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

FORM 10-Q

(Mark One)

☒ **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 Number: 001-34171

FOUNDATION HEALTHCARE, INC.
(Exact name of registrant as specified in its charter)

OKLAHOMA	**20-0180812**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

13900 N. Portland Avenue, Ste. 200
Oklahoma City, Oklahoma 73134
(Address of principal executive offices)

(405) 608-1700
(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 ☐ 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

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	☐ (Do not check if a smaller reporting company)	Smaller reporting company	☒

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

As of September 2, 2016, 18,078,337 shares of the registrant's common stock, $0.0001 par value, were outstanding.

FOUNDATION HEALTHCARE, INC.
FORM 10-Q
For the Quarter Ended June 30, 2016

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Certain statements under the captions "Part I. Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations," and "Part II. Item 1A. Risk Factors," and elsewhere in this report constitute "forward-looking statements." Certain, but not necessarily all, of such forward-looking statements can be identified by the use of forward-looking terminology such as "anticipates," "believes," "expects," "may," "will," or "should" or other variations thereon, or by discussions of strategies that involve risks and uncertainties. Our actual results or industry results may be materially different from any future results expressed or implied by such forward-looking statements. Factors that could cause actual results to differ materially include general economic and business conditions; our ability to implement our business strategies; competition; availability of key personnel; increasing operating costs; unsuccessful promotional efforts; changes in brand awareness; acceptance of new product offerings; and changes in, or the failure to comply with government regulations. We undertake no obligation to update or revise any forward looking statements, whether as a result of new information, future events or otherwise, except as may be required under applicable securities laws.

In this report, for example, we make forward-looking statements, including statements discussing our expectations about: future financial performance and condition; future liquidity and capital resources; future cash flows; existing debt; our business strategy and operating philosophy; effects of competition in our markets; costs of providing care to our patients; our compliance with new and existing laws and regulations as well as costs and benefits associated with compliance; the impact of national healthcare reform; other income from electronic health records ("EHR"); the impact of accounting methodologies; industry and general economic trends; patient shifts to lower cost healthcare plans which generally provide lower reimbursement; reimbursement changes; patient volumes and related revenues; claims and legal actions relating to professional liabilities; governmental investigations and voluntary self-disclosures; and physician recruiting and retention.

Throughout this report the first personal plural pronoun in the nominative case form "we" and its objective case form "us", its possessive and the intensive case forms "our" and "ourselves" and its reflexive form "ourselves" refer collectively to Foundation Healthcare, Inc. and its subsidiaries.

PART I. FINANCIAL INFORMATION

Item 1. Foundation Healthcare, Inc. Condensed Consolidated Financial Statements.

The condensed consolidated financial statements included in this report have been prepared by us pursuant to the rules and regulations of the Securities and Exchange Commission. The condensed consolidated balance sheet as of December 31, 2015 has been derived from audited financial statements, and the condensed consolidated balance sheet as of June 30, 2016, the condensed consolidated statements of operations for the three months and six months ended June 30, 2016 and 2015, and the condensed consolidated statements of cash flows for the six months ended June 30, 2016 and 2015, have been prepared without audit. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to those rules and regulations, although we believe that the disclosures are adequate to make the information presented not misleading. It is suggested that these condensed consolidated financial statements be read in conjunction with the financial statements and the related notes thereto included in our latest annual report on Form 10-K.

The consolidated statements for the unaudited interim periods presented include all adjustments, consisting of normal recurring adjustments, necessary to present a fair statement of the results for such interim periods. The results for any interim period may not be comparable to the same interim period in the previous year or necessarily indicative of earnings for the full year.

FOUNDATION HEALTHCARE, INC.

Condensed Consolidated Balance Sheets
(Unaudited)

	June 30, 2016	December 31, 2015
ASSETS		
Cash	$ 1,062,218	$ 5,062,492
Accounts receivable, net of allowance for doubtful accounts of $5,050,000 and $6,062,000, respectively	30,965,490	30,383,942
Receivables from affiliates	412,860	509,886
Supplies inventories	3,673,166	3,737,901
Prepaid and other current assets	12,166,019	3,325,330
Current assets from discontinued operations	408,303	416,390
Total current assets	48,688,056	43,435,941
Property and equipment, net	50,619,333	52,781,982
Equity method investments in affiliates	2,944,195	3,012,631
Deferred tax asset	836,290	836,290
Intangible assets, net	9,826,763	10,952,170
Goodwill	13,537,809	7,601,809
Other assets	836,835	1,016,093
Other assets from discontinued operations	—	8,713
Total assets	$ 127,289,281	$ 119,645,629
LIABILITIES, PREFERRED NONCONTROLLING INTEREST AND SHAREHOLDERS' DEFICIT		
Liabilities:		
Accounts payable	$ 20,790,348	$ 9,060,060
Accrued liabilities	14,305,754	13,252,521
Preferred noncontrolling interests dividends payable	156,171	157,888
Short-term debt	425,654	308,769
Current portion of long-term debt	9,028,572	4,601,320
Current portion of capital lease obligations	4,071,318	4,478,968
Other current liabilities	2,065,574	590,827
Current liabilities from discontinued operations	2,348,262	2,356,165
Total current liabilities	53,191,653	34,806,518
Long-term debt, net of current portion	40,153,072	41,529,277
Long-term capital lease obligations, net of current portion	28,373,441	29,130,693
Deferred lease incentive	7,289,403	7,672,745
Other liabilities	7,013,650	6,479,181
Total liabilities	136,021,219	119,618,414
Preferred noncontrolling interest	6,960,000	6,960,000
Commitments and contingencies (Note 11)		
Foundation Healthcare shareholders' deficit:		
Preferred stock $0.0001 par value, 10,000,000 authorized; no shares issued and outstanding	—	—
Common stock $0.0001 par value, 500,000,000 shares authorized; 18,078,337 and 17,303,180 issued and outstanding, respectively	1,807	1,730
Paid-in capital	22,723,100	20,885,915
Accumulated deficit	(43,770,740)	(32,074,090)
Total Foundation Healthcare shareholders' deficit	(21,045,833)	(11,186,445)
Noncontrolling interests	5,353,895	4,253,660
Total deficit	(15,691,938)	(6,932,785)
Total liabilities, preferred noncontrolling interest and shareholders' deficit	$ 127,289,281	$ 119,645,629

See Accompanying Notes to Condensed Consolidated Financial Statements

FOUNDATION HEALTHCARE, INC.

Condensed Consolidated Statements of Operations
For the Three Months Ended June 30, 2016 and 2015
(Unaudited)

	2016	2015
Net Revenues:		
Patient services	$ 28,609,556	$ 30,152,597
Provision for doubtful accounts	(2,598,924)	(2,177,522)
Net patient services revenue	26,010,632	27,975,075
Management fees from affiliates	1,639,679	1,973,754
Other revenue, net	(307,828)	1,914,125
Revenues	27,342,483	31,862,954
Equity in earnings of affiliates	334,388	319,673
Operating Expenses:		
Salaries and benefits	12,424,992	7,915,961
Supplies	9,500,381	7,390,390
Other operating expenses	13,334,836	13,398,977
Depreciation and amortization	2,660,038	1,345,948
Total operating expenses	37,920,247	30,051,276
Other Income (Expense):		
Interest expense, net	(1,055,776)	(279,257)
Gain on sale of equity investment in affiliate	2,140,832	—
Other income (expense)	89,649	(32,231)
Net other income (expense)	1,174,705	(311,488)
Income (loss) from continuing operations, before taxes	(9,068,671)	1,819,863
Benefit (provision) for income taxes	(1,200,000)	114,038
Income (loss) from continuing operations, net of taxes	(10,268,671)	1,933,901
Income (loss) from discontinued operations, net of tax	(4,320)	3,857,135
Net income (loss)	(10,272,991)	5,791,036
Less: Net income (loss) attributable to noncontrolling interests	(1,271,443)	1,074,022
Net income (loss) attributable to Foundation Healthcare	(9,001,548)	4,717,014
Preferred noncontrolling interests dividends	(154,455)	(177,670)
Net income (loss) attributable to Foundation Healthcare common stock	$ (9,156,003)	$ 4,539,344
Earnings per common share (basic and diluted):		
Net income (loss) attributable to continuing operations attributable to Foundation Healthcare common stock	$ (0.52)	$ 0.04
Income (loss) from discontinued operations, net of tax	0.00	0.22
Net income (loss) per share, attributable to Foundation Healthcare common stock	$ (0.52)	$ 0.26
Weighted average number of common and diluted shares outstanding	17,769,424	17,248,154

See Accompanying Notes to Condensed Consolidated Financial Statements

FOUNDATION HEALTHCARE, INC.

Condensed Consolidated Statements of Operations
For the Six Months Ended June 30, 2016 and 2015
(Unaudited)

		2016		2015
Net Revenues:				
Patient services	$	67,045,799	$	58,090,495
Provision for doubtful accounts		(4,520,909)		(2,598,546)
Net patient services revenue		62,524,890		55,491,949
Management fees from affiliates		2,552,712		3,223,076
Other revenue, net		901,959		2,690,079
Revenues		65,979,561		61,405,104
Equity in earnings of affiliates		723,758		731,072
Operating Expenses:				
Salaries and benefits		26,167,540		15,655,824
Supplies		17,123,144		13,460,051
Other operating expenses		30,127,633		27,482,454
Depreciation and amortization		5,408,900		2,727,455
Total operating expenses		78,827,217		59,325,784
Other Income (Expense):				
Interest expense, net		(2,247,722)		(605,323)
Gain on sale of equity investment in affiliate		2,140,832		—
Other income (expense):		319,214		(14,882)
Net other income (expense)		212,324		(620,205)
Income (loss) from continuing operations, before taxes		(11,911,574)		2,190,187
Benefit (provision) for income taxes		—		114,038
Income (loss) from continuing operations, net of taxes		(11,911,574)		2,304,225
Income (loss) from discontinued operations, net of tax		(16,081)		3,771,057
Net income (loss)		(11,927,655)		6,075,282
Less: Net income (loss) attributable to noncontrolling interests		(543,348)		2,494,916
Net income (loss) attributable to Foundation Healthcare		(11,384,307)		3,580,366
Preferred noncontrolling interests dividends		(312,342)		(372,885)
Net income (loss) attributable to Foundation Healthcare common stock	$	(11,696,649)	$	3,207,481
Earnings per common share (basic and diluted):				
Net loss attributable to continuing operations attributable to Foundation Healthcare common stock	$	(0.67)	$	(0.03)
Income (loss) from discontinued operations, net of tax		(0.00)		0.22
Net income (loss) per share, attributable to Foundation Healthcare common stock	$	(0.67)	$	0.19
Weighted average number of common and diluted shares outstanding		17,540,685		17,252,228

See Accompanying Notes to Condensed Consolidated Financial Statements

FOUNDATION HEALTHCARE, INC.

Condensed Consolidated Statements of Cash Flows
For the Six Months Ended June 30, 2016 and 2015
(Unaudited)

	2016	2015
Operating activities:		
Net income (loss)	$ (11,927,655)	$ 6,075,282
Less: Income (loss) from discontinued operations, net of tax	(16,081)	3,771,057
Income (loss) from continuing operations, net of tax	(11,911,574)	2,304,225
Adjustments to reconcile income (loss) from continuing operations, net of tax, to net cash provided by (used in) operating activities:		
Depreciation and amortization	5,408,900	2,727,455
Stock-based compensation, net of cashless vesting	(87,738)	293,255
Provision for doubtful accounts	4,520,909	2,598,546
Equity in earnings of affiliates	(723,758)	(731,072)
Gain on sale of equity investment in affiliate	(2,140,832)	—
Changes in assets and liabilities, net of acquisition:		
Accounts receivable, net of provision for doubtful accounts	(4,489,457)	(4,400,806)
Receivables from affiliates	97,026	243,924
Supplies inventories	64,735	(7,693)
Prepaid and other current assets	(8,840,689)	721,773
Other assets	136,089	(105,221)
Accounts payable	10,727,527	(1,694,267)
Accrued liabilities	1,428,043	1,483,207
Other current liabilities	374,747	227,516
Other liabilities	151,127	197,975
Net cash provided by (used in) operating activities from continuing operations	(5,284,945)	3,858,817
Net cash used in operating activities from discontinued operations	(7,184)	(602,074)
Net cash provided by (used in) operating activities	(5,292,129)	3,256,743
Investing activities:		
Acquisition of business, net of cash received	(158,000)	—
Proceeds from sale of equity investment in affiliate	2,200,000	—
Purchase of property and equipment	(2,009,454)	(720,760)
Disposal of property and equipment	—	99,267
Distributions from affiliates	792,194	1,245,998
Net cash provided by investing activities from continuing operations	824,740	624,505
Net cash provided by investing activities from discontinued operations	-	8,388,233
Net cash provided by investing activities	824,740	9,012,738
Financing activities:		
Debt proceeds	5,915,642	1,920,112
Debt payments	(3,977,052)	(9,881,531)
Preferred noncontrolling interest dividends	(314,059)	(390,405)
Preferred noncontrolling interest redemptions	—	(870,000)
Distributions to noncontrolling interests	(1,157,416)	(1,771,064)
Net cash provided by (used in) financing activities from continuing operations	467,115	(10,992,888)
Net cash provided by (used in) financing activities from discontinued operations	—	—
Net cash provided by (used in) financing activities	467,115	(10,992,888)
Net change in cash	(4,000,274)	1,276,593
Cash at beginning of period	5,062,492	2,860,025
Cash at end of period	$ 1,062,218	$ 4,136,618

See Accompanying Notes to Condensed Consolidated Financial Statements

Notes to Condensed Consolidated Financial Statements
For the Periods Ended June 30, 2016 and 2015
(Unaudited)

Note 1 – Nature of Business

Foundation Healthcare, Inc. (the "Company") is organized under the laws of the state of Oklahoma and owns controlling interests in surgical hospitals located in Texas. The Company also owns noncontrolling interests in ambulatory surgery centers ("ASCs") located in Texas, Pennsylvania, New Jersey, Ohio, and Maryland. The Company provides management services to a majority of the facilities that it has noncontrolling interests (referred to as "Affiliates") under the terms of various management agreements.

Note 2 – Basis of Presentation

Going Concern and Management's Plan – As of June 30, 2016, the Company had an accumulated deficit of $43.8 million and a working capital deficit of $5.4 million (adjusted for redemption payments of $0.9 million payable to preferred noncontrolling interest holders in October 2016). During the six months ended June 30, 2016, the Company generated a net loss attributable to Foundation Healthcare common stock of $11.7 million and used $5.3 million in cash flow from operating activities from continuing operations. As of June 30, 2016, the Company had cash and cash equivalents of $1.1 million and has no availability under a $15.5 million line of credit from its senior lender. Given the due dates of certain liability and debt payments and preferred noncontrolling interests redemption requirements, management projects that the Company may not be able to meet, at the current revenue levels, all of the Company's obligations as they become due over the next twelve months. Management plans to meet the projected cash flow shortage from the sale of certain assets and from projected increase in revenues and decrease in expenses at the Company's hospitals.

If the Company is unable to sell assets, increase revenue or reduce expenses as described above, the Company may be forced to obtain extensions on existing debt and other obligations as they become due over the next twelve months. Although the Company has historically been successful in obtaining extensions, there is no assurance that the Company will be able to obtain them in the future. In addition, the Company may choose to raise additional funds through the sale of equity or assets, but there is no assurance that the Company will be successful in completing such actions.

If the Company is not able to sell certain assets, generate additional revenue or reduce expenses at its hospitals, does not obtain extensions on some of its debt or other obligations during the next twelve months or if the Company is not able to raise additional funds through the sale of equity or assets, the Company may not have sufficient cash on hand or be able to generate sufficient cash flow from operations in order to meet the Company's cash requirements over the next twelve months. These uncertainties raise substantial doubt about the Company's ability to continue as a going concern. The Company's consolidated financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

Senior Credit Facility Modification and Waiver – The Company is required to maintain compliance with certain financial covenants imposed by its Senior Lenders. As of June 30, 2016, the Company was not in compliance with those covenants. On August 19, 2016, the Senior Lenders waived the financial covenant violations and modified the financial covenant requirements for the remainder of 2016 and first quarter of 2017. In addition, the Senior Lenders extended the due date of a required $3 million principal payment on the Revolving Loan to January 15, 2017. There is no assurance that the Senior Lenders will waive any future covenant violations. See Note 9 – Borrowings and Capital Lease Obligations for additional information.

Note 3 – Summary of Significant Accounting Policies

For a complete list of the Company's significant accounting policies, please see the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

Interim Financial Information – The condensed consolidated financial statements included herein are unaudited and have been prepared in accordance with generally accepted accounting principles for interim financial statements and in accordance with Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America ("GAAP") for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three months and six months ended June 30, 2016 are not necessarily indicative of results that may be expected for the year ended December 31, 2016. The consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Form 10-K for the year ended December 31, 2015. The December 31, 2015 consolidated balance sheet was derived from audited financial statements.

Consolidation – The accompanying consolidated financial statements include the accounts of the Company and its wholly owned, majority owned and controlled subsidiaries. All significant inter-company accounts and transactions have been eliminated in consolidation.

The Company accounts for its investments in Affiliates in which the Company exhibits significant influence, but does not control, in accordance with the equity method of accounting. The Company does not consolidate its equity method investments, but rather measures them at their initial costs and then subsequently adjusts their carrying values through income for their respective shares of the earnings or losses during the period. The Company monitors its investments for other-than-temporary impairment by considering factors such as current economic and market conditions and the operating performance of the companies and records reductions in carrying values when necessary.

Use of estimates – The preparation of financial statements in conformity with generally accepted accounting principles requires management of the Company to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Reclassifications – Certain amounts presented in prior years have been reclassified to conform to the current year's presentation. Such reclassifications had no effect on net income.

Revenue recognition and accounts receivable – The Company recognizes revenues in the period in which services are performed and billed. Accounts receivable primarily consist of amounts due from third-party payors and patients. The Company's ability to collect outstanding receivables is critical to its results of operations and cash flows. Amounts the Company receives for treatment of patients covered by governmental programs such as Medicare and Medicaid and other third-party payors such as health maintenance organizations, preferred provider organizations and other private insurers are generally less than the Company's established billing rates. Additionally, to provide for accounts receivable that could become uncollectible in the future, the Company establishes an allowance for doubtful accounts to reduce the carrying value of such receivables to their estimated net realizable value. Accordingly, the revenues and accounts receivable reported in the Company's consolidated financial statements are recorded at the net amount expected to be received.

Contractual Discounts and Cost Report Settlements – The Company derives a significant portion of its revenues from Medicare, Medicaid and other payors that receive discounts from its established billing rates. The Company must estimate the total amount of these discounts to prepare its consolidated financial statements. The Medicare and Medicaid regulations and various managed care contracts under which these discounts must be calculated are complex and are subject to interpretation and adjustment. The Company estimates the allowance for contractual discounts on a payor-specific basis given its interpretation of the applicable regulations or contract terms. These interpretations sometimes result in payments that differ from the Company's estimates. Additionally, updated regulations and contract renegotiations occur frequently, necessitating regular review and assessment of the estimation process by management. Changes in estimates related to the allowance for contractual discounts affect revenues reported in the Company's accompanying consolidated statements of operations.

Cost report settlements under reimbursement agreements with Medicare, Medicaid and Tricare are estimated and recorded in the period the related services are rendered and are adjusted in future periods as final settlements are determined. There is a reasonable possibility that recorded estimates will change by a material amount in the near term. The estimated net cost report settlements due to the Company were $2.8 million and $0.5 million as of June 30, 2016 and December 31, 2015 respectively, and are included in prepaid and other current assets in the accompanying consolidated balance sheets. We increased our cost report estimate by $2.3 million during the six months ended June 30, 2016 based on settlements from our final filed cost report for 2013 and 2014 and an estimate of the 2015 cost report and estimated recoveries from filing amended cost reports for 2012, 2013 and 2014 for the Houston hospital acquired in December 2015 (see Note 4 – Acquisitions). The Company's management believes that adequate provisions have been made for adjustments that may result from final determination of amounts earned under these programs.

Laws and regulations governing Medicare and Medicaid programs are complex and subject to interpretation. The Company believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing that would have a material effect on the Company's financial statements. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties and exclusion from the Medicare and Medicaid programs.

Provision and Allowance for Doubtful Accounts – To provide for accounts receivable that could become uncollectible in the future, the Company establishes an allowance for doubtful accounts to reduce the carrying value of such receivables to their estimated net realizable value. The primary uncertainty lies with uninsured patient receivables and deductibles, co-payments or other amounts due from individual patients.

The Company has an established process to determine the adequacy of the allowance for doubtful accounts that relies on a number of analytical tools and benchmarks to arrive at a reasonable allowance. No single statistic or measurement determines the adequacy of the allowance for doubtful accounts. Some of the analytical tools that the Company utilizes include, but are not limited to, the aging of accounts receivable, historical cash collection experience, revenue trends by payor classification, revenue days in accounts receivable, the status of claims submitted to third party payors, reason codes for declined claims and an assessment of the Company's ability to address the issue and resubmit the claim and whether a patient is on a payment plan and making payments consistent with that plan. Accounts receivable are written off after collection efforts have been followed in accordance with the Company's policies.

Due to the nature of the healthcare industry and the reimbursement environment in which the Company operates, certain estimates are required to record net revenues and accounts receivable at their net realizable values at the time products or services are provided. Inherent in these estimates is the risk that they will have to be revised or updated as additional information becomes available, which could have a material impact on the Company's operating results and cash flows in subsequent periods. Specifically, the complexity of many third-party billing arrangements and the uncertainty of reimbursement amounts for certain services from certain payors may result in adjustments to amounts originally recorded.

