

Net Medical Xpress Solutions, Inc.
Form 10-Q
August 15, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2016

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

For the transition period from _____ to _____

COMMISSION FILE No. 333-30176

NET MEDICAL EXPRESS SOLUTIONS, INC.

(Exact name of Registrant as specified in charter)

NEVADA
(State or other jurisdiction of
incorporation or organization)

91-1287406
(I.R.S. Employer Identification No.)

5021 Indian School Road, Suite 100

Albuquerque, New Mexico 87110

(Address of principal executive offices) (Zip Code)

(505) 255-1999

(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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES []
NO [X]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer []

Accelerated filer []

Non-accelerated filer []

Smaller reporting company [X]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES []

NO [X]

The number of shares outstanding of each of the issuer's classes of common stock at August 5, 2016 was 19,402,814.

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USE OF PRONOUNS AND OTHER WORDS

The pronouns *we* , *us* , *our* and the equivalent used in this annual report mean Net Medical Xpress Solutions, Inc. and consolidated subsidiaries. In the notes to our financial statements, the *Company* means Net Medical Xpress Solutions, Inc. and consolidated subsidiaries. The pronoun *you* means the reader of this quarterly report.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS AND INFORMATION

This quarterly report on Form 10-Q, other reports we have filed and will file pursuant to Section 15(d) of the Securities Exchange Act of 1934 and press releases we have issued and will issue will have contained and will contain, as the case may be, forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and are intended to enjoy the benefits of that act. Unless the context is otherwise, We use words such as *anticipate* , *assumption* , *believe* , *could* , *estimate* , *expect* , *forecast* , *intend* , *may* , *objective* , *plans* , *potential* , *predict* , *project* and *projection* , *seek* , *should* , *will continue* , *will result* and *would* , whether nouns or pronouns and verbs or adverbs in the future tense and words and phrases that convey similar meaning and uncertainty of and information about future events or outcomes and statements about performance that is not an historical fact to identify these forward-looking statements. Such words and statements involve estimates, assumptions and uncertainties, which could cause actual results to differ materially from those expressed in them. Any forward-looking statements are qualified in their entirety by reference to the factors discussed throughout this document. All forward-looking statements concerning economic conditions, rates of growth, rates of income or values as may be included in this document are based on information available to us on the dates noted, and we assume no obligation to update any such forward-looking statements. It is important to note that our actual results may differ materially from those in such forward-looking statements due to fluctuations in interest rates, inflation, government regulations, economic conditions and competitive product and pricing pressures in the geographic and business areas in which we conduct operations, including our plans, objectives, expectations and intentions and other factors discussed elsewhere in this Report.

There are a number of important factors beyond our control that could cause actual results to differ materially from the results anticipated by these forward-looking statements. While we make these forward-looking statements based on our beliefs and on various factors and using numerous assumptions using information available at the time we make these statements. Forward-looking statements (i) are neither predictions nor guaranties of future events or circumstances, and (ii) the assumptions, beliefs, expectations, forecasts and projections about future events may differ materially from actual results. You have no assurance the factors and assumptions we have used as a basis for forward-looking statements will prove to be materially accurate when the events they anticipate actually occur in the future; and, you should not place undue reliance on any such forward-looking statements. We undertake no obligation to publicly update any forward-looking statement to reflect developments occurring after the date of this annual report or after the date of any previous or subsequent report or any press release after publication.

PART I FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS****Net Medical Xpress Solutions, Inc.**

Condensed Consolidated Balance Sheets

(Rounded to the nearest thousand)

| | June 30, 2016 (Unaudited) | December 31, 2015 |
|-----------------------------------------------------------------------------------------------------------------------|---------------------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and equivalents | \$ 387,000 | \$ 410,000 |
| Accounts receivable, net of allowance of \$28,000 and \$28,000, respectively | 488,000 | 429,000 |
| Inventory | 20,000 | 27,000 |
| Prepaid expenses and other assets | 146,000 | 76,000 |
| Total current assets | 1,041,000 | 942,000 |
| Furniture, equipment and improvements, net of accumulated depreciation of \$704,000 and \$688,000, respectively | | |
| | 6,000 | 16,000 |
| Security deposits | 4,000 | 4,000 |
| Goodwill | 239,000 | 239,000 |
| Total Assets | \$ 1,290,000 | \$ 1,201,000 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 485,000 | \$ 439,000 |
| Line of credit | 10,000 | 6,000 |
| Accrued expenses | 56,000 | 52,000 |
| Insurance payable | 108,000 | 40,000 |
| Deferred revenue | 1,000 | 9,000 |
| Capital lease | 5,000 | 8,000 |
| Notes payable - related party | 57,000 | 55,000 |
| Total current liabilities | 722,000 | 609,000 |
| Long-term liabilities | | |
| Capital lease - long-term portion | - | 1,000 |

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| | | | |
|---------------------------------------------------|------------------------------------------------------|--------------|--------------|
| | Total long-term liabilities | - | 1,000 |
| Total liabilities | | 722,000 | 610,000 |
| Stockholders' equity: | | | |
| | Preferred stock, \$0.001 par value, 500,000 | | |
| | shares authorized, 0 shares issued and | | |
| | outstanding, as of 6/30/16 and 12/31/15 respectively | - | - |
| | Common stock, \$0.001 par value, 200,000,000 | | |
| | shares authorized, 19,402,814 and 19,402,814 | | |
| | shares issued and outstanding as of 6/30/16 | | |
| | and 12/31/15, respectively | 19,000 | 19,000 |
| | Paid-in capital | 16,193,000 | 16,193,000 |
| | Subscriptions payable | 75,000 | 21,000 |
| | Accumulated deficit | (15,719,000) | (15,642,000) |
| | Total stockholders' equity (deficit) | 568,000 | 591,000 |
| Total Liabilities and Stockholders' Equity | | \$ 1,290,000 | \$ 1,201,000 |

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

Net Medical Xpress Solutions, Inc.

