka.

MTBC was founded in 1999 and incorporated under the laws of the State of Delaware in 2001. In 2004, MTBC formed MTBC Private Limited (or “MTBC Pvt. Ltd.”), a 99.9% majority-owned subsidiary of MTBC based in Pakistan. The remaining 0.01% of the shares of MTBC Pvt. Ltd. is owned by the founder and Executive Chairman of MTBC. In 2016, MTBC formed MTBC Acquisition Corp. (“MAC”), a Delaware corporation, in connection with its acquisition of substantially all of the assets of MediGain, LLC and its subsidiary, Millennium Practice Management Associates, LLC (together “MediGain). MAC has a wholly owned subsidiary in Sri Lanka, RCM MediGain Colombo, Pvt. Ltd. In May 2018, MTBC formed MTBC Health, Inc. (“MHI”) and MTBC Practice Management, Corp. (“MPM”), each a Delaware corporation in connection with MTBC’s acquisition of substantially all of the revenue cycle management, practice management and group purchasing organization assets of Orion Healthcorp, Inc. and 13 of its affiliates (together, “Orion”). MHI is a direct, wholly owned subsidiary of MTBC, and was formed to own and operate the revenue cycle management and group purchasing organization businesses acquired from Orion. MPM is a wholly owned subsidiary of MHI and was formed to own and operate the practice management business acquired from Orion. In March 2019, MTBC formed MTBC-Med, Inc. (“MED”), a Delaware corporation, in connection with its acquisition of substantially all of the assets of Etransmedia Technology, Inc. and its subsidiaries (“ETM”). See Note 3.

**2. BASIS OF PRESENTATION**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial reporting and as required by Regulation S-X, Rule 8-03. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of the Company’s management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting of items of a normal and recurring nature) necessary to present fairly the Company’s financial position as of June 30, 2019, the results of operations for the three and six months ended June 30, 2019 and 2018 and cash flows for the six months ended June 30, 2019 and 2018. When preparing financial statements in conformity with GAAP, the Company must make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ significantly from those estimates.

The condensed consolidated balance sheet as of December 31, 2018 was derived from our audited consolidated financial statements. The accompanying unaudited condensed consolidated financial statements and notes thereto should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2018, which are included in the Company’s Annual Report on Form 10-K, filed with the SEC on March 20, 2019.

|  |  |  |
| --- | --- | --- |
|  | 8 |  |

|  |
| --- |
|  |

***Recent Accounting Pronouncements*** — In February 2016, the Financial Accounting Standards Board “FASB” issued ASU No. 2016-02, *Leases (Topic 842).* The new standard requires organizations that have leased assets, referred to as “lessees,” to recognize on the balance sheet the assets and liabilities that represent the rights and obligations created by those leases, respectively. Under the new guidance, a lessee is required to recognize assets and liabilities for leases with lease terms of more than 12 months. Consistent with current GAAP, the recognition, measurement and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. However, unlike current GAAP which requires only capital leases to be recognized on the balance sheet, the new ASU requires both types of leases to be recognized on the balance sheet. The FASB has subsequently issued further ASU’s related to the standard providing additional practical expedients and an optional transition method allowing entities to not recast comparative periods. The amendments in ASU No. 2016-02 are now effective.

We adopted the standard on January 1, 2019 using the optional transition adjustment method. As part of the adoption of ASC 842, we performed an assessment of the impact of the new lease recognition standard has on the condensed consolidated financial statements. All of our leases, which consist of facility and equipment leases, have been classified as operating leases. The Company does not have any financing leases. We adopted the requirements of the new standard without restating the prior periods. There was no impact to the accumulated deficit as of the date of adoption. For leases in place at the transition date, we adopted the package of practical expedients that allows us to not reassess: (1) whether any expired or existing contracts are or contain leases, (2) lease classification for any expired or existing leases and (3) initial direct costs for any expired or existing leases.

We have also adopted the practical expedients that allow us to treat the lease and non-lease components of our leases as a single component for our facility leases. We elected the short-term lease recognition exemption for all leases that qualify. As such, for those leases that qualify, we did not recognize ROU asset or lease liabilities as part of the transition adjustment. As of January 1, 2019, the impact on the consolidated assets was approximately $4.2 million and the impact on the consolidated liabilities was approximately $4.4 million. The adoption of ASC 842 did not have a material effect on the Company’s results of operations, stockholders’ equity, or statement of cash flows.

We have also evaluated, documented, and implemented required changes in internal control as part of our adoption of the new lease recognition standard. These changes include implementing updated accounting policies affected by ASC 842 and implementing a new information technology application to calculate our right-of-use assets, lease liabilities and required disclosures.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses: Measurement of Credit Losses on Financial Instruments* (“ASU 2016-13”). The guidance in ASU 2016-13 replaces the incurred loss impairment methodology under current GAAP. The new impairment model requires immediate recognition of estimated credit losses expected to occur for most financial assets and certain other instruments. It will apply to all entities. For trade receivables, loans and held-to-maturity debt securities, entities will be required to estimate lifetime expected credit losses. This may result in the earlier recognition of credit losses. ASU 2016-13 is effective for annual periods beginning after December 15, 2019, and interim periods within those annual periods. Early adoption is permitted for fiscal years beginning after December 15, 2018. We are currently in the process of evaluating this new guidance, which we expect will not have a material impact on our consolidated financial statements and results of operations.

On February 14, 2018, the FASB issued ASU 2018-02, *Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.* These amendments provide financial statement preparers with an option to reclassify standard tax effects within accumulated other comprehensive income to retained earnings in each period in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act is recorded. This guidance is effective for fiscal years beginning after December 15, 2018, and interim periods therein. The Company does not anticipate any material impact on the consolidated financial statements as a result of this standard.

|  |  |  |
| --- | --- | --- |
|  | 9 |  |

|  |
| --- |
|  |

**3. ACQUISITIONS**

**2019 Acquisition**

On April 3, 2019, the Company executed an asset purchase agreement (“APA”) to acquire substantially all of the assets of ETM. The purchase price was $1.6 million and the assumption of certain liabilities, excluding acquisition-related costs of approximately $125,000. Per the APA, the acquisition had an effective date of April 1, 2019. The acquisition has been accounted for as a business combination.

The ETM acquisition added additional clients to the Company’s customer base and, similar to previous acquisitions, broadened the Company’s presence in the healthcare information technology industry through geographic expansion of its customer base and by increasing available customer relationship resources and specialized trained staff.

The purchase price allocation for ETM was performed by the Company and is summarized as follows:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Customer relationships |  | $ | 856,000 |  |
| Accounts receivable |  |  | 547,377 |  |
| Contract asset |  |  | 139,169 |  |
| Operating lease right-of-use assets |  |  | 1,224,480 |  |
| Property and equipment |  |  | 91,277 |  |
| Goodwill |  |  | 39,901 |  |
| Operating lease liabilities |  |  | (1,224,480 | ) |
| Accrued expenses |  |  | (73,724 | ) |
| Total |  | $ | 1,600,000 |  |

The acquired accounts receivable are recorded at fair value which represents amounts that have subsequently been paid or are expected to be paid by clients. The fair value of customer relationships was based on the estimated discounted cash flows generated by these intangibles. The goodwill from this acquisition is deductible ratably for income tax purposes over fifteen years and represents the Company’s ability to have an expanded local presence in additional markets and operational synergies that we expect to achieve that would not be available to other market participants.

The weighted-average amortization period of the acquired intangible assets is four years.

Revenue earned from the clients obtained from the ETM acquisition was approximately $2.0 million during both the three and six months ended June 30, 2019.

**2018 Acquisition**

On May 7, 2018, the Company executed an APA to acquire substantially all of the revenue cycle, practice management, and group purchasing organization assets of Orion. The purchase price was $12.6 million, excluding acquisition-related costs of approximately $245,000. Per the APA, the acquisition had an effective date of July 1, 2018. The acquisition has been accounted for as a business combination.

The Orion acquisition added a significant number of clients to the Company’s customer base and, similar to previous acquisitions, broadened the Company’s presence in the healthcare information technology industry through geographic expansion of its customer base and by increasing available customer relationship resources and specialized trained staff. The acquisition also included Orion’s practice management and group purchasing services. The practice management services provide three pediatric medical practices with the nurses, administrative support, facilities, supplies, equipment, marketing, RCM, accounting and other non-clinical services needed to efficiently operate the practices. The group purchasing services enable medical providers to purchase various vaccines directly from selected pharmaceutical companies at a discounted price.

|  |  |  |
| --- | --- | --- |
|  | 10 |  |

|  |
| --- |
|  |

The Company engaged a third-party valuation specialist to assist the Company in valuing the assets acquired from Orion. The following table summarizes the purchase price allocation.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Customer relationships |  | $ | 6,250,000 |  |
| Accounts receivable |  |  | 5,654,919 |  |
| Contract asset |  |  | 861,341 |  |
| Inventory |  |  | 307,278 |  |
| Property and equipment |  |  | 319,352 |  |
| Goodwill |  |  | 329,852 |  |
| Accounts payable |  |  | (677,872 | ) |
| Accrued expenses |  |  | (444,870 | ) |
| Total |  | $ | 12,600,000 |  |

The acquired accounts receivable are recorded at fair value which represents amounts that have subsequently been paid or are expected to be paid by clients. The inventory acquired represents vaccines held at the managed practices. The fair value of customer relationships was based on the estimated discounted cash flows generated by these intangibles. The goodwill from this acquisition is deductible ratably for income tax purposes over fifteen years and represents the Company’s ability to have an expanded local presence in additional markets, operational synergies that we expect to achieve that would not be available to other market participants and the ability to offer group purchasing and practice management services.

The weighted-average amortization period of the acquired intangibles is seven years.

Revenue earned from the clients obtained from the Orion acquisition was approximately $7.1 million and $14.8 million during the three and six months ended June 30, 2019, respectively.

**Pro forma financial information (Unaudited)**

The unaudited pro forma information below represents condensed consolidated results of operations as if the Orion and ETM acquisitions occurred on January 1, 2018. The pro forma information has been included for comparative purposes and is not indicative of results of operations that the Company would have had if the acquisitions occurred on the above date, nor is it necessarily indicative of future results. The unaudited pro forma information reflects material, non-recurring pro forma adjustments directly attributable to the business combinations. The difference between the actual revenue and the pro forma revenue is approximately $19.1 million of additional revenue recorded by Orion and approximately $6.5 million of additional revenue recorded by ETM for the six months ended June 30, 2018. The difference between the actual and pro forma results for the three months ended June 30, 2019 represent approximately $200,000 of transaction and integration costs incurred by the Company during the period.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended**  **June 30,** | | | | | |  |  | **Six Months**  **Ended June 30,** | | | | | |  |
|  |  | **2019** | |  |  | **2018** | |  |  | **2019** | |  |  | **2018** | |  |
| Total revenue |  | $ | 16,749 |  |  | $ | 21,129 |  |  | $ | 33,897 |  |  | $ | 42,610 |  |
| Net loss |  | $ | (571 | ) |  | $ | (2,618 | ) |  | $ | (2,729 | ) |  | $ | (5,953 | ) |
| Net loss attributable to common shareholders |  | $ | (2,058 | ) |  | $ | (3,867 | ) |  | $ | (5,708 | ) |  | $ | (7,977 | ) |
| Net loss per common share |  | $ | (0.17 | ) |  | $ | (0.33 | ) |  | $ | (0.48 | ) |  | $ | (0.69 | ) |

|  |  |  |
| --- | --- | --- |
|  | 11 |  |

|  |
| --- |
|  |

**4. GOODWILL AND INTANGIBLE ASSETS-NET**

Goodwill consists of the excess of the purchase price over the fair value of identifiable net assets of businesses acquired. The following is the summary of the changes to the carrying amount of goodwill for the six months ended June 30, 2019 and the year ended December 31, 2018:

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Six Months Ended** | |  |  | **Year Ended** | |  |
|  |  | **June 30, 2019** | |  |  | **December 31, 2018** | |  |
| Beginning gross balance |  | $ | 12,593,795 |  |  | $ | 12,263,943 |  |
| Acquisition |  |  | 39,901 |  |  |  | 329,852 |  |
| Ending gross balance |  | $ | 12,633,696 |  |  | $ | 12,593,795 |  |

Of the total goodwill, approximately $90,000 is allocated to the Practice Management segment and the balance is allocated to the Healthcare IT segment.