The patient and their third party insurance provider typically share in the payment for the Company's products and services. The amount patients are responsible for includes co-payments, deductibles, and amounts not covered due to the provider being out-of-network. Due to uncertainties surrounding deductible levels and the number of out-of-network patients, the Company is not certain of the full amount of patient responsibility at the time of service. The Company estimates amounts due from patients prior to service and generally collects those amounts prior to service. Remaining amounts due from patients are then billed following completion of service.

The activity in the allowance for doubtful accounts for the six months ending June 30, 2016 follows:

		2016
Balance at beginning of period	$	6,062,000
Provisions recognized as reduction in revenues		4,520,909
Write-offs, net of recoveries		(5,532,909)
Balance at end of period	$	5,050,000

Cash and cash equivalents – The Company considers all highly liquid temporary cash investments with an original maturity of three months or less to be cash equivalents. Certificates of deposit with original maturities of more than three months are also considered cash equivalents if there are no restrictions on withdrawing funds from the account.

Restricted Cash – As of June 30, 2016 and December 31, 2015, the Company had restricted cash of approximately $0.1 million and $0.2 million respectively, included in cash in the accompanying consolidated balance sheets. The restricted cash is pledged as collateral against certain debt of the Company.

Goodwill and Intangible Assets – The Company evaluates goodwill for impairment at least on an annual basis and more frequently if certain indicators are encountered. Goodwill is to be tested at the reporting unit level, defined as an ASC or hospital (referred to as a component), with the fair value of the reporting unit being compared to its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is not considered to be impaired. The Company will complete its annual impairment test in December 2016.

Intangible assets other than goodwill which include physician membership interests, service contracts and covenants not to compete are amortized over their estimated useful lives using the straight line method. The remaining lives range from two to twenty years. The Company evaluates the recoverability of identifiable intangible asset whenever events or changes in circumstances indicate that an intangible asset's carrying amount may not be recoverable.

Net income (loss) per share – Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding for the period. Diluted income (loss) per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted during the period. Dilutive securities having an anti-dilutive effect on diluted loss per share are excluded from the calculation.

Supplemental Cash Flow Information – the following details the supplemental cash flow information for the six months ended June 30, 2016 and 2015:

	2016	2015
Cash paid for interest and income taxes:		
Interest expense	$ 1,778,000	$ 929,000
Income taxes	$ —	$ —
Noncash investing activities:		
Common stock issued in business acquisition	$ 1,925,000	$ —

Recently Adopted and Recently Issued Accounting Guidance

Adopted Guidance

In January 2015, the FASB issued changes to the presentation of extraordinary items. Such items are defined as transactions or events that are both unusual in nature and infrequent in occurrence, and, currently, are required to be presented separately in an entity's income statement, net of income tax, after income from continuing operations. The changes eliminate the concept of an extraordinary item and, therefore, the presentation of such items will no longer be required. Notwithstanding this change, an entity will still be required to present and disclose a transaction or event that is both unusual in nature and infrequent in occurrence in the notes to the financial statements. The Company adopted these changes on January 1, 2016. The adoption of these changes had no impact on the Company's consolidated financial statements.

In February 2015, the FASB issued changes to the analysis that an entity must perform to determine whether it should consolidate certain types of legal entities. These changes (i) modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities or voting interest entities, (ii) eliminate the presumption that a general partner should consolidate a limited partnership, (iii) affect the consolidation analysis of reporting entities that are involved with variable interest entities, particularly those that have fee arrangements and related party relationships, and (iv) provide a scope exception from consolidation guidance for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. The Company adopted these changes on January 1, 2016. The adoption of these changes had no impact on the Company's consolidated financial statements.

In April 2015, the FASB issued changes to the presentation of debt issuance costs. Currently, such costs are required to be presented as a noncurrent asset in an entity's balance sheet and amortized into interest expense over the term of the related debt instrument. The changes require that debt issuance costs be presented in an entity's balance sheet as a direct deduction from the carrying value of the related debt liability. The amortization of debt issuance costs remains unchanged. The Company adopted these changes on January 1, 2016. The adoption of these changes resulted in a decrease of approximately $580,000, to other assets and long-term debt, net of current portion, respectively, included in the accompanying consolidated balance sheet as of June 30, 2016.

In August 2014, the FASB issued changes to the disclosure of uncertainties about an entity's ability to continue as a going concern. Under GAAP, continuation of a reporting entity as a going concern is presumed as the basis for preparing financial statements unless and until the entity's liquidation becomes imminent. Even if an entity's liquidation is not imminent, there may be conditions or events that raise substantial doubt about the entity's ability to continue as a going concern. Because there is no guidance in GAAP about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern or to provide related note disclosures, there is diversity in practice with respect to whether, when, and how an entity discloses the relevant conditions and events in its financial statements. As a result, these changes require an entity's management to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that financial statements are issued. Substantial doubt is defined as an indication that it is probable that an entity will be unable to meet its obligations as they become due within one year after the date that financial statements are issued. If management has concluded that substantial doubt exists, then the following disclosures should be made in the financial statements: (i) principal conditions or events that raised the substantial doubt, (ii) management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations, (iii) management's plans that alleviated the initial substantial doubt or, if substantial doubt was not alleviated, management's plans that are intended to at least mitigate the conditions or events that raise substantial doubt, and (iv) if the latter in (iii) is disclosed, an explicit statement that there is substantial doubt about the entity's ability to continue as a going concern. The Company adopted these changes on January 1, 2016. The adoption of these changes had no impact on the Company's consolidated financial statements.

In September 2015, the FASB issued changes to the accounting for business combinations simplifying the accounting for measurement period Adjustments. The update eliminates the requirement for an acquirer to retrospectively adjust its financial statements for changes to provisional amounts that are identified during the measurement-period following the consummation of a business combination. Instead, the update requires these types of adjustments to be made during the reporting period in which they are identified and would require additional disclosure or separate presentation of the portion of the adjustment that would have been recorded in the previously reported periods as if the adjustment to the provisional amounts had been recognized as of the acquisition date. The Company adopted these changes on January 1, 2016. The adoption of these changes had no impact on the Company's consolidated financial statements.

Issued Guidance

In July 2015, the FASB issued changes to the subsequent measurement of inventory. Currently, an entity is required to measure its inventory at the lower of cost or market, whereby market can be replacement cost, net realizable value, or net realizable value less an approximately normal profit margin. The changes require that inventory be measured at the lower of cost and net realizable value, thereby eliminating the use of the other two market methodologies. Net realizable value is defined as the estimated selling prices in the ordinary course of business less reasonably predictable costs of completion, disposal, and transportation. These changes do not apply to inventories measured using LIFO (last-in, first-out) or the retail inventory method. Currently, the Company applies the net realizable value market option to measure its inventories at the lower of cost or market. These changes become effective for the Company on January 1, 2017. Management has determined that the adoption of these changes will not have an impact on the Company's consolidated financial statements.

In May 2014, the FASB issued changes to the recognition of revenue from contracts with customers. These changes created a comprehensive framework for all entities in all industries to apply in the determination of when to recognize revenue, and, therefore, supersede virtually all existing revenue recognition requirements and guidance. This framework is expected to result in less complex guidance in application while providing a consistent and comparable methodology for revenue recognition. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve this principle, an entity should apply the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract(s), (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract(s), and (v) recognize revenue when, or as, the entity satisfies a performance obligation. These changes become effective for the Company on January 1, 2018. Management is currently evaluating the potential impact of these changes on the Company's consolidated financial statements.

In February 2016, the FASB issued changes to the accounting for leases, which requires an entity that leases assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. The update is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018 and must be adopted using a modified retrospective approach. Management is currently evaluating the impact of this update on the consolidated financial statements.

In March 2016, the FASB issued changes to employee share-based payment accounting, which simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification on the statement of cash flows. For public companies, the new guidance is effective for annual reporting periods (including interim periods within those periods) beginning after December 15, 2016, with early adoption permitted. The Company is in the process of evaluating the impact of adoption of this guidance on its financial statements.

In June 2016, the FASB issued changes to the impairment model for most financial instruments, including trade receivables from an incurred loss method to a new forward-looking approach, based on expected losses. The estimate of expected credit losses will require entities to incorporate considerations of historical information, current information and reasonable and supportable forecasts. These changes are effective for the Company in the first quarter of 2020 and must be adopted using a modified retrospective transition approach. The Company is currently assessing the impact of the adoption of these changes on the Company's results of operations, financial position and cash flows.

Note 4 – Acquisitions

On December 31, 2015, the Company closed the acquisition comprising substantially all of the hospital assets and hospital operating entity of University General Health Systems, Inc. (“UGHS”), consisting primarily of a sixty-nine bed acute care hospital located in the Medical City area of Houston, Texas (referred to as University General Hospital, LP or “UGH”). Subsequent to the acquisition, UGH is being operated as Foundation Surgical Hospital of Houston.

The acquisition of UGH was based on management’s belief that UGH fits into the Company’s acquisition and development strategy and operating model that enables the Company to grow by taking advantage of highly-fragmented markets, an increasing demand for short stay surgery and a need by physicians to forge strategic alliances to meet the needs of the evolving healthcare landscape while also shaping the clinical environments in which they practice. The Company expects the acquisition of UGH will generate positive earnings and cash flow that will be accretive to the earnings and cash flow of the Company. The Company expects the goodwill attributable to UGH to be tax deductible.

The Company paid $25.1 million in cash for the net assets acquired from UGHS.

The fair value amounts have been initially recorded using preliminary estimates. The Company has engaged a third-party valuation company to complete a valuation of the fair value of the assets acquired and liabilities assumed in the acquisition. A portion of the valuation has been completed and management believes the valuation will be fully completed by September 30, 2016. The preliminary estimates will be revised in future periods and the revisions may materially affect the presentation of the Company’s consolidated financial results. Any changes to the initial estimates of the fair value of the assets and liabilities will be recorded as adjustments to those assets and liabilities and residual amounts will be allocated to goodwill. The preliminary purchase allocations for the acquisition of UGHS are as follows:

	Preliminary	Adjustments	Adjusted
Accounts receivable	$ 7,229,000	$ —	$ 7,229,000
Supplies inventories	1,689,000	—	1,689,000
Other current assets	395,000	—	395,000
Total current assets	9,313,000	—	9,313,000
Property and equipment	40,363,000	(733,000)	39,630,000
Other assets	307,000	—	307,000
Intangible, net	—	3,930,000	3,930,000
Goodwill	9,450,000	(2,822,000)	6,628,000
Total assets acquired	59,433,000	375,000	59,808,000
Liabilities assumed:			
Accounts payable and accrued liabilities	1,589,000	375,000	1,964,000
Current portion of long-term debt and capital lease obligations	4,740,000	—	4,740,000
Total current liabilities	6,329,000	375,000	6,704,000
Long-term debt and capital lease obligations, net of current portion	28,004,000	—	28,004,000
Total liabilities assumed	34,333,000	375,000	34,708,000
Net assets acquired	$ 25,100,000	$ —	$ 25,100,000

On May 11, 2016, the Company closed the acquisition of 51% of Ninety Nine Healthcare Management, LLC (“99 Mgmt”). 99 Mgmt has developed a clinically and financially integrated multi-specialty practice model which can increase participating physicians’ revenues.

The acquisition of 99 Mgmt was based on management’s belief that 99 Mgmt will allow the Company to offer services to its physician partners that lead to higher revenues by aligning the goals and incentives for patients, physicians, hospitals, employers and payers. The Company expects the acquisition of 99 Mgmt to generate positive earnings and cash flow. The Company expects the goodwill attributable to 99 Mgmt will not be tax deductible.

The Company paid $440,000 in cash and issued 700,000 shares of the Company’s common stock for purchase of 99 Mgmt. In addition, the Company has agreed to issue an additional 200,000 shares of the Company’s common stock upon 99 Mgmt’s completion of a signed network contract with BCBS of Texas that allows for one of the Company’s hospitals to participate as a contracted hospital provider. There is no time limit for completion of the contract.

The fair value amounts have been initially recorded using preliminary estimates. The Company will complete a valuation of the fair value of the assets acquired and liabilities assumed in the acquisition. The preliminary estimates will be revised in future periods and the revisions may materially affect the presentation of the Company's consolidated financial results. Any changes to the initial estimates of the fair value of the assets and liabilities will be recorded as adjustments to those assets and liabilities and residual amounts will be allocated to goodwill. The preliminary purchase allocations for the acquisition of 99 Mgmt are as follows:

	Preliminary
Cash	$ 282,000
Accounts receivable	613,000
Total current assets	895,000
Property and equipment	47,000
Goodwill	5,936,000
Other assets	16,000
Total assets acquired	6,894,000
Liabilities assumed:	
Accounts payable and accrued liabilities	628,000
Contingent consideration	550,000
Total liabilities assumed	1,178,000
Noncontrolling interests	2,801,000
Net assets acquired	$ 2,915,000

During the three months and six months ended June 30, 2016, the Company incurred approximately $234,000 and $268,000, respectively, in expenses related to the acquisitions. The expenses incurred related primarily to legal fees related to the purchase agreement and structure of the transaction, professional fees related to the audits of the 2015 and 2014 financial statements of UGH and additional professional fees related to the valuation of the fair value of the acquisitions.

Since the UGHS acquisition occurred on December 31, 2015, there are no acquisition revenues and earnings included in the Company's consolidated statements of operations for the year ended December 31, 2015. The revenue and earnings of the combined entity had the acquisition dates of UGHS and 99 Mgmt been January 1, 2015 are as follows:

				Attributable to Foundation HealthCare common stock	
	Revenue	Loss From Continuing Operations	Net Income (Loss)	Net Loss	Net Loss Per Share
Actual:					
From 1/1/2016 to 6/30/2016	$ 21,511,000	$ (7,227,000)	$ (7,227,000)	$ (7,227,000)	$ (0.41)
Supplemental Pro Forma:					
From 1/1/2016 to 6/30/2016	$ 67,834,000	$ (12,048,000)	$ (12,064,000)	$ (11,833,000)	$ (0.66)
From 1/1/2015 to 12/31/2015	$ 184,169,000	$ (939,000)	$ 5,792,000	$ (1,560,000)	$ (0.09)

The pro forma information is presented for informational purposes only and is not necessarily indicative of the results of operations that actually would have been achieved had the acquisition been consummated as of that time, nor is it intended to be a projection of future results.

Note 5 – Divestitures

On June 30, 2016, the Company sold its 8% interest in Summit Hospital, an Equity Owned Hospital located in Edmond, Oklahoma. The Company received $2.2 million in proceeds from the sale of Summit resulting in a gain of $2.1 million.

On July 15, 2015, the Company sold its 10% interest in the Kirby Glen Surgery, LLC, one of its Equity Owned ASCs located in Houston, Texas. The Company received $0.2 million in combined proceeds for the sale of the equity interest and termination of our management agreement.

On June 12, 2015, the Company executed an agreement pursuant to which the Company sold a portion of its 20% equity investment in Grayson County Physician Property, LLC ("GCPP") through a series of transactions. In conjunction with the sale, the management agreement under which the Company provided certain services including billing and collections, general management services, legal support, and accounting services was terminated. The Company's decision to sell the assets of GCPP was part of the Company's strategic plan to focus on the growth of its majority owned surgical hospital businesses. The Company received $7.8 million of proceeds as a result of the sale and $0.5 million for the termination of the management agreement. The Company used $7.0 million of these proceeds to reduce the Company's principal balance of the note held by the Company's senior lender. The remainder of the proceeds will be used for working capital needs and possible future acquisitions. See Note 6 – Discontinued Operations for additional information.

On March 31, 2015, Houston Orthopedic Surgical Hospital, L.L.C. ("HOSH"), our Equity Owned hospital in Houston, Texas, sold substantially all of its assets under an asset purchase agreement. Given that the Company does not exhibit control with the 20% investment in HOSH, the Company accounts for the investment on a cost or cash basis. As a result of the HOSH sale, the Company received a distribution on May 12, 2015 $1.8 million, of which $0.6 million is being held in escrow until October 2016.

Note 6 – Discontinued Operations

The partial sale of GCPP in June 2015 was part of the Company's strategic plan to focus on majority owned hospital investments. As a result, the proceeds from the sale, the remaining equity ownership, and the results of operations and cash flows related to the equity investment in GCPP for all periods presented have been classified as discontinued operations.

The operating results for the Company's discontinued operations for the six months ended June 30, 2016 and 2015 are summarized below:

	2016	2015
Revenues:		
Equity in earnings of GCCP	$ —	$ 24,784
Sleep operations	—	—
Total revenues	$ —	$ 24,784
Net income (loss) before taxes:		
GCCP	$ —	$ 24,784
Sleep operations	(16,081)	(70,737)
Gain on sale of equity investment in GCCP	—	6,331,048
Gain on sale of building in GCCP	—	—
Income tax (provision) benefit	—	(2,514,038)
Net income (loss) from discontinued operations, net of tax	$ (16,081)	$ 3,771,057

The balance sheet items for the Company's discontinued operations as of June 30, 2016 and December 31, 2015 are summarized below:

	June 30, 2016	December 31, 2015
Cash and cash equivalents	$ —	$ 5,219
Other current assets	408,303	411,171
Total current assets	408,303	416,390
Fixed assets, net	—	8,713
Total assets	$ 408,303	$ 425,103
Payables and accrued liabilities	$ 766,928	$ 774,831
Income taxes payable	1,581,334	1,581,334
Total liabilities	$ 2,348,262	$ 2,356,165

Note 7 – Equity Investments in Affiliates

The Company invests in non-majority interests in its Affiliates. The Company's equity investments and respective ownership interest as of June 30, 2016 and December 31, 2015 are as follows:

		Ownership %	
Affiliate	Location	June 30, 2016	December 31, 2015
Surgical Hospitals:			
Summit Medical Center	Edmond, OK	0%	8%
ASCs:			
Foundation Surgery Affiliate of Nacogdoches, LLP	Nacogdoches, TX	13%	13%
Park Ten Surgery Center/Physicians West Houston	Houston, TX	10%	10%
Foundation Surgery Affiliate of Middleburg Heights, LLC	Middleburg Heights, OH	10%	10%
Foundation Surgery Affiliate of Huntingdon Valley, LP	Huntingdon Valley, PA	20%	20%
New Jersey Surgery Center, LLC	Mercerville, NJ	10%	10%
Foundation Surgery Affiliate of Northwest Oklahoma City, LLC	Oklahoma City, OK	20%	20%
Cumberland Valley Surgery Center, LLC	Hagerstown, MD	34%	34%
Frederick Surgical Center, LLC	Frederick, MD	20%	20%

The results of operations for the six months ended June 30, 2016 and 2015, of the Company's equity investments in Affiliates are as follows:

	2016	2015
Net operating revenues	$ 23,035,340	$ 24,990,428
Net income	$ 6,027,677	$ 6,159,449

The results of financial position as of June 30, 2016 and December 31, 2015, of the Company's equity investments in Affiliates are as follows:

	June 30, 2016	December 31, 2015
Current assets	$ 9,969,648	$ 12,371,752
Noncurrent assets	5,817,247	7,699,093
Total assets	$ 15,786,895	$ 20,070,845
Current liabilities	$ 3,833,829	$ 4,240,326
Noncurrent liabilities	1,540,610	2,266,793
Total liabilities	$ 5,374,439	$ 6,507,119
Members' equity	$ 10,412,456	$ 13,563,726

Note 8 – Goodwill and Other Intangibles

Changes in the carrying amount of goodwill as follows:

	Gross Amount	Accumulated Impairment Loss	Net Carrying Value
December 31, 2015	$ 29,647,191	$ (22,045,382)	$ 7,601,809
Acquisition - 99 Mgmt (Note 4)	5,936,000	—	5,936,000
June 30, 2016	$ 35,583,191	$ (22,045,382)	$ 13,537,809

Goodwill and intangible assets with indefinite lives must be tested for impairment at least once a year. Carrying values are compared with fair values, and when the carrying value exceeds the fair value, the carrying value of the impaired asset is reduced to its fair value. The Company tests goodwill for impairment on an annual basis in the fourth quarter or more frequently if management believes indicators of impairment exist. The performance of the test involves a two-step process. The first step of the impairment test involves comparing the fair values of the applicable reporting units with their aggregate carrying values, including goodwill. The Company generally determines the fair value of its reporting units using the income approach methodology of valuation that includes the discounted cash flow method as well as other generally accepted valuation methodologies. If the carrying amount of a reporting unit exceeds the reporting unit's fair value, the Company performs the second step of the goodwill impairment test to determine the amount of impairment loss. The second step of the goodwill impairment test involves comparing the implied fair value of the affected reporting unit's goodwill with the carrying value of that goodwill.

Changes in the carrying amount of intangible assets during the six months ended June 30, 2016 were as follows:

	Carrying Amount	Accumulated Amortization	Net
December 31, 2015	$ 18,454,500	$ (7,502,330)	$ 10,952,170
Amortization	—	(1,125,407)	(1,125,407)
June 30, 2016	$ 18,454,500	$ (8,627,737)	$ 9,826,763

Intangible assets as of June 30, 2016 and December 31, 2015 include the following:

		June 30, 2016			December 31, 2015
	Useful Life (Years)	Carrying Value	Accumulated Amortization	Net	Net
Management fee contracts	6 - 8	$ 3,498,500	$ (2,822,807)	$ 675,693	$ 893,723
Non-compete agreements	5	2,027,000	(1,458,925)	568,075	771,161
Physician memberships	7	6,468,000	(3,388,000)	3,080,000	3,542,000
Medicare provider agreements	20	3,930,000	(95,241)	3,834,759	3,930,000
Trade name	5	381,000	(227,447)	153,553	192,379
Service Contracts	10	2,150,000	(635,317)	1,514,683	1,622,907
		$ 18,454,500	$ (8,627,737)	$ 9,826,763	$ 10,952,170

Amortization expense for the three months ended June 30, 2016 and 2015 was $610,439 and $514,553, respectively. Amortization expense for the six months ended June 30, 2016 and 2015 was $1,125,407 and $1,029,113, respectively.

