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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2018

OR

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

For the transition period from ______________ to ______________

Commission file number 0-23367

BIRNER DENTAL MANAGEMENT SERVICES, INC.

(Exact name of registrant as specified in its charter)

COLORADO	**84-1307044**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

1777 S. HARRISON STREET, SUITE 1400 DENVER, COLORADO	**80210**
(Address of principal executive offices)	(Zip Code)

(303) 691-0680
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes X No ____

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

Large accelerated filer ____ Accelerated filer ____ Non-accelerated filer ____ (Do not check if a smaller reporting company) Smaller reporting company X

Emerging growth company ____

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

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

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

Class	Shares Outstanding as of August 3, 2018
Common Stock, no par value	1,881,761

BIRNER DENTAL MANAGEMENT SERVICES, INC. AND SUBSIDIARIES
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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

BIRNER DENTAL MANAGEMENT SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

ASSETS	December 31, 2017	June 30, 2018
CURRENT ASSETS:		
Cash	$ 1,888,828	$ 350,419
Accounts receivable, net of allowance for doubtful accounts of approximately $500,000 and $475,000, respectively	3,772,514	4,205,245
Note receivable	33,768	17,309
Prepaid expenses and other assets	655,310	866,809
Total current assets	6,350,420	5,439,782
PROPERTY AND EQUIPMENT, net	5,016,141	4,713,348
OTHER NONCURRENT ASSETS:		
Intangible assets, net	5,876,053	5,453,770
Deferred charges and other assets	163,991	163,991
Total assets	$ 17,406,605	$ 15,770,891
LIABILITIES AND SHAREHOLDERS' DEFICIT		
CURRENT LIABILITIES:		
Accounts payable	$ 4,210,521	$ 3,415,887
Accrued expenses	777,863	705,831
Accrued payroll and related expenses	2,009,720	2,594,949
Current maturities of long-term debt	750,000	6,189,590
Total current liabilities	7,748,104	12,906,257
LONG-TERM LIABILITIES:		
Deferred tax liability, net	101,482	-
Bank credit facilities, net	5,684,085	-
Convertible senior subordinated secured notes, net	4,445,862	4,619,745
Other long-term obligations	1,190,811	1,424,059
Total liabilities	19,170,344	18,950,061
SERIES A PREFERRED STOCK, no par value, 100 shares authorized, 10 shares outstanding	10,000	10,000
SERIES B PREFERRED STOCK, no par value, 2,000,000 shares authorized, none outstanding	-	-
SHAREHOLDERS' EQUITY / (DEFICIT):		
Preferred Stock, no par value, 7,999,900 shares authorized; none outstanding	-	-
Common Stock, no par value, 20,000,000 shares authorized; 1,872,761and 1,878,761 shares issued and outstanding, respectively	2,060,208	2,169,852
Accumulated deficit	(3,833,947)	(5,359,022)
Total shareholders' deficit	(1,773,739)	(3,189,170)
Total liabilities and shareholders' deficit	$ 17,406,605	$ 15,770,891

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

BIRNER DENTAL MANAGEMENT SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Quarters Ended June 30,		Six Months Ended June 30,	
	2017	2018	2017	2018
REVENUE:				
Dental practice revenue	$ 13,753,775	$ 14,405,938	$ 28,372,479	$29,264,013
Capitation revenue	1,025,443	947,941	2,067,419	1,911,334
	14,779,218	15,353,879	30,439,898	31,175,347
DIRECT EXPENSES:				
Clinical salaries and benefits	9,252,188	9,640,816	18,718,487	19,460,892
Dental supplies	672,187	693,739	1,300,592	1,390,053
Laboratory fees	931,760	934,006	1,812,901	1,817,381
Occupancy	1,652,889	1,634,467	3,203,149	3,248,488
Advertising and marketing	167,467	140,516	337,371	271,974
Depreciation and amortization	913,693	755,819	1,878,494	1,534,520
General and administrative	1,287,012	1,304,013	2,550,637	2,639,955
	14,877,196	15,103,376	29,801,631	30,363,263
Contribution from dental offices	(97,978)	250,503	638,267	812,084
CORPORATE EXPENSES:				
General and administrative	1,011,917 [1]	1,088,474 [1]	1,971,374 [2]	2,089,862 [2]
Stock grant	175,000 [3]	-	175,000 [3]	-
Depreciation and amortization	38,864	30,700	84,948	64,074
OPERATING LOSS	(1,323,759)	(868,671)	(1,593,055)	(1,341,852)
OTHER EXPENSE:				
Increase in fair value of embedded derivatives	-	250,000	-	250,000
Interest expense, net	94,414	170,041	166,838	334,184
LOSS BEFORE INCOME TAXES	(1,418,173)	(1,288,712)	(1,759,893)	(1,926,036)
Income tax benefit	(516,899)	(17,020)	(633,561)	(176,352)
NET LOSS	$ (901,274)	$ (1,271,692)	$ (1,126,332)	$ (1,749,684)
Net loss per share of Common Stock - Basic	$ (0.48)	$ (0.68)	$ (0.60)	$ (0.93)
Net loss per share of Common Stock - Diluted	$ (0.48)	$ (0.68)	$ (0.60)	$ (0.93)
Weighted average number of shares of Common Stock and dilutive securities:				
Basic	1,866,580	1,875,245	1,863,746	1,874,971
Diluted	1,866,580	1,875,245	1,863,746	1,874,971

[1] Corporate expenses - general and administrative includes $51,019 and $56,668 of stock-based compensation expense pursuant to ASC Topic 718 for the quarters ended June 30, 2017 and 2018, respectively.