Intangible assets include customer contracts and relationships and covenants not-to-compete acquired in connection with acquisitions, as well as trademarks acquired and software costs. Intangible assets - net as of June 30, 2019 and December 31, 2018 consist of the following:

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **June 30, 2019** | |  |  | **December 31, 2018** | |  |
| Contracts and relationships acquired |  | $ | 23,597,300 |  |  | $ | 22,741,300 |  |
| Non-compete agreements |  |  | 1,236,377 |  |  |  | 1,236,377 |  |
| Other intangible assets |  |  | 1,606,552 |  |  |  | 1,477,059 |  |
| Total intangible assets |  |  | 26,440,229 |  |  |  | 25,454,736 |  |
| Less: Accumulated amortization |  |  | (19,933,080 | ) |  |  | (18,820,733 | ) |
| Intangible assets - net |  | $ | 6,507,149 |  |  | $ | 6,634,003 |  |

Amortization expense was approximately $1.2 million and $854,000 for the six months ended June 30, 2019 and 2018 and $612,000 and $415,000 for the three months ended June 30, 2019 and 2018, respectively. The weighted-average amortization period is currently seven years.

As of June 30, 2019, future amortization scheduled to be expensed is as follows:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Years ending** |  |  | |  |
| **December 31** |  |  | |  |
| 2019 (six months) |  | $ | 959,035 |  |
| 2020 |  |  | 1,301,600 |  |
| 2021 |  |  | 1,157,877 |  |
| 2022 |  |  | 800,107 |  |
| 2023 |  |  | 338,528 |  |
| Thereafter |  |  | 1,950,002 |  |
| Total |  | $ | 6,507,149 |  |

|  |  |  |
| --- | --- | --- |
|  | 12 |  |

|  |
| --- |
|  |

**5. NET LOss per COMMON share**

The following table reconciles the weighted-average shares outstanding for basic and diluted net loss per share for the three and six months ended June 30, 2019 and 2018:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended**  **June 30,** | | | | | |  |  | **Six Months Ended**  **June 30,** | | | | | |  |
|  |  | **2019** | |  |  | **2018** | |  |  | **2019** | |  |  | **2018** | |  |
| Basic and Diluted: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net loss attributable to common shareholders |  | $ | (2,257,678 | ) |  | $ | (1,053,437 | ) |  | $ | (4,046,069 | ) |  | $ | (1,753,733 | ) |
| Weighted-average common shares used to compute basic and diluted loss per share |  |  | 12,022,143 |  |  |  | 11,665,174 |  |  |  | 11,984,284 |  |  |  | 11,641,190 |  |
| Net loss attributable to common shareholders per share - Basic and Diluted |  | $ | (0.19 | ) |  | $ | (0.09 | ) |  | $ | (0.34 | ) |  | $ | (0.15 | ) |

All unvested restricted stock units (“RSUs”), the 200,000 warrants granted to Opus Bank (“Opus”) and the 153,489 warrants granted to Silicon Valley Bank (“SVB”) have been excluded from the above calculations as they were anti-dilutive. Vested RSUs and vested restricted shares have been included in the above calculations.

**6. Debt**

*SVB* — During October 2017, the Company opened a revolving line of credit from SVB under a three-year agreement. The SVB credit facility is a secured revolving line of credit where borrowings are based on a formula of 200% of repeatable revenue adjusted by an annualized attrition rate as defined in the credit agreement. During the third quarter of 2018, the credit line was increased from $5 million to $10 million and the term was extended for an additional year. Nothing was drawn on this line of credit as of June 30, 2018 or 2019. Interest on the SVB revolving line of credit is charged at the prime rate plus 1.50%. There is also a fee of one-half of 1% annually for the unused portion of the credit line. The debt is secured by all of the Company’s domestic assets and 65% of the shares in its offshore facilities. Future acquisitions are subject to approval by SVB.

*Vehicle Financing Notes* — The Company financed certain vehicle purchases both in the United States and in Pakistan. The vehicle financing notes have three to six years terms and were issued at current market rates.

*Insurance Financing* — The Company finances certain insurance purchases over the term of the policy life. The interest rate charged is 5.87%.

**7. leases**

We determine if an arrangement is a lease at inception. Operating leases are included in operating lease right-of-use (“ROU”) assets, current operating lease liability and noncurrent operating lease liability in our condensed consolidated balance sheet as of June 30, 2019. The Company does not have any finance leases.

ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. ROU assets and liabilities are recognized at the lease commencement date based on the estimated present value of lease payments over the lease term.

We use our estimated incremental borrowing rates, which are derived from information available at the lease commencement date, in determining the present value of lease payments. For leases in existence at the adoption of ASC 842, we used the incremental borrowing rate as of January 1, 2019. We give consideration to our bank financing arrangements, geographical location and collateralization of assets when calculating our incremental borrowing rates.

Our lease terms include options to extend the lease when it is reasonably certain that we will exercise that option. Leases with a term of less than 12 months are not recorded in the condensed consolidated balance sheet. Our lease agreements do not contain any residual value guarantees. For real estate leases, we account for the lease and non-lease components as a single lease component. Some leases include escalation clauses and termination options that are factored in the determination of the lease payments when appropriate.

If a lease is modified after the effective date, the operating lease ROU asset and liability is re-measured using the current incremental borrowing rate.

|  |  |  |
| --- | --- | --- |
|  | 13 |  |

|  |
| --- |
|  |

We lease all of our facilities and some equipment. Lease expense is included in direct operating costs and general and administrative expenses in the condensed consolidated statements of operations based on the nature of the expense. As of June 30, 2019, we had 34 leased properties, five in Practice Management and 29 in Healthcare IT, with remaining terms ranging from less than one year to five years. Our lease terms are determined taking into account lease renewal options, the Company’s anticipated operating plans and leases that are on a month-to-month basis. We also have some related party leases – see Note 9.

The components of lease expense were as follows:

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended**  **June 30, 2019** | |  |  | **Six Months Ended**  **June 30, 2019** | |  |
| Operating lease cost |  | $ | 639,393 |  |  | $ | 1,104,621 |  |
| Short-term lease cost |  |  | 32,425 |  |  |  | 137,976 |  |
| Variable lease cost |  |  | 12,450 |  |  |  | 19,033 |  |
| Total- net lease cost |  | $ | 684,268 |  |  | $ | 1,261,630 |  |

Short-term lease cost represents leases that were not capitalized as the lease term as of the later of January 1, 2019 or the beginning of the lease was less than 12 months. Variable lease costs include utilities, real estate taxes and common area maintenance costs.

Supplemental balance sheet information related to leases was as follows:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  | **June 30, 2019** | |  |
| Operating leases: |  |  |  |  |
| Operating lease ROU asset, net |  | $ | 4,860,780 |  |
|  |  |  |  |  |
| Current operating lease liabilities |  | $ | 2,077,030 |  |
| Non-current operating lease liabilities |  |  | 2,876,232 |  |
| Total operating lease liabilities |  | $ | 4,953,262 |  |
|  |  |  |  |  |
| Operating leases: |  |  |  |  |
| ROU assets, gross |  | $ | 5,878,215 |  |
| Asset lease expense |  |  | (943,028 | ) |
| Foreign exchange loss |  |  | (74,407 | ) |
| ROU assets, net |  | $ | 4,860,780 |  |
|  |  |  |  |  |
| Weighted average remaining lease term (in years): |  |  |  |  |
| Operating leases |  |  | 2.67 |  |
| Weighted average discount rate: |  |  |  |  |
| Operating leases |  |  | 7.04 | % |

Supplemental cash flow and other information related to leases was as follows:

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended**  **June 30, 2019** | |  |  | **Six Months Ended**  **June 30, 2019** | |  |
| Cash paid for amounts included in the measurement of lease liabilities: |  |  |  |  |  |  |  |  |
| Operating cash flows from operating leases |  | $ | 646,824 |  |  | $ | 1,124,884 |  |
|  |  |  |  |  |  |  |  |  |
| ROU assets obtained in exchange for lease liabilities: |  |  |  |  |  |  |  |  |
| Operating leases |  | $ | 1,453,751 |  |  | $ | 1,634,041 |  |

|  |  |  |
| --- | --- | --- |
|  | 14 |  |

|  |
| --- |
|  |

Maturities of lease liabilities are as follows:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Operating leases** |  |  | |  |
| 2019 (six months) |  | $ | 1,287,711 |  |
| 2020 |  |  | 2,033,900 |  |
| 2021 |  |  | 1,397,022 |  |
| 2022 |  |  | 561,914 |  |
| 2023 |  |  | 141,314 |  |
| Total lease payments |  |  | 5,421,861 |  |
| Less: imputed interest |  |  | (468,599 | ) |
| Total lease obligations |  |  | 4,953,262 |  |
| Less: current obligations |  |  | (2,077,030 | ) |
| Long-term lease obligations |  | $ | 2,876,232 |  |

As of June 30, 2019, we do not have operating lease commitments that have not yet commenced.

Disclosures related to periods prior to adoption of ASC 842:

Operating lease rent expense was approximately $220,000 and $436,000 for the three and six months ended June 30, 2018, respectively. Month to month leases and cancellable leases are not included in the table below. Certain leases are maintained on a month to month basis. This includes leases for the US corporate facility and other locations with the Executive Chairman (see Note 9). As of December 31, 2018, future lease payment obligations under non-cancellable operating leases were as follows:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Operating leases** |  |  | |  |
| 2019 |  | $ | 932,068 |  |
| 2020 |  |  | 715,059 |  |
| 2021 |  |  | 510,927 |  |
| 2022 |  |  | 412,585 |  |
| 2023 |  |  | 91,797 |  |
| Total |  | $ | 2,662,436 |  |

**8. Commitments and Contingencies**

**Legal Proceedings** — On May 30, 2018, the Superior Court of New Jersey, Chancery Division, Somerset County (the “Chancery Court”) denied the Company’s and MTBC Acquisition Corp.’s (“MAC”) request to enjoin an arbitration proceeding demanded by Randolph Pain Relief and Wellness Center (“RPRWC”) related to RCM services provided by parties unaffiliated with the Company and MAC. On June 15, 2018, the Company and MAC filed an appeal of the Chancery Court’s decision with the Superior Court of New Jersey, Appellate Division. On July 19, 2018, the Chancery Court ordered that the arbitration be stayed pending the Company’s and MAC’s appeal. On appeal, the Company and MAC contended they were never party to the billing services agreement giving rise to the arbitration claim, did not assume the obligations of Millennium Practice Management Associates, Inc. (“MPMA”) under such agreement, and any agreement to arbitrate disputes arising under such agreement does not apply to the Company or MAC. On January 30, 2019, the parties conducted oral arguments before the Appellate Court. On April 23, 2019, the Appellate Division reversed the trial court’s order, in part, ruling that the Company is not required to participate in the arbitration, but upheld the portion of the trial court’s order requiring MAC to participate in the arbitration based on the trial court’s finding, that MAC had assumed MPMA’s contractual responsibilities. The Appellate Division remanded RPRWC’s demand for the Company to arbitrate back to the trial court for further proceedings. RPRWC’s arbitration demand alleges MPMA, a subsidiary of MediGain, LLC, breached a billing services agreement and seeks compensatory damages of six million, six hundred thousand dollars and costs. On June 6, 2019, the Chancery Court conducted a scheduling conference to establish deadlines for exchanging written discovery between the parties on issues related to whether MTBC, in addition to MAC is required to arbitrate the underlying dispute. Currently, the parties are exchanging discovery requests and responding to same. The Court has scheduled an additional status conference on August 6, 2019. The allegations of breach of contract made by RPRWC have not been the subject of the ongoing legal proceedings. RPRWC has not provided the Company or MAC with information sufficient to enable the Company and MAC to estimate a range of possible losses that may arise from this matter. The Company and MAC plan to vigorously defend against RPRWC’s claim and in the event of a loss, if any, they anticipate the loss to be substantially less than the amount claimed.

|  |  |  |
| --- | --- | --- |
|  | 15 |  |

|  |
| --- |
|  |

**Acquisitions —** In connection with one of the Company’s acquisitions, contingent consideration as of June 30, 2019 is payable in cash, which represents the date through which contingent payments are required. Depending on the terms of the agreement, if the performance measures are not achieved, the Company may pay less than the recorded amount, and if the performance measures are exceeded, the Company may pay more than the recorded amount.