Amortization expense for the next five years related to these intangible assets is expected to be as follows:

Twelve months ending June 30,	
2017	$ 2,248,629
2018	1,808,554
2019	1,329,931
2020	713,931
2021	405,931
Thereafter	3,319,786

Note 9 – Borrowings and Capital Lease Obligations

The Company's short-term debt obligations are as of June 30, 2016 and December 31, 2015 are as follows:

	Rate (1)	June 30, 2016	December 31, 2015
Insurance premium financings	4.8 - 5.0%	$ 425,653	$ 308,769

(1) Effective rate as of June 30, 2016

The Company has various insurance premium financing notes payable that bear interest rates ranging from 4.8% to 5.0%. The insurance notes mature in October 2016 and the Company is required to make monthly principal and interest payments totaling $134,051.

The Company's long-term debt obligations at June 30, 2016 and December 31, 2015 are as follows:

	Rate (1)	Maturity Date	June 30, 2016	December 31, 2015
Senior Lender:				
Note payable	4.3%	Dec. 2020	$ 27,361,606	$ 28,375,000
Line of credit	4.3%	Dec. 2018	14,500,000	10,500,000
Unamortized loan origination costs			(579,962)	(644,403)
Other Lenders:				
Note payable - subordinated note	3.0%	Dec. 2019	7,900,000	7,900,000
Total			49,181,644	46,130,597
Less: Current portion of long-term debt			(9,028,572)	(4,601,320)
Long-term debt			$ 40,153,072	$ 41,529,277

(1) Effective rate as of June 30, 2016

Senior Credit Facility

Effective December 31, 2015, the Company entered into a Credit Agreement (the "Senior Credit Facility") with Texas Capital Bank, National Association, serving as the lead bank for two other banks (collectively "Senior Lenders"). The Senior Credit Facility replaced and consolidated all of the Company's and the Company's subsidiaries' debt in the original principal amount of $28.4 million, which is referred to as the Term Loan, and provides for an additional revolving loan in the amount of $15.5 million, which is referred to as the Revolving Loan. The Company has also entered into a number of ancillary agreements in connection with the Senior Credit Facility, including deposit account control agreements, subsidiary guarantees, security agreements and promissory notes.

Maturity Dates. The Term Loan matures on December 30, 2020 and the Revolving Loan matures on December 30, 2018.

Interest Rates. Borrowings under the Senior Credit Facility are made, at the Company's option, as either Base Rate loans or LIBOR loans. "Base Rate" for any day is the highest of (i) the Prime Rate, (ii) the Federal Funds Rate plus one half of one percent (0.5%), and (iii) Adjusted LIBOR plus one percent (1.00%). LIBOR loans are based on either the one month, two month or three month LIBOR rate at the Company's option. From August 19, 2016 to June 30, 2017, all outstanding amounts under the Senior Credit Facility shall bear interest based on the Base Rate and the Base Rate shall not at be less than 3.5%. The interest rate is either a Base Rate or LIBOR plus the Applicable Margins based on our Senior Debt to EBITDA Ratio, as defined.

The Applicable Margins are as follows:

Pricing Level	Senior Debt to EBITDA Ratio	Base Rate Portion	LIBOR Portion and Letter of Credit Fee	Commitment Fee
1	< 2.0 : 1.0	2.75%	3.75%	0.375%
2	≥ 2.0 : 1.0 but < 2.5 : 1.0	3.00%	4.00%	0.375%
3	≤ 2.5 : 1.0	3.25%	4.25%	0.375%

The Applicable Margin in effect will be adjusted within 45 days following the end of each quarter based on the Company's Senior Debt to EBITDA ratio. The Senior Debt to EBITDA Ratio is calculated by dividing all of our senior indebtedness (excluding capital lease obligations for Foundation Surgical Hospital of Houston), that is by the Company's EBITDA for the preceding four fiscal quarters. EBITDA is defined in the Senior Credit Facility as the Company's net income *plus* (b) *the sum of* the following: interest expense; income taxes; depreciation; amortization; extraordinary losses determined in accordance with GAAP; cash and noncash stock compensation expense; and other non-recurring expenses reducing such net income which do not represent a cash item in such period or any future period, *minus* (c) *the sum of* the following: income tax credits; extraordinary gains determined in accordance with GAAP; and all non-recurring, non-cash items increasing net income.

Interest and Principal Payments. The Company is required to make quarterly payments of principal and interest on the Term Loan. The first four quarterly payments on the Term Loan will be $1,013,393, on the first day of each April, July, October, and January during the term hereof, commencing April 1, 2016. The Company is required to make quarterly payments on the Revolving Loan equal to the accrued and unpaid interest. All unpaid principal and interest on the Term Loan and Revolving Loan must be paid on the respective maturity dates of each Loan.

Borrowing Base. The Company's ability to borrow money under the Revolving Loan is limited to the Company's Borrowing Base. The Company's Borrowing Base is equal to the *sum of* (i) 80% of the eligible account of Foundation Surgical Hospital of San Antonio, not to exceed the outstanding principal balance of the intercompany note payable by the San Antonio Hospital to the Company, (ii) 80% of the eligible account of Foundation Surgical Hospital of El Paso, not to exceed the outstanding principal balance of the intercompany note payable by the El Paso Hospital to the Company, and (iii) 80% of the eligible account of Foundation Surgical Hospital of Houston, not to exceed the outstanding principal balance of the intercompany note payable by the Houston Hospital to the Company.

Mandatory Prepayments. The Company must make mandatory prepayments of the Term Loans in the following situations, among others:

- The Company must apply 100% of the net proceeds from the sale of worn out and obsolete equipment not necessary or useful for the conduct of the Company's business;
- Commencing with the fiscal year ending December 31, 2016, the Company must apply 50% of our Excess Cash Flow for such fiscal year to the installment payments due on the Company's Term Loan;
- The Company must apply 50% of the net cash proceeds from the issuance of equity interests to the installment payments due on the Company's Term Loan; provided that no prepayment need to be made for the year ended December 31, 2016 once the Company has made mandatory prepayments in excess of $10,000,000;
- The Company must apply 100% of the net cash proceeds from the issuance of debt (other than certain permitted debt) to the prepayment of the Term Loan;
- The Company must prepay 100% of the net cash proceeds paid to the Company other than in the ordinary course of business; and
- The Company must prepay 100% of the net cash proceeds the Company receives from the prepayment of intercompany notes.

Voluntary Prepayments. The Company may prepay amounts under the Term Loan or Revolving Loan at any time provided that the Company is required to pay a prepayment fee of 2% of the amount prepaid if payment is made prior to the first anniversary, 1.5% if the prepayment is made after the first anniversary but prior to the second anniversary and 1% if the prepayment is made after the second anniversary but prior to the third anniversary.

Guaranties. Each of the Company's direct or indirect wholly-owned subsidiaries jointly and severally and unconditionally guaranty payment of the Company's obligations owed to Lenders.

Financial Covenants:

Debt to EBITDA Ratio. As of December 31, 2015, the Company must maintain a Debt to EBITDA Ratio, not in excess of 3.50 to 1.00. Thereafter, the Company must maintain a Debt to EBITDA Ratio as of the last day of any fiscal quarter, not in excess of (a) 3.25 to 1.00 for the fiscal quarters ending December 31, 2015, March 31, 2016 and June 30, 2016; (b) 2.75 to 1.00 for the fiscal quarters ending June 30, 2017 and September 30, 2017; (c) 2.50 to 1.00 for the fiscal quarters ending December 31, 2017, March 31, 2018, June 30, 2018 and September 30, 2018; and (d) 2.25 to 1.00 for the fiscal quarter ending December 31, 2018 and at the end of each fiscal quarter thereafter. As of June 30, 2016, the Company's Debt to EBITDA Ratio was 7.21.

Senior Debt to EBITDA Ratio. As of December 31, 2015, the Company must maintain a Senior Debt to EBITDA Ratio not in excess of 3.00 to 1.00. Thereafter, the Company must maintain a Senior Debt to EBITDA Ratio as of the last day of any fiscal quarter, not in excess of (a) 3.00 to 1.00 for the fiscal quarters ending December 31, 2015, March 31, 2016 and June 30, 2016; (b) 2.50 to 1.00 for the fiscal quarters ending June 30, 2017 and September 30, 2017; (c) 2.25 to 1.00 for the fiscal quarters ending December 31, 2017, March 31, 2018, June 30, 2018 and September 30, 2018; and (d) 2.00 to 1.00 for the fiscal quarter ending December 31, 2018 and at the end of each fiscal quarter thereafter. As of June 30, 2016, the Company's Senior Debt to EBITDA Ratio was 6.23.

Pre-Distribution Fixed Charge Coverage Ratio. The Company must maintain as of the last day of any fiscal quarter (excluding the fiscal quarters ending September 30, 2016, December 31, 2016 and March 31, 2017) a Pre-Distribution Fixed Charge Coverage Ratio in excess of 1.30 to 1.00. As of June 30, 2016, the Company's Pre-Distribution Fixed Charge Coverage Ratio was 0.63.

Post-Distribution Fixed Charge Coverage Ratio. The Company must maintain as of the last day of any fiscal quarter (excluding the fiscal quarters ending September 30, 2016, December 31, 2016 and March 31, 2017), a Post-Distribution Fixed Charge Coverage Ratio in excess of 1.05 to 1.00. As of June 30, 2016, the Company's Post-Distribution Fixed Charge Coverage Ratio was 0.48.

EBITDA. The Company must have EBITDA of at least $1,750,000 for the fiscal quarter ending September 30, 2016 and $4,250,000 for the fiscal quarter ending December 31, 2016 and each quarter thereafter.

Capital Expenditures. The Company shall not make capital expenditures in excess of $5,000,000 during any fiscal year.

As of June 30, 2016, the Company was not in compliance with the Senior Credit Facility financial covenants; however the Senior Lenders have waived the financial covenant violations. As described above, the Senior Lenders have modified the financial covenants for the remainder of 2016.

Collateral. Payment and performance of the Company's obligations under the Senior Credit Facility are secured in general by all of the Company and the Company's guarantors' assets.

Negative Covenants. The Senior Credit Facility has restrictive covenants that, among other things, limits or restricts the Company's ability to do the following without the consent of the Senior Lenders:

- Incur additional indebtedness;
- Create or incur additional liens on the Company's assets;
- Engage in mergers or acquisitions;
- Pay dividends or make any other payment or distribution in respect of the Company's equity interests;
- Make loans and investments;
- Issue equity, except for stock compensation awards to employees;
- Engage in transaction with affiliates;
- Dispose of the Company's assets, except for certain approved assets;
- Engage in any sale and leaseback arrangements; and
- Prepay debt to debtors other than the Senior Lenders.

Defaults and Remedies. In addition to the general defaults of failure to perform our obligations under the Loan Agreement, events of default also include the occurrence of a change in control, as defined, and the loss of our Medicare or Medicaid certification, collateral casualties, entry of a uninsured judgment of $500,000 or more, failure of first liens on collateral and the termination of any of the Company's management agreements that represent more than 10% of the Company's management fees for the preceding 18 month period. In the event of a monetary default, all of the Company's obligations due under the Senior Credit Facility shall become immediately due and payable. In the event of a non-monetary default, the Company has 10 days or in some cases three days to cure before the Senior Lenders have the right to declare the Company's obligations due under the Senior Credit Facility immediately due and payable.

Modification and Waiver. On May 11, 2016, the Company entered into a Loan Modification Agreement and Waiver with its Senior Lenders ("Senior Credit Modification One"). Under the Senior Credit Modification One, the Company's Revolving Loan was increased from $12.5 million to $15.5 million. The $3.0 million of borrowing represents a temporary advance that must be repaid by July 31, 2016 (the "Temporary Advance"). In addition, the Senior Lenders consented to the sale of certain of the Company's assets and waived certain technical defaults in the Senior Credit Facility related to timing deadlines for certain financial information provided by the Company to the Senior Lenders for the UGH Acquisition. On August 19, 2016, the Company entered into a Loan Modification Agreement and Waiver with its Senior Lenders ("Senior Credit Modification Two"). Under the Senior Credit Modification Two, the Senior Lenders waived the financial covenant violations for the fiscal quarter ended June 30, 2016 and modified the financial covenants for the fiscal quarters ending September 30, 2016 and December 31, 2016 by replacing the Debt to EBITDA Ratio, Senior Debt to EBITDA Ratio, and Pre and Post Distribution Fixed Charge Coverage Ratios with the EBITDA covenant. In addition, the Senior Lenders extended the due date for the repayment of the Temporary Advance to January 15, 2017.

During the period from August 19, 2016 to June 30, 2017, the Senior Credit Modification Two prohibits the Company from making any interest or redemption payments to its preferred noncontrolling interest holders (see Note 10 – Preferred Noncontrolling Interests) and prohibits the Company from making any payments on the $7.9 million subordinated note payable. Under the Senior Credit Modification Two, the Company must also maintain total cash balances in excess of $2 million ("Minimum Cash Balances") and the Company's total accounts payable past due by 91 days or more must be less than $6.3 million.

At June 30, 2016, future maturities of long-term debt were as follows:

Years ended June 30:		
2017	$	9,028,572
2018		5,883,582
2019		17,383,582
2020		4,073,786
2021		12,812,122
Thereafter		—

The Company's capital lease obligations as of June 30, 2016 and December 31, 2015 are as follows:

	Rate (1)	Maturity Date	June 30, 2016	December 31, 2015
Building	7.5%	Jul. 2036	$ 24,168,540	$ 24,424,341
Equipment	5.1 - 9.1%	Mar. 2017 - Dec. 2020	8,276,219	9,185,320
Total			32,444,759	33,609,661
Less: Current portion of capital leases			(4,071,318)	(4,478,968)
Capital leases obligations			$ 28,373,441	$ 29,130,693

(1) Effective rate as of June 30, 2016

The Company has entered into a capital lease covering the FSH Houston hospital facility, see Note 4 - Acquisition. The capital lease bears an interest at fixed rate of 7.5%. The Company is required to make monthly principal and interest payments under the capital lease totaling $193,611. The Company is also required to maintain a $1.0 million letter of credit payable to the lessor in the event of a default on the lease.

The Company has entered into various capital leases that are collateralized by certain computer and medical equipment used by the Company. The capital leases bear interest at fixed rates ranging from 5.1% to 9.1%. The Company is required to monthly principal and interest payments under the capital leases totaling $278,142.

At June 30, 2016, future maturities of capital lease obligations were as follows:

Years ended June 30:		
2017	$	4,071,318
2018		2,942,345
2019		1,560,415
2020		1,630,374
2021		1,227,285
Thereafter		21,013,022

Note 10 – Preferred Noncontrolling Interests

During 2013, the Company's wholly-owned subsidiary, Foundation Health Enterprises, LLC ("FHE") completed a private placement offering of $9,135,000. The offering was comprised of 87 units ("FHE Unit" or "preferred noncontrolling interest"). Each FHE Unit was offered at $105,000 and entitled the purchaser to one (1) Class B membership interest in FHE, valued at $100,000, and 1,000 shares of the Company's common stock, valued at $5,000. The total consideration of $9,135,000 was comprised of $8,700,000 attributable to the preferred noncontrolling interest and $435,000 attributable to the 87,000 shares of the Company's common stock.

The FHE Units provide for a cumulative preferred annual return of 9% on the amount allocated to the Class B membership interests. The FHE Units will be redeemed by FHE in five annual installments beginning in October 2014. The FHE Unit holders agreed to defer the first installment payment until March 2015. The first and second installments were paid in April 2015 and October 2015, respectively. The Senior Credit Modification Two also prohibits the Company from making any interest or redemption payments to its preferred noncontrolling interest holders (see Note 10 – Preferred Noncontrolling Interests) during the period from August 19, 2016 to June 30, 2017. The first four installments shall be in the amount of $10,000 per FHE Unit and the final installment will be in the amount of the unreturned capital contribution and any undistributed preferred distributions. The FHE Units are convertible at the election of the holder at any time prior to the complete redemption into restricted common shares of the Company at a conversion price of $20.00 per share. Since the FHE Units have a redemption feature and a conversion feature which the Company determined to be substantive, the preferred noncontrolling interests has been recorded at the mezzanine level in the accompanying consolidated balance sheets and the corresponding dividends are recorded as a reduction of accumulated deficit.

Note 11 – Commitments and Contingencies

Legal claims – The Company is exposed to asserted and unasserted legal claims encountered in the normal course of business, including claims for damages for personal injuries, medical malpractice, breach of contracts, wrongful restriction of or interference with physicians' staff privileges and employment related claims. In certain of these actions, plaintiffs request payment for damages, including punitive damages that may not be covered by insurance. Management believes that the ultimate resolution of these matters will not have a material adverse effect on the operating results or the financial position of the Company. There were no settlement expenses during the six months ended June 30, 2016 and 2015 related to the Company's ongoing unasserted legal claims.

Self-insurance – Effective January 1, 2014, the Company began using a combination of insurance and self-insurance for employee-related healthcare benefits. The self-insurance liability is determined actuarially, based on the actual claims filed and an estimate of incurred but not reported claims. Self-insurance reserves as of June 30, 2016 and December 31, 2015 were $629,909 and $424,593, respectively, and are included in accrued liabilities in the accompanying consolidated balance sheets.

Note 12 – Fair Value Measurements

Fair value is the price that would be received from the sale of an asset or paid to transfer a liability (i.e., an exit price) in the principal or most advantageous market in an orderly transaction between market participants. In determining fair value, the accounting standards established a three-level hierarchy that distinguishes between (i) market data obtained or developed from independent sources (i.e., observable data inputs) and (ii) a reporting entity's own data and assumptions that market participants would use in pricing an asset or liability (i.e., unobservable data inputs). Financial assets and financial liabilities measured and reported at fair value are classified in one of the following categories, in order of priority of observability and objectivity of pricing inputs:

- *Level 1* – Fair value based on quoted prices in active markets for identical assets or liabilities.
- *Level 2* – Fair value based on significant directly observable data (other than Level 1 quoted prices) or significant indirectly observable data through corroboration with observable market data. Inputs would normally be (i) quoted prices in active markets for similar assets or liabilities, (ii) quoted prices in inactive markets for identical or similar assets or liabilities or (iii) information derived from or corroborated by observable market data.
- *Level 3* – Fair value based on prices or valuation techniques that require significant unobservable data inputs. Inputs would normally be a reporting entity's own data and judgments about assumptions that market participants would use in pricing the asset or liability.

The fair value measurement level for an asset or liability is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques should maximize the use of observable inputs and minimize the use of unobservable inputs.

Recurring Fair Value Measurements: The carrying value of the Company's financial assets and financial liabilities is their cost, which may differ from fair value. The carrying value of cash held as demand deposits, money market and certificates of deposit, accounts receivable, short-term borrowings, accounts payable and accrued liabilities approximated their fair value. At June 30, 2016, the fair value of the Company's long-term debt, including the current portion was determined to be approximately equal to its carrying value.

Nonrecurring Fair Value Measurements: In May 2016, the Company completed the acquisition of 99 Mgmt; see Note 3 – Acquisition for additional information. The assets acquired and liabilities assumed in the acquisition were recorded at their fair values on the date of the acquisition. For the acquisition, the nonrecurring fair value measurements were developed using significant unobservable inputs (Level 3) using discounted cash flow calculations based upon the Company's weighted average cost of capital and third-party valuation services. Assumptions used were similar to those that would be used by market participants performing valuations of these business units and were based on analysis of current and expected future economic conditions and the updated strategic plan for each business unit. The assets acquired were valued at $6,894,000 and the liabilities assumed were $1,178,000.

Note 13 – Related Party Transactions

Effective June 1, 2014, the Company's hospital subsidiary located in El Paso, Texas entered into a sublease agreement with The New Sleep Lab International, Ltd., referred to as New Sleep. New Sleep is controlled by Dr. Robert Moreno, one of our Directors. The sublease with New Sleep calls for monthly rent payments of $8,767 and the sublease expires on November 30, 2018. The space subleased from New Sleep will be sublet to physician partners and casual uses of our hospital and is located in a building that also houses one of our imaging facilities. During the six months ended June 30, 2016, the Company incurred approximately $47,200 in lease expense under the terms of the lease.

As of June 30, 2016, the Company had $0.1 million on deposit at Valliance Bank. Valliance Bank is controlled by Mr. Roy T. Oliver, one of our greater than 5% shareholders. A noncontrolling interest in Valliance Bank is held by Mr. Joseph Harroz, Jr., a director of the Company. Mr. Stanton Nelson, the Company's Chief Executive Officer and Mr. Harroz also serve as directors of Valliance Bank.

The Company has entered into agreements with certain of its Affiliate ASCs and hospitals to provide management services. As compensation for these services, the surgery centers and hospitals are charged management fees which are either fixed or are based on a percentage of the Affiliates cash collected or the Affiliates net revenue. The percentages range from 2.25% to 6.0%.

As of June 30, 2016 and December 31, 2015, the Company has obligations of $1.4 million that are owed to Foundation Healthcare Affiliates ("FHA"), the Company's majority shareholder, related to transactions that occurred prior to the Foundation acquisition in July 2013. The amounts owed to FHA are included in other liabilities in the accompanying consolidated balance sheets.