[2] Corporate expenses - general and administrative includes $86,255 and $109,644 of stock-based compensation expense pursuant to ASC Topic 718 for the six months ended June 30, 2017 and 2018, respectively.

[3] The Company issued 12,500 shares of Common Stock under a settlement agreement with an activist shareholder group. The shares were values at $175,000 based on the closing price of the Common Stock on the date of the grant.

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

BIRNER DENTAL MANAGEMENT SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' DEFICIT
(UNAUDITED)

	Common Stock			
	Shares	Amount	Accumulated Deficit	Shareholders' Deficit
BALANCES, December 31, 2017	1,872,761	$ 2,060,208	$ (3,833,947)	$ (1,773,739)
Adoption of ASU No. 2014-09 (Topic 606) - see Note 4	-	-	224,609	224,609
Stock-based compensation expense	6,000	109,644	-	109,644
Net loss	-	-	(1,749,684)	(1,749,684)
BALANCES, June 30, 2018	1,878,761	$ 2,169,852	$ (5,359,022)	$ (3,189,170)

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

BIRNER DENTAL MANAGEMENT SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Six Months Ended June 30,	
	2017	2018
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (1,126,332)	$ (1,749,684)
Adjustments to reconcile net loss to net cash provided (used) by operating activities:		
Depreciation and amortization	1,963,442	1,598,594
Amortization of debt issuance costs	14,989	52,948
Stock-based compensation expense	86,255	109,644
Provision for doubtful accounts	362,087	380,694
Benefit from deferred income taxes	(586,569)	(176,352)
Stock grant	175,000	-
Increase in fair value of embedded derivatives	-	250,000
Changes in assets and liabilities:		
Accounts receivable	(965,904)	(369,131)
Prepaid expenses and other assets	15,441	(211,499)
Deferred charges and other assets	(8,250)	-
Accounts payable	1,248,742	(794,634)
Accrued expenses	(60,014)	(59,207)
Accrued payroll and related expenses	258,241	427,589
Income taxes payable (receivable)	(46,992)	-
Other long-term obligations	(18,568)	(16,752)
Net cash provided (used) by operating activities	1,311,568	(557,790)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Note receivable	15,503	16,459
Capital expenditures	(325,958)	(873,519)
Net cash used in investing activities	(310,455)	(857,060)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Advances - line of credit	12,970,788	-
Repayments - line of credit	(12,924,930)	-
Repayments - reducing revolving loan	(1,000,000)	(250,000)
Accrued interest - senior subordinated secured notes	-	126,441
Net cash used in financing activities	(954,142)	(123,559)
NET CHANGE IN CASH	46,971	(1,538,409)
CASH, beginning of period	157,923	1,888,828
CASH, end of period	$ 204,894	$ 350,419

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

BIRNER DENTAL MANAGEMENT SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Six Months Ended June 30,	
	2017	2018
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest	$ 89,120	$ 150,094

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

BIRNER DENTAL MANAGEMENT SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
June 30, 2018

(1) UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The condensed consolidated financial statements included herein are unaudited and have been prepared by Birner Dental Management Services, Inc. (the "Company") pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States ("GAAP") have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures included herein are adequate to make the information presented not misleading. A description of the Company's accounting policies and other financial information is included in the audited consolidated financial statements as filed with the SEC in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments necessary to present fairly the financial position of the Company as of June 30, 2018 and the results of operations and cash flows for the periods presented. All such adjustments are of a normal recurring nature. The results of operations for the quarter and six months ended June 30, 2018 are not necessarily indicative of the results that may be achieved for a full fiscal year and cannot be used to indicate financial performance for the entire year.

(2) LIQUIDITY, GOING CONCERN, AND FINANCIAL RESOURCES UPDATE

The Company has historically operated with negative working capital and was able to meet its current obligations through operating cash flows and availability on its revolving line of credit. Recent decreases in operating cash flows led the Company to take certain actions including raising $5 million in a private placement as described below.

In July 2017, the Company received notice of events of default and acceleration from counsel to Guaranty Bank and Trust Company (the "Bank") in connection with the Loan and Security Agreement, dated as of March 29, 2016, as amended (collectively, the "Loan Agreement" or the "Credit Facility"). On December 28, 2017, following discussions and negotiations with the Bank and a number of potential investors and lenders over several months, the Company entered into a Securities Purchase Agreement (the "Securities Purchase Agreement") and completed a private placement of $5 million of convertible senior subordinated secured notes (the "Notes") and 10 attached shares of Series A Convertible Preferred Stock (the "Series A Preferred Stock") with Palm Active Dental, LLC and Palm Global Small Cap Master Fund LP (the "Palm Investors"). Also on December 28, 2017, the Company and the Bank entered into the Fifth Amendment to the Loan Agreement (the "Fifth Amendment"), under which the Company repaid approximately $1.5 million of the term loan portion and $1.1 million of the revolving line of credit of the Loan Agreement and the Bank waived all then-existing defaults, default interest, fees, and penalties under the Credit Facility. Among other things, the Fifth Amendment increased the revolving line of credit from $1.1 million to $2.0 million, extended the maturity date of the loans under the Credit Facility to March 31, 2023 and modified the repayment terms of the term loan and the EBITDA, leverage ratio and other financial covenants under the Credit Facility. Under the Credit Facility and related pledge and security agreements, the Bank has liens and security interests on substantially all of the assets of the Company. See Note 7 for additional information regarding the Notes and the Credit Facility.