Condensed Consolidated Statements of Operations

(Rounded to the nearest thousand)

(Unaudited)

| | For the three months ended | | For the six months ended | |
|-----------------------------------------------------|----------------------------|------------|--------------------------|--------------|
| | June 30, | | June 30, | |
| | 2016 | 2015 | 2016 | 2015 |
| Revenues | | | | |
| Net Medical Xpress Services | \$ 357,000 | \$ 724,000 | \$ 779,000 | \$ 1,506,000 |
| Net Medical Xpress Specialists | 418,000 | 281,000 | 836,000 | 632,000 |
| Net Medical Xpress Solutions | 33,000 | 103,000 | 77,000 | 192,000 |
| Net Medical Xpress Staffing | 19,000 | 20,000 | 53,000 | 38,000 |
| Gross revenues | 827,000 | 1,128,000 | 1,745,000 | 2,368,000 |
| Cost of services | 643,000 | 850,000 | 1,272,000 | 1,773,000 |
| Gross profit | 184,000 | 278,000 | 473,000 | 595,000 |
| Operating costs and expenses: | | | | |
| General and administrative | 263,000 | 218,000 | 505,000 | 435,000 |
| Depreciation and amortization | 2,000 | 3,000 | 5,000 | 6,000 |
| Research and development | 13,000 | 26,000 | 35,000 | 50,000 |
| Total operating costs and expenses | 278,000 | 247,000 | 545,000 | 491,000 |
| Net operating income (loss) | (94,000) | 31,000 | (72,000) | 104,000 |
| Other income (expense): | | | | |
| Interest expense | (3,000) | (2,000) | (5,000) | (4,000) |
| Total other income (expense) | (3,000) | (2,000) | (5,000) | (4,000) |
| Net income (loss) | \$ (97,000) | \$ 29,000 | \$ (77,000) | \$ 100,000 |
| Income (loss) per share - basic | \$ (0.00) | \$ 0.00 | \$ (0.00) | \$ 0.01 |
| Income (loss) per share - diluted | \$ (0.00) | \$ 0.00 | \$ (0.00) | \$ 0.00 |
| Basic weighted average common shares outstanding | 19,413,608 | 19,413,608 | 19,413,608 | 19,413,608 |

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| | | | | |
|-------------------------------------------------------|------------|------------|------------|------------|
| Diluted weighted average common shares outstanding | 19,413,608 | 20,050,525 | 19,413,608 | 20,050,525 |
|-------------------------------------------------------|------------|------------|------------|------------|

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

Net Medical Xpress Solutions, Inc.

Condensed Consolidated Statements of Cash Flows

(Rounded to the nearest thousand)

(Unaudited)

| | For the six months ended June 30, | |
|----------------------------------------------------------------|--------------------------------------|------------|
| | 2016 | 2015 |
| Cash flows from operating activities | | |
| Net (loss) income | \$ (77,000) | \$ 100,000 |
| Adjustments to reconcile net (loss) income to | | |
| net cash provided by (used in) operating activities: | | |
| Common stock issued for services to board members and officers | 54,000 | 54,000 |
| Common stock issued for services | - | 20,000 |
| Depreciation and amortization | 5,000 | 6,000 |
| Depreciation and amortization allocated to cost of goods sold | 5,000 | 6,000 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (59,000) | 23,000 |
| Inventory | 7,000 | 11,000 |
| Prepaid expenses and other assets | (70,000) | 32,000 |
| Accounts payable | 46,000 | (94,000) |
| Line of credit | 4,000 | (20,000) |
| Accrued expenses | 4,000 | (19,000) |
| Deferred revenue | (8,000) | 3,000 |
| Net cash (used) provided by operating activities | (89,000) | 122,000 |
| Cash flows (used in) provided by financing activities | | |
| Repayment of principal under capital lease | (4,000) | (4,000) |
| Proceeds from notes payable - related party | 2,000 | 1,000 |
| Net proceeds from insurance financing | 160,000 | - |
| Net payments to insurance financing | (92,000) | - |
| Net cash provided (used) by financing activities | 66,000 | (3,000) |
| Net increase in cash equivalents | (23,000) | 119,000 |
| Cash equivalents - beginning | 410,000 | 277,000 |
| Cash equivalents - ending | \$ 387,000 | \$ 396,000 |
| Supplemental disclosures: | | |
| Interest paid | \$ 5,000 | \$ 3,000 |

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| | | | | |
|------------------------------|----|---------|----|---------|
| Tax paid | \$ | - | \$ | - |
| Insurance contracts financed | \$ | 160,000 | \$ | 117,000 |

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

Net Medical Xpress Solutions, Inc.

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

NOTE A - BASIS OF PRESENTATION

The interim financial statements included herein, presented in accordance with United States generally accepted accounting principles and stated in US dollars, have been prepared by the Company, without audit. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading.

These statements reflect all adjustments, consisting of normal recurring adjustments, which, in the opinion of management, are necessary for fair presentation of the information contained therein. It is suggested that these interim financial statements be read in conjunction with the financial statements of the Company for the year ended December 31, 2015 and notes thereto included in the Company's Form 10-K. The Company follows the same accounting policies in the preparation of interim reports.

Results of operations for the interim periods are not indicative of annual results.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation:

The accompanying consolidated financial statements include the accounts Net Medical Xpress Solutions, Inc. and its wholly-owned subsidiary, Telerad Service, Inc. Intercompany transactions and balances have been eliminated in consolidation.

Use of Estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents:

The Company considers all highly liquid instruments purchased with a maturity of three months or less to be cash equivalents. At June 30, 2016, the Company did not have cash and equivalents that exceeded federally insured limits.

Trade Accounts Receivable:

The Company extends unsecured credit to customers under normal trade agreements which generally require payment within 30 - 45 days. Accounts not paid within 15 days after their original due date are considered delinquent. Unless specified by the customer, payments are applied to the oldest unpaid invoice. Accounts receivable are presented at the amount billed.

The Company also estimates an allowance for doubtful accounts, which amounted to \$28,000 and \$28,000 at June 30, 2016 and December 31, 2015, respectively. The estimate is based upon management's review of all accounts and an assessment of the Company's historical evidence of collections. Specific accounts are charged directly to the reserve when management obtains evidence of a customer's insolvency. Charge-offs, net of recoveries, for the six months ended June 30, 2016 and 2015 totaled \$0 and \$0, respectively.

Net Medical Xpress Solutions, Inc.

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Property and Equipment:

Property and equipment are stated at cost. Major renewals and improvements are charged to the asset accounts while replacements, maintenance and repairs that do not improve or extend the lives of the respective assets are expensed. At the time property and equipment are retired or otherwise disposed of, the asset and related accumulated depreciation accounts are relieved of the applicable amounts. Gains or losses from retirements or sales are credited or charged to income.