Note 14 – Subsequent Events

Management evaluated all activity of the Company and concluded that no material subsequent events have occurred that would require recognition in the consolidated financial statements or disclosure in the notes to the consolidated financial statements, except for the following:

On July 7, 2016, the Company sold certain raw land adjacent to its Consolidated Hospital located in El Paso, Texas to Chihuahua Development, LLC ("Chihuahua") for $1.3 million. The sale resulted in a loss of $0.2 million. Chihuahua is controlled by Mr. Robert Byers who is a shareholder and director of FHA.

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

Company Overview

Our primary business is the ownership of surgical hospitals and ambulatory surgical centers (ASCs) in targeted regional markets in the Southeastern United States. We currently have three majority-owned hospitals (Consolidated Hospitals) in Texas. We have seven minority-owned ASCs located in Texas, Pennsylvania, New Jersey, Maryland and Ohio. In addition to our ownership interests, we provide management services under contract to most of our minority-owned facilities. Finally, we have a legacy business that provides sleep testing management services.

Our strategy is to create a regional network of high-quality, yet cost effective, surgical facilities that meet the needs of patients, physicians and payors. We believe our facilities provide a friendly and convenient environment for our patients to receive high quality care. We operate our facilities, structure our strategic relationships and adopt staffing, scheduling and clinical systems and protocols with the goal of increasing physician productivity and satisfaction. In light of the efficiency of our facilities, we believe we are competitively positioned among payors to generate good clinical outcomes while containing costs. Our commitment to the needs of all relevant parties coupled with the strong growth dynamics of our markets lead us to believe that the number of procedures performed at our facilities each year will increase.

Going Concern and Management's Plan

As of June 30, 2016, we had an accumulated deficit of $43.8 million and a working capital deficit of $5.4 million (adjusted for redemption payments of $0.9 million payable to preferred noncontrolling interest holders in October 2016). During the six months ended June 30, 2016, we generated a net loss attributable to Foundation Healthcare common stock of $11.7 million and used $5.3 million in cash flow from operating activities from continuing operations. As of June 30, 2016, we had cash and cash equivalents of $1.1 million and no availability under a $15.5 million line of credit from its senior lender. Given the due dates of certain liability and debt payments and preferred noncontrolling interests redemption requirements, management projects that we may not be able to meet all of our obligations as they become due over the next twelve months. We plan to meet the projected cash flow shortage from the sale of certain assets and projected increase in revenues and decreases in expenses at our hospitals.

If we are unable to sell assets, increase revenue or reduce expenses as described above, we may be forced to obtain extensions on existing debt and other obligations as they become due over the next twelve months. Although we have historically been successful in obtaining extensions, there is no assurance that we will be able to obtain them in the future. In addition, we may choose to raise additional funds through the sale of equity or assets, but there is no assurance that we will be successful in completing such actions.

If we are not able to sell certain assets, generate additional revenue or reduce expenses at our hospitals, do not obtain extensions on some of our debt or other obligations during the next twelve months or if we are not able to raise additional funds through the sale of equity or assets, we may not have sufficient cash on hand or be able to generate sufficient cash flow from operations in order to meet our cash requirements over the next twelve months. These uncertainties raise substantial doubt about our ability to continue as a going concern. Our consolidated financial statements do not include any adjustments that might be necessary if we are unable to continue as a going concern.

Senior Credit Facility Modification and Waiver

We are required to maintain compliance with certain financial covenants imposed by its Senior Lenders. As of June 30, 2016, we were not in compliance with those covenants. On August 19, 2016, the Senior Lenders waived the financial covenant violations and modified the financial covenant requirements for the remainder of 2016 and first quarter of 2017. In addition, the Senior Lenders extended the due date of a required $3 million principal payment on the Revolving Loan to January 15, 2017. There is no assurance that the Senior Lenders will waive any future covenant violations. See Liquidity and Capital Resources – Senior Credit Facility for additional information.

Hospital and ASC Business Overview

At our Consolidated Hospitals, we serve as a majority owner, day-to-day manager, and we have significant influence over the operations of such facilities. When we have control of the facility, we account for our investment in the facility as a consolidated subsidiary. For our Equity Owned facilities, our influence does not represent control of the facility, but we do have the ability to exercise significant influence over operating and financial policies, we account for our investment in the facility under the equity method, and treat the facility as a nonconsolidated affiliate.

For our Consolidated Hospitals, our financial statements reflect 100% of the revenues and expenses for these subsidiaries, after elimination of intercompany transactions and accounts. The net income attributable to our physician partners who have ownership in our Consolidated Hospitals is included in net income attributable to noncontrolling interests in our consolidated statements of operations.

For our Equity Owned facilities, our share of the net income of each Equity Owned facility is based on the facility's net income and our percentage of ownership in the facility and is included in our consolidated statements as equity in earnings of affiliates. We earn management fees from most of our Equity Owned facilities for our management of the day-to-day operations. We also provide management services to one ASC that we don't own any equity interest.

The following summarizes certain key metrics for our surgical hospital and ASC business:

Facility Location	Number of Physician Partners	Number of Operating Rooms	Percentage Owned by Company	Managed by Company	Mgmt. Agreement Exp. Date
Consolidated Hospitals:					
San Antonio, Texas	22	6	51.0%	Yes	n/a
El Paso, Texas	71	6	51.0%	Yes	n/a
Houston, Texas (a)	n/a	8	100.0%	Yes	n/a
Equity Owned ASCs:					
Cumberland Valley, Maryland	14	1	33.7%	Yes	12/31/2020
Frederick, Maryland	20	4	20.1%	Yes	3/31/2017
Mercerville, New Jersey	25	3	10.0%	Yes	4/30/2020
Middleburg Heights, Ohio	13	4	10.0%	Yes	2/28/2021
Huntingdon Valley, Pennsylvania	22	4	20.0%	Yes	Monthly
Houston, Texas	15	4	10.0%	Yes	3/31/2021
Nacogdoches, Texas	9	3	12.5%	Yes	Monthly
Managed Only ASC:					
Baton Rouge, Louisiana	17	6	0.0%	Yes	Monthly
Lafayette, Louisiana	3	4	0.0%	Yes	Monthly

(a) Our hospital located in Houston, Texas is expected to be syndicated with physician partners.

Our facilities are licensed at the state level and are accredited by either the Accreditation Association for Ambulatory Healthcare (AAAHC) or the Det Norske Veritas (DNV). The only exception is our ASC in Nacogdoches, Texas which meets the accreditation standards, but the governing board of this ASC has elected to not seek accreditation. We recognize that accreditation is a crucial quality benchmark for payors since many managed care organizations will not contract with a facility until it is accredited. We believe that our historical success in obtaining and retaining accreditation for our facilities reflects our commitment to providing high quality care in our facilities.

Generally, each facility is owned and operated by either a limited partnership or limited liability company in which ownership interests are held by our local physician partners who practice at the facility and by us. Our partnership and limited liability company agreements typically provide for the monthly or quarterly pro rata distribution of cash equal to net profits from operations, less amounts held in reserve for expenses and working capital. These limited partnership or limited liability company agreements generally grant us representation on the facility's governing board and ensure our participation in fundamental decisions. Our influence over the businesses of our facilities is further enhanced by our management agreements with such facilities.

Our surgical hospitals and ASC facilities depend upon third-party reimbursement programs to pay for our services rendered to patients, including governmental Medicare and managed Medicare programs, a broad mix of private insurance programs, and co-pays, deductibles and cash payments from patients. Private payors typically employ reimbursement methodologies similar to those used by government providers. Under Medicare, our facilities are reimbursed for the services rendered through the payment of facility fees which vary depending on the type of facility (hospital, HOPD or ASC), and type of procedure. Hospitals and HOPDs are reimbursed for outpatient procedures in a manner similar to most ASCs except that the methodologies employed to calculate reimbursement rates generally result in rates that are higher than those for comparable procedures at free-standing ASCs. ASCs are reimbursed through the payment of a composite "ASC rate" which is set by us based on a survey of comparative rates, which includes payment for most of the expenses associated with the performance of a procedure such as nursing services, supplies, and staffing costs. Reimbursement rates for inpatient hospital services are determined using Medicare severity diagnosis related groups which are intended to compensate hospitals according to the estimated intensity of hospital resources necessary to furnish care for a particular diagnosed illness.

Our surgical hospital and ASC facilities depend upon third-party reimbursement programs, including governmental and private insurance programs, to pay for the preponderance of the services rendered to patients. Our surgical hospital and ASC facilities derive a portion of their revenues from governmental healthcare programs, primarily Medicare and managed Medicare programs, and the remainder from a wide mix of commercial payors and patient co-pays and deductibles. Private payors typically follow the method in which the government reimburses healthcare providers. Under the government's methodology our surgical hospital and ASC facilities are reimbursed for the performance of services through the payment of facility fees which vary according to whether the facility is a hospital or an ASC and the type of procedure that is performed. Hospitals are reimbursed for outpatient procedures in a manner similar to ASCs except that the methodologies employed to calculate reimbursement generally result in hospitals being reimbursed in this setting at a higher rate than free-standing ASCs. ASCs are reimbursed through the payment of a composite "ASC rate" which includes payment for most of the expenses associated with the performance of a procedure such as nursing services, supplies, and staffing costs. The reimbursement rates for inpatient hospital services are determined using Medicare severity diagnosis related groups which are intended to compensate hospitals according to the estimated intensity of hospital resources necessary to furnish care for a particular diagnosed illness.

Our revenues from the ASC and surgical hospital facilities are derived from (i) the pro rata distributions we receive on our ownership in the facilities, and (ii) management fees that we receive from these facilities. Such management fees are generally calculated as a percentage of the monthly net revenues. We own equity interests in all of our ASC and surgical hospital facilities except the ASCs in Baton Rouge and Lafayette, Louisiana which we manage. We possess management agreements with all of our facilities.

Changes in Consolidated Hospitals and Equity Owned Investments

On June 30, 2016, we sold our 8% interest in Summit Hospital, an Equity Owned Hospital located in Edmond, Oklahoma. We received $2.2 million in proceeds from the sale of Summit.

On May 11, 2016, we acquired 51% of the outstanding membership interests of Ninety Nine Healthcare Management, LLC ("99 Management"). 99 Management is a healthcare management located in Dallas, Texas. We believe the purchase of 99 Management will allow us to provide practice management services for our physician partners. We paid $440,000 in cash and issued 700,000 shares of our common stock for the purchase of the membership interests in 99 Management. We will issue an additional 200,000 shares of our common stock upon the execution by 99 Management of a signed contract between 99 Management and Blue Cross/Blue Shield of Texas for a narrow network program covering the Houston, Texas market

On December 31, 2015, we purchased substantially all of the hospital assets and hospital operating entity of University General Health Systems, Inc., consisting primarily of a sixty-nine bed acute care hospital located in the Medical City area of Houston, Texas ("UGH"). The purchase price of the UGH was $25.1 million, net of liabilities assumed. The UGH hospital is now operated as Foundation Surgical Hospital of Houston and referred to as "FSH Houston."

On July 15, 2015, we sold our 10% interest in the Kirby Glen Surgery, LLC, one of our Equity Owned ASCs located in Houston, Texas. We received $0.2 million in combined proceeds for the sale of the equity interest and termination of our management agreement.

On June 12, 2015, we sold a portion of our 20% equity investment in Grayson County Physician Property, LLC ("GCPP"), our Equity Owned hospital in Sherman, Texas, through a series of transactions. In conjunction with the sale, the management agreement under which we provided certain services including billing and collections, general management services, legal support, and accounting services was terminated. Our decision to sell the assets of GCPP was part of our overall strategic plan to focus on the growth of our majority owned surgical hospital businesses and divest any minority interest holdings. We received $7.8 million in proceeds as a result of the sale and $0.5 million in additional proceeds for the termination our management agreement. We used $7.0 million of these proceeds to reduce our principal balance of the note held by Bank SNB (our senior lender).

On March 31, 2015, Houston Orthopedic Surgical Hospital, L.L.C. ("HOSH"), our Equity Owned hospital in Houston, Texas, sold substantially all of its assets under an asset purchase agreement. Given that we do not exhibit control with our 20% investment in HOSH, we account for our investment on a cost or cash basis. As a result of the HOSH sale, we received a distribution on May 12, 2015 for $1.8 million, of which $0.6 million is being held in escrow until October 2016.

On January 1, 2015, Foundation Surgery Affiliates of Northwest Oklahoma City, LLC, or FSA OKC, our Equity Owned ASC located in Oklahoma City, Oklahoma was sold to Summit Medical Center LLC, or Summit Hospital, in exchange for unit ownership in Summit Hospital. As part of the transaction, the units of Summit Hospital were distributed to the individual FSA OKC investors including us. As a result of the transaction, we received an 8% ownership interest in Summit Hospital. In addition, the ASC facility in Oklahoma City is now operated as an HOPD for Summit Hospital. On June 30, 2016, we sold the 8% interest in Summit Hospital for $2.2 million.

Results of Operations

The following table sets forth selected results of our operations for the three months and six months ended June 30, 2016 and 2015. The following information was derived and taken from our unaudited financial statements appearing elsewhere in this report.

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2016	2015	2016	2015
Net Revenues:				
Patient services	$ 28,609,556	$ 30,152,597	$ 67,045,799	$ 58,090,495
Provision for doubtful accounts	(2,598,924)	(2,177,522)	(4,520,909)	(2,598,546)
Net patient services revenue	26,010,632	27,975,075	62,524,890	55,491,949
Management fee from affiliates	1,639,679	1,973,754	2,552,712	3,223,076
Other revenue	(307,828)	1,914,125	901,959	2,690,079
Revenue	27,342,483	31,862,954	65,979,561	61,405,104
Equity in earnings from affiliates	334,388	319,673	723,758	731,072
Operating Expenses:				
Salaries and benefits	12,424,992	7,915,961	26,167,540	15,655,824
Supplies	9,500,381	7,390,390	17,123,144	13,460,051
Other operating expenses	13,334,836	13,398,977	30,127,633	27,482,454
Depreciation and amortization	2,660,038	1,345,948	5,408,900	2,727,455
Net other (income) expense	(1,174,705)	311,488	(212,324)	620,205
Income (loss) from continuing operations, before taxes	(9,068,671)	1,819,863	(11,911,574)	2,190,187
(Provision) Benefit for income taxes	(1,200,000)	114,038	—	114,038
Income (loss) from continuing operations, net of taxes	(10,268,671)	1,933,901	(11,911,574)	2,304,225
Discontinued operations, net of tax	(4,320)	3,857,135	(16,081)	3,771,057
Net income (loss)	(10,272,991)	5,791,036	(11,927,655)	6,075,282
Less: Noncontrolling interests	(1,271,443)	1,074,022	(543,348)	2,494,916
Net loss attributable to Foundation Healthcare	$ (9,001,548)	$ 4,717,014	$ (11,384,307)	$ 3,580,366

Discussion of Three Month Period Ended June 30, 2016 and 2015

Patient services revenue decreased $1.6 million, or 5.3%, during the three months ended June 30, 2016 compared with the second quarter of 2015. The decrease was primarily due to:

- A decrease in average reimbursement per surgical case at FSH El Paso driven by a reduced case mix of lower revenue surgical cases, primarily spine procedures, which resulted in a decrease of $9.0 million. Revenue per case at FSH El Paso decreased by $4,500 per inpatient case and $3,300 per outpatient case during the second quarter of 2016 compared to average revenue per case in the second quarter of 2015;
- A change in the billing codes for toxicology tests at our reference lab at FSH El Paso resulted in a reduction in revenue per test of $550 on approximately 5,400 tests resulting in a reduction in toxicology revenue of $3.2 million for the second quarter of 2016 compared to the second quarter of 2015; and
- A decrease in surgical case volume at Foundation Bariatric Hospital of San Antonio, LLC ("FSH San Antonio") resulting in a decrease of $0.7 million.

These decreases were partially offset by the addition of FSH Houston in 2016, which provided $11.3 million in patient service revenue in the second quarter of 2016.

Provision for doubtful accounts increased $0.4 million, or 18.2%, during the three months ended June 30, 2016 compared with the second quarter of 2015. Provision for doubtful accounts as a percent of patient services revenue was 9.1% and 7.2% for the second quarter of 2016 and 2015, respectively. The addition of the FSH Houston also resulted in an increase of $2.1 million and there was a $0.1 million increase at FSH San Antonio. The increases were offset by a decrease in provision for doubtful accounts at FSH El Paso of $1.8 million related the lower revenues in the second quarter of 2016.

Management fees from affiliates decreased $0.4 million, or 20.0%, during the three months ended June 30, 2016 compared with the second quarter of 2015. The decrease is due to lower collections at FSH San Antonio and FSH El Paso resulting in $0.8 million and lower collections at the ASC facilities resulting in $0.3 million. This was offset by fees from 99 Mgmt. of $0.7 million in the second quarter of 2016.

Other revenue decreased $2.2 million, or 115.8%, during the three months ended June 30, 2016 compared with the second quarter of 2015. The decrease is due to a $1.0 million Medicare EHR recoupment in the second quarter of 2016 at FSH El Paso, related to a 2013 meaningful use payment and a $1.2 million gain recorded in May 2015 resulting from the sale of our equity interest in Houston Orthopedic Surgical Hospital ("HOSH").

Income from equity investments in affiliates in the second quarter of 2016 approximated the second quarter of 2015.

Salaries and benefits increased $4.5 million, or 57.0%, to $12.4 million from $7.9 million during the three months ended June 30, 2016, compared with the second quarter of 2015. The increase is due to the addition of the FSH Houston resulting in $5.1 million, offset by decreases of $0.2 million, $0.3 million and $0.1 million at FSH San Antonio, FSH El Paso and corporate, respectively, due to lower staff levels.

Supplies expense increased $2.1 million, or 28.4 %, to $9.5 million from $7.4 million during the three months ended June 30 2016, compared with the second quarter of 2015. The increase is due to the addition of the FSH Houston adding in $3.3 million which was offset by a decrease of $0.6 million at both FSH El Paso and FSH San Antonio primarily due to case mix at FSH El Paso and lower volumes at FSH San Antonio.

Other operating expenses decreased $0.1 million, or 0.7%, to $13.3 million from $13.4 million during the three months ended June 30, 2016, compared with the second quarter of 2015. The decrease is due to a $5.9 million reduction in outsource fees related to the toxicology reference laboratory services at FSH El Paso offset by an increase due to the addition of FSH Houston and 99 Mgmt resulting in $4.5 million and $0.6 million, respectively. Additionally, corporate overhead increased by $0.5 million due to legal costs incurred related to the acquisition of FSH Houston and consulting fees related to the review of central billing office procedures at FSH Houston and increases in various operating expenses at FSH San Antonio of $0.2 million.

Depreciation and amortization represents the depreciation expense associated with our fixed assets and the amortization attributable to our intangible assets. Depreciation and amortization increased $1.4 million, or 107.7%, to $2.7 million from $1.3 million during the three months ended June 30, 2016, compared with the second quarter of 2015. The increase is due to the addition of the FSH Houston.

Net other (income) expense represents primarily interest expense on borrowings reduced by interest income earned on cash and the gain or loss on the sale of equity investments in affiliates and gains or losses on certain asset dispositions. During the three months ended June 30, 2016, we had net other income of $1.2 million versus net other expense of $0.3 million during the second quarter of 2015. The increase is due to the gain on the sale of our equity investment in Summit hospital of $2.2 million offset by an increase in interest expense of $0.7 million. The increase in interest expense is primarily due to the addition of FSH Houston.

Discontinued operations represent the equity in earnings of GCCP and the operations of our independent diagnostic testing facilities ("IDTF") which were classified as held for sale in 2013. Our equity investment in GCCP and the related earnings were classified as discontinued in 2015 as the sale of our GCCP interest was part of our strategic shift to focus on majority owned investments. The results from our discontinued operations for the three months ended June 30, 2016 and 2015 are summarized below:

	2016	2015
Revenues:		
Equity in earnings of GCCP	$ —	$ 24,784
Sleep operations	—	—
Total revenues	$ —	$ 24,784
Net income (loss) before taxes:		
GCCP	$ —	$ 24,784
Sleep operations	(4,320)	15,341
Gain on sale of equity investment in GCCP	—	6,331,048
Income tax (provision) benefit	—	(2,514,038)
Net income (loss) from discontinued operations, net of tax	$ (4,320)	$ 3,857,135

Noncontrolling interests were allocated $1.3 million of net loss during the three months ended June 30, 2016 compared to $1.1 million of net income during the second quarter of 2015. Noncontrolling interests are the equity ownership interests, held by outside investors, in our majority owned hospital subsidiaries, FSH El Paso and FSH San Antonio.

Net income (loss) attributable to Foundation Healthcare. Our operations resulted in a net loss of $9.0 million during the second quarter of 2016, compared to net income of $4.7 million during the second quarter of 2015.

Discussion of Six Month Period Ended June 30, 2016 and 2015

Patient services revenue increased $8.9 million, or 15.3%, during the six months ended June 30, 2016 compared with the first six months of 2015. The increase was primarily due to:

- The addition of the FSH Houston, which resulted in an increase of $23.3 million.

The offsetting decrease in patient services revenue is due to:

- A decrease in average reimbursement per surgical case at FSH El Paso driven by a reduced case mix of lower revenue surgical cases, primarily spine procedures, which resulted in a decrease of $10.4 million. Revenue per case at FSH El Paso decreased by $4,500 per inpatient case and $3,300 per outpatient case during the first six months of 2016 compared to average revenue per case in the first six months of 2015;
- A change in the billing codes for toxicology tests at our reference lab at FSH El Paso resulted in a reduction in revenue per test of $550 on approximately 5,400 tests resulting in a reduction in toxicology revenue of $3.2 million for the first six months of 2016 compared to the first six months of 2015; and
- A decrease in surgical case volume, during the six months ended June 30, 2016, at Foundation Bariatric Hospital of San Antonio, LLC ("FSH San Antonio") resulting in a decrease of $0.8 million.