The Company was not in compliance with its required EBITDA covenant under the Loan Agreement at June 30, 2018. On or before August 15, 2018, an affiliate of the Palm Investors is expected to purchase $468,000 principal amount of additional Notes and one attached share of Series A Preferred Stock to permit the Company to regain compliance with the EBITDA covenant as permitted under the Fifth Amendment. The Company also exceeded the capital expenditures covenant for the quarter ended June 30, 2018, and received a Bank waiver on August 14, 2018 in this regard.

Due to the above issues, there is substantial doubt about the Company's ability to continue as a going concern. The Company is implementing a plan to reduce expenses including wages through staff reductions and is considering the closure or sale of some of its Offices with larger losses. This plan also considers certain revenue enhancing features including increasing the productivity of its hygiene program and adding ancillary orthodontic procedures. Although the Company expects it may miss the Bank EBITDA covenant in the third quarter of 2018, the Company is currently working on contingency plans to cure the Bank EBITDA covenant if such covenant is violated. The contingency plans include amending the Credit Facility to allow for consecutive quarterly cure payments and additional private funding to make such cure payment. The Company believes its action plans will allow the Company to meet its Bank covenants beginning with the fourth quarter of 2018. The Company has prepared its business plan for the ensuing 12 months and

believes that management's plans, when implemented, will allow the Company sufficient liquidity and financial resources to operate for the ensuing 12 month period.

(3) SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation/Basis of Consolidation

The accompanying condensed consolidated financial statements have been prepared on the accrual basis of accounting. These financial statements present the financial position and results of operations of the Company and the dental offices ("Offices"), which are under the control of the Company. The Offices are organized as professional corporations ("P.C.s") and the Company provides business services to the Offices under long-term management agreements (the "Management Agreements"). All intercompany accounts and transactions have been eliminated in the consolidation.

The Company treats Offices as consolidated subsidiaries where it has a long-term and unilateral controlling financial interest over the assets and operations of the Offices. The Company maintains control of substantially all of its Offices via the Management Agreements. The Company is a business service organization and does not engage in the practice of dentistry or the provision of dental hygiene services. These services are provided by licensed professionals. Certain key features of these arrangements either enable the Company at any time and in its sole discretion to cause a change in the shareholder of the P.C. (i.e., "nominee shareholder") or allow the Company to vote the shares of stock held by the owner of the P.C. and to elect a majority of the board of directors of the P.C. The accompanying condensed consolidated statements of operations reflect revenue, which is the amount billed to patients less contractual adjustments. Direct expenses consist of all the expenses incurred in operating the Offices and paid by the Company. Under the Management Agreements, the Company assumes responsibility for the management of most aspects of the Offices' business (the Company does not engage in the practice of dentistry or the provision of dental hygiene services), including personnel recruitment and training; comprehensive administrative, business and marketing support and advice; and facilities, equipment, and support personnel as required to operate the practices.

The Company prepares its consolidated financial statements in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 810, which provides for consolidation of variable interest entities ("VIEs") of which the Company is the primary beneficiary. The Company has concluded that the P.C.s meet the definition of VIEs as defined by this standard and that the Company is the primary beneficiary of these VIEs. This conclusion was reached because the Company has the power to direct significant activities of the VIEs and the Company is obligated to absorb losses of and/or provide rights to receive benefits from the VIEs.

Revenue

Revenue is generally recognized when services are provided and is reported at estimated net realizable amounts due from insurance companies, preferred provider and health maintenance organizations (i.e., third-party payors) and patients for services rendered, net of contractual and other adjustments. Dental services are billed and collected by the Company in the name of the Offices.

Revenue under certain third-party payor agreements is subject to audit and retroactive adjustments. To the Company's knowledge, there are no material claims, disputes or other unsettled matters that exist concerning third-party reimbursements as of June 30, 2018.

Most of the Company's patients are insured under third-party payor agreements. The Company's billing system generates contractual adjustments for each patient encounter based on fee schedules for the patient's insurance plan. The services provided are attached to the patient's fee schedule based on the insurance the patient has at the time the service is provided. Therefore, the revenue that is recorded by the billing system is based on insurance contractual amounts. Additionally, each patient at the time of service signs a form agreeing that the patient is ultimately responsible for the contracted fee if the insurance company does not pay the fee for any reason.

Note Receivable

A note receivable was created as part of a dental Office acquisition, of which approximately $17,000 in principal amount was outstanding at June 30, 2018. The note has equal monthly principal and interest amortization payments and a maturity date of October 31, 2018. The note bears interest at 6%, which is accrued monthly. If the note is uncollectible, an allowance for doubtful accounts will be created. There was no allowance for doubtful accounts for the note as of June 30, 2018 or December 31, 2017.

Intangible Assets

The Company's dental practice acquisitions have involved the purchase of tangible and intangible assets and the assumption of certain liabilities of the acquired dental Offices. As part of the purchase price allocation, the Company allocated the purchase price to the tangible and identifiable intangible assets acquired and liabilities assumed, based on estimated fair market values. Costs of acquisition in excess of the net estimated fair value of tangible assets acquired and liabilities assumed were allocated to the Management Agreement related to the Office. The Management Agreement represents the Company's right to manage the Offices during the 40-year term of the Management Agreement. The assigned value of the Management Agreement is amortized using the straight-line method over a period of 25 years. Amortization remained constant at $211,000 for the quarters ended June 30, 2018 and 2017 and at $422,000 for the six months ended June 30, 2018 and 2017.