**9. Related PARTIES**

The Company had sales to a related party, a physician who is the wife of the Executive Chairman. Revenues from this customer were approximately $9,000 for both the six months ended June 30, 2019 and 2018, and $5,000 and $4,000 for the three months ended June 30, 2019 and 2018, respectively. As of June 30, 2019 and December 31, 2018, the receivable balance due from this customer was approximately $1,500 and $1,600, respectively.

The Company is a party to a nonexclusive aircraft dry lease agreement with Kashmir Air, Inc. (“KAI”), which is owned by the Executive Chairman. The Company recorded an expense of approximately $64,000 for both the six month periods ended June 30, 2019 and 2018, and $32,000 for both the three months ended June 30, 2019 and 2018. As of June 30, 2019 and December 31, 2018, the Company had a liability outstanding to KAI of approximately $1,000 and $11,000 respectively, which is included in accrued liability to related party in the condensed consolidated balance sheets. The original aircraft lease expired on March 31, 2019 and was not included in the ROU asset at January 1, 2019 or March 31, 2019. A lease for a different aircraft at the same lease rate was entered into as of April 1, 2019 and has been included in the ROU asset and operating lease liability at June 30, 2019.

The Company leases its corporate offices in New Jersey, its temporary housing for its foreign visitors, a storage facility and its backup operations center in Bagh, Pakistan, from the Executive Chairman. The related party rent expense for the six months ended June 30, 2019 and 2018 was approximately $94,000 and $95,000, respectively, and for three months ended June 30, 2019 and 2018 was approximately $46,000 and $47,000, and is included in direct operating costs and general and administrative expense in the consolidated statements of operations. Current assets-related party in the condensed consolidated balance sheets includes security deposits and prepaid rent related to the leases of the Company’s corporate offices in the amount of approximately $13,000 and $25,000 as of June 30, 2019 and December 31, 2018, respectively.

Included in the ROU asset at June 30, 2019 is approximately $570,000 applicable to the related party leases. Included in the current and non-current operating lease liability at June 30, 2019 is approximately $274,000 and $296,000, respectively applicable to the related party leases.

**10. REVENUE**

*Introduction*

The Company accounts for revenue in accordance with ASC 606, *Revenue from Contracts with Customers*, which was adopted January 1, 2018 using the modified retrospective method. All revenue is recognized as our performance obligations are satisfied. A performance obligation is a promise in a contract to transfer a distinct good or service to a customer, and is the unit of account under ASC 606. Under ASC 606, the Company recognizes revenue when the revenue cycle management services begin on the medical billing claims, which is generally upon receipt of the claim from the provider. For revenue cycle management services, the Company estimates the value of the consideration it will earn over the remaining contractual period as our services are provided and recognizes the fees over the term; this estimation involves predicting the amounts our clients will ultimately collect associated with the services they provided. The selling price of the Company’s services equals the contractual price. Certain significant estimates, such as payment-to-charge ratios, effective billing rates and the estimated contractual payment periods are required to measure revenue cycle management revenue under ASC 606.

Most of our current contracts with customers contain a single performance obligation. For contracts where we provide multiple services, such as where we perform multiple ancillary services, each service represents its own performance obligation. Selling prices are based on the contractual price for the service, which approximates the stand alone selling price.

|  |  |  |
| --- | --- | --- |
|  | 16 |  |

|  |
| --- |
|  |

We apply the portfolio approach as permitted by ASC 606 as a practical expedient to contracts with similar characteristics and we use estimates and assumptions when accounting for those portfolios. Our contracts generally include standard commercial payment terms. We have no significant obligations for refunds, warranties or similar obligations and our revenue does not include taxes collected from our customers.

*Disaggregation of Revenue from Contracts with Customers*

We derive revenue from seven primary sources: revenue cycle management services, practice management services, professional services, ancillary services, group purchasing services, printing and mailing services, and clearinghouse and EDI (electronic data interchange) services.

The following table represents a disaggregation of revenue for the three and six months ended June 30:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended June 30,** | | | | | |  |  | **Six Months Ended June 30,** | | | | | |  |
|  |  |  | **2019** |  |  |  | **2018** |  |  |  | **2019** |  |  |  | **2018** |  |
| **Healthcare IT:** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Revenue cycle management services |  | $ | 11,432,683 |  |  | $ | 7,866,650 |  |  | $ | 21,990,125 |  |  | $ | 15,259,040 |  |
| Professional services |  |  | 383,336 |  |  |  | 59,653 |  |  |  | 718,771 |  |  |  | 184,268 |  |
| Ancillary services |  |  | 930,181 |  |  |  | 313,454 |  |  |  | 1,429,277 |  |  |  | 562,091 |  |
| Group purchasing services |  |  | 205,066 |  |  |  | - |  |  |  | 405,113 |  |  |  | - |  |
| Printing and mailing services |  |  | 358,440 |  |  |  | 301,279 |  |  |  | 750,100 |  |  |  | 649,523 |  |
| Clearinghouse and EDI services |  |  | 150,869 |  |  |  | 141,901 |  |  |  | 286,933 |  |  |  | 335,340 |  |
| **Practice Management:** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Practice management services |  |  | 3,288,924 |  |  |  | - |  |  |  | 6,249,391 |  |  |  | - |  |
| Total |  | $ | 16,749,499 |  |  | $ | 8,682,937 |  |  | $ | 31,829,710 |  |  | $ | 16,990,262 |  |

*Revenue cycle management services:*

Revenue cycle management services are the recurring process of submitting and following up on claims with health insurance companies in order for the healthcare providers to receive payment for the services they rendered. MTBC typically invoices customers on a monthly basis based on the actual collections received by its customers and the agreed-upon rate in the sales contract. The services include use of practice management software and related tools (on a software-as-a-service (“SaaS”) basis), electronic health records (on a SaaS basis), medical billing services and use of mobile health solutions. We consider the services to be one performance obligation since the promises are not distinct in the context of the contract. The performance obligation consists of a series of distinct services that are substantially the same and have the same periodic pattern of transfer to our customers.

In many cases, our clients may terminate their agreements with 90 days’ notice without cause, thereby limiting the term in which we have enforceable rights and obligations, although this time period can vary between clients. Our payment terms are normally net 30 days. Although our contracts typically have stated terms of one or more years, under ASC 606 our contracts are considered month-to-month and accordingly, there is no financing component.

For the majority of our revenue cycle management contracts, the total transaction price is variable because our obligation is to process an unknown quantity of claims, as and when requested by our customers over the contract period. When a contract includes variable consideration, we evaluate the estimate of the variable consideration to determine whether the estimate needs to be constrained; therefore, we include variable consideration in the transaction price only to the extent that it is probable that a significant reversal of the amount of cumulative revenue recognized will not occur when the uncertainty associated with variable consideration is subsequently resolved. Estimates to determine variable consideration such as payment to charge ratios, effective billing rates, and the estimated contractual payment periods are updated at each reporting date. Revenue is recognized over the performance period using the input method.

|  |  |  |
| --- | --- | --- |
|  | 17 |  |

|  |
| --- |
|  |

*Other revenue streams:*

MTBC also provides implementation and professional services to clearinghouse and other customers and records revenue monthly on a time and materials or a fixed rate basis. This is a separate performance obligation from the clearinghouse and recurring EDI services provided, for which the Company receives and records monthly fees. The performance obligation is satisfied over time as the implementation or professional services are rendered.

Ancillary services represent services such as coding and transcription that are rendered in connection with the delivery of revenue cycle management and related medical services. The Company invoices customers monthly, based on the actual amount of services performed at the agreed upon rate in the contract. These services are only offered to revenue cycle management customers. These services do not represent a material right because the services are optional to the customer and customers electing these services are charged the same price for those services as if they were on a standalone basis. Each individual coding or transcription transaction processed represents a performance obligation, which is satisfied over time as that individual service is rendered.

The Company provides group purchasing services which enable medical providers to purchase various vaccines directly from selected pharmaceutical companies at a discounted price. Currently, there are approximately 4,000 medical providers who are members of the program. Revenue is recognized as the vaccine shipments are made to the medical providers. Fees from the pharmaceutical companies are paid either quarterly or annually and the Company adjusts its revenue accrual at the time of payment. The Company makes significant judgments regarding the variable consideration which we expect to be entitled to for the group purchasing services which includes the anticipated shipments to the members enrolled in the program, anticipated volumes of purchases made by the members, and the changes in the number of members. The amounts recorded are constrained by estimates of decreases in shipments and loss of members to avoid a significant revenue reversal in the subsequent period. The only performance obligation is to provide the pharmaceutical companies with the medical providers who want to become members in order to purchase vaccines. The performance obligation is satisfied once the medical provider agrees to purchase a specific quantity of vaccines and the medical provider’s information is forwarded to the vaccine suppliers. The Company records a contract asset for revenue earned and not paid as the ultimate payment is conditioned on achieving certain volume thresholds.

The Company provides printing and mailing services for both revenue cycle management customers and a non- revenue cycle management customer, and invoices on a monthly basis based on the number of prints, the agreed-upon rate per print and the postage incurred. The performance obligation is satisfied once the printing and mailing is completed.

The medical billing clearinghouse service takes claim information from customers, checks the claims for errors and sends this information electronically to insurance companies. MTBC invoices customers on a monthly basis based on the number of claims submitted and the agreed-upon rate in the agreement. This service is provided to medical practices and providers to medical practices who are not revenue cycle management customers. The performance obligation is satisfied once the relevant submissions are completed.

For all of the above revenue streams other than group purchasing services, revenue is recognized over time, which is typically one month or less, which closely matches the point in time that the customer simultaneously receives and consumes the benefits provided by the Company. For the group purchasing services, revenue is recognized at a point in time. Other than the group purchasing services, each of the Company’s services are substantially the same and have the same periodic pattern of transfer to the customer. Each service provided by the Company is considered a separate performance obligation.

*Practice management services:*

The Company also provides practice management services under long-term management service agreements to three medical practices. We provide the medical practices with the nurses, administrative support, facilities, supplies, equipment, marketing, RCM, accounting, and other non-clinical services needed to efficiently operate their practices. Revenue is recognized as the services are provided to the medical practices. Revenue recorded in the consolidated statements of operations represents the reimbursement of costs paid by the Company for the practices and the management fee earned each month for managing the practice. The management fee is based on either a fixed fee or a percentage of the net operating income.

|  |  |  |
| --- | --- | --- |
|  | 18 |  |

|  |
| --- |
|  |

The Company assumes all financial risk for the performance of the managed medical practices. Revenue is impacted by amount of the costs incurred by the practices and their operating income. The gross billing of the practices is impacted by billing rates, changes in current procedural terminology code reimbursement and collection trends which in turn impacts the management fee that the Company is entitled to. Billing rates are reviewed at least annually and adjusted based on current insurer reimbursement practices. The performance obligation is satisfied as the management services are provided.

Our contracts for practice management services have approximately an additional 20 years remaining and are only cancellable under very limited circumstances. The Company receives a management fee each month for managing the day-to-day business operations of each medical group as a fixed fee or a percentage payment of the net operating income which is included in revenue in the consolidated statements of operations.

The Company also provides accounting services and a practice manager to one additional medical practice for which it receives monthly fees.