Provision for doubtful accounts increased $1.9 million, or 73.1%, during the six months ended June 30, 2016 compared with the first six months of 2015. Provision for doubtful accounts as a percent of patient services revenue was 6.7% and 4.5% for the first six months of 2016 and 2015, respectively. The increase was due to the addition of the FSH Houston of $2.5 million and an increase in the reserve at FSH San Antonio of $0.5 million compared to the first half of 2015. This was partially offset by a reduction in the provision for doubtful accounts at FSH El Paso of $1.1 million due in part to the adjustments related to the change in toxicology lab rates.

Management fees from affiliates decreased $0.6 million, or 18.8%, during the six months ended June 30, 2016 compared with the first six months of 2015. The decrease is due to lower collections at FSH El Paso and FSH San Antonio resulting in $1.0 million and lower collections at our managed ASCs resulting in $0.3 million, offset by management fees from 99 Mgmt. of $0.7 million.

Other revenue decreased $1.8 million, or 66.7%, during the six months ended June 30, 2016 compared with the first six months of 2015. The decrease is primarily due to a $1.0 million Medicare EHR recoupment in the second quarter of 2016 at FSH El Paso, related to a 2013 meaningful use payment and a $1.2 million gain recorded in May 2015 resulting from the sale of our equity interest in Houston Orthopedic Surgical Hospital ("HOSH"). This was partially offset by various differences in other revenue at FSH San Antonio and FSH El Paso totaling $0.4 million.

Income from equity investments in affiliates in the first six months of 2016 approximated the first six months of 2015.

Salaries and benefits increased $10.5 million, or 66.9%, to $26.2 million from $15.7 million during the six months ended June 30, 2016, compared with the first six months of 2015. The increase is due to the addition of the FSH Houston resulting in $10.9 million, which was offset by a decreases of $0.1 million, $0.2 million and $0.1 million at our corporate, FSH San Antonio and FSH El Paso locations respectively.

Supplies expense increased $3.6 million, or 26.6%, to $17.1 million from $13.4 million during the six months ended June 30 2016, compared with the first six of 2015. The increase is due to the addition of the FSH Houston resulting in $4.8 million which was offset by a decrease of $0.5 million at FSH San Antonio due to lower volumes and FSH El Paso of $0.7 million due to a combination of changes in case mix and lower volumes.

Other operating expenses increased $2.6 million, or 9.5%, to $30.1 million from $27.5 million during the six months ended June 30, 2016, compared with the first six months of 2015. The increase is due to the addition of the FSH Houston and 99 Mgmt. resulting in $8.1 million and $0.6 million respectively, an increase at corporate of $0.5 million related to legal and consulting fees incurred for the acquisition of FSH Houston and an increase of $0.2 million at FSH San Antonio. The increases were offset by a $6.8 million decrease in outsource fees related to the toxicology reference laboratory services at FSH El Paso.

Depreciation and amortization represents the depreciation expense associated with our fixed assets and the amortization attributable to our intangible assets. Depreciation and amortization increased $2.7 million, or 100.0%, to $5.4 million from $2.7 million during the six months ended June 30, 2016, compared with the first six months 2015. The increase is due to the addition of the FSH Houston resulting in $2.8 million which was offset by a reduction at corporate of $0.1 million.

Net other (income) expense represents primarily interest expense on borrowings reduced by interest income earned on cash and the gain or loss on the sale of equity investments in affiliates. During the six months ended June 30, 2016, we had net other income of $0.2 million versus net other expense of $0.6 million during the first six months of 2015. The increase is due to the gain on the sale of our equity investment in Summit hospital of $2.2 million and an increase of $0.2 million at FSH Houston FSH El Paso offset by an increase in interest expense of $1.6 million. The increase in interest expense is primarily due to the addition of FSH Houston and additional interest expense at corporate.

Discontinued operations represent the equity in earnings of GCCP and the operations of our independent diagnostic testing facilities ("IDTF") which were classified as held for sale in 2013. Our equity investment in GCCP and the related earnings were classified as discontinued in 2015 as the sale of our GCCP interest was part of our strategic shift to focus on majority owned investments. The results from our discontinued operations for the six months ended June 30, 2016 and 2015 are summarized below:

	2016	2015
Revenues:		
Equity in earnings of GCCP	$ —	$ 24,784
Sleep operations	—	—
Total revenues	$ —	$ 24,784
Net income (loss) before taxes:		
GCCP	$ —	$ 24,784
Sleep operations	(16,081)	(70,737)
Gain on sale of equity investment in GCCP	—	6,331,048
Gain on sale of building in GCCP	—	—
Income tax (provision) benefit	—	(2,514,038)
Net income (loss) from discontinued operations, net of tax	$ (16,081)	$ 3,771,057

Noncontrolling interests were allocated $0.5 million of net loss during the six months ended June 30, 2016 compared to $2.5 million of net income during the first six months of 2015. Noncontrolling interests are the equity ownership interests, held by outside investors, in our majority owned hospital subsidiaries, FSH El Paso and FSH San Antonio.

Net income (loss) attributable to Foundation Healthcare. Our operations resulted in a net loss of $11.4 million during the first six months of 2016, compared to net income of $3.6 million during the first six months of 2015.

Liquidity and Capital Resources

Generally our liquidity and capital resource needs are funded from operations, loan proceeds, equity offerings and more recently, lease and other real estate financing transactions. As of June 30, 2016, our liquidity and capital resources included cash of $1.1 million and working capital deficit of $4.5 million. We have a working capital deficit of $5.4 million after adjusting for $0.9 million of redemption payments due to preferred noncontrolling interest holders in October 2016. As of December 31, 2015, our liquidity and capital resources included cash of $5.1 million and a working capital of $7.8 million (adjusted for $0.9 million of redemption payments due to preferred interest holders during 2016).

Cash used in operating activities from continuing operations was $5.3 million during the six months ended June 30, 2016 compared to the first six months of 2015 when cash provided by operating activities from continuing operations was $3.9 million. During the six months ended June 30, 2016, the primary uses of cash from operating activities from continuing operations were cash generated by income from continuing operations (net loss reduced by non-cash items) of $4.9 million and increases in accounts receivable and prepaids and other current assets of $13.3 million. During the six months ended June 30, 2016, the primary sources of cash from continuing operations were decreases in supplies inventories, receivables from affiliates and other assets of $0.3 million and increases in accounts payable, accrued liabilities and other current and noncurrent liabilities of $12.7 million. During the six months ended June 30, 2015, the primary sources of cash from continuing operations were cash generated by income from continuing operation (net income increased by non-cash items) of $7.2 million, a decrease in receivables from affiliates and prepaid and other current assets of $1.0 million and increases in accrued liabilities and other current and noncurrent liabilities of $1.9 million. The primary uses of cash from continuing operations, were increases in accounts receivables and other assets totaling $4.5 million and a decrease in accounts payable totaling $1.7 million.

Cash used by operating activities from discontinued operations was $7,000 during the six months ended June 30, 2016 compared to the first six months of 2015 when cash used in operating activities from discontinued operations was $0.6 million.

Net cash provided by investing activities from continuing operations during the six months ended June 30, 2016 was $0.8 million compared to the first six months of 2015 when net cash provided by investing activities from continuing operations was $0.6 million. Investing activities during the first six months of 2016 were primarily related to proceeds from the sale of our equity investment the Summit hospital totaling $2.2 million and distributions received from equity investments of $0.8 million which were offset by purchases of property and equipment of $2.0 million. During the six months ending June 30, 2016, we used $0.2 million in cash for the purchase of 99 Mgmt, net of the cash received. Investing activities during the first six months of 2015 were primarily related to distributions received from equity investments of $1.2 million which were offset by purchases of property and equipment, net of disposals, of $0.6 million.

There were no investing activities from discontinued operations during the first six months of 2016. Cash provided by investing activities from discontinued operations for the six months ended June 30, 2015 was $8.3 million and was comprised of the proceeds we received from the sale of our equity investment in GCPP. We used $7.0 million of the proceeds to pay down our senior debt.

Net cash provided by financing activities from continuing operations during the six months ended June 30, 2016 was $0.5 million compared to the first six months of 2015 when net cash used in financing activities from continuing operations was $11.0 million. During the six months ended June 30, 2016 and 2015, we received debt proceeds of $5.9 million and $1.9 million, respectively, and we made debt payments of $4.0 and $9.9 million, respectively. During the six months ended June 30, 2016 and 2015, we made distributions to noncontrolling interests of $1.2 million and $1.8 million, respectively. During the six months ended June 30, 2016 and 2015, we paid preferred noncontrolling dividends of $0.3 and $0.4 million, respectively. During the six months ended June 30, 2015, we made preferred noncontrolling interest redemptions of $0.9 million.

There were no financing activities from discontinued operations during the first six months of 2016 or 2015.

We expect the total level of spending for capital expenditures to be greater in 2016 as compared to 2015 as a result of our various capital commitments in connection with the acquisition of UGH and our other Consolidated Hospitals.

Our business strategy contemplates the selective acquisition of additional hospitals, and we regularly review potential acquisitions. It could be necessary for us to seek additional financing to fund larger hospital acquisitions. We regularly evaluate opportunities to sell additional equity, obtain credit agreements from lenders or restructure our long-term debt or equity for strategic reasons or to further strengthen our financial position. The sale of additional equity could result in additional dilution to our stockholders.

As of June 30, 2016, we had an accumulated deficit of $43.8 million and a working capital deficit of $5.4 million (adjusted for redemption payments of $0.9 million payable to preferred noncontrolling interest holders in October 2016). During the six months ended June 30, 2016, we generated a net loss attributable to Foundation Healthcare common stock of $11.7 million and used $5.3 million in cash flow from operating activities from continuing operations. As of June 30, 2016, we had cash and cash equivalents of $1.1 million and no availability under a $15.5 million line of credit from its senior lender. Based the due dates of certain liability and debt payments, management projects that we may not be able to meet all of our obligations as they become due over the next twelve months. We plan to meet the projected cash flow shortage from the sale of certain assets, the projected increase in revenues and reduction in expenses at our hospitals.

If we are unable to sell assets, increase revenue or decreases expenses as described above, we may be forced to obtain extensions on existing debt and other obligations as they become due over the next twelve months. Although we have historically been successful in obtaining extensions, there is no assurance that we will be able to obtain them in the future. In addition, we may choose to raise additional funds through the sale of equity or assets, but there is no assurance that we will be successful in completing such actions.

If we are not able to sell certain assets, generate additional revenue or reduce expenses at our hospitals, do not obtain extensions on some of our debt or other obligations during the next twelve months or if we are not able to raise additional funds through the sale of equity or assets, we may not have sufficient cash on hand or generate sufficient cash flow from operations to meet our cash requirements over the next twelve months. These uncertainties raise substantial doubt about our ability to continue as a going concern. Our consolidated financial statements do not include any adjustments that might be necessary if we are unable to continue as a going concern.

Senior Credit Facility

Effective December 31, 2015, the Company entered into a Credit Agreement (the “Senior Credit Facility”) with Texas Capital Bank, National Association serving as the lead bank along with two other commercial banks (collectively “Senior Lenders”). The Senior Credit Facility replaced and consolidates all of the Company’s and the Company’s subsidiaries’ debt in the principal amount of $28.4 million, which is referred to as the Term Loan, and provides for an additional revolving loan in the amount of $15.5 million, which is referred to as the Revolving Loan. The Company has also entered into a number of ancillary agreements in connection with the Senior Credit Facility, including deposit account control agreements, subsidiary guarantees, security agreements and promissory notes.

Maturity Dates. The Term Loan matures on December 30, 2020 and the Revolving Loan matures on December 30, 2018.

Interest Rates. Borrowings under the Senior Credit Facility are made, at the Company’s option, as either Base Rate loans or LIBOR loans. “Base Rate” for any day is the highest of (i) the Prime Rate, (ii) the Federal Funds Rate plus one half of one percent (0.5%), and (iii) Adjusted LIBOR plus one percent (1.00%). LIBOR loans are based on either the one month, two month or three month LIBOR rate at the Company’s option. From August 19, 2016 to June 30, 2017, all outstanding amounts under the Senior Credit Facility shall bear interest based on the Base Rate and the Base Rate shall not at be less than 3.5%. The interest rate is either a Base Rate or LIBOR plus the Applicable Margins based on our Senior Debt to EBITDA Ratio, as defined.

The Applicable Margins are as follows:

Pricing Level	Senior Debt to EBITDA Ratio	Base Rate Portion	LIBOR Portion and Letter of Credit Fee	Commitment Fee
1	< 2.0 : 1.0	2.75%	3.75%	0.375%
2	≥ 2.0 : 1.0 but < 2.5 : 1.0	3.00%	4.00%	0.375%
3	≤ 2.5 : 1.0	3.25%	4.25%	0.375%

The Applicable Margin in effect will be adjusted within 45 days following the end of each quarter based on the Company’s Senior Debt to EBITDA ratio. The Senior Debt to EBITDA Ratio is calculated by dividing all of our senior indebtedness (excluding capital lease obligations for Foundation Surgical Hospital of Houston), that is by the Company’s EBITDA for the preceding four fiscal quarters. EBITDA is defined in the Senior Credit Facility as the Company’s net income *plus* (b) *the sum of* the following: interest expense; income taxes; depreciation; amortization; extraordinary losses determined in accordance with GAAP; cash and noncash stock compensation expense; and other non-recurring expenses reducing such net income which do not represent a cash item in such period or any future period, *minus* (c) *the sum of* the following: income tax credits; extraordinary gains determined in accordance with GAAP; and all non-recurring, non-cash items increasing net income.

Interest and Principal Payments. The Company is required to make quarterly payments of principal and interest on the Term Loan. The first four quarterly payments on the Term Loan will be $1,013,393, on the first day of each April, July, October, and January during the term hereof, commencing April 1, 2016. The Company is required to make quarterly payments on the Revolving Loan equal to the accrued and unpaid interest. All unpaid principal and interest on the Term Loan and Revolving Loan must be paid on the respective maturity dates of each Loan.

Borrowing Base. The Company's ability to borrow money under the Revolving Loan is limited to the Company's Borrowing Base. The Company's Borrowing Base is equal to the *sum of* (i) 80% of the eligible account of Foundation Surgical Hospital of San Antonio, not to exceed the outstanding principal balance of the intercompany note payable by the San Antonio Hospital to the Company, (ii) 80% of the eligible account of Foundation Surgical Hospital of El Paso, not to exceed the outstanding principal balance of the intercompany note payable by the El Paso Hospital to the Company, and (iii) 80% of the eligible account of Foundation Surgical Hospital of Houston, not to exceed the outstanding principal balance of the intercompany note payable by the FSH Houston to the Company.

Mandatory Prepayments. The Company must make mandatory prepayments of the Term Loans in the following situations, among others:

- The Company must apply 100% of the net proceeds from the sale of worn out and obsolete equipment not necessary or useful for the conduct of the Company's business;
- Commencing with the fiscal year ending December 31, 2016, the Company must apply 50% of our Excess Cash Flow for such fiscal year to the installment payments due on the Company's Term Loan;
- The Company must apply 50% of the net cash proceeds from the issuance of equity interests to the installment payments due on the Company's Term Loan; provided that no prepayment need to be made for the year ended December 31, 2016 once the Company has made mandatory prepayments in excess of $10,000,000;
- The Company must apply 100% of the net cash proceeds from the issuance of debt (other than certain permitted debt) to the prepayment of the Term Loan;
- The Company must prepay 100% of the net cash proceeds paid to the Company other than in the ordinary course of business; and
- The Company must prepay 100% of the net cash proceeds the Company receives from the prepayment of intercompany notes.

Voluntary Prepayments. The Company may prepay amounts under the Term Loan or Revolving Loan at any time provided that the Company is required to pay a prepayment fee of 2% of the amount prepaid if payment is made prior to the first anniversary, 1.5% if the prepayment is made after the first anniversary but prior to the second anniversary and 1% if the prepayment is made after the second anniversary but prior to the third anniversary.

Guaranties. Each of the Company's direct or indirect wholly-owned subsidiaries jointly and severally and unconditionally guaranty payment of the Company's obligations owed to Lenders.

Financial Covenants:

Debt to EBITDA Ratio. As of December 31, 2015, the Company must maintain a Debt to EBITDA Ratio, not in excess of 3.50 to 1.00. Thereafter, the Company must maintain a Debt to EBITDA Ratio as of the last day of any fiscal quarter, not in excess of (a) 3.25 to 1.00 for the fiscal quarters ending December 31, 2015, March 31, 2016 and June 30, 2016; (b) 2.75 to 1.00 for the fiscal quarters ending June 30, 2017 and September 30, 2017; (c) 2.50 to 1.00 for the fiscal quarters ending December 31, 2017, March 31, 2018, June 30, 2018 and September 30, 2018; and (d) 2.25 to 1.00 for the fiscal quarter ending December 31, 2018 and at the end of each fiscal quarter thereafter. As of June 30, 2016, the Company's Debt to EBITDA Ratio was 7.21.

Senior Debt to EBITDA Ratio. As of December 31, 2015, the Company must maintain a Senior Debt to EBITDA Ratio not in excess of 3.00 to 1.00. Thereafter, the Company must maintain a Senior Debt to EBITDA Ratio as of the last day of any fiscal quarter, not in excess of (a) 3.00 to 1.00 for the fiscal quarters ending December 31, 2015, March 31, 2016 and June 30, 2016; (b) 2.50 to 1.00

for the fiscal quarters ending June 30, 2017 and September 30, 2017; (c) 2.25 to 1.00 for the fiscal quarters ending December 31, 2017, March 31, 2018, June 30, 2018 and September 30, 2018; and (d) 2.00 to 1.00 for the fiscal quarter ending December 31, 2018 and at the end of each fiscal quarter thereafter. As of June 30, 2016, the Company's Senior Debt to EBITDA Ratio was 6.23.

Pre-Distribution Fixed Charge Coverage Ratio. The Company must maintain as of the last day of any fiscal quarter (excluding the fiscal quarters ending September 30, 2016, December 31, 2016 and March 31, 2017) a Pre-Distribution Fixed Charge Coverage Ratio in excess of 1.30 to 1.00. As of June 30, 2016, the Company's Pre-Distribution Fixed Charge Coverage Ratio was 0.63.

Post-Distribution Fixed Charge Coverage Ratio. The Company must maintain as of the last day of any fiscal quarter (excluding the fiscal quarters ending September 30, 2016, December 31, 2016 and March 31, 2017), a Post-Distribution Fixed Charge Coverage Ratio in excess of 1.05 to 1.00. As of June 30, 2016, the Company's Pre-Distribution Fixed Charge Coverage Ratio was 0.48.

EBITDA. The Company must have EBITDA of at least $1,750,000 for the fiscal quarter ending September 30, 2016 and $4,250,000 for the fiscal quarter ending December 31, 2016 and each quarter thereafter.

Capital Expenditures. The Company shall not make capital expenditures in excess of $5,000,000 during any fiscal year.

As of June 30, 2016, the Company was not in compliance with the Senior Credit Facility financial covenants; however the Senior Lenders have waived the financial covenant violations. As described above, the Senior Lenders have modified the financial covenants for the remainder of 2016. There is no assurance that the Senior Lenders will waive any future violations of the financial covenants.

Collateral. Payment and performance of the Company's obligations under the Senior Credit Facility are secured in general by all of the Company and the Company's guarantors' assets.

Negative Covenants. The Senior Credit Facility has restrictive covenants that, among other things, limits or restricts the Company's ability to do the following without the consent of the Senior Lenders:

- Incur additional indebtedness;
- Create or incur additional liens on the Company's assets;
- Engage in mergers or acquisitions;
- Pay dividends or make any other payment or distribution in respect of the Company's equity interests;
- Make loans and investments;
- Issue equity, except for stock compensation awards to employees;
- Engage in transaction with affiliates;
- Dispose of the Company's assets, except for certain approved assets;
- Engage in any sale and leaseback arrangements; and
- Prepay debt to debtors other than the Senior Lenders.

Defaults and Remedies. In addition to the general defaults of failure to perform our obligations under the Loan Agreement, events of default also include the occurrence of a change in control, as defined, and the loss of our Medicare or Medicaid certification, collateral casualties, entry of a uninsured judgment of $500,000 or more, failure of first liens on collateral and the termination of any of the Company's management agreements that represent more than 10% of the Company's management fees for the preceding 18 month period. In the event of a monetary default, all of the Company's obligations due under the Senior Credit Facility shall become immediately due and payable. In the event of a non-monetary default, the Company has 10 days or in some cases three days to cure before the Senior Lenders have the right to declare the Company's obligations due under the Senior Credit Facility immediately due and payable.

Modification and Waiver. On May 11, 2016, the Company entered into a Loan Modification Agreement and Waiver with its Senior Lenders ("Senior Credit Modification One"). Under the Senior Credit Modification One, the Company's Revolving Loan was increased from $12.5 million to $15.5 million. The $3.0 million of borrowing represents a temporary advance that must be repaid by July 31, 2016 (the "Temporary Advance"). In addition, the Senior Lenders consented to the sale of certain of the Company's assets and waived certain technical defaults in the Senior Credit Facility related to timing deadlines for certain financial information provided by the Company to the Senior Lenders for the UGH Acquisition. On August 19, 2016, the Company entered into a Loan

Modification Agreement and Waiver with its Senior Lenders ("Senior Credit Modification Two"). Under the Senior Credit Modification Two, the Senior Lenders waived the financial covenant violations for the fiscal quarter ended June 30, 2016 and modified the financial covenants for the fiscal quarters ending September 30, 2016 and December 31, 2016 by replacing the Debt to EBITDA Ratio, Senior Debt to EBITDA Ratio, and Pre and Post Distribution Fixed Charge Coverage Ratios with the EBITDA covenant. In addition, the Senior Lenders extended the due date for the repayment of the Temporary Advance to January 15, 2017. During the period from August 19, 2016 to June 30, 2017, the Senior Credit Modification Two prohibits the Company from making any interest or redemption payments to its preferred noncontrolling interest holders and prohibits the Company from making any payments on the $7.9 million subordinated note payable. Under the Senior Credit Modification Two, the Company must also maintain total cash balances in excess of $2 million ("Minimum Cash Balances") and the Company's total accounts payable past due by 91 days or more must be less than $6.3 million.