The Management Agreements cannot be terminated by a P.C. without cause, consisting primarily of bankruptcy or material default by the Company.

If facts and circumstances indicate that the carrying value of long-lived and intangible assets may be impaired, the Company will perform an evaluation of recoverability. If an evaluation is required, the estimated future undiscounted cash flows associated with the asset will be compared to the asset’s carrying amount to determine if a write-down to market value or discounted cash flow value is required. There were no impairment write-downs associated with the Company’s long-lived and intangible assets during the quarters ended June 30, 2018 and 2017.

Stock-Based Compensation Expense

The Company recognizes compensation expense on a straight line basis over the requisite service period of the award. Total stock-based compensation expense included in the Company’s condensed consolidated statements of operations for the quarters ended June 30, 2018 and 2017 was approximately $57,000 and $51,000, respectively, related to stock options and restricted stock. Total stock-based compensation expense included in the Company’s condensed consolidated statements of operations for the six months ended June 30, 2018 and 2017 was approximately $110,000 and $86,000, respectively, related to stock options. Total stock-based compensation expense was recorded as a component of corporate general and administrative expense.

The Black-Scholes option-pricing model was used to estimate the option fair values. The option-pricing model requires a number of assumptions, of which the most significant are expected stock price volatility, the expected pre-vesting forfeiture rate, expected dividend rate and the expected option term (the amount of time from the grant date until the options are exercised or expire). Expected volatility was calculated based upon actual historical stock price movements over the most recent period ended June 30, 2018 equal to the expected option term. Expected pre-vesting forfeitures were estimated based on historical pre-vesting forfeitures over the most recent period ended June 30, 2018 for the expected option term.

The fair value of restricted stock granted to independent directors in June 2017 and 2018 was calculated by taking the product of the number of shares granted times the stock price on the day the restricted stock was granted and spreading this value over the vesting period of the restricted stock.

Recent Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update (“ASU”) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* (“Topic 606”). This update established a comprehensive revenue recognition standard for virtually all industries in GAAP. Topic 606 changed the amount and timing of revenue and cost recognition, implementation, disclosures and documentation. Topic 606 could be adopted under the full retrospective method or the modified retrospective transition method. The Company adopted Topic 606 as of January 1, 2018 using the modified retrospective transition method and it did not have a material effect on its consolidated financial statements. The Company has included the disclosures required by Topic 606 in Note 4.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842).* Under the new guidance, lessees will be required to recognize assets and liabilities on the balance sheet for the rights and obligations created by all leases with terms of more than 12 months. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018. The Company anticipates the adoption of ASU 2016-02 will have a material impact on its consolidated financial statements by increasing both total assets and total liabilities on the balance sheet.

(4) REVENUE

On January 1, 2018, the Company adopted Topic 606 using the modified retrospective method applied to all contracts as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts are not adjusted and continue to be reported in accordance with the Company's historical accounting under prior guidance. The Company's revenue includes premium and service revenues. Service revenue includes net patient revenue that is recorded based upon established billing rates, less allowances for contractual adjustments, and are recognized as services are provided. The Company identified service revenue associated with the placement of orthodontic braces and crown and bridge procedures as contracts that are affected by the adoption of Topic 606. For these two revenue streams, the Company identified distinct performance obligations for the placement of braces and for crown and bridge procedures and allocated transaction prices to these performance obligations using the available observable data and bottom up methods.

Under Topic 606, for contracts involving orthodontic procedures, the Company recognizes 40% of the contract amount when the orthodontic braces are initially placed on the patient, 45% of the contract amount monthly during the average 20 month term of the contract, and a final 15% of the contract amount in the last month of the contract. This coincides with the Company's analysis of the required performance obligations under the Company's orthodontic service revenue contracts.

Under Topic 606, for crown and bridge procedures, revenue associated with the final placement of the permanent crown will be recognized at the point in time this performance obligation is satisfied.

The Company recorded a net decrease to the opening accumulated deficit of approximately $225,000 as of January 1, 2018 due to the cumulative impact to revenue and cost of sales of adopting Topic 606, with the impact primarily related to revenue related to orthodontic brace and crown and bridge procedures.

See the table below for the overall net effect of the change in the Company's revenue recognition procedures.

	Balance Sheet as of 12/31/2017 As Reported	Effect of the Adoption of ASC Topic 606	Balance Sheet as of 1/1/2018 As Adjusted
Accounts Receivable	3,772,514	444,294	4,216,808
Accrued Expenses	777,863	(12,825)	765,038
Accrued Payroll	2,009,720	157,640	2,167,360
Deferred Income Taxes Payable	101,482	74,870	176,352
Accumulated Deficit	3,833,947	(224,609)	3,609,338

	12 Months Ended 12/31/2016 As Reported	Effect of the Adoption of ASC Topic 606	12 Months Ended 12/31/2016 As Adjusted
Revenue	61,762,294	283,570	62,045,864
Direct Expenses	59,920,759	86,050	60,006,809
Contribution From Dental Offices	1,841,535	197,520	2,039,055
Coporate Expenses	3,727,470	-	3,727,470
Operating Loss	(1,885,935)	197,520	(1,688,415)
Interest Expense	253,940	-	253,940
Loss Before Income Taxes	(2,139,875)	197,520	(1,942,355)
Income Tax Expense / (Benefit)	(753,973)	49,380	(704,593)
Net Loss	(1,385,902)	148,140	(1,237,762)

	12 Months Ended 12/31/2017 As Reported	Effect of the Adoption of ASC Topic 606	12 Months Ended 12/31/2017 As Adjusted
Revenue	60,712,404	160,723	60,873,127
Direct Expenses	59,851,062	58,766	59,909,828
Contribution From Dental Offices	861,342	101,957	963,299
Coporate Expenses	4,186,859	-	4,186,859
Operating Loss	(3,325,517)	101,957	(3,223,560)
Interest Expense	443,640	-	443,640
Loss Before Income Taxes	(3,769,157)	101,957	(3,667,200)
Income Tax Expense / (Benefit)	(1,119,926)	25,489	(1,094,437)
Net Loss	(2,649,231)	76,468	(2,572,763)

(5) LOSS PER SHARE

The Company calculates net loss per share ("EPS") in accordance with ASC Topic 260.