Depreciation is computed on the straight-line and accelerated methods for financial reporting and income tax reporting purposes based upon the following estimated useful lives:

| | |
|----------------------|---------|
| Software development | 3 years |
| Equipment | 5 years |
| Computer hardware | 5 years |
| Office furniture | 7 years |

Long-Lived Assets:

The Company accounts for its long-lived assets in accordance with Accounting Standards Codification (ASC) Topic 360-10-05, Accounting for the Impairment or Disposal of Long-Lived Assets. ASC Topic 360-10-05 requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the historical cost carrying value of an asset may no longer be appropriate. The Company assesses recoverability of the carrying value of an asset by estimating the future net cash flows expected to result from the asset, including eventual disposition. If the future net cash flows are less than the carrying value of the asset, an impairment loss is recorded equal to the difference between the asset's carrying value and fair value or disposable value. The Company determined that none of its long-term assets at June 30, 2016 or December 31, 2015 were impaired.

Stock-Based Compensation:

The Company accounts for stock-based payments to employees in accordance with ASC 718, Stock Compensation (ASC 718). Stock-based payments to employees include grants of stock, grants of stock options and issuance of warrants that are recognized in the consolidated statement of operations based on their fair values at the date of grant.

The Company accounts for stock-based payments to non-employees in accordance with ASC 505-50, Equity-Based Payments to Non-Employees. Stock-based payments to non-employees include grants of stock, grants of stock options and issuances of warrants that are recognized in the consolidated statement of operations based on the value of the vested portion of the award over the requisite service period as measured at its then-current fair value as of each financial reporting date.

The Company calculates the fair value of option grants and warrant issuances utilizing the Black Scholes pricing model. The amount of stock-based compensation recognized during a period is based on the value of the portion of the awards that are ultimately expected to vest. ASC 718 requires forfeitures to be estimated at the time stock options are granted and warrants are issued to employees and non-employees, and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Net Medical Xpress Solutions, Inc.

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Stock-Based Compensation, continued:

The term forfeitures is distinct from cancellations or expirations and represents only the unvested portion of the surrendered stock option or warrant. The Company estimates forfeiture rates for all unvested awards when calculating the expense for the period. In estimating the forfeiture rate, the Company monitors both stock option and warrant exercises as well as employee termination patterns. The resulting stock-based compensation expense for both employee and non-employee awards is generally recognized on a straight-line basis over the period in which the Company expects to receive the benefit, which is generally the vesting period.

During the six months ended June 30, 2016 and 2015, the Company recognized stock-based compensation expense totaling \$0 and \$74,000, from the issuance of a total of 0 and 0 shares of its common stock to officers, directors, and consultants (See Note E).

Income Taxes:

The Company accounts for its income taxes under the provisions of ASC Topic 740, Income Taxes. The method of accounting for income taxes under ASC 740 is an asset and liability method. The asset and liability method requires the recognition of deferred tax liabilities and assets for the expected future tax consequences of temporary differences between tax bases and financial reporting bases of other assets and liabilities.

Gain (Loss) per Share:

The Company reports earnings (loss) per share in accordance with ASC Topic 260-10, "Earnings per Share." Basic earnings (loss) per share is computed by dividing income (loss) available to common shareholders by the weighted average number of common shares available. Diluted earnings (loss) per share is computed similar to basic earnings (loss) per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive.

Revenue Recognition:

The Company recognizes revenue in accordance with ASC Topic 985 *Software Revenue Recognition* as amended.

Revenue from proprietary software sales that does not require further commitment from the Company is recognized upon persuasive evidence of an arrangement as provided by agreements executed by both parties, delivery of the software, and determination that collection of a fixed or determinable fee is probable. These sales are generally direct purchases of a software product and there is no other involvement by the Company.

With certain sales of its software products, the Company offers software maintenance, upgrade and support arrangements. These contracts may be elements in a multiple-element arrangement or may be sold in a stand-alone basis. Revenues from maintenance and support services are recognized ratably on a straight-line basis over the term that the maintenance service is provided.

Net Medical Xpress Solutions, Inc.

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Revenue Recognition, continued:

Charges for hosting are likewise spread ratably over the term of the hosting agreement, with the typical hosting agreement having a term of 12 months, with renewal on an annual basis. The Company sells some hosting contracts in conjunction with the sale of software, and some hosting contracts without an associated software sale. When the hosting arrangement is sold in conjunction with a software sale, the Company allocates a portion of the fee to the software license. Hosting services do not require the customer to purchase the software license, and for those hosting contracts that are sold without an associated software sale, the customer has neither the right nor the ability to operate the software on its own.

Should the sale of software involve an arrangement with multiple elements (for example, the sale of a software license along with the sale of maintenance and support to be delivered over the contract period), the Company allocates revenue to each component of the arrangement using the residual value method based on the fair value of the undelivered elements. The Company defers revenue from the arrangement equivalent to the fair value of the undelivered elements and recognizes the remaining amount at the time of the delivery of the product or when all other revenue recognition criteria have been met. Fair values for the ongoing maintenance and support obligations are based upon separate sales of renewals of maintenance contracts. Fair value of services, such as training or consulting, is based upon separate sales of these services to other customers.

The Company follows the guidance in FASB ASC Topic 605, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* for custom software development arrangements that require significant production, customization or modification to its core software. Revenue is generally recognized for such arrangements under the percentage-of-completion method. Under percentage-of-completion accounting, both the product license and custom software development revenue are recognized as work progresses based on specific milestones in accordance with FASB ASC Topic 450. The Company believes that project milestones based on completion of specific tasks provide the best approximation of progress toward the completion of the contract. At June 30, 2016 and June 30, 2015, there were no custom software development arrangements in progress.

The Company also occasionally derives revenue from the sale of third party hardware, which is billed as a separate deliverable under consulting or custom development contracts. Revenue from radiological services, radiological quality assurance (QA) services, software installation, and any training or consulting services is recognized when the services are rendered. These revenues include services that are not essential to the functionality of the software. If these services are included in a software agreement with multiple elements, amounts are allocated to these categories

based on the estimated number of hours required to complete the work, which is the same criteria used to bill for the services separately. License revenue is recognized ratably over the term of the license.

Amounts collected prior to satisfying the above revenue recognition criteria are included in deferred revenue.

The application of ASC 605, as amended, requires judgment, including a determination that collectability is probable and the fee is fixed and determinable.

Net Medical Xpress Solutions, Inc.

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Revenue Recognition, continued:

The Company follows the guidance provided by SEC Staff Accounting Bulletin (SAB) No. 101, *Revenue Recognition in Financial Statements* and SAB No. 104, *Revenue Recognition*, which provide guidance on the recognition, presentation and disclosure of revenue in financial statements filed with the SEC.

Due to uncertainties inherent in the estimation process it is at least reasonably possible that completion costs for contracts in progress will be further revised in the near-term.

The cost of services, consisting of staff payroll, outside services, equipment rental, communication costs and supplies, is expensed as incurred.

Research and Development Expenses:

Costs of research and development activities are expensed as incurred.