Contractual Obligations

Our future commitments under contractual obligations by expected maturity date at June 30, 2016 are as follows:

	< 1 year	1-3 years	3-5 years	> 5 years	Total
Short-term debt (1)	$ 425,814	$ —	$ —	$ —	$ 425,814
Long-term debt (1)	14,067,601	34,304,389	19,446,607	—	67,818,597
Capital building lease	2,319,973	4,639,150	4,637,946	34,913,822	46,510,891
Operating leases	12,912,967	25,803,436	25,760,038	77,464,874	141,941,315
Other long term liabilities	—	—	—	—	—
Preferred noncontrolling interests (2)	1,431,186	6,181,600	—	—	7,612,786
Total	$ 31,157,541	$ 70,928,575	$ 49,844,591	$ 112,378,696	$ 264,309,403

(1) Includes principal and interest obligations.
(2) Represents the redemption obligation, including interest, of our preferred noncontrolling interests.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

CRITICAL ACCOUNTING POLICIES

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and include amounts based on management's prudent judgments and estimates. Actual results may differ from these estimates. Management believes that any reasonable deviation from those judgments and estimates would not have a material impact on our consolidated financial position or results of operations. To the extent that the estimates used differ from actual results, however, adjustments to the statement of earnings and corresponding balance sheet accounts would be necessary. These adjustments would be made in future statements. For a complete discussion of all our significant accounting policies including recently adopted and recently issued accounting guidance, please see Note 3 to our consolidated financial statements included in Part 1 Item 1 of the Form 10-Q and our Note 3 to our consolidated financial statements included our 2015 annual report on Form 10-K.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

We are a smaller reporting entity as defined in Rule 12b-2 of the Exchange Act and as such, are not required to provide the information required by Item 305 of Regulation S-K with respect to Quantitative and Qualitative Disclosures about Market Risk.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Our management (with the participation of our Principal Executive Officer and Principal Financial Officer evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")), as of June 30, 2016. Based on this evaluation, our Principal Executive Officer and Principal Financial Officer concluded that these disclosure controls and procedures are effective, except for the following material weakness:

During the second quarter of 2016, we identified a material weakness in our controls over financial reporting, as described below. Based upon that discovery, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are not effective at a level that provides reasonable assurance as of the last day of the period covered by this report.

The material weakness in internal control over financial reporting resulted from our inability to file our quarterly report on Form 10-Q within the required time frame. Specifically, we did not maintain a sufficient complement of personnel with the appropriate level of accounting knowledge and experience to properly prepare our quarterly report in a timely fashion.

Plan for Remediation of Material Weakness

We are currently in the process of implementing our remediation plans. To date, we have implemented and are continuing to implement a number of measures to address the material weakness identified. We have hired temporary personnel with the appropriate level of accounting knowledge and experience and are in the process of hiring personnel on a permanent basis. We are also designing additional controls around identification, documentation and application of technical accounting guidance with particular emphasis on events outside of the ordinary course of business.

Changes in Internal Control over Financial Reporting

Except as noted above, there were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended June 30, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting, except as noted below:

On December 31, 2015, we completed our acquisition of UGH. We have extended our oversight and monitoring processes that support our internal control over financial reporting to include UGH's operations.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

Aetna Life Insurance Company v. Huntingdon Valley Surgery Center, Foundation Surgery Affiliates, LLC and Foundation Management Affiliates, LLC, Case No. 13-3101, United States District Court for the Eastern District of Pennsylvania. On December 2, 2013, Aetna Life Insurance Company ("Aetna") filed a complaint against Huntingdon Valley Surgery Center ("HVSC") and the Foundation defendants alleging that the Foundation defendants impose on the ASCs that they manage an unlawful "out of network business model" by means of which the defendants offer illegal inducements to physicians and patients to drive patient referrals to HVSC, which does not have a contract with Aetna and could therefore charge higher rates for its services. Aetna is asserting violations of Pennsylvania's anti-kickback statute by all defendants, conspiracy to violate Pennsylvania's anti-kickback statute by all defendants, insurance fraud, aiding and abetting insurance fraud, tortious interference with the contracts between Aetna and its in-network physicians. Aetna has reached a settlement with HVSC. On the Aetna claims against the Foundation defendants, the Court has granted the Foundation defendants a partial summary judgment on all such claims except tortious interference. In April 2016, Aetna appealed the decision to the U.S. Court of Appeals for the Third Circuit.

United States of America ex rei. Mary Dupont, M.D., Relator, v. Metropolitan Medical Partners LLC. d/b/a Surgery Center of Chevy Chase; Surgical Synergies, Inc.; Foundation Surgery Affiliates, LLC; and Foundation Healtlzcare, Inc., Case No. No. 13-cv-03590-PJM, U.S. District Court for the District of Maryland, Greenbelt Division. In November, 2013, the relator, Mary Dupont, M.D. ("Dupont"), filed under seal a False Claims Act ("FCA") or "qui tam" complaint initiating this action. On October 30, 2014, the federal government filed a Notice of Election to Decline Intervention and on November 12, 2014, the Court entered an Order unsealing the Dupont complaint. Dupont filed her First Amended Complaint on June 19, 2015. Dupont, a urologist and physician-investor in an ambulatory surgery center in Chevy Chase, Maryland (the "Center"), alleged that the Center, in concert with defendant Surgical Synergies, Inc. ("SSI") and the Foundation defendants, effectively shut her out of her practice at the Center by imposing a 75 procedure-per-year quota on procedures performed at the Center, and, barring her from performing an allegedly unprofitable procedure involving the surgical implantation of a mesh sling. The First Amended Complaint alleged claims including Medicare fraud, Presentation of False Claims, and violations of the Maryland False Health Claims Act. In August 2015, all defendants, including the Foundation defendants, moved to dismiss the First Amended Complaint and argued that the First Amended Complaint failed to state a claim for relief as against them under Federal Rules of Civil Procedure 12(b)(6) and 9(b) because Dupont failed to plead the requisite details of any specific false claim with particularity, failed to adequately plead any conspiracy to violate the FCA, and failed to sufficiently plead any violation of the federal anti-kickback statute, which constituted the alleged substantive basis of her FCA claims. The Foundation defendants also argued that the FCA claims against them should be dismissed for lack of subject matter jurisdiction. In September 2015, Dupont filed a Second Amended Complaint by consent, making limited factual modifications to her pleading and reasserting the claims made in the First Amended Complaint. In October 2015, all defendants, including the Foundation defendants, filed motions to dismiss the Second Amended Complaint on essentially the same grounds as were asserted against the First Amended Complaint. On February 3, 2016, the Court granted Defendants' motions to dismiss in part, dismissing with prejudice Dupont's claim under the Maryland False Health Claims Act and dismissing without prejudice Dupont's "Economic Loss" claim. The Court's February 3, 2016 Order did not reach the merits of Defendants' motions to dismiss the remaining counts, but instead granted Dupont leave to file a Third Amended Complaint which was done in March 2016. In April 2016, Defendants filed a motion to dismiss. A hearing on the motion to dismiss has been rescheduled for September 20, 2016.

In the normal course of business, we may become involved in litigation or in legal proceedings. Including the litigation described above, we are not aware of any such litigation or legal proceedings that we believe will have, individually or in the aggregate, a material adverse effect on our business, financial condition and results of operations.

Item 1A. Risk Factors.

There are no material changes from the risk factors previously disclosed in our 2015 Annual Report on Form 10-K, except as follows:

We will require significant amounts of additional financing to execute our business plan and fund our other liquidity needs. If our operating results do not meet or exceed our projections, we may be unable to continue operations and could be forced to substantially curtail operations or cease operations all together.

As of June 30, 2016, we had an accumulated deficit of $43.8 million and a working capital deficit of $5.4 million (adjusted for redemption payments of $0.9 million payable to preferred noncontrolling interest holders in October 2016). During the six months ended June 30, 2016, we generated a net loss attributable to Foundation Healthcare common stock of $11.7 million and used $5.3 million in cash flow from operating activities from continuing operations. As of June 30, 2016, we had cash and cash equivalents of $1.1 million and we have no availability under a $15.5 million line of credit from its senior lender. Based the due dates of certain liability and debt payments and preferred noncontrolling interests redemption requirements, management projects that we may not be able to meet all of our obligations as they become due over the next twelve months. We plan to meet the projected cash flow shortage from the sale of certain assets and projected increase in revenues and decreases in expenses at our hospitals.

If we are unable to sell assets, increase revenue or decrease expenses as described above, we may be forced to obtain extensions on existing debt and other obligations as they become due over the next twelve months. Although we have historically been successful in obtaining extensions, there is no assurance that we will be able to obtain them in the future. In addition, we may choose to raise additional funds through the sale of equity or assets, but there is no assurance that we will be successful in completing such actions.

If we are not able to sell certain assets, generate additional revenue or reduce expenses at our hospitals, do not obtain extensions on some of our debt or other obligations during the next twelve months or if we are not able to raise additional funds through the sale of equity or assets, we may not have sufficient cash on hand or be able to generate sufficient cash flow from operations to meet our cash requirements over the next twelve months. These uncertainties raise substantial doubt about our ability to continue as a going concern. Our consolidated financial statements do not include any adjustments that might be necessary if we are unable to continue as a going concern.

We have a bank credit facility of approximately $41 million and we may not maintain compliance with certain financial covenants. These covenants and other provisions of the credit facility could also have a negative impact on our liquidity or restrict our activities.

Under the Loan Agreement covering the Senior Credit Facility we agreed to continuously maintain compliance with the following financial covenants (collectively referred to as "Debt Ratios"):

Debt to EBITDA Ratio. As of December 31, 2015, we must maintain a Debt to EBITDA Ratio not in excess of 3.50 to 1.00. Thereafter, we must maintain a Debt to EBITDA Ratio as of the last day of any fiscal quarter, not in excess of (a) 3.25 to 1.00 for the fiscal quarters ending December 31, 2015, March 31, 2016 and June 30, 2016; (b) 2.75 to 1.00 for the fiscal quarters ending March 31, 2017, June 30, 2017 and September 30, 2017; (c) 2.50 to 1.00 for the fiscal quarters ending December 31, 2017, March 31, 2018, June 30, 2018 and September 30, 2018; and (d) 2.25 to 1.00 for the fiscal quarter ending December 31, 2018 and at the end of each fiscal quarter thereafter.

Senior Debt to EBITDA Ratio. As of December 31, 2015, we must maintain a Senior Debt to EBITDA Ratio not in excess of 3.00 to 1.00. Thereafter, we must maintain a Senior Debt to EBITDA Ratio as of the last day of any fiscal quarter, not in excess of (a) 3.00 to 1.00 for the fiscal quarters ending December 31, 2015, March 31, 2016 and June 30, 2016; (b) 2.50 to 1.00 for the fiscal quarters ending March 31, 2017, June 30, 2017 and September 30, 2017; (c) 2.25 to 1.00 for the fiscal quarters ending December 31, 2017, March 31, 2018, June 30, 2018 and September 30, 2018; and (d) 2.00 to 1.00 for the fiscal quarter ending December 31, 2018 and at the end of each fiscal quarter thereafter.

Pre-Distribution Fixed Charge Coverage Ratio. We must maintain as of the last day of any fiscal quarter a Pre-Distribution Fixed Charge Coverage Ratio not in excess of 1.30 to 1.00.

Post-Distribution Fixed Charge Coverage Ratio. We must maintain as of the last day of any fiscal quarter, a Post-Distribution Fixed Charge Coverage Ratio not in excess of 1.05 to 1.00.

EBITDA. The Company must have EBITDA of at least $1,750,000 for the fiscal quarter ending September 30, 2016 and $4,250,000 for the fiscal quarter ending December 31, 2016.

As of June 30, 2016, we were not in compliance with the Debt Ratios. Our Senior Lenders waived the noncompliance with the Debt Ratios and modified the Debt Ratios for the fiscal quarters ending September 30, 2016 and December 31, 2016. Item 2. – Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources –Senior Credit Facility for discussion of the classification of the debt owed to the Senior Lenders. There is no assurance that the Senior Lenders will waive any future violations of the Debt Ratios.

In addition to these financial covenants, the Senior Credit Facility also contains various other provisions that limit our ability to engage in specified types of transactions. The Senior Credit Facility has restrictive covenants that, among other things, restricts our ability to do the following without the consent of the Senior Lenders:

- Incur additional indebtedness;
- Create or incur additional liens on our assets;
- Engage in mergers or acquisitions;
- Pay dividends or make any other payment or distribution in respect of our equity interests;
- Make loans and investments;
- Issue equity;
- Engage in transaction with affiliates;
- Dispose of our assets; and
- Engage in any sale and leaseback arrangements; and
- Prepay debt to borrowers other than the Senior Lenders.

A breach of any of these covenants could result in a default under the Senior Credit Facility.

Moreover, in addition to the general defaults of failure to perform our obligations under the Loan Agreement, events of default also include the occurrence of a change in control, as defined, and the loss of our Medicare or Medicaid certification, collateral casualties, entry of a uninsured judgment of $500,000 or more, failure of first liens on collateral and the termination of any of our management agreements that represent more than 10% of our management fees for the preceding 18 month period. In the event of a monetary default, all of our obligations due under the Senior Credit Facility shall become immediately due and payable. In the event of a non-monetary default, we have 10 days, or in some cases three days, to cure before the Senior Lenders have the right to declare our obligations due under the Senior Credit Facility immediately due and payable. If the Senior Lenders accelerate the payment of outstanding principal and interest, we will need to file a current report on Form 8-K with the SEC disclosing the event of default and the acceleration of payment of all principal and interest. In addition, we do not expect to be able to pay all outstanding principal and interest if the Senior Lenders accelerate the due dates for such amounts. Since we have granted the Senior Lenders a security interest in all of our assets, the Senior Lenders could elect to foreclose on such assets. If the Senior Lenders declare an event of default and/or accelerate the payment of our obligations under the Senior Credit Facility, then the disclosure of such fact may cause a material decrease in the price of our stock. The declaration of an event of default and the move to foreclose on our assets may cause a material adverse effect on our ability to operate our business in the ordinary course of business as well as a material adverse effect on our liquidity, results of operations and financial position.

Our overall leverage and the terms of the Senior Credit Facility could:

- limit our ability to obtain additional financing in the future for working capital, capital expenditures and acquisitions;
- make it more difficult to satisfy our obligations under the terms of our indebtedness;
- limit our ability to refinance our indebtedness on terms acceptable to us or at all;
- limit our flexibility to plan for and adjust to changing business and market conditions in the industry in which we operate and increase our vulnerability to general adverse economic and industry conditions;
- require us to dedicate a substantial portion of our cash flow to make interest and principal payments on our debt, thereby limiting the availability of our cash flow to fund future acquisitions, working capital, business activities, and other general corporate requirements;
- limit our ability to obtain additional financing for working capital, to fund growth or for general corporate purposes, even when necessary to maintain adequate liquidity; and
- subject us to higher levels of indebtedness relative to competitors, which may cause a competitive disadvantage and may reduce our flexibility in responding to increased competition.

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

We do not have anything to report under this Item.

Item 3. Defaults Upon Senior Securities.

We do not have anything to report under this Item.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

On June 20, 2016, we extended the maturity date of warrants issued in a public offering on June 20, 2011, covering 711,546 shares of our common stock, from June 20, 2016 to June 20, 2017.

The financial results included in this quarterly report on Form 10-Q include changes from the financial results we released on August 15, 2016. The primary differences include:

- At August 15, 2016, we had not executed the Senior Credit Modification Two and as a result all of the debt owed to our Senior Lenders was classified as current. As a result of executing the Senior Credit Modification Two, the debt owed to our Senior Lenders is now classified as long-term except for the current portion due over the next twelve months;
- During the three months ended June 30, 2016, we identified an adjustment to the preliminary purchase accounting numbers used for the FSH Houston acquisition. Subsequent to our earnings release, we determined that the adjustment should be recorded in current operations. The change resulted in a reduction to goodwill and patient services revenues of $1.3 million; and
- We made certain reclassifications between balance sheet accounts.

On August 24, 2016, Hugh King, our Chief Financial Officer, announced his retirement from the Company effective December 31, 2016. Mr. King will continue to serve in his capacity as Chief Financial Officer through December 31, 2016. We are in the process of selecting his replacement.

Item 6. Exhibits.

(a) Exhibits:

Exhibit No.	Description
4.1+	Form of Amended and Restated Warrant Agreement dated June 20, 2016 issued pursuant to the Underwriting Agreement dated June 14, 2011.
31.1+	Certification of Stanton Nelson, Principal Executive Officer of Registrant.
31.2+	Certification of Hubert King, Principal Financial Officer of Registrant.
32.1+	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of Sarbanes-Oxley Act of 2002 of Stanton Nelson, Principal Executive Officer of Registrant.
32.2+	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of Sarbanes-Oxley Act of 2002 of Hubert King, Principal Financial Officer of Registrant.
101. INS	XBRL Instance Document.
101. SCH	XBRL Taxonomy Extension Schema Document.
101. CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101. DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101. LAB	XBRL Taxonomy Extension Label Linkbase Document.
101. PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

\+ Filed herewith.

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.

FOUNDATION HEALTHCARE, INC.
(Registrant)

By: /S/ STANTON NELSON
Stanton Nelson
Chief Executive Officer
(Principal Executive Officer)

Date: September 2, 2016

By: /S/ HUBERT KING
Hubert King
Chief Financial Officer
(Principal Financial and Accounting Officer)

Date: September 2, 2016

Exhibit 4.1

AMENDED AND RESTATED
COMMON STOCK PURCHASE WARRANT

FOUNDATION HEALTHCARE, INC.

Warrant Shares: ________________ Original Issue Date: June 20, 2011
Warrant No. ____________________ Amended and Restated Date: June 20, 2016

THIS COMMON STOCK PURCHASE WARRANT (the "Warrant") certifies that, for value received, ____________________ (the "Holder") is entitled, upon the terms and subject to the limitations on exercise and the conditions hereinafter set forth, at any time on or after the Issue Date and on or prior to the close of business on the six-year anniversary of the Issue Date (the "Termination Date") but not thereafter, to subscribe for and purchase from Foundation Healthcare, Inc., an Oklahoma corporation, f/k/a Graymark Healthcare, Inc. (the "Company"), up to xx,xxx shares (the "Warrant Shares") of its common stock, par value $0.0001 per share (the "Common Stock"). The purchase price of one share of Common Stock under this Warrant shall be equal to the Exercise Price, as defined in Section 2(b).

This Warrant is being amended and restated to, among other things, (i) provide for a change in the name of the Company from Graymark Healthcare, Inc. to Foundation Healthcare, Inc., (ii) to affect 1-for-10 reverse split of the Company's common stock that was effective on January 8, 2015, (iii) to affect anti-dilution adjustments since the original issue date and (iv) to extend the Termination Date to June 20, 2017.

Section 1. Definitions. Capitalized terms used herein shall have the meanings given to them herein. As used herein, (i) "business day" means any day on which the New York Stock Exchange, Inc. is open for trading, and (ii) "Affiliate" has the meaning ascribed to it in Rule 12b-2 under the Securities Exchange Act of 1934, as amended (the "Exchange Act").

Section 2. Exercise.

a) Exercise of Warrant. Exercise of the purchase rights represented by this Warrant may be made, in whole or in part, at any time or times on or after the Issue Date and on or before the Termination Date by delivery to the Company (or such other office or agency of the Company as it may designate by notice in writing to the registered Holder at the address of the Holder appearing on the books of the Company) of a duly executed facsimile copy of the Notice of Exercise Form annexed hereto; and, within three trading days of the date said Notice of Exercise is delivered to the Company, the Company shall have received payment of the aggregate Exercise Price of the shares thereby purchased by wire transfer or cashier's check drawn on a United States bank. Notwithstanding anything herein to the contrary, the Holder shall not be required to physically surrender this Warrant to the Company until the Holder has purchased all of the Warrant Shares available hereunder and the Warrant has been exercised in full, in which case, the Holder shall surrender this Warrant to the Company for cancellation within three trading days of the date the final Notice of Exercise is delivered to the Company. Partial exercises of this Warrant resulting in purchases of a portion of the total number of

Warrant Shares available hereunder shall have the effect of lowering the outstanding number of Warrant Shares purchasable hereunder in an amount equal to the applicable number of Warrant Shares purchased. The Company shall maintain in the Warrant Register (as defined below) records showing the number of Warrant Shares purchased and the date of such purchases. The Company shall deliver any objection to any Notice of Exercise Form within one business say of receipt of such notice. **The Holder and any assignee, by acceptance of this Warrant, acknowledge and agree that, by reason of the provisions of this paragraph, following the purchase of a portion of the Warrant Shares hereunder, the number of Warrant Shares available for purchase hereunder at any given time may be less than the amount stated on the face hereof.**

b) Exercise Price. The exercise price per share of the Common Stock under this Warrant shall be $12.42, subject to adjustment hereunder (the "Exercise Price").

c) Mechanics of Exercise.

i. Delivery of Certificates Upon Exercise. Certificates for shares purchased hereunder shall be transmitted by the Company's transfer agent to the Holder by crediting the account of the Holder's prime broker with the Depository Trust Company ("DTC") through its Deposit Withdrawal Agent Commission ("DWAC") system if the Company is then a participant in such system and there is an effective registration statement permitting the issuance of the Warrant Shares to or resale of the Warrant Shares by Holder, and otherwise by physical delivery to the address specified by the Holder in the Notice of Exercise by the date that is three trading days after the latest of (A) the delivery to the Company of the Notice of Exercise Form, (B) surrender of this Warrant (if required) and (C) payment of the aggregate Exercise Price as set forth above (such date, the "Warrant Share Delivery Date"). This Warrant shall be deemed to have been exercised on the first date on which all of the foregoing have been delivered to the Company. The Warrant Shares shall be deemed to have been issued, and Holder or any other person so designated to be named therein shall be deemed to have become a holder of record of such shares for all purposes, as of the date the Warrant has been exercised, with payment to the Company of the Exercise Price and all taxes required to be paid by the Holder, if any, pursuant to Section 2(c)(vi) prior to the issuance of such shares, having been paid. If the Company fails for any reason to deliver to the Holder certificates evidencing the Warrant Shares subject to a Notice of Exercise by the Warrant Share Delivery Date, the Company shall pay to the Holder, in cash, as liquidated damages and not as a penalty, for each $1,000 of Warrant Shares subject to such exercise (based on the VWAP (as defined below) of the Common Stock on the date of the applicable Notice of Exercise), $10.00 per trading day (increasing to $20.00 per trading day on the fifth trading day after such liquidated damages begin to accrue) for each trading day after such Warrant Share Delivery Date until such certificates are delivered or Holder rescinds such exercise.