	Quarters Ended June 30,					
	2017			2018		
	Net Loss	Shares	Per Share Amount	Net Loss	Shares	Per Share Amount
Basic EPS	$ (901,274)	1,866,580	$ (0.48)	$ (1,271,692)	1,875,245	$ (0.68)
Effect of Dilutive Stock Options	-	-	-	-	-	-
Diluted EPS	$ (901,274)	1,866,580	$ (0.48)	$ (1,271,692)	1,875,245	$ (0.68)

For the quarters ended June 30, 2018 and 2017, options to purchase 516,500 and 540,166 shares, respectively, of the Company's common stock ("Common Stock") were not included in the computation of diluted EPS because their effect was anti-dilutive.

	Six Months Ended June 30,					
	2017			2018		
	Net Loss	Shares	Per Share Amount	Net Loss	Shares	Per Share Amount
Basic EPS	$ (1,126,332)	1,863,746	$ (0.60)	$ (1,749,684)	1,874,971	$ (0.93)
Effect of Dilutive Stock Options	-	-	-	-	-	-
Diluted EPS	$ (1,126,332)	1,863,746	$ (0.60)	$ (1,749,684)	1,874,971	$ (0.93)

For the six months ended June 30, 2018 and 2017, options to purchase 516,500 and 540,166 shares, respectively, of Common Stock were not included in the computation of diluted EPS because their effect was anti-dilutive.

(6) STOCK-BASED COMPENSATION PLANS

The Company's 2005 Equity Incentive Plan, as amended ("2005 Plan"), terminated in March 2015. The 2005 Plan provided for the grant of incentive stock options, restricted stock, restricted stock units and stock grants to eligible employees (including officers and employee-directors) and non-statutory stock options to eligible employees, directors and consultants. As of June 30, 2018, there were 297,500 vested options and 2,500 unvested options granted under the 2005 Plan that remained outstanding in accordance with their terms and there were no shares available for issuance under the 2005 Plan due to its termination.

The Company's shareholders approved the 2015 Equity Incentive Plan ("2015 Plan") in June 2015. The 2015 Plan replaced the 2005 Plan. The Company's shareholders approved an amendment to the 2015 Plan at the June 2018 annual meeting of shareholders to reserve an additional 200,000 shares of Common Stock for issuance. After this amendment, the maximum number of shares of Common Stock that may be delivered to participants and their beneficiaries under the 2015 Plan is 400,000. The 2015 Plan provides for the grant of incentive stock options, stock appreciation right awards, restricted stock awards, stock unit awards and other stock-based awards to eligible recipients. The objectives of the 2015 Plan are to attract and retain the best possible candidates for positions of responsibility and provide for additional performance incentives by providing eligible individuals with the opportunity to acquire equity in the Company. The 2015 Plan is administered by a committee (the "Committee") of two or more outside directors from the Company's Board of Directors (the "Board"). The Committee determines the eligible individuals to whom awards under the 2015 Plan may be granted, as well as the time or times at which awards will be granted, the number of shares subject to awards to be granted to any eligible individual, the term of the award, vesting terms and conditions and any other terms and conditions of the grant in addition to those contained in the 2015 Plan. Each grant under the 2015 Plan

will be confirmed by and subject to the terms of an award agreement. As of June 30, 2018, there were 49,834 vested options and 166,666 unvested options granted under the 2015 Plan. On June 20, 2017 and June 20, 2018, the independent directors of the Board were granted 2,000 shares each of restricted Common Stock pursuant to the 2015 Plan. Fifty percent of the shares vest 12 months from the grant date, and the remaining shares vest 24 months from the grant date. As of June 30, 2018, 161,500 shares were available for issuance under the 2015 Plan.

The Company uses the Black-Scholes option-pricing model to estimate the fair value of each option granted with the following weighted average assumptions:

	Quarters Ended June 30,		Six Months Ended June 30,	
Valuation Assumptions	2017	2018	2017	2018
Expected life [1]	4.97	4.00	4.58	4.22
Risk-free interest rate [2]	1.75%	2.72%	1.79%	2.70%
Expected volatility [3]	50%	88%	50%	85%
Expected dividend yield	0.00%	0.00%	0.00%	0.00%
Expected forfeiture [4]	0.86%	30.00%	12.51%	30.00%

[1] The expected life, in years, of stock options is estimated based on historical experience.
[2] The risk-free interest rate is based on U.S. Treasury bills whose term is consistent with the expected life of the stock options.
[3] The expected volatility is estimated based on historical and current stock price data for the Company.
[4] Forfeitures are estimated based on historical experience.