Advertising Expenses:

The Company expenses advertising costs which consist primarily of direct mailings, promotional items and print media, as incurred. Advertising expenses amounted to \$0 and \$0 for the six months ended June 30, 2016 and 2015, respectively.

Fair Value of Financial Instruments:

The Company adopted the Financial Accounting Standards Board (FASB) standard related to fair value measurement at inception. The standard defines fair value, establishes a framework for measuring fair value and expands disclosure of fair value measurements. The standard applies under other accounting pronouncements that require or permit fair value measurements and, accordingly, does not require any new fair value measurements. The standard clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability

in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. The recorded values of long-term debt approximate their fair values, as interest approximates market rates. As a basis for considering such assumptions, the standard established a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

.
Level 1: Observable inputs such as quoted prices in active markets;

.
Level 2: Inputs other than quoted prices in active markets that are observable either directly or indirectly; and

.
Level 3: Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

The Company's financial instruments consist of cash, accounts receivable, inventory, prepaid expenses, leasehold improvements, property and equipment, deposits, other assets, accounts payable, accrued expenses, deferred revenue, capital leases and notes payable. The recorded values of cash, accounts receivable, inventory, prepaid expenses, and accounts payable approximate fair values due to the short maturities of such instruments. Recorded values for notes payable and related liabilities approximate fair values, since their stated or imputed interest rates are commensurate with prevailing market rates for similar obligations.

Net Medical Xpress Solutions, Inc.

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**Recent Pronouncements:**

The Company's management has reviewed recent accounting pronouncements issued through the date of the issuance of these financial statements. In management's opinion, no pronouncements apply or will have a material effect on the Company's financial statements.

NOTE C - GOING CONCERN

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has incurred cumulative net losses of approximately \$15,719,000 since its inception and requires capital for its contemplated operational and marketing activities to take place. The Company's ability to raise additional capital through the future issuances of the common stock is unknown. The obtainment of additional financing, the successful development of the Company's contemplated plan of operations, and its transition, ultimately, to the attainment of profitable operations are necessary for the Company to continue operations. The ability to successfully resolve these factors raise substantial doubt about the Company's ability to continue as a going concern. The financial statements of the Company do not include any adjustments that may result from the outcome of these aforementioned uncertainties.

NOTE D - FURNITURE, EQUIPMENT, AND IMPROVEMENTS

Furniture, equipment, and improvements as of June 30, 2016 and December 31, 2015 consisted of the following:

| | June 30, 2016 | December 31, 2015 |
|-----------------------------------|---------------|-------------------|
| Computers | \$ 499,000 | \$ 499,000 |
| Furniture, fixtures and equipment | 150,000 | 150,000 |
| Automobiles | 41,000 | 41,000 |
| Leasehold improvements | 20,000 | 20,000 |
| | 710,000 | 710,000 |
| Accumulated depreciation | (704,000) | (694,000) |

| | | | |
|----|-------|----|--------|
| \$ | 6,000 | \$ | 16,000 |
|----|-------|----|--------|

Depreciation expense for the three months ended June 30, 2016 and 2015 was \$2,000 and \$3,000, respectively. Depreciation expense for the six months ended June 30, 2016 and 2015 was \$5,000 and \$6,000, respectively.

NOTE E - GOODWILL

On July 1, 2013, the Company completed its merger with MedTel Solutions, LLC (MedTel), an Alabama limited liability company, in accordance with its Merger Agreement dated June 28, 2013. MedTel was organized on June 13, 2012 for the purpose of engaging in and is now engaged in the business of providing licensed medical practitioners to perform services via telemedicine. Pursuant to the agreement, the Company authorized the issuance of 3,000,000 shares of its common stock in exchange for 100% of the outstanding membership interests of MedTel. The fair value of the consideration given up totaled \$275,000 of which \$36,000 has been allocated to the fair value of net identifiable assets and the remaining \$239,000 to goodwill.

Net Medical Xpress Solutions, Inc.

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

NOTE E - GOODWILL (CONTINUED)

In accordance with FASB ASC 350, Intangibles - Goodwill and Other, the Company performs goodwill impairment testing at least annually, unless indicators of impairment exist in interim periods. The impairment test for goodwill uses a two-step approach. Step one compares the estimated fair value of a reporting unit with goodwill to its carrying value. If the carrying value exceeds the estimated fair value, step two must be performed. Step two compares the carrying value of the reporting unit to the fair value of all of the assets and liabilities of the reporting unit (including any unrecognized intangibles) as if the reporting unit was acquired in a business combination. If the carrying amount of a reporting unit's goodwill exceeds the implied fair value of its goodwill, an impairment loss is recognized in an amount equal to the excess. As of June 30, 2016, there is no impairment of goodwill.

In connection with the merger, the Company also entered two employment agreements with the former holders of MedTel membership interests. Each agreement provides for bonus compensation of 2,000,000 shares of common stock to be earned equally upon attainment of quarterly sales and profitability goals. As of June 30, 2016, these goals have not been met.

NOTE F - CAPITAL TRANSACTIONS

Common stock:

During the six-month period ended June 30, 2016, the Company effected the following stock transactions:

Earned compensation for two directors from shares to be issued during 2016 of \$27,000 is included in expense for the three months ended June 30, 2016.

Earned compensation for two outside directors from shares to be issued during 2016 of \$27,000 is included in expense for the three months ended June 30, 2016.

The Company effected a 9:1 reverse stock split that became effective June 20, 2016. All share amounts and prices have been retroactively restated.

Exercise prices and weighted-average contractual lives of stock options outstanding as of June 30, 2016, are as follows:

| Options Outstanding | | | Options Exercisable | | |
|---------------------|-------------|-------------|---------------------|-------------|----------|
| | | Weighted | | | Weighted |
| | | Average | Weighted | | Average |
| | | Remaining | Average | | Exercise |
| Exercise | Number | Contractual | Exercise | Number | Price |
| Prices | Outstanding | Life | Prices | Exercisable | Price |
| \$0.27-\$0.40 | 722,222 | 0.88 | \$0.28 | 722,222 | \$0.28 |

Net Medical Xpress Solutions, Inc.

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

NOTE F - CAPITAL TRANSACTIONS (CONTINUED)

Summary of Options Granted and Outstanding:

| | For the six months ended | |
|----------------------------------|--------------------------|------------------------------------|
| | June 30, 2016 | |
| | Shares | Weighted Average Exercise Price |
| Options: | | |
| Outstanding at beginning of year | 722,222 | \$0.28 |
| Granted | - | - |
| Cancelled | - | - |
| Exercised | - | - |
| Outstanding at end of period | 722,222 | \$0.28 |

NOTE G - MAJOR CUSTOMERS

During the six-month period ended June 30, 2016, two customers accounted for 37% or approximately \$640,000 of the Company's revenue.