"VWAP" means, for any date, the price determined by the first of the following clauses that applies: (a) if the Common Stock is then listed or quoted on NYSE Amex, The NASDAQ Capital Market, The NASDAQ Global Market, The NASDAQ Global Select Market or the New York Stock Exchange (each, a "Trading Market"), the daily volume weighted average price of the Common Stock for such date (or the nearest preceding date) on the Trading Market on which the Common Stock is then listed or quoted as reported by Bloomberg L.P. (based on a trading day from 9:30 a.m. (New York City time) to 4:02 p.m. (New York City time), (b) if the OTC Bulletin Board is not a Trading Market, the volume weighted average price of the Common Stock for such date (or the nearest preceding date) on the OTC Bulletin Board, (c) if the Common Stock is not then listed or quoted for trading on the OTC Bulletin Board and if prices for the Common Stock are then reported in the "Pink Sheets" published by Pink OTC Markets, Inc. (or a similar organization or agency succeeding to its functions of reporting prices), the most recent bid price per share of the Common Stock so reported, or (d) in all other cases, the fair market value of a share of Common Stock as determined by an independent appraiser selected in good faith by the Holders of a majority in interest of the Warrants then outstanding and reasonably acceptable to the Company, the fees and expenses of which shall be paid by the Company

ii. Delivery of New Warrants Upon Exercise. If this Warrant shall have been exercised in part, the Company shall, at the request of a Holder and upon surrender of this Warrant certificate, at the time of delivery of the certificate or certificates representing Warrant Shares, deliver to Holder a new Warrant evidencing the rights of Holder to purchase the unpurchased Warrant Shares called for by this Warrant, which new Warrant shall in all other respects be identical with this Warrant.

iii. Rescission Rights. If the Company fails to cause its transfer agent to transmit to the Holder a certificate or the certificates representing the Warrant Shares pursuant to Section 2(c)(i) by the Warrant Share Delivery Date, then, the Holder will have the right to rescind such exercise.

iv. Compensation for Buy-In on Failure to Timely Deliver Certificates Upon Exercise. In addition to any other rights available to the Holder, if the Company fails to cause its transfer agent to transmit to the Holder a certificate or the certificates representing the Warrant Shares pursuant to an exercise on or before the Warrant Share Delivery Date, and if after such date the Holder is required by its broker to purchase (in an open market transaction or otherwise) or the Holder's brokerage firm otherwise purchases, shares of Common Stock to deliver in satisfaction of a sale by the Holder of the Warrant Shares which the Holder anticipated receiving upon such exercise (a "Buy-In"), then the Company shall, within three trading days after the Holder's request and in the Holder's discretion, either (A) pay cash to the Holder in an amount equal to the Holder's total purchase price (including brokerage commissions, if any) for the shares of Common Stock so purchased (the "Buy-In Price"), at which point the Company's obligation to deliver such certificate (and to issue such Warrant Shares or credit such Holder's balance account with DTC) shall terminate, or (B) promptly honor its obligation to deliver to the Holder a certificate or certificates representing such Warrant Shares or credit such Holder's balance account with DTC and pay cash to the Holder in an amount equal to the excess (if any) of the Buy-In Price over the product of (1) such number of shares of Common Stock, times (2) the VWAP on the date of exercise.

v. No Fractional Shares or Scrip. No fractional shares or scrip representing fractional shares shall be issued upon the exercise of this Warrant. As to any fraction of a share which the Holder would otherwise be entitled to purchase upon such exercise, the Company shall, at its election, either pay a cash adjustment in respect of such final fraction in an amount equal to such fraction multiplied by the Exercise Price or round up to the next whole share.

vi. Charges, Taxes and Expenses. Issuance of certificates for Warrant Shares shall be made without charge to the Holder for any issue or transfer tax or other incidental expense in respect of the issuance of such certificate, all of which taxes and expenses shall be paid by the Company, and such certificates shall be issued in the name of the Holder or in such name or names as may be directed by the Holder; provided, however, that in the event certificates for Warrant Shares are to be issued in a name other than the name of the Holder, this Warrant when surrendered for exercise shall be accompanied by the Assignment Form attached hereto duly executed by the Holder and the Company may require, as a condition thereto, the payment of a sum sufficient to reimburse it for any transfer tax incidental thereto.

vii. Closing of Books. The Company will not close its stockholder books or records in any manner which prevents the timely exercise of this Warrant, pursuant to the terms hereof.

d) Holder's Exercise Limitations. The Company shall not effect any exercise of this Warrant, and a Holder shall not have the right to exercise any portion of this Warrant, pursuant to Section 2 or otherwise, to the extent that after giving effect to such issuance after exercise as set forth on the applicable Notice of Exercise, the Holder (together with the Holder's Affiliates, and any other Persons (as defined below) acting as a group together with the Holder or any of the Holder's Affiliates), would beneficially own in excess of the Beneficial Ownership Limitation (as defined below). For purposes of the foregoing sentence, the number of shares of Common Stock beneficially owned by the Holder and its Affiliates shall include the number of shares of Common Stock issuable upon exercise of this Warrant with respect to which such determination is being made, but shall exclude the number of shares of Common Stock which would be issuable upon (i) exercise of the remaining, nonexercised portion of this Warrant beneficially owned by the Holder or any of its Affiliates and (ii) exercise or conversion of the unexercised or nonconverted portion of any other securities of the Company (including, without limitation, any other common stock equivalents) subject to a limitation on conversion or exercise analogous to the limitation contained herein beneficially owned by the Holder or any of its Affiliates. Except as set forth in the preceding sentence, for purposes of this Section 2(d), beneficial ownership shall be calculated in accordance with Section 13(d) of the Exchange Act and the rules and regulations promulgated thereunder, it being acknowledged by the Holder that the Company is not representing to the Holder that such calculation is in compliance with Section 13(d) of the Exchange Act and the Holder is solely responsible for any schedules required to be filed in accordance therewith. To the extent that the limitation contained in this Section 2(d) applies, the determination of whether this Warrant is exercisable (in relation to other securities owned by the Holder together with any Affiliates) and of which portion of this Warrant is exercisable shall be in the sole discretion of the Holder, and the submission of a Notice of Exercise shall be deemed to be the Holder's determination of whether this Warrant is exercisable (in relation to other securities owned by the Holder together with any Affiliates) and of which portion of this Warrant is exercisable, in each case subject to the Beneficial Ownership Limitation, and the Company shall have no obligation to verify or confirm the accuracy of such determination. In addition, a determination as to any group status as contemplated above shall be determined in accordance with Section 13(d) of the Exchange Act and the rules and regulations promulgated thereunder. For purposes of this Section 2(d), in determining the number of outstanding shares of Common Stock, a Holder may rely on the number of outstanding shares of Common Stock as reflected in (A) the Company's most recent periodic or annual report filed with the Commission, as the case may be, (B) a more recent public announcement by the Company or (C) a more recent written notice by the Company or its transfer agent setting forth the number of shares of Common Stock outstanding. Upon the written or oral request of a Holder, the Company shall within three trading days confirm orally and in writing to the Holder the number of shares of Common Stock then outstanding. In any case, the number of outstanding shares of Common Stock shall be determined after giving effect to the conversion or exercise of securities of the Company, including this Warrant, by the Holder or its Affiliates since the date as of which such number of outstanding shares of Common Stock was reported. The "Beneficial Ownership Limitation" shall be 4.99% of the number of shares of the Common Stock outstanding immediately after giving effect to the issuance of shares of Common Stock issuable upon exercise of this Warrant. The Holder, upon not less than 61 days' prior notice to the Company, may increase or decrease the Beneficial Ownership Limitation provisions of this Section 2(d), provided that the Beneficial Ownership Limitation in no event exceeds 9.99% of the number of shares of the Common Stock outstanding immediately after giving effect to the issuance of shares of Common Stock upon exercise of this Warrant held by the Holder and the provisions of this Section 2(d) shall continue to apply. Any such increase or decrease will not be effective until the 61st day after such notice is delivered to the Company. The provisions of this paragraph shall be construed and implemented in a manner otherwise than in strict conformity with the terms of this Section 2(d) to correct this paragraph (or any portion hereof) which may be defective or inconsistent with the intended Beneficial Ownership Limitation herein contained or to make changes or supplements necessary or desirable to properly give effect to such limitation. The limitations contained in this paragraph shall apply to a successor holder of this Warrant.

Section 3. Certain Adjustments.

a) Stock Dividends and Splits. If the Company, at any time while this Warrant is outstanding: (i) pays a stock dividend or otherwise makes a distribution or distributions on shares of its Common Stock or any other equity or equity equivalent securities payable in shares of Common Stock (which, for avoidance of doubt, shall not include any shares of Common Stock issued by the Company upon exercise of this Warrant), (ii) subdivides outstanding shares of Common Stock into a larger number of shares, (iii) combines (including by way of reverse stock split) outstanding shares of Common Stock into a smaller number of shares, or (iv) issues by reclassification of shares of the Common Stock any shares of capital stock of the Company, then in each case the Exercise Price shall be multiplied by a fraction of which the numerator shall be the number of shares of Common Stock (excluding treasury shares, if any) outstanding immediately before such event and of which the denominator shall be the number of shares of Common Stock outstanding immediately after such event, and the number of shares issuable upon exercise of this Warrant shall be proportionately adjusted such that the aggregate Exercise Price of this Warrant shall remain unchanged. Any adjustment made pursuant to this Section 3(a) shall become effective immediately after the record date for the determination of stockholders entitled to receive such dividend or distribution and shall become effective immediately after the effective date in the case of a subdivision, combination or re-classification.

b) Pro Rata Distributions. If the Company, at any time while this Warrant is outstanding, shall distribute to all holders of Common Stock (and not to the Holders) evidences of its indebtedness or assets (including cash and cash dividends) or rights or warrants to subscribe for or purchase any security other than the Common Stock (which shall be subject to Section 3(b)), then in each such case the Exercise Price shall be adjusted by multiplying the Exercise Price in effect immediately prior to the record date fixed for determination of stockholders entitled to receive such distribution by a fraction of which the denominator shall be the VWAP determined as of the record date mentioned above, and of which the numerator shall be such VWAP on such record date less the then per share fair market value at such record date of the portion of such assets or evidence of indebtedness so distributed applicable to one outstanding share of the Common Stock as determined by the Company's Board of Directors in good faith. In either case the adjustments shall be described in a statement provided to the Holder of the portion of assets or evidences of indebtedness so distributed or such subscription rights applicable to one share of Common Stock. Such adjustment shall be made whenever any such distribution is made and shall become effective immediately after the record date mentioned above.

c) Fundamental Transaction. If, at any time while this Warrant is outstanding, (i) the Company, directly or indirectly, in one or more related transactions effects any merger or consolidation of the Company with or into another Person in which the Company is not the surviving entity or the stockholders of the Company immediately prior to such merger or consolidation do not own, directly or indirectly, at least 50% of the outstanding voting securities of the surviving entity, (ii) the Company, directly or indirectly, effects any sale, lease, license, assignment, transfer, conveyance or other disposition of all or substantially all of its assets in one or a series of related transactions, (iii) any, direct or indirect, purchase offer, tender offer or exchange offer (whether by the Company or another Person) is completed pursuant to which all or substantially all of the holders of Common Stock are permitted to sell, tender or exchange their shares for other securities, cash or property and has been accepted by the holders of 50% or more of the outstanding Common Stock, or (iv) the Company, directly or indirectly, in one or more related transactions effects any reclassification, reorganization or recapitalization of the Common Stock or any compulsory share exchange pursuant to which the Common Stock is effectively converted into or exchanged for other securities, cash or property (other than as a result of a subdivision or combination of shares of Common Stock covered by Section 3(a) above), (each a "Fundamental Transaction"), then, upon any subsequent exercise of this Warrant, the Holder shall have the right to receive, for each Warrant Share that would have been issuable upon such exercise immediately prior to the occurrence of such Fundamental Transaction, at the option of the Holder (without regard to any limitation in Section 2(d) on the exercise of this Warrant), the number of shares of Common Stock of the successor or acquiring corporation or of the Company, if it is the surviving corporation, and any additional consideration (the "Alternate Consideration") receivable as a result of such Fundamental Transaction by a holder of the number of shares of Common Stock for which this Warrant is exercisable immediately prior to such Fundamental Transaction (without regard to any limitation in Section 2(d) on the exercise of this Warrant). For purposes of any such exercise, the determination of the Exercise Price shall be appropriately adjusted to apply to such Alternate Consideration based on the amount of Alternate Consideration issuable in respect of one share of Common Stock in such Fundamental Transaction, and the Company shall apportion the Exercise Price among the Alternate Consideration in a reasonable manner reflecting the relative value of any different components of the Alternate Consideration. If holders of Common Stock are given any choice as to the securities, cash or property to be received in a Fundamental Transaction, then the Holder shall be given the same choice as to the Alternate Consideration it receives upon any exercise of this Warrant following such Fundamental Transaction. Notwithstanding anything to the contrary, in the event of a Fundamental Transaction other than one in which a Successor Entity (as defined below) that is a publicly traded corporation whose stock is quoted or listed for trading on an Eligible Market (as defined below) assumes this Warrant such that the Warrant shall be exercisable for the publicly traded Common Stock of such Successor Entity, the Company or any Successor Entity shall, at the Holder's option, exercisable at any time concurrently with, or within 30 days after, the consummation of the Fundamental Transaction, purchase this Warrant from the Holder by paying to the Holder an amount of cash equal to the Black Scholes Value of the remaining unexercised portion of this Warrant on the date of the consummation of such Fundamental Transaction. As used herein (w) "Black Scholes Value" means the value of this Warrant based on the Black and Scholes Option Pricing Model obtained from the "OV" function on Bloomberg, L.P. ("Bloomberg") determined as of the day of consummation of the applicable Fundamental Transaction for pricing purposes and reflecting (A) a risk-free interest rate corresponding to the U.S. Treasury rate for a period equal to the time between the date of the public announcement of the applicable Fundamental Transaction and the Termination Date, (B) an expected volatility equal to the greater of 100% and the 100 day volatility obtained from the HVT function on Bloomberg as of the trading day immediately following the public announcement of the applicable Fundamental Transaction, (C) the underlying price per share used in such calculation shall be the sum of the price per share being offered in cash, if any, plus the value of any non-cash consideration, if any, being offered in such Fundamental Transaction and (D) a remaining option time equal to the time between the date of the public announcement of the applicable Fundamental Transaction and the Termination Date, (1) "Successor Entity" means the Person (or, if so elected by the Holder, the Parent Entity (as defined below)) formed by, resulting from or surviving any Fundamental Transaction or the Person (or, if so elected by the Holder, the Parent Entity) with which such Fundamental Transaction shall have been entered into, (2) "Eligible Market" means the NYSE Amex, The NASDAQ Capital Market, The NASDAQ Global Market, The NASDAQ Global Select Market, the New York Stock Exchange or the OTC Bulletin Board (or any successors to any of the foregoing), (3) "Parent Entity" of a Person means an entity that, directly or indirectly, controls the applicable Person and whose common stock or equivalent equity security is quoted or listed on an Eligible Market, or, if there is more than one such Person or Parent Entity, the Person or Parent Entity with the largest public market capitalization as of the date of consummation of the Fundamental Transaction. The terms of any agreement pursuant to which a Fundamental Transaction is effected shall include terms requiring any such successor or surviving entity to comply with the provisions of this Section 3(e) and insuring that this Warrant (or any such replacement security) will be similarly adjusted upon any subsequent transaction analogous to a Fundamental Transaction, and (4) "Person" means an individual, a limited liability company, a partnership, a joint venture, a corporation, a trust, an unincorporated organization, any other entity and a government or any department or agency thereof.

d) Number of Warrant Shares. Simultaneously with any adjustment to the Exercise Price pursuant to paragraph (a) and (e) of this Section, the number of Warrant Shares that may be purchased upon exercise of this Warrant shall be increased or decreased proportionately, so that after such adjustment the aggregate Exercise Price payable hereunder for the increased or decreased number of Warrant Shares shall be the same as the aggregate Exercise Price in effect immediately prior to such adjustment.

e) Subsequent Equity Sales.

i. Except as provided in subsection (e)(iii) hereof, if and whenever the Company shall issue or sell, or is, in accordance with any of subsections (e)(ii)(l) through (e)(ii)(7) hereof, deemed to have issued or sold, any shares of Common Stock for no consideration or for a consideration per share less than the Exercise Price in effect immediately prior to the time of such issue or sale, then and in each such case (a "Trigger Issuance") the then-existing Exercise Price shall be reduced as of the close of business on the effective date of the Trigger Issuance, to a price determined as follows:

$$\text{Adjusted Exercise Price} = \frac{(A \times B) + D}{A+C}$$

where

"A" equals the number of shares of Common Stock outstanding, including Additional Shares of Common Stock (as defined below) deemed to be issued hereunder, immediately preceding such Trigger Issuance;

"B" equals the Exercise Price in effect immediately preceding such Trigger Issuance;

"C" equals the number of Additional Shares of Common Stock issued or deemed issued hereunder as a result of the Trigger Issuance; and

"D" equals the aggregate consideration, if any, received or deemed to be received by the Company upon such Trigger Issuance;

provided, however, that in no event shall the Exercise Price after giving effect to such Trigger Issuance be greater than the original Exercise Price.

For purposes of this subsection (e), "Additional Shares of Common Stock" shall mean all shares of Common Stock issued by the Company or deemed to be issued pursuant to this subsection (e), other than Exempt Issuances (as defined below).

ii. For purposes of this subsection 3(e), the following subsections (e)(ii)(l) to (e)(ii)(7) shall also be applicable:

(1) Issuance of Rights or Options. In case at any time the Company shall in any manner grant (directly and not by assumption in a merger or otherwise) any warrants or other rights to subscribe for or to purchase, or any options for the purchase of, Common Stock or any stock or security convertible into or exchangeable for Common Stock (such warrants, rights or options being called "Options" and such convertible or exchangeable stock or securities being called "Convertible Securities"), whether or not such Options or the right to convert or exchange any such Convertible Securities are immediately exercisable, and the price per share for which Common Stock is issuable upon the exercise of such Options or upon the conversion or exchange of such Convertible Securities (determined by dividing (i) the sum (which sum shall constitute the applicable consideration) of (x) the total amount, if any, received or receivable by the Company as consideration for the granting of such Options, plus (y) the aggregate amount of additional consideration payable to the Company upon the exercise of all such Options, plus (z), in the case of such Options which relate to Convertible Securities, the aggregate amount of additional consideration, if any, payable upon the issue or sale of such Convertible Securities and upon the conversion or exchange thereof, by (ii) the total maximum number of shares of Common Stock issuable upon the exercise of such Options or upon the conversion or exchange of all such Convertible Securities issuable upon the exercise of such Options) shall be less than the Exercise Price in effect immediately prior to the time of the granting of such Options, then the total number of shares of Common Stock issuable upon the exercise of such Options or upon conversion or exchange of the total amount of such Convertible Securities issuable upon the exercise of such Options shall be deemed to have been issued for such price per share as of the date of granting of such Options or the issuance of such Convertible Securities and thereafter shall be deemed to be outstanding for purposes of adjusting the Exercise Price. Except as otherwise provided in subsection 3(e)(ii)(3), no adjustment of the Exercise Price shall be made upon the actual issue of such Common Stock or of such Convertible Securities upon exercise of such Options or upon the actual issue of such Common Stock upon conversion or exchange of such Convertible Securities.

(2) Issuance of Convertible Securities. In case the Company shall in any manner issue (directly and not by assumption in a merger or otherwise) or sell any Convertible Securities, whether or not the rights to exchange or convert any such Convertible Securities are immediately exercisable, and the price per share for which Common Stock is issuable upon such conversion or exchange (determined by dividing (i) the sum (which sum shall constitute the applicable consideration) of (x) the total amount received or receivable by the Company as consideration for the issue or sale of such Convertible Securities, plus (y) the aggregate amount of additional consideration, if any, payable to the Company upon the conversion or exchange thereof, by (ii) the total number of shares of Common Stock issuable upon the conversion or exchange of all such Convertible Securities) shall be less than the Exercise Price in effect immediately prior to the time of such issue or sale, then the total maximum number of shares of Common Stock issuable upon conversion or exchange of all such Convertible Securities shall be deemed to have been issued for such price per share as of the date of the issue or sale of such Convertible Securities and thereafter shall be deemed to be outstanding for purposes of adjusting the Exercise Price, provided that (a) except as otherwise provided in subsection 3(e)(ii)(3), no adjustment of the Exercise Price shall be made upon the

actual issuance of such Common Stock upon conversion or exchange of such Convertible Securities and (b) no further adjustment of the Exercise Price shall be made by reason of the issue or sale of Convertible Securities upon exercise of any Options to purchase any such Convertible Securities for which adjustments of the Exercise Price have been made pursuant to the other provisions of subsection 3(e).