A summary of option activity as of June 30, 2018, and changes during the quarter then ended, is presented below:

	Number of Options	Weighted-Average Exercise Price	Range of Exercise Prices	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (thousands)
Outstanding at January 1, 2018	560,666	$ 14.99	$ 4.30 - $19.75	3.4	$ 55
Granted	45,000	$ 7.67	$ 7.00 - $8.00		
Cancelled	(89,166)	$ 18.48	$ 4.30 - $19.75		
Outstanding at June 30, 2018	516,500	$ 13.75	$ 4.30 - $18.95	3.7	$ 24
Exercisable at June 30, 2018	347,334	$ 15.58	$ 10.04 - $18.95	2.6	$ -

The weighted average grant date fair values of options granted during the quarters ended June 30, 2018 and 2017 were $4.86 per share and $5.68 per share, respectively. As of June 30, 2018, there was approximately $504,000 of total unrecognized compensation expense related to non-vested stock options, which is expected to be recognized over a weighted average period of 2.62 years.

A summary of restricted stock activity as of June 30, 2018, and changes during the quarter then ended, is presented below:

	Shares	Weighted-Average Grant-Date Fair-Value
Balance at January 1, 2018	8,000	$ 13.50
Granted	12,000	$ 5.50
Vested	(4,000)	$ 13.50
Balance at June 30, 2018	16,000	$ 7.50

As of June 30, 2018, total unrecognized share-based compensation expense from unvested restricted stock was $117,000 which is expected to be recognized over a weighted average period of approximately 1.52 years. As of June 30, 2018, 16,000 shares were expected to vest in the future.

(7) DEBT

On December 28, 2017, the Company and the Bank entered into the Fifth Amendment, under which the Company repaid approximately $1.5 million of the term loan portion and approximately $1.1 million of the revolving line of credit of the Credit Facility with net proceeds of the private placement discussed below, and the Bank waived all outstanding defaults, default interest, fees, and penalties under the Credit Facility. Among other things, the Fifth Amendment increased the revolving line of credit from $1.1 million to $2.0 million, extended the maturity date of the loans under the Credit Facility to March 31, 2023, and modified the repayment terms of the term loan and the EBITDA, leverage ratio and other financial covenants under the Credit Facility. The outstanding principal balance of the Term Loan (as defined in the Credit Facility) was $6.25 million as of June 30, 2018, and no amounts were drawn on the $2.0 million revolving line of credit as of June 30, 2018.

Under the Fifth Amendment, the Term Loan bears interest as follows:

Funded Debt / EBITDA (each as defined in the Fifth Amendment)	**LIBOR SPREAD**
Greater than 3.0	LIBOR + 3.75%
Less than or equal to 3.0 but greater than 2.5	LIBOR + 3.25%
Less than or equal to 2.5 but greater than 2.0	LIBOR + 2.90%
Less than or equal to 2.0	LIBOR + 2.50%

Effective January 1, 2018, a commitment fee on the average daily unused amount of the revolving line of credit is assessed each quarter in the amount of 0.25% per annum.

The Company must pay the unpaid principal balance of the Term Loan as follows: (i) $125,000 on the last day of each calendar quarter in 2018, (ii) $100,000 on or before the date that is 30 days after the date the Form 10-Q for the second fiscal quarter of 2018 is filed by the Company with the SEC but only if EBITDA (as defined in the Fifth Amendment) measured for the 12 months ending June 30, 2018 is equal to or more than $2,400,000, (iii) $175,000 on March 31, 2019 and June 30, 2019, (iv) $100,000 on or before the date that is 30 days after the date the Form 10-Q for the second fiscal quarter of 2019 is filed by the Company with the SEC, but only if EBITDA measured for the 12 months ending June 30, 2019 is equal to or more than $3,000,000, (v) $200,000 on September 30, 2019 and December 31, 2019, and (vi) $250,000 on the last day of each calendar quarter thereafter, commencing with March 31, 2020, with a final payment in an aggregate amount equal to the unpaid principal balance of the Term Loan on March 31, 2023. In addition, the Company must make mandatory prepayments commencing with the quarter ending September 30, 2019 equal to the

"Excess Cash Flow Amount" as defined in the Fifth Amendment. In any event, the Company must make payments so that the principal balance of the Term Loan is $5,750,000 as of December 31, 2018, $4,750,000 as of December 31, 2019, $3,600,000 as of December 31, 2020, $2,100,000 as of December 31, 2021, and $750,000 as of December 31, 2022.

For the six months ended June 30, 2018, the Company's EBITDA was $366,000, and was $432,000 after adding back Bank-allowed one-time expenses of $66,000 related to accounting and valuation consulting services the Company utilized in connection with the $5 million financing completed in December 2017, which was less than the required Bank covenant amount of $900,000. On or before August 15, 2018, an affiliate of the Palm Investors will purchase $468,000 principal amount of additional Notes and attached Series A Preferred Stock to permit the Company to regain compliance with the EBITDA covenant as permitted under the Fifth Amendment. Due to these facts, all Bank debt totaling approximately $6.2 million is classified as current as of June 30, 2018.