As of June 30, 2016, balances due from one customer comprised 44% or approximately \$229,000 of total accounts receivable.

NOTE H - REPORTABLE SEGMENTS

Management has identified the Company's reportable segments based on separate lines of business. The parent company, Net Medical Xpress Solutions, derives revenues from the development and marketing of proprietary internet technology-based software. Net Medical Xpress Staffing, the Company's new division within the parent

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company, specializes in the recruitment and staffing of telemedicine physicians. The Company's wholly-owned subsidiary, Telerad Service, Inc., operates under the trade names Net Medical Xpress Services and Net Medical Xpress Specialists. Net Medical Xpress Services provides medical diagnostic reading services. Net Medical Xpress Specialists provides telemedicine services to hospitals and other medical entities.

Information related to the Company's reportable segments for the six months ended June 30, 2016 is as follows:

| | Services | Specialists | Solutions | Staffing | TOTAL |
|--------------------------|-------------|-------------|------------|------------|-------------|
| Revenue | \$779,000 | \$836,000 | \$77,000 | \$53,000 | \$1,745,000 |
| Cost of Service | 694,000 | 501,000 | 53,000 | 24,000 | 1,272,000 |
| General & administrative | 214,000 | 123,000 | 100,000 | 68,000 | 505,000 |
| Depreciation | 1,000 | 0 | 4,000 | 0 | 5,000 |
| Research & development | 0 | 16,000 | 19,000 | 0 | 35,000 |
| Operating Income (loss) | \$(130,000) | \$196,000 | \$(99,000) | \$(39,000) | \$(72,000) |
| Total assets | \$518,000 | \$514,000 | \$115,000 | \$143,000 | \$1,290,000 |

Net Medical Xpress Solutions, Inc.

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

NOTE H - REPORTABLE SEGMENTS (CONTINUED)

A reconciliation of the segments' operating loss to the consolidated net loss is as follows:

| | | |
|----------------------------|----|----------|
| Segment s operating income | \$ | (72,000) |
| Other income (expense) | | (5,000) |
| Consolidated net income | \$ | (77,000) |

Information related to the Company's reportable segments for the six months ended June 30, 2015 is as follows:

| | Services | Specialists | Solutions | Staffing | TOTAL |
|--------------------------|-------------|-------------|------------|------------|-------------|
| Revenue | \$1,506,000 | \$632,000 | \$192,000 | \$38,000 | \$2,368,000 |
| Cost of Service | 1,224,000 | 452,000 | 84,000 | 13,000 | 1,773,000 |
| General & administrative | 177,000 | 100,000 | 107,000 | 51,000 | 435,000 |
| Depreciation | 1,000 | 0 | 5,000 | 0 | 6,000 |
| Research & development | 0 | 25,000 | 25,000 | 0 | 50,000 |
| Operating Income (loss) | \$104,000 | \$55,000 | \$(29,000) | \$(26,000) | \$104,000 |
| Total assets | \$691,000 | \$313,000 | \$141,000 | \$252,000 | \$1,397,000 |

A reconciliation of the segments' operating loss to the consolidated net loss is as follows:

| | | |
|----------------------------|----|---------|
| Segment s operating income | \$ | 104,000 |
| Other income (expense) | | (4,000) |
| Consolidated net income | \$ | 100,000 |

NOTE I - COMMITMENTS AND CONTINGENCIES

Leases:

The Company leases office space in New Mexico expiring on January 31, 2017. The Company also leases office and computer equipment. Future minimum lease payments as of June 30, 2016, are as follows:

| Year | Amount |
|------|----------|
| 2016 | \$47,000 |
| 2017 | \$9,000 |

Rent expense for the three months ended June 30, 2016 and 2015 amounted to \$22,000 and \$22,000, respectively. Rent expense for the six months ended June 30, 2016 and 2015 amounted to \$44,000 and \$43,000, respectively.

Net Medical Xpress Solutions, Inc.

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

NOTE I - COMMITMENTS AND CONTINGENCIES (CONTINUED)

Employment Agreement (Related Party):

During the first quarter of 2013, the Company entered into a new employment agreement with Mr. Govatski for annual compensation of \$30,000 for a term of one year commencing on January 1, 2013. The agreement will automatically renew for one additional term unless terminated by either party. The non-compete agreement has remained intact and becomes effective only in the event of termination by either party and will remain in effect for a period of one year.

NOTE J - SUBSEQUENT EVENTS

The Company's management has reviewed all material events through the date of this report in accordance with ASC 855-10 (Subsequent Events), and believes there are no material subsequent events to report.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION

OVERVIEW

We operate our business in four divisions.

Our parent company, Net Medical Xpress Solutions, primarily provides Picture Archiving and Communication System (PACS) hardware and software to hospitals and other medical facilities. Our PACS is compliant with the Health Insurance Accountability and Portability Act (HIPAA). We sell our PACS, trade named XR-Express, to medical facilities and also provide it as a hosted Software as a Service (SaaS), where the customer is billed on a monthly basis according to usage volume. The SaaS option allows our customers to optimize their operations without investing significant time and money on upfront costs for hardware, software, tech support and training.

Our wholly-owned subsidiary, Telerad Service, Inc. operates under three trade names: Net Medical Xpress Services, Net Medical Xpress Specialists and Net Medical Xpress Staffing.

Net Medical Xpress Services provides medical diagnostic reading services. We provide reports for x-rays, echocardiograms, EKGs, CTs, MRIs, and other diagnostic modalities for over 16,000 facilities in the U.S. We provide radiology and cardiology services 24 hours per day, seven days per week, and 365 days per year. Our average response time for x-ray reads is ten to fifteen minutes, and for ultrasounds it is twenty to thirty minutes.

Net Medical Xpress Specialists provides specialist services via the internet to hospitals and other medical entities. Our initial operations have been in emergency room neurology and stroke evaluation. Once the customer facility is ready, we usually can connect the neurologist and the patient within fifteen to thirty minutes for the initial evaluation. Since signing our first facility in 2011, we have expanded to include several regional hospitals in New Mexico and are continuing to grow the specialist program, both in specialties and in facilities covered. At this time, we have physicians credentialed to provide services for neurology/stroke evaluation, behavioral medicine, cardiology, critical care and primary care. We currently are marketing numerous other services within the specialist program. The specialists program provides patient care 24 hours per day, seven days per week, and 365 days per year. This division also provides primary care services via the internet to individual patients. Generally, we contract with corporations or insurance plans to provide primary care services to their individual customers.