Our practice management services obligations consist of a series of distinct services that are substantially the same and have the same periodic pattern of transfer to our customers. Revenue is recognized over time, however, for reporting and convenience purposes management fee is computed at each month end.

*Information about contract balances:*

The contract asset in the condensed consolidated balance sheets represents the revenue associated with the amounts we estimate our revenue cycle management clients will ultimately collect associated with the services they have provided and the relative fee we charge associated with those collections, together with amounts related to the group purchasing services. As of June 30, 2019, the estimated revenue expected to be recognized in the future related to the remaining revenue cycle management performance obligations outstanding was approximately $2 million. We expect to recognize substantially all of the revenue for the remaining performance obligations over the next three months. Approximately $0.5 million of the contract asset represents revenue earned, not paid, from the group purchasing services.

Accounts receivable are shown separately at their net realizable value in our condensed consolidated balance sheets. Amounts that we are entitled to collect under the applicable contract are recorded as accounts receivable. Invoicing is performed at the end of each month when the services have been provided. The contract asset results from our revenue cycle management services and is due to the timing of revenue recognition, submission of claims from our customers and payments from the insurance providers. The contract asset includes our right to payment for services already transferred to a customer when the right to payment is conditional on something other than the passage of time. For example, contracts for revenue cycle management services where we recognize revenue over time but do not have a contractual right to payment until the customer receives payment of their claim from the insurance provider. The contract asset also includes the revenue accrued, not received, for the group purchasing services.

|  |  |  |
| --- | --- | --- |
|  | 19 |  |

|  |
| --- |
|  |

The contract asset was approximately $2.5 million and $1.7 million as of June 30, 2019 and June 30, 2018, respectively. Changes in the contract asset are recorded as adjustments to net revenue. The changes primarily result from providing services to revenue cycle management customers that result in additional consideration and are offset by our right to payment for services becoming unconditional and changes in the revenue accrued for the group purchasing services. The contract asset for our group purchasing services is reduced when we receive payments from vaccine manufacturers and is increased for revenue earned, not received. Deferred revenue represents sign-up fees received from customers that are amortized over three years. The opening and closing balances of the Company’s accounts receivable, contract asset and deferred revenue are as follows for the six months ended June 30, 2019 and 2018:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Accounts Receivable, Net** | |  |  | **Contract Asset** | |  |  | **Deferred Revenue (current)** | |  |  | **Deferred Revenue  (long term)** | |  |
| Beginning balance as of January 1, 2019 |  | $ | 7,331,474 |  |  | $ | 2,608,631 |  |  | $ | 25,355 |  |  | $ | 18,949 |  |
| ETM acquisition |  |  | - |  |  |  | 139,169 |  |  |  | - |  |  |  | - |  |
| Increase (decrease), net |  |  | 187,466 |  |  |  | (274,129 | ) |  |  | (9,130 | ) |  |  | (589 | ) |
| Ending balance as of June 30, 2019 |  | $ | 7,518,940 |  |  | $ | 2,473,671 |  |  | $ | 16,225 |  |  | $ | 18,360 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Beginning balance as of January 1, 2018 |  | $ | 3,879,463 |  |  | $ | 1,342,692 |  |  | $ | 62,104 |  |  | $ | 28,615 |  |
| (Decrease) increase, net |  |  | (441,613 | ) |  |  | 326,631 |  |  |  | (34,429 | ) |  |  | (403 | ) |
| Ending balance as of June 30, 2018 |  | $ | 3,437,850 |  |  | $ | 1,669,323 |  |  | $ | 27,675 |  |  | $ | 28,212 |  |

*Deferred commissions:*

Our sales incentive plans include commissions payable to employees and third parties at the time of initial contract execution that are capitalized as incremental costs to obtain a contract. The capitalized commissions are amortized over the period the related services are transferred. As we do not offer commissions on contract renewals, we have determined the amortization period to be the estimated client life, which is three years. Deferred commissions were approximately $60,000 and $113,000 at June 30, 2019 and 2018, respectively, and are included in the other assets amounts in the condensed consolidated balance sheets.

**11. STOCK-BASED COMPENSATION**

In April 2014, the Company adopted its Equity Incentive Plan (the “Plan”), reserving 1,351,000 shares of common stock for grants to employees, officers, directors and consultants. During April 2017, the Plan was amended and restated whereby an additional 1,500,000 shares of common stock and 100,000 shares of Series A Preferred Stock were added to the plan for future issuance. During June 2018, the Company’s shareholders approved the addition of 200,000 preferred shares to the Plan for future grants. As of June 30, 2019, 554,910 shares of common stock and 138,400 shares of Series A Preferred Stock are available for grant under the Plan. Permissible awards include incentive stock options, non-statutory stock options, stock appreciation rights, restricted stock, RSUs, performance stock and cash-settled awards and other stock-based awards in the discretion of the Compensation Committee of the Board of Directors including unrestricted stock grants.

The common stock equity based RSUs contain a common provision in which the units shall immediately vest and become converted into common shares at the rate of one share per RSU, immediately after a change in control, as defined in the award agreement. The preferred stock RSUs contain a similar provision, which vest and convert to Series A Preferred Stock upon a change in control.

***Common and preferred stock RSUs***

In February 2019, the Compensation Committee approved executive bonuses to be paid in shares of Series A Preferred Stock, with the number of shares and the amount based on specified criteria being achieved during the year 2019. The actual amount will be settled in early 2020 based on the achievement of the specified criteria. For the three and six months ended June 30, 2019, an expense of approximately $301,000 and $602,000, respectively, was recorded for these bonuses based on the value of the shares at the grant date and recognized over the service period. The portion of the stock compensation expense to be used for the payment of withholding and payroll taxes is included in accrued compensation in the condensed consolidated balance sheets. The balance of the stock compensation expense has been recorded as additional paid-in capital.

|  |  |  |
| --- | --- | --- |
|  | 20 |  |

|  |
| --- |
|  |

The following table summarizes the RSU transactions related to the common and preferred stock under the Equity Incentive Plan for the six months ended June 30, 2019:

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Common Stock** | |  |  | **Preferred Stock** | |  |
| Outstanding and unvested shares at January 1, 2019 |  |  | 929,347 |  |  |  | 44,800 |  |
| Granted |  |  | 5,000 |  |  |  | 44,000 |  |
| Vested |  |  | (319,813 | ) |  |  | (44,800 | ) |
| Forfeited |  |  | (12,120 | ) |  |  | - |  |
| Outstanding and unvested shares at June 30, 2019 |  |  | 602,414 |  |  |  | 44,000 |  |

Of the total outstanding and unvested common stock RSUs at June 30, 2019, 568,081 RSUs are classified as equity and 34,333 RSUs are classified as a liability. All of the preferred stock RSUs are classified as equity.

***Stock-based compensation expense***

The Company recognizes compensation expense on a straight-line basis over the total requisite service period for the entire award. For stock awards classified as equity, the market price of our common stock or preferred stock on the date of grant is used in recording the fair value of the award and includes the related taxes. For stock awards classified as a liability, the earned amount is marked to market based on the end of period common stock price. The liability for the cash-settled awards was approximately $479,000 and $118,000 at June 30, 2019 and December 31, 2018, respectively, and is included in accrued compensation in the condensed consolidated balance sheets.

The following table summarizes the components of share-based compensation expense for the three and six months ended June 30, 2019 and 2018:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Stock-based compensation included in the** |  | **Three Months Ended June 30,** | | | | | |  |  | **Six Months Ended June 30,** | | | | | |  |
| **condensed consolidated statements of operations:** |  | **2019** | |  |  | **2018** | |  |  | **2019** | |  |  | **2018** | |  |
| Direct operating costs |  | $ | 46,207 |  |  | $ | 8,475 |  |  | $ | 96,858 |  |  | $ | 9,859 |  |
| General and administrative |  |  | 711,050 |  |  |  | 396,674 |  |  |  | 1,407,471 |  |  |  | 522,600 |  |
| Research and development |  |  | 4,353 |  |  |  | 4,563 |  |  |  | 9,834 |  |  |  | 4,943 |  |
| Selling and marketing |  |  | 31,053 |  |  |  | - |  |  |  | 36,025 |  |  |  | - |  |
| Total stock-based compensation expense |  | $ | 792,663 |  |  | $ | 409,712 |  |  | $ | 1,550,188 |  |  | $ | 537,402 |  |

**12. INCOME TAXES**

The income tax expense for the three months ended June 30, 2019 was approximately $55,000, comprised of a current tax expense of $15,000 and deferred tax expense of $40,000. The current income tax provision and the deferred income tax benefit for the six months ended June 30, 2019 were approximately $30,000 and $15,000, respectively.

The current income tax provision for the three and six months ended June 30, 2019 and 2018 primarily relates to state minimum taxes and foreign income taxes.

Although the Company is forecasting a return to profitability, it has incurred cumulative losses which make realization of deferred tax asset difficult to support in accordance with ASC 740. Accordingly, a valuation allowance has been recorded against the Federal and state deferred tax assets as of June 30, 2019 and December 31, 2018.

**13. FAIR VALUE OF FINANCIAL INSTRUMENTS**

As of June 30, 2019, and December 31, 2018, the carrying amounts of accounts receivable, accounts payable and accrued expenses approximated their estimated fair values because of the short term nature of these financial instruments.

*Fair value measurements-Level 2*

Our notes payable are carried at cost and approximate fair value since the interest rates being charged approximate market rates. As a result, the Company categorizes these borrowings as level 2 in the fair value hierarchy.

|  |  |  |
| --- | --- | --- |
|  | 21 |  |

|  |
| --- |
|  |

*Contingent Consideration*

The Company’s contingent consideration of approximately $280,000 and $526,000 as of June 30, 2019 and December 31, 2018, respectively, are Level 3 liabilities. The fair value of the contingent consideration at June 30, 2019 and December 31, 2018 was primarily driven by changes in revenue estimates related to the acquisitions during 2015 and 2016, the passage of time and the associated discount rate. Due to the number of factors used to determine contingent consideration, it is not possible to determine a range of outcomes. Subsequent adjustments to the fair value of the contingent consideration liability will continue to be recorded in the Company’s results of operations until all contingencies are settled.

The following table provides a reconciliation of the beginning and ending balances for the contingent consideration measured at fair value using significant unobservable inputs (Level 3):

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Fair Value Measurement at Reporting Date Using Significant Unobservable Inputs, Level 3** | | | | | |  |
|  |  | **Six Months Ended June 30,** | | | | | |  |
|  |  | **2019** | |  |  | **2018** | |  |
| Balance - January 1, |  | $ | 526,432 |  |  | $ | 603,411 |  |
| Change in fair value |  |  | (64,203 | ) |  |  | 42,780 |  |
| Payments |  |  | (182,664 | ) |  |  | (82,725 | ) |
| Balance - June 30, |  | $ | 279,565 |  |  | $ | 563,466 |  |

1**4.** **SEGMENT REPORTING**

Both our Chief Executive Officer and Executive Chairman serve as the Chief Operating Decision Maker (“CODM”), organize the Company, manage resource allocations and measure performance among two operating and reportable segments: (i) Healthcare IT and (ii) Practice Management.