Convertible Senior Subordinated Secured Notes

On December 28, 2017, the Company entered into the Securities Purchase Agreement with the Palm Investors. Under the Securities Purchase Agreement, the Company sold Notes in the aggregate principal amount of $4,990,000 together with 10 attached shares of Series A Preferred Stock for $1,000 per share. The Company used approximately $2.6 million of the net proceeds under the Securities Purchase Agreement to repay the Bank as described above. The balance of the net proceeds are being used for vendor payments, working capital, capital expenditures, and other general corporate purposes. The Notes and attached shares of Series A Preferred Stock are convertible at the option of the holders into shares of Series B Convertible Preferred Stock ("Series B Preferred Stock"), which in turn are convertible at the option of the holders into shares of the Company's Common Stock at a price of $5.00 per share. Assuming (i) the conversion of the Notes and Series A Preferred Stock into Series B Preferred Stock and (ii) conversion of the Series B Preferred Stock into Common Stock and without including conversion of the additional Notes and Series A Preferred Stock to be purchased by an affiliate of the Palm Investors discussed above, the Palm Investors beneficially own in the aggregate 1,000,000 shares of Common Stock, representing approximately 34.8% of the Company's outstanding shares of Common Stock.

Upon the occurrence of a Fundamental Transaction, as defined in the Notes, the Company must repay all unpaid principal amount of the Notes plus an amount equal to all accrued and unpaid interest and the amount of interest that would have been paid from the date of such repayment through the maturity date had the Notes remained outstanding to such date (a "Mandatory Prepayment"). A Fundamental Transaction includes, among other things, one or more related transactions that result in holders of the Company's Common Stock immediately prior to such transactions owning 50% or less of the surviving company or owning relative interests in the surviving company that are not substantially the same as prior to such transactions, liquidation or dissolution of the Company, or a change in the majority of the Board over a 12 month period. Other than in connection with a Mandatory Prepayment, the Notes may not be prepaid by the Company without the consent of holders of the majority of the Notes.

The Notes mature on September 30, 2023 and accrue interest on a quarterly basis at a rate of 5% per annum until December 28, 2020. Thereafter, interest accrues on a quarterly basis at a rate of (i) 5% per annum if the VWAP (as defined in the Notes) for each of any 30 consecutive Trading Days (as defined in the Notes) during the immediately preceding quarter is less than $15 per share of Common Stock, (ii) 2.5% per annum if the VWAP for each of any 30 consecutive Trading Days during the immediately preceding quarter is equal to or greater than $15 per share of Common Stock and equal to or less than $20 per share of Common Stock, and (iii) 0% if the VWAP for each of any 30 consecutive Trading Days during the immediately preceding quarter exceeds $20 per share of Common Stock. Subject to the terms of the Subordination Agreement (described below), which prohibits the payment of cash interest unless the Total Cash Flow Leverage Ratio, as defined in the Fifth Amendment, is less than 2:1, the Company has the option to pay interest in cash or by increasing the principal amount of the Notes in the amount of any unpaid and accrued interest. Approximately $126,000 was recognized as interest expense during the six months ended June 30, 2018 and the increased liability is included in convertible senior subordinated secured notes, net on the accompanying condensed consolidated balance sheets.

Certain terms of the Notes (the "Embedded Derivatives") meet the definition of a derivative that requires bifurcation from the Notes and separate accounting under ASC Topic 815, *Derivatives and Hedging*. The Embedded Derivatives consist of variable interest rate and make-whole features. Because the Embedded Derivatives are to be classified together as a liability and separated from the Notes, the Company recognized a discount on the Notes as of the closing date of approximately $170,000, which will be amortized to interest expense over the term of the Notes. As of June 30, 2018, the fair value of the Embedded Derivatives approximated the fair value at the date of issuance and is included in other long-term obligations in the accompanying condensed consolidated balance sheets. See Note 8 for additional information regarding the Embedded Derivatives.

Concurrent with the Securities Purchase Agreement and the Fifth Amendment, the Company, the Bank and the Palm Investors entered into a Subordination Agreement and the Company and the Palm Investors entered into a Security Agreement and Registration Rights Agreement. Under the Subordination Agreement, the Palm Investors and their successors in interest subordinated their rights under the Notes, the Series A Preferred Stock and the Series B Preferred Stock to the Bank in respect of the Credit Facility. Under the Security Agreement, the Company granted the holders of the Notes a subordinate security interest in substantially all of the Company's assets. Under the Registration Rights Agreement, the Company granted the Palm Investors and their successors in interest the right to demand registration under the Securities Act of 1933, as amended, of the resale of the shares of Common Stock underlying the Series B Preferred Stock. The Company also granted certain "piggy-back" registration rights in the Registration Rights Agreement.

If the Company fails to meet certain performance targets set forth in the Securities Purchase Agreement, the Palm Investors have the exclusive right, voting separately as a class, to designate to the Board a third Palm Investor director, in which case the Board must take all actions necessary to cause and accept the resignation of one additional current director and cause such third Palm Investor director to be appointed as a director. Further, if the Company (a) fails to meet any of the modified performance targets set forth in the Securities Purchase Agreement or (b) fails to comply with a financial covenant under the Loan Agreement, the Board is required to immediately form a special committee of the Board with (i) the power to initiate searches for, and to recruit, retain or replace the Chief Executive Officer, Chief Financial Officer and Chief Operating Officer of the Company, (ii) the ability to retain an executive search firm, at the Company's expense, to manage any search for Chief Executive Officer, Chief Financial Officer and Chief Operating Officer initiated by the search committee, and (iii) the ability to engage such advisors, at the Company's expense, as necessary to assist with the search committee's efforts. Any search committee created due to the Company's failure to meet any of the modified performance targets will be chaired by one of the Palm Investor directors and consist solely of independent directors, while any search committee created due to the Company's failure to comply with the financial covenants will be composed of a majority of Palm Investor directors.

The Company failed to meet certain performance targets as of June 30, 2018. As a result, on July 16, 2018, Paul Valuck D.D.S. resigned from the Board and Burton J. Rubin was appointed to the Board representing the third Palm Investor director. In addition, the Board has formed a search committee for the purposes described above.