We are participating in a \$15.1 million federal grant with the University of New Mexico Health Science Center to establish a statewide 30 hospital telemedicine network to support critical cerebral emergency support services. The grant was awarded by the Center for Medicare and Medicaid Services (CMS) to help CMS study the impact of providing telemedicine for critical care services in rural areas. The project calls for the university to form a statewide

30-hospital telehealth system (THS) in conjunction with Net Medical Xpress Solutions for a three-year period; it was recently extended for three additional years. The program will provide remote emergency neurological consultations using Net Medical's video conferencing equipment and telemedicine management services. After the grant is completed, we will continue to provide telemedicine consultations for the hospitals within the system.

Net Medical Xpress Staffing specializes in the recruitment and staffing of physicians for telemedicine services. We recruit physicians for our own telemedicine services, as well as for outside customers. We currently have a database of over 500 physicians in varying stages of contracting, credentialing, training and providing services with us. The majority of these physicians are primary care physicians.

RESULTS OF OPERATIONS

TOTAL REVENUES:

For the Three Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$827,000 | \$1,128,000 | \$(301,000) | (26.7)% |

For the Six Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$1,745,000 | \$2,368,000 | \$(623,000) | (26.3)% |

These changes are a result of the following factors:

Net Medical Xpress Services Revenues

1. Radiological services:

For the Three Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$350,000 | \$695,000 | \$(345,000) | (49.6)% |

For the Six Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$765,000 | \$1,447,000 | \$(682,000) | (47.1)% |

The decrease in radiological services for both the three months and the six months ended June 30, 2016 is due to two factors: approximately 70% is due to the loss of one major customer; the remainder is due to a net decreased volume of reads by existing customers. The teleradiology market is becoming increasingly competitive. Two trends we have noticed are that the smaller customers are using multiple teleradiology services in order to meet their budgets, and the larger customers are converting to running their own in-house teleradiology programs. Therefore, we anticipate focusing some efforts on expanding our customer base in order to sustain our revenues in the current competitive environment; however, the majority of our focus will be on the virtual telemedicine services as described in our Specialists division.

2. Cardiological services:

For the Three Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$7,000 | \$29,000 | \$(22,000) | (75.9)% |

For the Six Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$14,000 | \$59,000 | \$(45,000) | (76.3)% |

The decrease in cardiological services for both the three months and the six months ended June 30, 2016 is due the loss of one customer. This market is similar to the teleradiology market, with new service providers regularly entering the market. The growing competition increases the downward pressure on prices and creates a trend for customers to use multiple services to meet their needs.

Net Medical Xpress Specialists Revenues

1. Neurological services:

For the Three Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$206,000 | \$217,000 | \$(11,000) | (5.1)% |

For the Six Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$525,000 | \$429,000 | \$96,000 | 22.4% |

The decrease in neurological services revenue for the three months ended June 30, 2016 is primarily due to a decrease in volume of consults from existing customers. The increase in neurological services revenue for the six months ended June 30, 2016 is primarily due to the Access grant with the University of New Mexico (see overview above), and the addition of several new customers during the first quarter of 2016. We are continuing to add new customers as part of the grant, and separate from the grant. Therefore, we expect revenues in this category to continue their upward trend during 2016.

2. Specialists program primary care services:

For the Three Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$70,000 | \$52,000 | \$18,000 | 34.6% |

For the Six Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$127,000 | \$100,000 | \$27,000 | 27.0% |

We began offering primary care consultations in July 2014 to individuals enrolled by our customers described in the overview above. We are still growing this division by adding new customers, which will result in continued gradual revenue increases during 2016.

3. Specialists program hardware sales:

For the Three Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$131,000 | \$11,000 | \$120,000 | 1090.9% |

For the Six Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$155,000 | \$101,000 | \$54,000 | 53.5% |

The increase in specialists program equipment sales for the three months and the six months ended June 30, 2016 is due to the sale of equipment to healthcare facilities under the Access grant during the first half of 2016. Equipment is purchased by new customers prior to beginning consultations. As a result, we expect revenues in this category to vary from quarter to quarter as we add new customers.

4. Specialists program behavioral medicine services:

For the Three Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$11,000 | \$1,000 | \$10,000 | 1,000.0% |

For the Six Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$29,000 | \$2,000 | \$27,000 | 1,350.0% |

We began offering behavioral medicine consults during the second quarter of 2015. We anticipate that revenues in this division will increase slightly for the remainder of 2016 as we continue to build our customer base.

Net Medical Xpress Solutions Revenues

1. Software usage fees:

For the Three Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$24,000 | \$68,000 | \$(44,000) | (64.7)% |

For the Six Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$50,000 | \$139,000 | \$(89,000) | (64.0)% |

The decrease in software usage fees for the three months and the six months ended June 30, 2016 as compared to the same periods in 2015 is due to the loss of two customers. We believe this trend in our teleradiology customers is similar to the trend we are seeing in our own teleradiology business due to increased competition. Downward pressure on prices and increased regulations are making it more difficult for some of our smaller customers to sustain their businesses, while many of the larger potential customers are building their own in-house PACS systems.

2. Software hosting and maintenance:

For the Three Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$9,000 | \$16,000 | \$(7,000) | (43.8)% |

For the Six Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$26,000 | \$29,000 | \$(3,000) | (10.3)% |

We only have a few customers that are using our hosting and maintenance services, and we are not currently focusing on increasing revenues in this category. Therefore, we anticipate this revenue to remain relatively steady or even decrease slightly during 2016.

3. Other revenues:

For the Three Months Ended June 30,

| | <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|----------------------|-------------|-------------|----------------------------|--------------------------|
| Custom Programming | \$0 | \$19,000 | \$(19,000) | (100.0)% |
| Hardware Maintenance | \$0 | \$0 | \$0 | Not meaningful |

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For the Six Months Ended June 30,

| | <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|----------------------|-------------|-------------|----------------------------|--------------------------|
| Custom Programming | \$0 | \$24,000 | \$(4,000) | (100.0)% |
| Hardware Maintenance | \$1,000 | \$0 | \$1,000 | Not meaningful |

We performed several small custom programming projects during the first quarter of 2015, and none during 2016. We continue to offer programming services for customer database integration, and for other projects for our existing and new customers, but we don't expect this to be a major revenue source for us in the future.

We performed one hardware repair project for a customer during the second quarter of 2016. We do not expect this to be a major revenue source for us in the future.