(3) Change in Option Price or Conversion Rate. Upon the happening of any of the following events, namely, if the purchase price provided for in any Option referred to in subsection 3(e)(ii)(l), the additional consideration, if any, payable upon the conversion or exchange of any Convertible Securities referred to in subsections 3(e)(ii)(l) or 3(e)(ii)(2), or the rate at which Convertible Securities referred to in subsections 3(e)(ii)(l) or 3(e)(ii)(2) are convertible into or exchangeable for Common Stock shall change at any time (including, but not limited to, changes under or by reason of provisions designed to protect against dilution), the Exercise Price in effect at the time of such event shall forthwith be readjusted to the Exercise Price which would have been in effect at such time had such Options or Convertible Securities still outstanding provided for such changed purchase price, additional consideration or conversion rate, as the case may be, at the time initially granted, issued or sold. On the termination of any Option for which any adjustment was made pursuant to this subsection 3(e) or any right to convert or exchange Convertible Securities for which any adjustment was made pursuant to this subsection 3(e) (including, without limitation, upon the redemption or purchase for consideration of such Convertible Securities by the Company), the Exercise Price then in effect hereunder shall forthwith be changed to the Exercise Price which would have been in effect at the time of such termination had such Option or Convertible Securities, to the extent outstanding immediately prior to such termination, never been issued.

(4) Stock Dividends. Subject to the provisions of this Section 3(e), in case the Company shall declare a dividend or make any other distribution upon any stock of the Company (other than the Common Stock) payable in Common Stock, Options or Convertible Securities, then any Common Stock, Options or Convertible Securities, as the case may be, issuable in payment of such dividend or distribution shall be deemed to have been issued or sold without consideration.

(5) Consideration for Stock. In case any shares of Common Stock, Options or Convertible Securities shall be issued or sold for cash, the consideration received therefor shall be deemed to be the gross amount received by the Company therefor. In case any shares of Common Stock, Options or Convertible Securities shall be issued or sold for a consideration other than cash, the amount of the consideration other than cash received by the Company shall be deemed to be the fair value of such consideration as determined in good faith by the Board of Directors of the Company. In case any Options shall be issued in connection with the issue and sale of other securities of the Company, together comprising one integral transaction in which no specific consideration is allocated to such Options by the parties thereto, such Options shall be deemed to have been issued for such consideration as determined in good faith by the Board of Directors of the Company. If Common Stock, Options or Convertible Securities shall be issued or sold by the Company and, in connection therewith, other Options or Convertible Securities (the "Additional Rights") are issued, then the consideration received or deemed to be received by the Company shall be reduced by the fair market value of the Additional Rights (as determined using the Black-Scholes option pricing model or another

method mutually agreed to by the Company and the Holder). The Board of Directors of the Company shall respond promptly, in writing, to an inquiry by the Holder as to the fair market value of the Additional Rights. In the event that the Board of Directors of the Company and the Holder are unable to agree upon the fair market value of the Additional Rights, the Company and the Holder shall jointly select an appraiser who is experienced in such matters. The decision of such appraiser shall be final and conclusive, and the cost of such appraiser shall be borne evenly by the Company and the Holder.

(6) Record Date. In case the Company shall take a record of the holders of its Common Stock for the purpose of entitling them (i) to receive a dividend or other distribution payable in Common Stock, Options or Convertible Securities or (ii) to subscribe for or purchase Common Stock, Options or Convertible Securities, then such record date shall be deemed to be the date of the issue or sale of the shares of Common Stock deemed to have been issued or sold upon the declaration of such dividend or the making of such other distribution or the date of the granting of such right of subscription or purchase, as the case may be.

(7) Treasury Shares. The number of shares of Common Stock outstanding at any given time shall not include shares owned or held by or for the account of the Company or any of its wholly-owned subsidiaries, and the disposition of any such shares (other than the cancellation or retirement thereof) shall be considered an issue or sale of Common Stock for the purpose of this subsection (e).

iii. Exempt Issuance. Notwithstanding the foregoing, no adjustment will be made under this paragraph (e) in respect of an Exempt Issuance. For the purposes of this Warrant, "Exempt Issuance" means the issuance of (a) shares of Common Stock, common stock equivalents, restricted stock units or other Options to employees, consultants officers or directors of the Company pursuant to any existing or future stock option, restricted stock, stock purchase or other equity compensation plan duly adopted for such purpose, by a majority of the non-employee members of the Board of Directors or a majority of the members of a committee of non-employee directors established for such purpose, and the issuance of Common Stock in respect of such common stock equivalents, restricted stock units or other Options, (b) securities (including Common Stock and common stock equivalents) upon the exercise, conversion or exchange of securities (including Convertible Securities and Options) issued and outstanding on the date hereof, including the Warrants, provided that such securities have not been amended since date hereof to increase the number of such securities or to decrease the exercise price, exchange price or conversion price of such securities, (c) securities issued pursuant to acquisitions or strategic transactions approved by a majority of the disinterested directors of the Company, provided that any such issuance shall only be to a Person (or to the equity holders of a Person) that the Company's Board of Directors determines in good faith is, itself or through its subsidiaries, an operating company or an owner of an asset in a business synergistic with the business of the Company and shall provide to the Company additional benefits in addition to the investment of funds, but shall not, for the purposes of this clause (c), include a transaction in which the Company is issuing securities primarily for the purpose of raising capital or to an entity whose primary business is investing in securities, and (d) the issuance of securities in a transaction described in Section 3(a) or 3(b) above.

iv. Upon any adjustment to the Exercise Price pursuant to this Section 3(e), the number of Warrant Shares purchasable hereunder shall be adjusted by multiplying such number by a fraction, the numerator of which shall be the Exercise Price in effect immediately prior to such adjustment and the denominator of which shall be the Exercise Price in effect immediately thereafter.

f) Calculations. All calculations under this Section 3 shall be made to the nearest cent or the nearest 1/100th of a share, as the case may be. For purposes of this Section 3, the number of shares of Common Stock deemed to be issued and outstanding as of a given date shall be the sum of the number of shares of Common Stock (excluding treasury shares, if any) issued and outstanding.

g) Notice to Holder.

i. Adjustment to Exercise Price. Whenever the Exercise Price is adjusted pursuant to any provision of this Section 3, the Company shall promptly mail to the Holder a notice setting forth the Exercise Price after such adjustment and setting forth a brief statement of the facts requiring such adjustment.

ii. Notice to Allow Exercise by Holder. After the Issue Date, (A) the Company shall declare a dividend (or any other distribution in whatever form) on the Common Stock, (B) the Company shall declare a special nonrecurring cash dividend on or a redemption of the Common Stock, (C) the Company shall authorize the granting to all holders of the Common Stock rights or warrants to subscribe for or purchase any shares of capital stock of any class or of any rights, (D) the approval of any stockholders of the Company shall be required in connection with any reclassification of the Common Stock, any consolidation or merger to which the Company is a party, any sale or transfer of all or substantially all of the assets of the Company, or any compulsory share exchange whereby the Common Stock is converted into other securities, cash or property, or (E) the Company shall authorize the voluntary or involuntary dissolution, liquidation or winding up of the affairs of the Company, then, in each case, the Company shall cause to be mailed to the Holder at its last address as it shall appear upon the Warrant Register of the Company, at least 20 calendar days prior to the applicable record or effective date hereinafter specified, a notice stating (x) the date on which a record is to be taken for the purpose of such dividend, distribution, redemption, rights or warrants, or if a record is not to be taken, the date as of which the holders of the Common Stock of record to be entitled to such dividend, distributions, redemption, rights or warrants are to be determined or (y) the date on which such reclassification, consolidation, merger, sale, transfer or share exchange is expected to become effective or close, and the date as of which it is expected that holders of the Common Stock of record shall be entitled to exchange their shares of the Common Stock for securities, cash or other property deliverable upon such reclassification, consolidation, merger, sale, transfer or share exchange; provided that the failure to mail such notice or any defect therein or in the mailing thereof shall not affect the validity of the corporate action required to be specified in such notice. To the extent that any notice provided hereunder constitutes, or contains, material, non-public information regarding the Company or any of its subsidiaries, the Company shall simultaneously file such notice with the Commission pursuant to a Current Report on Form 8-K. The Holder shall remain entitled to exercise this Warrant during the period commencing on the date of such notice to the effective date of the event triggering such notice except as may otherwise be expressly set forth herein.

Section 4. Transfer of Warrant.

a) Transferability. Subject to compliance with any applicable securities laws, this Warrant and all rights hereunder (including, without limitation, any registration rights) are transferable, in whole or in part, upon surrender of this Warrant at the principal office of the Company or its designated agent, together with a written assignment of this Warrant substantially in the form attached hereto duly executed by the Holder or its agent or attorney and funds sufficient to pay any transfer taxes payable upon the making of such transfer. Upon such surrender and, if required, such payment, the Company shall execute and deliver a new Warrant or Warrants in the name of the assignee or assignees, as applicable, and in the denomination or denominations specified in such instrument of assignment, and shall issue to the assignor a new Warrant evidencing the portion of this Warrant not so assigned, and this Warrant shall promptly be cancelled. The Warrant, if properly assigned in accordance herewith, may be exercised by a new holder for the purchase of Warrant Shares without having a new Warrant issued.

b) New Warrants. This Warrant may be divided or combined with other Warrants upon presentation hereof at the aforesaid office of the Company, together with a written notice specifying the names and denominations in which new Warrants are to be issued, signed by the Holder or its agent or attorney. Subject to compliance with Section 4(a), as to any transfer which may be involved in such division or combination, the Company shall execute and deliver a new Warrant or Warrants in exchange for the Warrant or Warrants to be divided or combined in accordance with such notice. All Warrants issued on transfers or exchanges shall be dated the initial issuance date set forth on the first page of this Warrant and shall be identical with this Warrant except as to the number of Warrant Shares issuable pursuant thereto.

c) Warrant Register. The Company shall register this Warrant, upon records to be maintained by the Company for that purpose (the "Warrant Register"), in the name of the record Holder hereof from time to time. The Company may deem and treat the registered Holder of this Warrant as the absolute owner hereof for the purpose of any exercise hereof or any distribution to the Holder, and for all other purposes, absent actual notice to the contrary. Upon thirty (30) days notice to the Holder, the Company may appoint a warrant agent to maintain the Warrant Register.

Section 5. Miscellaneous.

a) No Rights as Stockholder Until Exercise. This Warrant does not entitle the Holder to any voting rights, dividends or other rights as a stockholder of the Company prior to the exercise hereof as set forth in Section 2(c)(i).

b) Loss, Theft, Destruction or Mutilation of Warrant. The Company covenants that upon receipt by the Company of evidence reasonably satisfactory to it of the loss, theft, destruction or mutilation of this Warrant or any stock certificate relating to the Warrant Shares, and in case of loss, theft or destruction, of indemnity or security reasonably satisfactory to it (which, in the case of the Warrant, shall not include the posting of any bond), and upon surrender and cancellation of such Warrant or stock certificate, if mutilated, the Company will make and deliver a new Warrant or stock certificate of like tenor and dated as of such cancellation, in lieu of such Warrant or stock certificate.

c) Saturdays, Sundays, Holidays, etc. If the last or appointed day for the taking of any action or the expiration of any right required or granted herein shall not be a business day, then, such action may be taken or such right may be exercised on the next succeeding business day.

d) Authorized Shares. The Company covenants that, during the period the Warrant is outstanding, it will reserve from its authorized and unissued Common Stock a sufficient number of shares to provide for the issuance of the Warrant Shares upon the exercise of any purchase rights under this Warrant. The Company further covenants that its issuance of this Warrant shall constitute full authority to its officers who are charged with the duty of executing stock certificates to execute and issue the necessary certificates for the Warrant Shares upon the exercise of the purchase rights under this Warrant. The Company will take all such reasonable action as may be necessary to assure that such Warrant Shares may be issued as provided herein without violation of any applicable law or regulation, or of any requirements of the Trading Market upon which the Common Stock may be listed. The Company covenants that all Warrant Shares which may be issued upon the exercise of the purchase rights represented by this Warrant will, upon exercise of the purchase rights represented by this Warrant and payment for such Warrant Shares in accordance herewith, be duly authorized, validly issued, fully paid and nonassessable and free from all taxes, liens and charges created by the Company in respect of the issue thereof (other than taxes in respect of any transfer occurring contemporaneously with such issue).

Except and to the extent as waived or consented to by the Holder, the Company shall not by any action, including, without limitation, amending its certificate of incorporation or through any reorganization, transfer of assets, consolidation, merger, dissolution, issue or sale of securities or any other voluntary action, avoid or seek to avoid the observance or performance of any of the terms of this Warrant, but will at all times in good faith assist in the carrying out of all such terms and in the taking of all such actions as may be necessary or appropriate to protect the rights of Holder as set forth in this Warrant against impairment. Without limiting the generality of the foregoing, the Company will (i) not increase the par value of any Warrant Shares above the amount payable therefor upon such exercise immediately prior to such increase in par value, (ii) take all such action as may be necessary or appropriate in order that the Company may validly and legally issue fully paid and nonassessable Warrant Shares upon the exercise of this Warrant and (iii) use commercially reasonable efforts to obtain all such authorizations, exemptions or consents from any public regulatory body having jurisdiction thereof, as may be, necessary to enable the Company to perform its obligations under this Warrant.

Before taking any action which would result in an adjustment in the number of Warrant Shares for which this Warrant is exercisable or in the Exercise Price, the Company shall obtain all such authorizations or exemptions thereof, or consents thereto, as may be necessary from any public regulatory body or bodies having jurisdiction thereof.

e) Jurisdiction. All questions concerning the construction, validity, enforcement and interpretation of this Warrant shall be determined in accordance with the laws of the State of Oklahoma.

f) Restrictions. The Holder acknowledges that the Warrant Shares acquired upon the exercise of this Warrant, if not registered, and the Holder does not utilize cashless exercise, will have restrictions upon resale imposed by state and federal securities laws.

g) Nonwaiver and Expenses. No course of dealing or any delay or failure to exercise any right hereunder on the part of Holder shall operate as a waiver of such right or otherwise prejudice Holder's rights, powers or remedies. Without limiting any other provision of this Warrant, if the Company willfully and knowingly fails to comply with any provision of this Warrant, which results in any material damages to the Holder, the Company shall pay to Holder such amounts as shall be sufficient to cover any costs and expenses including, but not limited to, reasonable attorneys' fees, including those of appellate proceedings, incurred by Holder in collecting any amounts due pursuant hereto or in otherwise enforcing any of its rights, powers or remedies hereunder.

h) Notices. The Company shall provide Holder with prompt written notice of all actions taken pursuant to this Warrant. Whenever notice is required to be given under this Warrant, unless otherwise provided herein, such notice shall be given in writing, will be mailed (i) if within the domestic United States by first-class registered or certified airmail, or nationally recognized overnight express courier, postage prepaid, or by facsimile or (ii) if delivered from outside the United States, by International Federal Express or facsimile, and (iii) will be deemed given (A) if delivered by first-class registered or certified mail domestic, three business days after so mailed, (B) if delivered by nationally recognized overnight carrier, one business day after so mailed, (C) if delivered by International Federal Express, two business days after so mailed and (D) if delivered by facsimile, upon electronic confirmation of receipt, and will be delivered and addressed as follows:

(1) if to the Company, to:

Foundation Healthcare, Inc.
13900 N. Portland, Ste. 200
Oklahoma City, Oklahoma 73134
Attention: General Counsel
Facsimile: (405) 608-1700

With Copies to:

Goodwin Procter, LLP
100 Northern Avenue
Boston, Massachusetts 02210
Attention: Robert E. Puopolo, Esq.
Facsimile: 617- 321-4362

(2) if to the Holder, at the address of the Holder appearing on the books of the Company.

i) Limitation of Liability. No provision hereof, in the absence of any affirmative action by Holder to exercise this Warrant to purchase Warrant Shares, and no enumeration herein of the rights or privileges of Holder, shall give rise to any liability of Holder for the purchase price of any Common Stock or as a stockholder of the Company, whether such liability is asserted by the Company or by creditors of the Company.

j) Remedies. The Holder, in addition to being entitled to exercise all rights granted by law, including recovery of damages, will be entitled to specific performance of its rights under this Warrant. The Company agrees that monetary damages would not be adequate compensation for any loss incurred by reason of a breach by it of the provisions of this Warrant and hereby agrees to waive and not to assert the defense in any action for specific performance that a remedy at law would be adequate.

k) Successors and Assigns. Subject to applicable securities laws, this Warrant and the rights and obligations evidenced hereby shall inure to the benefit of and be binding upon the successors and permitted assigns of the Company and the successors and permitted assigns of Holder. The provisions of this Warrant are intended to be for the benefit of any Holder from time to time of this Warrant and shall be enforceable by the Holder or holder of Warrant Shares.

l) Amendment. This Warrant may be modified or amended or the provisions hereof waived with the written consent of the Company and the Holder.

m) Severability. Wherever possible, each provision of this Warrant shall be interpreted in such manner as to be effective and valid under applicable law, but if any provision of this Warrant shall be prohibited by or invalid under applicable law, such provision shall be ineffective to the extent of such prohibition or invalidity, without invalidating the remainder of such provisions or the remaining provisions of this Warrant.

n) Headings. The headings used in this Warrant are for the convenience of reference only and shall not, for any purpose, be deemed a part of this Warrant.

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(Signature Page Follows)

IN WITNESS WHEREOF, the Company has caused this Warrant to be executed by its officer thereunto duly authorized as of the date first above indicated.

FOUNDATION HEALTHCARE, INC.

By: /s/ STANTON NELSON
Name: Stanton Nelson
Title: Chief Executive Officer

ACKNOWLEDGED AND AGREED TO
THIS 20th DAY OF JUNE 2016:

HOLDER

By: ______________________________
Name:
Title:

NOTICE OF EXERCISE

TO: FOUNDATION HEALTHCARE, INC.

(1) The undersigned hereby elects to purchase ________ Warrant Shares of the Company pursuant to the terms of the attached Warrant (only if exercised in full), and tenders herewith payment of the exercise price in full, together with all applicable transfer taxes, if any. Payment shall be in lawful money of the United States by wire transfer or cashier's check.

(2) Please issue a certificate or certificates representing said Warrant Shares in the name of the undersigned or in such other name as is specified below:

____

The Warrant Shares shall be delivered to the following DWAC Account Number or by physical delivery of a certificate to:

____
____
____

____
[SIGNATURE OF HOLDER]

Name of Entity: _______________________________
Signature of Authorized Signatory of Entity: _______________________________
Name of Authorized Signatory: _______________________________
Title of Authorized Signatory: _______________________________
Date: _______________________________

ASSIGNMENT FORM

(To assign the foregoing warrant, execute
this form and supply required information.
Do not use this form to exercise the warrant.)

FOR VALUE RECEIVED, [____] all of or _____ shares of the foregoing Warrant and all rights evidenced thereby are hereby assigned to

_____________________________________whose address is

____

____

Dated:________________, ________

Holder's Signature:____________________________________

Holder's Address:____________________________________

____

Signature Guaranteed: ____________________________________

NOTE: The signature to this Assignment Form must correspond with the name as it appears on the face of the Warrant, without alteration or enlargement or any change whatsoever, and must be guaranteed by a bank or trust company. Officers of corporations and those acting in a fiduciary or other representative capacity should file proper evidence of authority to assign the foregoing Warrant.

Exhibit 31.1

CERTIFICATION

I, Stanton Nelson, certify that:

1. I have reviewed this Form 10-Q for the period ended June 30, 2016 of Foundation Healthcare, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, was made known to us by others within those entities, particularly during the period in which this report was being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal year that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: September 2, 2016

/S/ STANTON NELSON
Stanton Nelson
Chief Executive Officer
(Principal Executive Officer)

Exhibit 31.2

CERTIFICATION

I, Hubert King, certify that:

1. I have reviewed this Form 10-Q for the period ended June 30, 2016 of Foundation Healthcare, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, was made known to us by others within those entities, particularly during the period in which this report was being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal year that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: September 2, 2016

/S/ HUBERT KING
Hubert King
Chief Financial Officer
(Principal Financial and Accounting Officer)

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

Pursuant to 18 U.S.C. Section 1350 (as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002), I, the undersigned Chief Executive Officer of Foundation Healthcare, Inc. (the "Company"), hereby certify that, to the best of my knowledge, the Quarterly Report on Form 10-Q of the Company for the period ended June 30, 2016 (the "Quarterly Report") fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in the Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: September 2, 2016

/S/ STANTON NELSON
Chief Executive Officer
(Principal Executive Officer)

Exhibit 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

Pursuant to 18 U.S.C. Section 1350 (as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002), I, the undersigned Chief Financial Officer of Foundation Healthcare, Inc. (the "Company"), hereby certify that, to the best of my knowledge, the Quarterly Report on Form 10-Q of the Company for the period ended June 30, 2016 (the "Quarterly Report") fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in the Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: September 2, 2016

/S/ HUBERT KING
Chief Financial Officer
(Principal Financial and Accounting Officer)