|  |  |  |
| --- | --- | --- |
|  | 22 |  |

|  |
| --- |
|  |

The Healthcare IT segment includes revenue cycle management and other services. The Practice Management segment includes the management of three medical practices and starting April 1, 2019, certain practice management services are being provided to a fourth practice. Each segment is considered a reporting unit. The CODM evaluates financial performance of the business units on the basis of revenue and direct operating costs excluding unallocated amounts, which are mainly corporate overhead costs. Our CODM does not evaluate operating segments using asset or liability information. The accounting policies of the segments are the same as those disclosed in the Company’s Annual Report on Form 10-K for the year ended December 31, 2018 filed with the SEC on March 20, 2019. There was only one operating segment during the three and six months ended June 30, 2018 as the Practice Management segment was acquired in July 2018. The following table presents revenues, operating expenses and operating income (loss) by reportable segment:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Six Months Ended June 30, 2019** | | | | | | | | | | | | | |  |
|  |  | **Healthcare IT** | |  |  | **Practice Management** | |  |  | **Unallocated Corporate Expenses** | |  |  | **Total** | |  |
| Net revenue |  | $ | 25,580,319 |  |  | $ | 6,249,391 |  |  | $ | - |  |  | $ | 31,829,710 |  |
| Operating expenses: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Direct operating costs |  |  | 16,403,912 |  |  |  | 4,840,023 |  |  |  | - |  |  |  | 21,243,935 |  |
| Selling and marketing |  |  | 726,147 |  |  |  | 17,809 |  |  |  | - |  |  |  | 743,956 |  |
| General and administrative |  |  | 5,757,549 |  |  |  | 955,760 |  |  |  | 2,592,521 |  |  |  | 9,305,830 |  |
| Research and development |  |  | 473,064 |  |  |  | - |  |  |  | - |  |  |  | 473,064 |  |
| Change in contingent consideration |  |  | (64,203 | ) |  |  | - |  |  |  | - |  |  |  | (64,203 | ) |
| Depreciation and amortization |  |  | 1,435,071 |  |  |  | 157,830 |  |  |  | - |  |  |  | 1,592,901 |  |
| Total operating expenses |  |  | 24,731,540 |  |  |  | 5,971,422 |  |  |  | 2,592,521 |  |  |  | 33,295,483 |  |
| Operating income (loss) |  | $ | 848,779 |  |  | $ | 277,969 |  |  | $ | (2,592,521 | ) |  | $ | (1,465,773 | ) |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended June 30, 2019** | | | | | | | | | | | | | |  |
|  |  | **Healthcare IT** | |  |  | **Practice Management** | |  |  | **Unallocated Corporate Expenses** | |  |  | **Total** | |  |
| Net revenue |  | $ | 13,460,575 |  |  | $ | 3,288,924 |  |  | $ | - |  |  | $ | 16,749,499 |  |
| Operating expenses: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Direct operating costs |  |  | 8,929,458 |  |  |  | 2,466,937 |  |  |  | - |  |  |  | 11,396,395 |  |
| Selling and marketing |  |  | 374,196 |  |  |  | 8,361 |  |  |  | - |  |  |  | 382,557 |  |
| General and administrative |  |  | 3,295,146 |  |  |  | 559,390 |  |  |  | 1,289,218 |  |  |  | 5,143,754 |  |
| Research and development |  |  | 218,408 |  |  |  | - |  |  |  | - |  |  |  | 218,408 |  |
| Depreciation and amortization |  |  | 757,084 |  |  |  | 79,077 |  |  |  | - |  |  |  | 836,161 |  |
| Total operating expenses |  |  | 13,574,292 |  |  |  | 3,113,765 |  |  |  | 1,289,218 |  |  |  | 17,977,275 |  |
| Operating (loss) income |  | $ | (113,717 | ) |  | $ | 175,159 |  |  | $ | (1,289,218 | ) |  | $ | (1,227,776 | ) |

|  |  |  |
| --- | --- | --- |
|  | 23 |  |

|  |
| --- |
|  |

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

The following is a discussion of our consolidated financial condition and results of operations for the three and six months ended June 30, 2019 and 2018, and other factors that are expected to affect our prospective financial condition. The following discussion and analysis should be read together with our Condensed Consolidated Financial Statements and related notes beginning on page 4 of this Quarterly Report on Form 10-Q.

Some of the statements set forth in this section are forward-looking statements relating to our future results of operations. Our actual results may vary from the results anticipated by these statements. Please see “*Forward-Looking Statements*” on page 2 of this Quarterly Report on Form 10-Q.

**Overview**

MTBC, Inc., (formerly Medical Transcription Billing, Corp.) together with its consolidated subsidiaries (“MTBC” or the “Company”), is a healthcare information technology company that provides a suite of proprietary web-based solutions and business services to healthcare providers. Our integrated Software-as-a-Service (“SaaS”) platform and business services are designed to help our clients increase revenues, streamline workflows and make better business and clinical decisions, while reducing administrative burdens and operating costs. These solutions and services include:

Healthcare IT:

|  |  |  |
| --- | --- | --- |
|  | ● | Revenue cycle management (“RCM”) services; |

|  |  |  |
| --- | --- | --- |
|  | o | Proprietary, healthcare IT solutions, which are part of our RCM services, including: |

|  |  |  |
| --- | --- | --- |
|  | ● | Electronic health records, |
|  | ● | Practice management software and related tools, |
|  | ● | Mobile Health (“mHealth”) solutions, |
|  | ● | Healthcare claims clearinghouse, and |
|  | ● | Business intelligence, customized applications, interfaces and a variety of other technology solutions that support our healthcare clients. |

|  |  |  |
| --- | --- | --- |
|  | ● | Group purchasing services. |

Practice Management:

|  |  |  |
| --- | --- | --- |
|  | ● | Comprehensive practice management services. |

We are able to deliver our industry-leading solutions at very competitive prices because we leverage a combination of our proprietary software, which automates our workflows and increases efficiency, together with our team of experienced health industry experts throughout the United States, who are supported by our highly educated and specialized offshore workforce of approximately 2,200 team members at labor costs that we believe are approximately one-tenth the cost of comparable U.S. employees. Our unique business model has also allowed us to become a leading consolidator in our industry sector, in which we have gained a reputation for being able to acquire and transform distressed competitors into profitable operations of MTBC.

During April 2019, the Company acquired substantially all of the revenue cycle management and practice management business of Etransmedia Technology, Inc. and its subsidiaries (together “ETM”). The Company paid $1.6 million in cash for the acquisition.

During July 2018, the Company acquired substantially all of the revenue cycle management, practice management and group purchasing assets of Orion Healthcorp, Inc. and 13 of its affiliates (together, “Orion”). The Company paid $12.6 million in cash for the acquisition. This acquisition expanded the scope of our offerings to include additional niche hospital solutions, a service that negotiates vaccine discounts with pharmaceutical manufacturers and then extends those vaccine discounts to physician members, and a service that provides end-to-end practice management services to physician practices under multi-decade management service agreements.

|  |  |  |
| --- | --- | --- |
|  | 24 |  |

|  |
| --- |
|  |

Adoption of our RCM solutions requires little or no upfront expenditure by a practice. Additionally, for most of our solutions and customers, our financial performance is linked directly to the financial performance of our clients because the vast majority of our revenues are based on a percentage of our clients’ collections. The standard fee for our complete, integrated, end-to-end solution is among the lowest in the industry. We currently provide services to more than 11,000 providers, (which we define as physicians, nurses, nurse practitioners, physician assistants and other clinical staff that render bills for their services) practicing in approximately 1,800 independent medical practices and hospitals.

Our offshore operations in Pakistan and Sri Lanka accounted for approximately 17% and 32% of total expenses for the six months ended June 30, 2019 and 2018, respectively. A significant portion of those foreign expenses were personnel-related costs (approximately 79% for both the six months ended June 30, 2019 and 2018). Because personnel-related costs are significantly lower in Pakistan and Sri Lanka than in the U.S. and many other offshore locations, we believe our offshore operations give us a competitive advantage over many industry participants. We are able to achieve significant cost reductions as leverage technology to reduce manual work and strategically transition a portion of the remaining manual tasks to our highly-specialized, cost-efficient team in the U.S., Pakistan and Sri Lanka.

**Key Performance Measures**

We consider numerous factors in assessing our performance. Key performance measures used by management, including adjusted EBITDA, adjusted operating income, adjusted operating margin, adjusted net income and adjusted net income per share, are non-GAAP financial measures, which we believe better enable management and investors to analyze and compare the underlying business results from period to period.

These non-GAAP financial measures should not be considered in isolation, or as a substitute for or superior to, financial measures calculated in accordance with accounting principles generally accepted in the United States of America (“GAAP”). Moreover, these non-GAAP financial measures have limitations in that they do not reflect all the items associated with the operations of our business as determined in accordance with GAAP. We compensate for these limitations by analyzing current and future results on a GAAP basis as well as a non-GAAP basis, and we provide reconciliations from the most directly comparable GAAP financial measures to the non-GAAP financial measures. Our non-GAAP financial measures may not be comparable to similarly titled measures of other companies. Other companies, including companies in our industry, may calculate similarly titled non-GAAP financial measures differently than we do, limiting the usefulness of those measures for comparative purposes.

Adjusted EBITDA, adjusted operating income, adjusted operating margin, adjusted net income and adjusted net income per share provide an alternative view of performance used by management and we believe that an investor’s understanding of our performance is enhanced by disclosing these adjusted performance measures.

Adjusted EBITDA excludes the following elements which are included in GAAP net income (loss):

|  |  |  |
| --- | --- | --- |
|  | ● | Income tax (benefit) expense or the cash requirements to pay our taxes; |
|  | ● | Interest expense, or the cash requirements necessary to service interest on principal payments, on our debt; |
|  | ● | Foreign currency gains and losses and other non-operating expenditures; |
|  | ● | Stock-based compensation expense includes cash-settled awards and the related taxes, based on changes in the stock price; |
|  | ● | Depreciation and amortization charges; |
|  | ● | Integration costs, such as severance amounts paid to employees from acquired businesses, transaction costs, such as brokerage fees, pre-acquisition accounting costs and legal fees, exit costs related to contractual agreements and restructuring charges arising from discontinued facilities and operations; and |
|  | ● | Changes in contingent consideration. |

|  |  |  |
| --- | --- | --- |
|  | 25 |  |

|  |
| --- |
|  |

Set forth below is a presentation of our adjusted EBITDA for the three and six months ended June 30, 2019 and 2018:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended June 30,** | | | | | |  |  | **Six Months Ended June 30,** | | | | | |  |
|  |  | **2019** | |  |  | **2018** | |  |  | **2019** | |  |  | **2018** | |  |
|  |  | ($ in thousands) | | | | | | | | | | | | | |  |
| Net revenue |  | $ | 16,749 |  |  | $ | 8,683 |  |  | $ | 31,830 |  |  | $ | 16,990 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| GAAP net (loss) income |  | $ | (771 | ) |  | $ | 195 |  |  | $ | (1,067 | ) |  | $ | 270 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Provision for income taxes |  |  | 55 |  |  |  | 51 |  |  |  | 15 |  |  |  | 98 |  |
| Net interest expense |  |  | 33 |  |  |  | 44 |  |  |  | 50 |  |  |  | 113 |  |
| Foreign exchange / other expense |  |  | (539 | ) |  |  | (185 | ) |  |  | (296 | ) |  |  | (332 | ) |
| Stock-based compensation expense |  |  | 793 |  |  |  | 409 |  |  |  | 1,550 |  |  |  | 537 |  |
| Depreciation and amortization |  |  | 836 |  |  |  | 560 |  |  |  | 1,593 |  |  |  | 1,151 |  |
| Integration, transaction and restructuring costs |  |  | 733 |  |  |  | 472 |  |  |  | 939 |  |  |  | 651 |  |
| Change in contingent consideration |  |  | - |  |  |  | 11 |  |  |  | (64 | ) |  |  | 43 |  |
| Adjusted EBITDA |  | **$** | **1,140** |  |  | **$** | **1,557** |  |  | **$** | **2,720** |  |  | **$** | **2,531** |  |