Net Medical Xpress Staffing Revenues

1. Recruiting and staffing services:

For the Three Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$19,000 | \$20,000 | \$(1,000) | (5.0)% |

For the Six Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$53,000 | \$38,000 | \$15,000 | 39.5% |

The decrease in recruiting services during the three months ended June 30, 2016 is due to decreased fees from existing customers during the second quarter of 2016.

Approximately 20% of the increase in recruiting services during the six months ended June 30, 2016 is due to the addition of a new customer. The remaining increase is due to increased fees from existing customers. We are compensated for recruiting and providing telemedicine physicians based on the volume of usage by the customers. Although we are focusing more of our marketing efforts on the specialists program primary care services, we do still expect the revenues in this category to continue to increase modestly during 2016.

COST OF SERVICES:

For the Three Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$643,000 | \$850,000 | \$(207,000) | (24.4)% |

For the Six Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$1,272,000 | \$1,773,000 | \$(501,000) | (28.3)% |

Approximately eighty percent of the costs of services for the first half of 2016 and 2015 are direct costs related to the services and specialists divisions. These costs consist of radiologist fees, cardiologist fees, neurologist fees, professional credentialing, professional licenses, professional liability insurance costs, and costs of hardware associated with the specialists program. The majority of these costs are directly related to revenues; therefore, as revenues have decreased, cost of service has decreased.

GENERAL AND ADMINISTRATIVE EXPENSES:

For the Three Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$263,000 | \$218,000 | \$45,000 | 20.6% |

For the Six Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$505,000 | \$435,000 | \$70,000 | 16.1% |

The increase in general and administrative expenses during the three months ended June 30, 2016 is due to legal fees related to a physician lawsuit. The increase in general and administrative expenses during the six months ended June 30, 2016 is due to the legal fees mentioned above, plus increased marketing costs related to social media during the first quarter of 2016.

RESEARCH AND DEVELOPMENT COSTS:

For the Three Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$13,000 | \$26,000 | \$(13,000) | (50.0)% |

For the Six Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$35,000 | \$50,000 | \$(15,000) | (30.0)% |

The decrease in research and development costs for the three months and the six months ended June 30, 2016 is due to decreased programming costs related to the development of the specialists program. The primary development of the specialists program is complete; however, we continue to focus on expanding the program to include a variety of specialist services.

During the first six months of 2016, approximately 90% of our research and development costs were a direct result of staffing. In the software industry, it is common for research and development costs to be ongoing, since development of the next version of the software begins as soon as the current version is completed. In addition, we are constantly developing new applications for our existing software. We anticipate research and development costs during 2016 will continue to focus on the development and expansion of software and services for our specialists program. As a

result, these costs will likely remain steady during 2016.

DEPRECIATION:

For the Three Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$2,000 | \$3,000 | \$(1,000) | (33.3)% |

For the Six Months Ended June 30,

| <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|-------------|-------------|----------------------------|--------------------------|
| \$5,000 | \$6,000 | \$(1,000) | (16.7)% |

We expect depreciation to remain stable or decrease slightly during 2016 as assets are fully depreciated.

OTHER EXPENSE:

For the Three Months Ended June 30,

| | <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|------------------|-------------|-------------|----------------------------|--------------------------|
| Interest expense | \$3,000 | \$2,000 | \$1,000 | 50.0% |

For the Six Months Ended June 30,

| | <u>2016</u> | <u>2015</u> | <u>Increase (Decrease)</u> | <u>Percent Inc (Dec)</u> |
|------------------|-------------|-------------|----------------------------|--------------------------|
| Interest expense | \$5,000 | \$4,000 | \$1,000 | 25.0% |

Interest expense is primarily incurred on financed insurance premiums and the note payable listed on the balance sheet. We don't anticipate significant changes in this category during 2016.

REPORTABLE SEGMENTS

We believe gross profit is our key indicator of operating progress. Our four operating divisions generated the following gross profit, rounded to the nearest 1,000, during the first six months of 2016:

| | Services | Specialists | Solutions | Staffing | TOTAL |
|----------------------|------------|-------------|-----------|-----------|--------------|
| Revenue | \$ 779,000 | \$ 836,000 | \$ 77,000 | \$ 53,000 | \$ 1,745,000 |
| Direct costs | 694,000 | 501,000 | 53,000 | 24,000 | 1,272,000 |
| Gross profit | \$ 85,000 | 335,000 | \$ 24,000 | \$ 29,000 | \$473,000 |
| Gross Profit Percent | 11% | 40% | 31% | 55% | 27% |

The Net Medical Xpress Services division's gross profit was \$85,000, or 11%. Approximately 81% of the direct costs in this division are doctor fees, which are directly related to revenues. The market for teleradiology and telecardiology has become increasingly competitive during the last few years. As a result, we have seen the gross profit percentage in this division decrease by several percent compared to the level of three to five years ago. The gross profit percentage may change slightly as the mix of services changes, but in general we expect this percentage to remain relatively stable during 2016.

The Net Medical Xpress Specialists division's gross profit was \$335,000, or 40%. Approximately 60% of the direct cost in this division for the first quarter consists of doctor fees and hardware costs, which are directly related to

revenues. The remaining 40% consists of staffing costs for customer service, which are relatively fixed. The percentage of costs that are fixed has decreased from 40% to 25% as revenues have increased in this division. In general, we believe the gross profit percentage of this division will continue to increase slightly during 2016 as the revenues grow, while the fixed costs remain stable.

The Net Medical Xpress Solutions division's gross profit was \$24,000, or 31%. The majority of the direct costs in this division are staffing expenses, which do not vary directly with revenue. As a result, the gross profit percentage has decreased as the revenue has decreased. We expect the gross profit percentage of this division to remain in the range of 30% to 35% during 2016.

The Net Medical Xpress Staffing division's gross profit was \$29,000, or 55%. The majority of the direct costs in this division are staffing expenses, which do not vary with revenues. Although we still have doctors available for customers to use in their own telemedicine programs, we have shifted our focus to expanding the specialists primary care services. Therefore, we expect the revenues and costs to remain low in this division, which could result in significant variances in gross profit percentage from quarter to quarter during 2016.

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Our normal general and administrative expenses continue to be approximately \$200,000 to \$250,000 per quarter.

We have identified our reportable segments based on separate lines of business, as described in the Overview section above. Net Medical Xpress Solutions derives revenues from the development and marketing of proprietary internet technology-based software. Net Medical Xpress Staffing, the Company's new division within the parent company, specializes in the recruitment and staffing of telemedicine physicians. Net Medical Xpress Services provides medical diagnostic reading services. Net Medical Xpress Specialists provides telemedicine services to remote hospitals and other medical entities.