Adjusted operating income and adjusted operating margin exclude the following elements which are included in GAAP operating income (loss):

|  |  |  |
| --- | --- | --- |
|  | ● | Stock-based compensation expense includes cash-settled awards and the related taxes, based on changes in the stock price; |
|  | ● | Amortization of purchased intangible assets; |
|  | ● | Integration costs, such as severance amounts paid to employees from acquired businesses, transaction costs, such as brokerage fees, pre-acquisition accounting costs and legal fees, exit costs related to contractual agreements, and restructuring charges arising from discontinued facilities and operations; and |
|  | ● | Changes in contingent consideration. |

|  |  |  |
| --- | --- | --- |
|  | 26 |  |

|  |
| --- |
|  |

Set forth below is a presentation of our adjusted operating income and adjusted operating margin, which represents adjusted operating income as a percentage of net revenue, for the three and six months ended June 30, 2019 and 2018:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended June 30,** | | | | | |  |  | **Six Months Ended June 30,** | | | | | |  |
|  |  | **2019** | |  |  | **2018** | |  |  | **2019** | |  |  | **2018** | |  |
|  |  | ($ in thousands) | | | | | | | | | | | | | |  |
| Net revenue |  | $ | 16,749 |  |  | $ | 8,683 |  |  | $ | 31,830 |  |  | $ | 16,990 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| GAAP net (loss) income |  | $ | (771 | ) |  | $ | 195 |  |  | $ | (1,067 | ) |  | $ | 270 |  |
| Provision for income taxes |  |  | 55 |  |  |  | 51 |  |  |  | 15 |  |  |  | 98 |  |
| Net interest expense |  |  | 33 |  |  |  | 44 |  |  |  | 50 |  |  |  | 113 |  |
| Other income - net |  |  | (545 | ) |  |  | (218 | ) |  |  | (464 | ) |  |  | (370 | ) |
| GAAP operating (loss) income |  |  | (1,228 | ) |  |  | 72 |  |  |  | (1,466 | ) |  |  | 111 |  |
| GAAP operating margin |  |  | (7.3 | )% |  |  | 0.8 | % |  |  | (4.6 | )% |  |  | 0.7 | % |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Stock-based compensation expense |  |  | 793 |  |  |  | 409 |  |  |  | 1,550 |  |  |  | 537 |  |
| Amortization of purchased intangible assets |  |  | 551 |  |  |  | 337 |  |  |  | 1,037 |  |  |  | 698 |  |
| Integration, transaction and restructuring costs |  |  | 733 |  |  |  | 472 |  |  |  | 939 |  |  |  | 651 |  |
| Change in contingent consideration |  |  | - |  |  |  | 11 |  |  |  | (64 | ) |  |  | 43 |  |
| Non-GAAP adjusted operating income |  | **$** | **849** |  |  | **$** | **1,301** |  |  | **$** | **1,996** |  |  | **$** | **2,040** |  |
| Non-GAAP adjusted operating margin |  |  | 5.1 | % |  |  | 15.0 | % |  |  | 6.3 | % |  |  | 12.0 | % |

Adjusted net income and adjusted net income per share exclude the following elements which are included in GAAP net income (loss):

|  |  |  |
| --- | --- | --- |
|  | ● | Foreign currency gains and losses and other non-operating expenditures; |
|  | ● | Stock-based compensation expense includes cash-settled awards and the related taxes, based on changes in the stock price; |
|  | ● | Amortization of purchased intangible assets; |
|  | ● | Integration costs, such as severance amounts paid to employees from acquired businesses, transaction costs, such as brokerage fees, pre-acquisition accounting costs and legal fees, exit costs related to contractual agreements, and restructuring charges arising from discontinued facilities and operations; |
|  | ● | Changes in contingent consideration; and |
|  | ● | Income tax (benefit) expense resulting from the amortization of goodwill related to our acquisitions. |

|  |  |  |
| --- | --- | --- |
|  | 27 |  |

|  |
| --- |
|  |

No tax effect has been provided in computing non-GAAP adjusted net income and non-GAAP adjusted net income per share as the Company has sufficient carry forward net operating losses to offset the applicable income taxes. The following table shows our reconciliation of GAAP net (loss) income to non-GAAP adjusted net income for the three and six months ended June 30, 2019 and 2018:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended June 30,** | | | | | |  |  | **Six Months Ended June 30,** | | | | | |  |
|  |  | **2019** | |  |  | **2018** | |  |  | **2019** | |  |  | **2018** | |  |
|  |  | ($ in thousands) | | | | | | | | | | | | | |  |
| GAAP net (loss) income |  | $ | (771 | ) |  | $ | 195 |  |  | $ | (1,067 | ) |  | $ | 270 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Foreign exchange / other expense |  |  | (539 | ) |  |  | (185 | ) |  |  | (296 | ) |  |  | (332 | ) |
| Stock-based compensation expense |  |  | 793 |  |  |  | 409 |  |  |  | 1,550 |  |  |  | 537 |  |
| Amortization of purchased intangible assets |  |  | 551 |  |  |  | 337 |  |  |  | 1,037 |  |  |  | 698 |  |
| Integration, transaction and restructuring costs |  |  | 733 |  |  |  | 472 |  |  |  | 939 |  |  |  | 651 |  |
| Change in contingent consideration |  |  | - |  |  |  | 11 |  |  |  | (64 | ) |  |  | 43 |  |
| Income tax expense (benefit) related to goodwill |  |  | 40 |  |  |  | 40 |  |  |  | (15 | ) |  |  | 78 |  |
| Non-GAAP adjusted net income |  | **$** | **807** |  |  | **$** | **1,279** |  |  | **$** | **2,084** |  |  | **$** | **1,945** |  |

Set forth below is a reconciliation of our non-GAAP adjusted net income per share to our GAAP net loss attributable to common shareholders, per share:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended June 30,** | | | | | |  |  | **Six Months Ended June 30,** | | | | | |  |
|  |  | **2019** | |  |  | **2018** | |  |  | **2019** | |  |  | **2018** | |  |
| GAAP net loss attributable to common shareholders, per share |  | $ | (0.19 | ) |  | $ | (0.09 | ) |  | $ | (0.34 | ) |  | $ | (0.15 | ) |
| Impact of preferred stock dividend |  |  | 0.13 |  |  |  | 0.11 |  |  |  | 0.25 |  |  |  | 0.17 |  |
| Net (loss) income per end-of-period share |  |  | (0.06 | ) |  |  | 0.02 |  |  |  | (0.09 | ) |  |  | 0.02 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Foreign exchange / other expense |  |  | (0.04 | ) |  |  | (0.02 | ) |  |  | (0.02 | ) |  |  | (0.03 | ) |
| Stock-based compensation expense |  |  | 0.07 |  |  |  | 0.04 |  |  |  | 0.13 |  |  |  | 0.05 |  |
| Amortization of purchased intangible assets |  |  | 0.04 |  |  |  | 0.03 |  |  |  | 0.08 |  |  |  | 0.06 |  |
| Integration, transaction and restructuring costs |  |  | 0.06 |  |  |  | 0.04 |  |  |  | 0.08 |  |  |  | 0.06 |  |
| Change in contingent consideration |  |  | - |  |  |  | 0.00 |  |  |  | (0.01 | ) |  |  | 0.00 |  |
| Income tax expense (benefit) related to goodwill |  |  | 0.00 |  |  |  | 0.00 |  |  |  | (0.00 | ) |  |  | 0.01 |  |
| Non-GAAP adjusted net income per share |  | **$** | **0.07** |  |  | **$** | **0.11** |  |  | **$** | **0.17** |  |  | **$** | **0.17** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| End-of-period shares |  |  | 12,028,242 |  |  |  | 11,665,174 |  |  |  | 12,028,242 |  |  |  | 11,665,174 |  |

For purposes of determining non-GAAP adjusted net income per share, the Company used the number of common shares outstanding at the end of June 30, 2019 and 2018. Non-GAAP adjusted net income per share does not take into account dividends paid on our preferred stock. No tax effect has been provided in computing non-GAAP adjusted net income and non-GAAP adjusted net income per common share as the Company has sufficient carry forward net operating losses to offset the applicable income taxes.

**Key Metrics**

In addition to the line items in our condensed consolidated financial statements, we regularly review the following metrics. We believe information on these metrics is useful for investors to understand the underlying trends in our business.

***Providers and Practices Served:*** As of June 30, 2019, we provided services to an estimated universe of more than 11,000 providers (which we define as physicians, nurses, nurse practitioners, physician assistants and other clinical staff that render bills for their services), representing approximately 1,800 independent medical practices and hospitals. In addition, we served approximately 200 clients who were not medical practices, but are service organizations who serve the healthcare community. As of June 30, 2018, we served approximately 3,300 providers representing approximately 730 practices. The foregoing numbers include clients leveraging any of our products or services and are based in part upon estimates in cases where the precise number of practices or providers is unknown.

|  |  |  |
| --- | --- | --- |
|  | 28 |  |

|  |
| --- |
|  |

**Sources of Revenue**

*Revenue:* We primarily derive our revenues from revenue cycle management services, reported in our Healthcare IT segment, which is typically billed as a percentage of payments collected by our customers. This fee includes RCM, as well as the ability to use our EHR and practice management software as part of the bundled fee. All of these services are considered revenue cycle management revenue. These payments accounted for approximately 68% and 91% of our revenues during the three months ended June 30, 2019 and 2018, respectively and 69% and 90% for six months ended June 30, 2019 and 2018, respectively. Other Healthcare IT services, including printing and mailing operations and professional services, represented approximately 11% and 9% of revenues for the three months ended June 30, 2019 and 2018, respectively and 10% for both the six months ended June 30, 2019 and 2018.

As a result primarily of the Orion acquisition, we earned approximately 20% of our revenue from practice management services during both the three and six months ended June 30, 2019. This revenue represents fees based on our actual costs plus a percentage of the operating profit and is reported in our Practice Management segment. Also commencing July 1, 2018, we earned approximately 1% of our revenue during both the three and six months ended June 30, 2019 from group purchasing services which are reported in our Healthcare IT segment.

**Operating Expenses**

*Direct Operating Costs.* Direct operating cost consists primarily of salaries and benefits related to personnel who provide services to our customers, claims processing costs, costs to operate the three managed practices, including facility lease costs, supplies, insurance and other direct costs related to our services. Costs associated with the implementation of new customers are expensed as incurred. The reported amounts of direct operating costs do not include depreciation and amortization, which are broken out separately in the condensed consolidated statements of operations.

*Selling and Marketing Expense.* Selling and marketing expense consists primarily of compensation and benefits, commissions, travel and advertising expenses.

*Research and Development Expense.* Research and development expense consists primarily of personnel-related costs and third-party contractor costs.

*General and Administrative Expense.* General and administrative expense consists primarily of personnel-related expense for administrative employees, including compensation, benefits, travel, facility lease costs and insurance, software license fees and outside professional fees.

*Contingent Consideration.* Contingent consideration represents the portion of consideration payable to the sellers of some of our acquisitions, the amount of which is based on the achievement of defined performance measures contained in the purchase agreements. Contingent consideration is adjusted to fair value at the end of each reporting period.

*Depreciation and Amortization Expense.* Depreciation expense is charged using the straight-line method over the estimated lives of the assets ranging from three to ten years. Amortization expense is charged on either an accelerated or on a straight-line basis over a period of three or four years for most intangible assets acquired in connection with acquisitions including those intangibles related to the group purchasing services. Amortization expense related to the value of our practice management clients is amortized on a straight-line basis over a period of twelve years.

*Interest and Other Income (Expense).* Interest expense consists primarily of interest costs related to our working capital line of credit, term loans and amounts due in connection with acquisitions, offset by interest income. Other income (expense) results primarily from foreign currency transaction gains (losses) and income earned from temporary cash investments.

|  |  |  |
| --- | --- | --- |
|  | 29 |  |

|  |
| --- |
|  |

*Income Tax.* In preparing our condensed consolidated financial statements, we estimate income taxes in each of the jurisdictions in which we operate. This process involves estimating actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and financial reporting purposes. These differences result in deferred income tax assets and liabilities. Although the Company is forecasting a return to profitability, it incurred cumulative losses, which make realization of a deferred tax asset difficult to support in accordance with ASC 740. Accordingly, a valuation allowance has been recorded against all deferred tax assets as of June 30, 2019 and December 31, 2018.

**Critical Accounting Policies and Estimates**

The critical accounting policies and estimates used in the preparation of our condensed consolidated financial statements that we believe affect our more significant judgments and estimates used in the preparation of our condensed consolidated financial statements presented in this Report are described in Management’s Discussion and Analysis of Financial Condition and Results of Operations and in the Notes to the consolidated financial statements included in our Annual Report on Form 10- K for the year ended December 31, 2018.