Information related to the Company's reportable segments for the six months ended June 30, 2016 is as follows:

| | Services | Specialists | Solutions | Staffing | TOTAL |
|--------------------------|-------------|-------------|------------|------------|-------------|
| Revenue | \$779,000 | \$836,000 | \$77,000 | \$53,000 | \$1,745,000 |
| Cost of service | 694,000 | 501,000 | 53,000 | 24,000 | 1,272,000 |
| General & administrative | 214,000 | 123,000 | 100,000 | 68,000 | 505,000 |
| Depreciation | 1,000 | 0 | 4,000 | 0 | 5,000 |
| Research & development | 0 | 16,000 | 19,000 | 0 | 35,000 |
| Operating Income (loss) | \$(130,000) | \$196,000 | \$(99,000) | \$(39,000) | \$(72,000) |
| Total assets | \$518,000 | \$514,000 | \$115,000 | \$143,000 | \$1,290,000 |

A reconciliation of the segments' operating loss to the consolidated net loss is as follows:

| | | |
|----------------------------|----|----------|
| Segment's operating income | \$ | (72,000) |
| Other income (expense) | | (5,000) |
| Consolidated net income | \$ | (77,000) |

LIQUIDITY AND CAPITAL RESOURCES

Liquidity refers to our ability to generate adequate amounts of cash to meet our needs for cash. We believe we will have adequate liquidity to maintain current operations during 2016, but we may choose to locate additional sources of cash to facilitate growth and expansion.

We do not currently have material commitments for capital expenditures and do not anticipate entering into any such commitments during the next twelve months. Our current commitments consist primarily of lease obligations for

office space, computer equipment and office equipment.

At June 30, 2016, we had a working capital surplus of \$319,000 as opposed to a working capital surplus of \$333,000 at the beginning of the period, a decrease of \$14,000. This decrease is due to a combination of immaterial factors.

We may sell equity securities for cash or in return for services and incur debt as we have occasionally done in the past if our liquidity proves insufficient to meet our operating needs and facilitate growth and expansion of our services during 2016.

We anticipate that our primary uses of cash in the next year will continue to be for general operating purposes and to facilitate growth and expansion of our services. We anticipate our operating cash requirements for the next twelve months to be approximately \$4,000,000 to \$5,000,000. Profitability remains our primary goal.

OFF-BALANCE SHEET ARRANGEMENTS

We currently have no off-balance sheet arrangements.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States (GAAP) requires our management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. In accordance with GAAP, our actual realized results may differ from management's initial estimates as reported. A summary of our significant accounting policies is detailed in the notes to the financial statements, which are an integral component of this filing.

Revenue Recognition

Our software revenue recognition policies are in accordance with the ASC Topic 985, Software Revenue Recognition as amended. Revenue is recognized when (a) persuasive evidence of an arrangement exists, (b) delivery has occurred, (c) the fee is fixed or determinable, and (d) collectability is probable. We follow the guidance in ASC Topic 605, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* for custom software development arrangements that require us to provide significant production, customization or modification to our core software. Revenue is generally recognized for such arrangements under the percentage of completion method. Amounts collected prior to satisfying the above revenue recognition criteria are included in deferred revenue.

We follow the guidance provided by SEC Staff Accounting Bulletin (SAB) No. 101, Revenue Recognition in Financial Statements and SAB No. 104 Revenue Recognition which provide guidance on the recognition, presentation and disclosure of revenue in financial statements filed with the SEC. Revenue in our services and specialists divisions, software installation, training and consulting services is recognized when the services are rendered.

Software Development Costs

We account for software development costs in accordance with ASC Topic 985, Accounting for Costs of Computer Software to be Sold, Leased, or Otherwise Marketed. Product research and development expenses consist primarily of personnel, outside consulting and related expenses for development, and systems personnel and consultants and are charged to operations as incurred until technological feasibility is established. We consider technological feasibility to be established when all planning, designing, coding and testing have been completed to design specifications. After

technological feasibility is established, costs are capitalized. Historically, product development has been substantially completed with the establishment of technological feasibility and, accordingly, no costs have been capitalized.

See Note B to our Consolidated Financial Statements for a full discussion of our critical accounting policies and estimates.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 4. CONTROLS AND PROCEDURES

307 - Disclosure controls and procedures: As of June 30, 2016, we carried out an evaluation of the effectiveness of our disclosure controls and procedures, with the participation of our principal executive and principal financial officers. Disclosure controls and procedures are defined in Exchange Act Rule 15d-15(e) as controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Act (15 U.S.C. 78a *et seq.*) is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms [and] include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Based on our evaluation, our President/Chief Executive Officer and Chief Financial Officer have concluded that, as of June 30, 2016, such disclosure controls and procedures were not effective. The primary reasons for management's conclusions are that we did not have a plan in place for implementing controls and procedures and insufficient personnel to implement checks and balances. We believe that we will not have sufficient funds available to develop a plan in the foreseeable future. We do not anticipate that our business will need sufficient personnel in the foreseeable future that are needed to implement checks and balances.

308(b) - Changes in internal control over financial reporting: Based upon an evaluation by our management of our internal control over financial reporting, with the participation of our principal executive and principal financial officers, there were no changes made in our internal control over financial reporting during the quarter ended June 30, 2016 that have materially affected or are reasonably likely to materially affect this control.

Limitations on the Effectiveness of Internal Control: Our management does not expect that our disclosure controls and procedures or our internal control over financial reporting will necessarily prevent all fraud and material errors. An internal control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations on all internal control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, and/or by management override of the control. The design of any system of internal control is also based in part upon certain assumptions about risks and the likelihood of future events, and there is no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in circumstances and the degree of compliance with the policies and procedures may deteriorate. Because of the inherent limitations in a cost-effective internal control system, financial reporting misstatements due to error or fraud may occur and not be detected on a timely basis.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We incurred immaterial legal costs defending a suit against a physician that was finalized during the second quarter of 2016.

ITEM 1A. RISK FACTORS

We do not believe we have experienced any material changes in our risk factors subsequent to our last annual report on Form 10-K.

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

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURE

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

The following exhibits are attached to this report:

31.1

Rule 15d-14 (a) Certification by Principal Executive Officer

31.2

Rule 15d-14 (a) Certification by Principal Financial Officer

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Section 1350 Certification of Principal Executive Officer and Principal Financial Officer

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NET MEDICAL XPRESS SOLUTIONS, INC.

Date: August 15, 2016

By /s/ Richard F. Govatski
Richard F. Govatski, President (Principal
Executive Officer)

Date: August 15, 2016

By /s/ Teresa B. Dickey
Teresa B. Dickey, Treasurer (Principal
Financial Officer)