Except for the adoption of FASB ASC Topic 842, Leases, discussed below, there have been no material changes to our critical accounting policies and estimates during the six months ended June 30, 2019 as compared to those reported in our Annual Report on Form 10-K for the year ended December 31, 2018.

*Leases:*

We adopted ASU 2016-02: *Leases* (Topic 842) as of January 1, 2019. We determine if an arrangement is a lease at inception. Operating leases are included in operating lease right-of-use (“ROU”) assets, operating lease liability (current portion) and operating lease liability (noncurrent portion) in our condensed consolidated balance sheet at June 30, 2019. The Company does not have any finance leases.

ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. ROU assets and liabilities are recognized at the lease commencement date based on the estimated present value of lease payments over the lease term.

We use our estimated incremental borrowing rates, which are derived from information available at the lease commencement date, in determining the present value of lease payments. We give consideration to bank financing arrangements, geographical location and collateralization of assets when calculating our incremental borrowing rates.

Our lease term includes options to extend the lease when it is reasonably certain that we will exercise that option. Leases with a term of less than 12 months are not recorded in the condensed consolidated balance sheet. Our lease agreements do not contain any residual value guarantees. For real estate leases, we account for the leased and non-leased components as a single lease component. Some leases include escalation clauses and termination options that are factored into the determination of the future lease payments when appropriate.

There have been no material changes in our critical accounting policies and estimates from those described in the Management’s Discussion and Analysis of Financial Condition and Results of Operations, included in our Annual Report on Form 10-K for the year ended December 31, 2018, filed with the SEC on March 20, 2019.

|  |  |  |
| --- | --- | --- |
|  | 30 |  |

|  |
| --- |
|  |

**Results of Operations**

The following table sets forth our consolidated results of operations as a percentage of total revenue for the periods shown:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended June 30,** | | | | | |  |  | **Six Months Ended June 30,** | | | | | |  |
|  |  | **2019** | |  |  | **2018** | |  |  | **2019** | |  |  | **2018** | |  |
| Net revenue |  |  | 100.0 | % |  |  | 100.0 | % |  |  | 100.0 | % |  |  | 100.0 | % |
| Operating expenses: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Direct operating costs |  |  | 68.0 | % |  |  | 49.9 | % |  |  | 66.7 | % |  |  | 51.9 | % |
| Selling and marketing |  |  | 2.3 | % |  |  | 4.6 | % |  |  | 2.3 | % |  |  | 4.2 | % |
| General and administrative |  |  | 30.7 | % |  |  | 35.2 | % |  |  | 29.2 | % |  |  | 33.3 | % |
| Research and development |  |  | 1.3 | % |  |  | 2.9 | % |  |  | 1.5 | % |  |  | 3.0 | % |
| Change in contingent consideration |  |  | 0.0 | % |  |  | 0.1 | % |  |  | (0.2 | )% |  |  | 0.3 | % |
| Depreciation and amortization |  |  | 5.0 | % |  |  | 6.4 | % |  |  | 5.0 | % |  |  | 6.8 | % |
| Total operating expenses |  |  | 107.3 | % |  |  | 99.1 | % |  |  | 104.5 | % |  |  | 99.5 | % |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Operating (loss) income |  |  | (7.3 | )% |  |  | 0.9 | % |  |  | (4.5 | )% |  |  | 0.5 | % |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest expense - net |  |  | 0.2 | % |  |  | 0.5 | % |  |  | 0.2 | % |  |  | 0.7 | % |
| Other income - net |  |  | 3.3 | % |  |  | 2.5 | % |  |  | 1.5 | % |  |  | 2.2 | % |
| (Loss) income before income taxes |  |  | (4.2 | )% |  |  | 2.9 | % |  |  | (3.2 | )% |  |  | 2.0 | % |
| Income tax provision |  |  | 0.3 | % |  |  | 0.6 | % |  |  | 0.0 | % |  |  | 0.6 | % |
| Net (loss) income |  |  | (4.5 | )% |  |  | 2.3 | % |  |  | (3.2 | )% |  |  | 1.4 | % |

***Comparison of the three and six months ended June 30, 2019 and 2018***

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended** | | | | | |  |  |  | | | | | |  |  | **Six Months Ended** | | | | | |  |  |  | | | | | |  |
|  |  | **June 30,** | | | | | |  |  | **Change** | | | | | |  |  | **June 30,** | | | | | |  |  | **Change** | | | | | |  |
|  |  | **2019** | |  |  | **2018** | |  |  | **Amount** | |  |  | **Percent** | |  |  | **2019** | |  |  | **2018** | |  |  | **Amount** | |  |  | **Percent** | |  |
| Net revenue |  | $ | 16,749,499 |  |  | $ | 8,682,937 |  |  | $ | 8,066,562 |  |  |  | 93 | % |  | $ | 31,829,710 |  |  | $ | 16,990,262 |  |  | $ | 14,839,448 |  |  |  | 87 | % |

*Revenue.* Total revenue of $16.7 million and $31.8 million for the three and six months ended June 30, 2019 increased by $8.1 million or 93% and $14.8 million or 87% from revenue of $8.7 million and $17.0 million for the three and six months ended June 30, 2018, respectively. Revenue for the three and six months ended June 30, 2019 includes approximately $7.1 million and $14.8 million, respectively from customers acquired in the Orion acquisition. Of the six months amount, $8.2 million relates to RCM clients and other revenue streams, $6.2 million relates to practice management services and $405,000 relates to group purchasing services. Revenue for both the three and six months ended June 30, 2019 includes $2.0 million from customers acquired from the ETM acquisition.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended** | | | | | |  |  |  | | | | | |  |  | **Six Months Ended** | | | | | |  |  |  | | | | | |  |
|  |  | **June 30,** | | | | | |  |  | **Change** | | | | | |  |  | **June 30,** | | | | | |  |  | **Change** | | | | | |  |
|  |  | **2019** | |  |  | **2018** | |  |  | **Amount** | |  |  | **Percent** | |  |  | **2019** | |  |  | **2018** | |  |  | **Amount** | |  |  | **Percent** | |  |
| Direct operating costs |  | $ | 11,396,395 |  |  | $ | 4,333,573 |  |  | $ | 7,062,822 |  |  |  | 163 | % |  | $ | 21,243,935 |  |  | $ | 8,817,628 |  |  | $ | 12,426,307 |  |  |  | 141 | % |
| Selling and marketing |  |  | 382,557 |  |  |  | 403,057 |  |  |  | (20,500 | ) |  |  | (5 | )% |  |  | 743,956 |  |  |  | 708,071 |  |  |  | 35,885 |  |  |  | 5 | % |
| General and administrative |  |  | 5,143,754 |  |  |  | 3,054,205 |  |  |  | 2,089,549 |  |  |  | 68 | % |  |  | 9,305,830 |  |  |  | 5,654,939 |  |  |  | 3,650,891 |  |  |  | 65 | % |
| Research and development |  |  | 218,408 |  |  |  | 248,921 |  |  |  | (30,513 | ) |  |  | (12 | )% |  |  | 473,064 |  |  |  | 504,800 |  |  |  | (31,736 | ) |  |  | (6 | )% |
| Change in contingent consideration |  |  | - |  |  |  | 11,030 |  |  |  | (11,030 | ) |  |  | (100 | )% |  |  | (64,203 | ) |  |  | 42,780 |  |  |  | (106,983 | ) |  |  | (250 | )% |
| Depreciation |  |  | 223,724 |  |  |  | 144,917 |  |  |  | 78,807 |  |  |  | 54 | % |  |  | 431,342 |  |  |  | 295,988 |  |  |  | 135,354 |  |  |  | 46 | % |
| Amortization |  |  | 612,437 |  |  |  | 414,779 |  |  |  | 197,658 |  |  |  | 48 | % |  |  | 1,161,559 |  |  |  | 854,479 |  |  |  | 307,080 |  |  |  | 36 | % |
| Total operating expenses |  | $ | 17,977,275 |  |  | $ | 8,610,482 |  |  | $ | 9,366,793 |  |  |  | 109 | % |  | $ | 33,295,483 |  |  | $ | 16,878,685 |  |  | $ | 16,416,798 |  |  |  | 97 | % |

*Direct Operating Costs.* Direct operating costs of $11.4 million and $21.2 million for the three and six months ended June 30, 2019 increased by $7.1 million or 163% and $12.4 million or 141% from direct operating costs of $4.3 million and $8.8 million for the three and six months ended June 30, 2018. During the three months ended June 30, 2019, salary costs increased by $3.6 million and outsourcing and processing costs increased by $1.2 million. During the six months ended June 30, 2019, salary costs increased by $6.5 million and outsourcing and processing costs increased by $2.0 million. Facility costs increased by $556,000 for the three months ended June 30, 2019 and $952,000 for the six months ended June 30, 2019. Medical supplies for the managed practices, which were not incurred during the six months ended June 30, 2018, were $1.3 million and $2.4 million for the three and six months ended June 30, 2019, respectively. The increase in the costs for the three and six months ended June 30, 2019 were primarily related to the Orion and Etransmedia acquisitions.

|  |  |  |
| --- | --- | --- |
|  | 31 |  |

|  |
| --- |
|  |

*Selling and Marketing Expense.* Selling and marketing expense of $383,000 and $744,000 for the three and six months ended June 30, 2019 decreased by $21,000 or 5% and increased by $36,000 or 5% from selling and marketing expense of $403,000 and $708,000 for the three and six months ended June 30, 2018, respectively.

*General and Administrative Expense.* General and administrative expense of $5.1 million and $9.3 million for the three and six months ended June 30, 2019 increased by $2.1 million or 68% and $3.7 million or 65% compared to the same period in 2018. The increase in general and administrative expense for the three and six months ended June 30, 2019 was primarily related to additional salaries, facility costs and professional fees as a result of the Orion and Etransmedia acquisitions.

*Research and Development Expense.* Research and development expense of $218,000 and $473,000 for the three and six months ended June 30, 2019 decreased by $31,000 and $32,000 from research and development expense of $249,000 and $505,000 for the three and six months ended June 30, 2018, respectively. During the three months ended June 30, 2019, the Company capitalized approximately $178,000 of development costs in connection with its internal-use software.

*Contingent Consideration.* The change in contingent consideration of $107,000 for the six months ended June 30, 2019 was due to a favorable settlement of the amount due to the owners of a company previously acquired.

*Depreciation.* Depreciation of $224,000 and $431,000 for the three and six months ended June 30, 2019 increased by $79,000 or 54% and $135,000 or 46% from depreciation of $145,000 and $296,000 for the three and six months ended June 30, 2018, respectively, primarily due to additional purchases and the property and equipment acquired as part of the Orion and ETM acquisitions.

*Amortization Expense.* Amortization expense of $612,000 and $1.2 million for the three and six months ended June 30, 2019, respectively, increased by $198,000 and $307,000 from amortization expense of $415,000 and $854,000 for the three and six months ended June 30, 2018, respectively. The increase for the three and six months ended June 30, 2019 was primarily related to the intangible assets acquired from the Orion and Etransmedia acquisitions.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended** | | | | | |  |  |  | | | | | |  |  | **Six Months Ended** | | | | | |  |  |  | | | | | |  |
|  |  | **June 30,** | | | | | |  |  | **Change** | | | | | |  |  | **June 30,** | | | | | |  |  | **Change** | | | | | |  |
|  |  | **2019** | |  |  | **2018** | |  |  | **Amount** | |  |  | **Percent** | |  |  | **2019** | |  |  | **2018** | |  |  | **Amount** | |  |  | **Percent** | |  |
| Interest income |  | $ | 67,497 |  |  | $ | 29,939 |  |  | $ | 37,558 |  |  |  | 125 | % |  | $ | 145,697 |  |  | $ | 35,224 |  |  | $ | 110,473 |  |  |  | 314 | % |
| Interest expense |  |  | (100,562 | ) |  |  | (74,167 | ) |  |  | (26,395 | ) |  |  | (36 | )% |  |  | (195,958 | ) |  |  | (148,248 | ) |  |  | (47,710 | ) |  |  | (32 | )% |
| Other income - net |  |  | 545,221 |  |  |  | 218,589 |  |  |  | 326,632 |  |  |  | 149 | % |  |  | 464,191 |  |  |  | 369,963 |  |  |  | 94,228 |  |  |  | 25 | % |
| Income tax provision |  |  | 55,352 |  |  |  | 51,536 |  |  |  | 3,816 |  |  |  | 7 | % |  |  | 14,820 |  |  |  | 98,200 |  |  |  | (83,380 | ) |  |  | (85 | )% |

*Interest Income.* Interest income of $67,000 and $146,000 for the three and six months ended June 30, 2019 increased by $38,000 or 125% and $110,000 or 314% from interest income of $30,000 and $35,000 for the three and six months ended June 30, 2018, respectively. The interest income represents interest earned on temporary cash investments.

*Interest Expense.* Interest expense of $101,000 and $196,000 for the three and six months ended June 30, 2019, respectively, increased by $26,000 or 36% and increased by $48,000 or 32% from interest expense of $74,000 and $148,000 for the three and six months ended June 30, 2018, respectively. This increase was primarily due to the additional vehicle financing during the three and six months ended June 30, 2019. Interest expense includes the amortization of deferred financing costs, which was $96,000 during both the six months ended June 30, 2019 and 2018, respectively.

|  |  |  |
| --- | --- | --- |
|  | 32 |  |

|  |
| --- |
|  |

*Other (Expense) Income - net.* Other (expense) income - net was $545,000 and $464,000 for the three and six months ended June 30, 2019 respectively, compared to other income - net of $219,000 and $370,000 for the three and six months ended June 30, 2018, respectively. Other (expense) income primarily represents foreign currency transaction gains (losses) resulting from transactions in foreign currencies other than the functional currency. These transaction gains and losses are recorded in the condensed consolidated statements of operations related to the recurring measurement and settlement of such transactions.

*Income Tax Provision.* There was a $55,000 and $15,000 provision for income taxes for the three and six months ended June 30, 2019, respectively, compared to the provision for income taxes of $52,000 and $98,000 for the three and six months ended June 30, 2018, respectively. There was a federal tax benefit recorded in the first quarter of 2019 which reduced the provision for the income taxes for the six months ended June 30, 2019.

The current income tax provision for the three and six months ended June 30, 2019 was approximately $15,000 and $30,000, and primarily relates to state minimum taxes and foreign income taxes. Although the Company is forecasting a return to profitability, it has incurred losses historically and there is uncertainty regarding future U.S. taxable income, which makes realization of a deferred tax asset difficult to support in accordance with ASC 740. Accordingly, a valuation allowance was recorded against all deferred tax assets at June 30, 2019 and 2018.

**Liquidity and Capital Resources**

Borrowings under the SVB facility are based on 200% of repeatable revenue, reduced by an annualized attrition rate as defined in the agreement. As of June 30, 2019, nothing was drawn on the SVB credit agreement.

During the six months ended June 30, 2019, there was positive cash flow from operations of approximately $3.3 million and as of June 30, 2019 the Company had approximately $10.6 million in cash, positive working capital of $11.2 million and no bank debt.

During the second quarter of 2019, the Company paid the purchase price of $1.6 million for the ETM acquisition in cash.

During 2018, the Company paid the purchase price of $12.6 million for the Orion acquisition in cash. The Company occasionally utilizes its revolving line of credit with SVB, but, as of June 30, 2019, there was no balance outstanding. SVB doubled the maximum availability on the line from $5 million to $10 million in September 2018. During April 2018, the Company sold 420,000 shares of Series A Preferred Stock and raised net proceeds of approximately $9.4 million. During October 2018, the Company sold 600,000 additional shares of its Series A Preferred Stock raising net proceeds of approximately $13.4 million.

The following table summarizes our cash flows for the periods presented:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended June 30,** | | | | | |  |  | **Six Months Ended June 30,** | | | | | |  |
|  |  | **2019** | |  |  | **2018** | |  |  | **2019** | |  |  | **2018** | |  |
| Net cash provided by operating activities |  | $ | 2,375,420 |  |  | $ | 1,294,224 |  |  | $ | 3,312,929 |  |  | $ | 1,967,605 |  |
| Net cash used in investing activities |  |  | (1,993,282 | ) |  |  | (1,202,188 | ) |  |  | (2,504,220 | ) |  |  | (1,376,430 | ) |
| Net cash (used in) provided by financing activities |  |  | (1,671,737 | ) |  |  | 8,318,083 |  |  |  | (4,258,008 | ) |  |  | 7,204,046 |  |
| Effect of exchange rate changes on cash |  |  | (654,022 | ) |  |  | (228,570 | ) |  |  | (440,158 | ) |  |  | (434,834 | ) |
| Net (decrease) increase in cash |  | $ | (1,943,621 | ) |  | $ | 8,181,549 |  |  | $ | (3,889,457 | ) |  | $ | 7,360,387 |  |

The loss before income taxes was $716,000 and $1.1 million for the three and six months ended June 30, 2019, respectively, which included $836,000 and $1.6 million of non-cash depreciation and amortization, respectively. The income before tax for the three and six months ended June 30, 2018 was $247,000 and $369,000, respectively, which included $560,000 and $1.2 million of non-cash depreciation and amortization, respectively.

|  |  |  |
| --- | --- | --- |
|  | 33 |  |

|  |
| --- |
|  |

***Operating Activities***

Cash provided by operating activities was $3.3 million during the six months ended June 30, 2019, compared to $2.0 million during the six months ended June 30, 2018. The increase in the net loss of $1.3 million included the following changes in non-cash items: an increase in depreciation and amortization of $450,000, an increase in stock based compensation expense of $1.0 million, a change in the benefit for deferred income taxes of $93,000 and an increase in interest accretion of $163,000.

The net change in operating assets and liabilities increased by $319,000. Accounts receivable decreased by $268,000 for the six months ended June 30, 2019, compared with a decrease of $3,000 for the six months ended June 30, 2018. Accounts payable, accrued compensation and accrued expenses increased by $836,000 for the six months ended June 30, 2019 compared to a decrease of $180,000 for the six months ended June 30, 2018. For the three and six months ended June 30, 2019, the change in the lease liabilities is included in this amount.

***Investing Activities***

Capital expenditures were $904,000 and $376,000 for the six months ended June 30, 2019 and 2018, respectively. The capital expenditures for the six months ended June 30, 2019 primarily represented computer equipment purchased for the Pakistan office and $178,000 of capitalized development costs in connection with internal-use software.

***Financing Activities***

Cash used in financing activities during the six months ended June 30, 2019 was $4.3 million and cash provided by financing activities was $7.2 million for the six months ended June 30, 2018. Cash used in financing activities during the six months ended June 30, 2019 included $181,000 of repayments for debt obligations, $3.0 million of preferred stock dividends and $932,000 of tax withholding obligations paid in connection with stock awards issued to employees. Cash provided by financing activities included $9.4 million of net proceeds from issuing 420,000 shares of Preferred Stock during the six months ended June 30, 2018. Cash used in financing activities for six months ended June 30, 2018 included $139,000 of repayment for debt obligations, $1.7 million of preferred stock dividends and $214,000 of tax withholding obligations paid in connection with stock awards issued to employees. There were no borrowings or debt repayments during the six months ended June 30, 2019 and 2018.

**Contractual Obligations and Commitments**

We have contractual obligations under our line of credit and related to contingent consideration in connection with one acquisition made by the Company. We also maintain operating leases for property and certain office equipment. We were in compliance with all SVB covenants as of June 30, 2019. For additional information, see Contractual Obligations and Commitments under Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2018, filed with the SEC on March 20, 2019.

**Off-Balance Sheet Arrangements**

As of June 30, 2019 and 2018, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special-purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

***Item 3. Quantitative and Qualitative Disclosures about Market Risk***

We are a smaller reporting company as defined by 17 C.F.R. 229.10(f)(1) and are not required to provide information under this item, pursuant to Item 305(e) of Regulation S-K.

|  |  |  |
| --- | --- | --- |
|  | 34 |  |

|  |
| --- |
|  |

***Item 4. Controls and Procedures***

*Evaluation of Disclosure Controls and Procedures*

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, based on the 2013 framework and criteria established by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”), evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2019 as required by Rules 13a-15(b) and 15d-15(b) of the Exchange Act. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms.

Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the Company’s management, including its principal executive and principal financial officer, to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Based on the evaluation of our disclosure controls and procedures, as of June 30, 2019, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

*Changes in Internal Control Over Financial Reporting*

Beginning January 1, 2019, we implemented ASC 842, “*Leases.*” For its adoption, we implemented changes to our lease identification processes and control activities within them such as development of new entity-wide policies, in-house training, ongoing contract reviews and system changes to accommodate presentation and disclosure requirements.

There were no other changes in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

|  |  |  |
| --- | --- | --- |
|  | 35 |  |

|  |
| --- |
|  |

**Part II. Other Information**

***Item 1. Legal Proceedings***

See discussion of legal proceedings in “Note 8, Commitments And Contingencies” of the Notes to Condensed Consolidated Financial Statements in this Quarterly Report.

***Item 1A. Risk Factors***

Pursuant to the instructions of Item 1A of Form 10-Q, a smaller reporting company is not required to provide the information required by this Item.

***Item 2. Unregistered Sales of Equity Securities and Use of Proceeds***

None.

***Item 3. Defaults upon Senior Securities***

Not applicable.

***Item 4. Mine Safety Disclosures***

Not applicable.

***Item 5. Other Information***

Not applicable.

|  |  |  |
| --- | --- | --- |
|  | 36 |  |

|  |
| --- |
|  |

***Item 6. Exhibits***

|  |  |  |
| --- | --- | --- |
| **Exhibit Number** |  | **Exhibit Description** |
|  |  |  |
| 31.1 |  | [Certification of the Company’s Principal Executive Officer pursuant to Exchange Act Rules 13a-14(a)/15d-14(a), of the Securities Exchange Act of 1934, as amended.](ex31-1.htm) |
|  |  |  |
| 31.2 |  | [Certification of the Company’s Principal Financial Officer pursuant to Exchange Act Rules 13a-14(a)/15d-14(a), of the Securities Exchange Act of 1934, as amended.](ex31-2.htm) |
|  |  |  |
| 32.1\* |  | [Certification of the Company’s Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.](ex32-1.htm) |
|  |  |  |
| 32.2\* |  | [Certification of the Company’s Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.](ex32-2.htm) |
|  |  |  |
| 101.INS |  | XBRL Instance |
|  |  |  |
| 101.SCH |  | XBRL Taxonomy Extension Schema |
|  |  |  |
| 101.CAL |  | XBRL Taxonomy Extension Calculation Linkbase |
|  |  |  |
| 101.LAB |  | XBRL Taxonomy Extension Label Linkbase |
|  |  |  |
| 101.PRE |  | XBRL Taxonomy Extension Presentation Linkbase |
|  |  |  |
| 101.DEF |  | XBRL Taxonomy Extension Definition Linkbase |

\*The certifications on Exhibit 32 hereto are deemed not “filed” for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, or otherwise subject to the liability of that Section. Such certifications will not be deemed incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the Company specifically incorporates them by reference.

|  |  |  |
| --- | --- | --- |
|  | 37 |  |

|  |
| --- |
|  |

**Signatures**

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

|  |  |  |  |
| --- | --- | --- | --- |
|  |  | **MTBC, Inc.** | |
|  |  |  |  |
| August 7, 2019 |  | By: | */s/ Stephen Snyder* |
| Date |  |  | Stephen Snyder |
|  |  |  | Chief Executive Officer |
|  |  |  |  |
| August 7, 2019 |  | By: | */s/ Bill Korn* |
| Date |  |  | Bill Korn |
|  |  |  | Chief Financial Officer |

|  |  |  |
| --- | --- | --- |
|  | 38 |  |

|  |
| --- |
|  |