(8) DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

ASC Topic 825, "Disclosures About Fair Value of Financial Instruments," requires disclosure about the fair value of financial instruments. Carrying amounts for all financial instruments included in current assets and current liabilities approximate estimated fair values due to the short maturity of those instruments. The fair values of the Company's long-term debt are based on similar rates currently available to the Company. The Company believes the book value approximates fair value for the notes receivable.

The Company follows ASC Topic 820, "Fair Value Measurements and Disclosures," which defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosures about fair value measurements. The statement establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company's assumptions of what market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the reliability of the inputs as follows:

Level 1: Quoted prices are available in active markets for identical assets or liabilities.

Level 2: Quoted prices in active markets for similar assets and liabilities that are observable for the asset or liability; or

Level 3: Unobservable pricing inputs that are generally less observable from objective sources, such as discounted cash flow models or valuations.

ASC Topic 820 requires financial assets and liabilities to be classified based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of the fair value of assets and liabilities and their

placement within the fair value hierarchy levels. There were no transfers between the fair value hierarchy levels during the quarters ended June 30, 2018 and 2017.

The following table represents the Company's financial assets and liabilities that were accounted for at fair value on a recurring basis as of December 31, 2017 and June 30, 2018 by level within the fair value hierarchy:

	December 31, 2017 Fair Value Measurement Using			June 30, 2018 Fair Value Measurement Using		
	Level 1	**Level 2**	**Level 3**	**Level 1**	**Level 2**	**Level 3**
Contingent Liabilities	$ -	$ -	$ 321,000	$ -	$ -	$ 321,000
Embeded Derivatives derived from the Notes	$ -	$ -	$ 170,000	$ -	$ -	$ 420,000

Contingent Liabilities

As part of an Office acquisition completed in 2009, the Company recorded contingent liabilities to recognize an estimated amount to be paid as part of the acquisition agreement. These contingent liabilities are recorded at estimated fair values as of the date of acquisition, are payable upon the exercise of a put option by the seller beginning four years after the acquisition date and no later than ten years after the acquisition date, and are calculated at a multiple of the then trailing 12 months' operating cash flows. The Company remeasures the contingent liability to fair value each reporting date until the contingency is resolved. Any changes to the fair value are recognized into the income statement when determined. As of June 30, 2018, approximately $321,000 of contingent liabilities were recorded on the condensed consolidated balance sheets in other long-term obligations.

Embedded Derivatives derived from the Notes are a derivative liability bifurcated from the Notes, as described in Note 7. The fair value of the Embedded Derivatives was determined as the difference in the fair values of the Notes with and without the embedded features. The fair value analysis utilized Monte Carlo simulations and probability-weighted discounted cash flow valuation techniques, which included the use of significant unobservable inputs. Those inputs included assumptions regarding the likelihood of occurrence of a Fundamental Transaction and projected financial results of the Company over the term of the Notes. Other significant inputs included the Company's historical stock price volatility and risk-adjusted borrowing rates.

Sensitivity of Significant Unobservable Inputs

The following is a discussion of the sensitivity of significant unobservable inputs, the interrelationships between those inputs and other unobservable inputs used in recurring fair value measurement and how those inputs might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement.

Contingent liabilities

The significant unobservable input used in fair value measurement of the Company's contingent liability is the operating cash flow of one Office where the dentist has a put option whose value is calculated based on that Office's operating cash flow over a 12 month period. A significant increase or decrease in the performance of this Office would result in a significant change in the fair value measurement.

Embedded Derivatives derived from the Notes

The significant unobservable input used in fair value measurement of the Company's Embedded Derivatives derived from the Notes is the estimated likelihood of a Fundamental Transaction. A significant increase or decrease in the likelihood of a Fundamental Transaction taking place would result in a significant change in the fair value measurement.

(9) STOCK ISSUANCES

During the quarter ended June 30, 2017, the Company issued 12,500 shares of Common Stock under a settlement agreement with an activist shareholder group. The shares were valued at $175,000 based on the closing price of the Common Stock on the date of the grant.

On June 20, 2017 and June 20, 2018, the independent directors of the Board of Directors were granted 2,000 shares each of restricted Common Stock pursuant to the 2015 Plan. Fifty percent of the shares vest 12 months from the grant date, and the remaining shares vest 24 months from the grant date.

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

Forward-Looking Statements

The statements contained in this report that are not historical in nature are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical fact, included in this report that address activities, events or developments that we expect, believe, intend or anticipate will or may occur in the future, are forward-looking statements. When used in this document, the words "estimate," "believe," "anticipate," "project" and similar expressions are intended to identify forward-looking statements. Forward-looking statements are inherently subject to risks and uncertainties, many of which cannot be predicted with accuracy and some of which might not even be anticipated. These forward-looking statements include statements in this Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations," regarding intent, belief or current expectations of the Company or its officers with respect to the Company's prospects and performance in future periods, including improvement in operating results, revenue and Adjusted EBITDA (as defined herein), the amount of bank debt, compliance with debt covenants, performance of *de novo* offices, the payment or nonpayment of dividends on its Common Stock, dentist count, dentist turnover and recruitment, dentist productivity, new patient visits and patient flow and the impact of certain shareholder matters.

Investors and prospective investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties. Such forward-looking statements involve certain risks and uncertainties that could cause actual results to differ materially from anticipated results. These risks and uncertainties include the failure to successfully recruit, retain and integrate dentists and other employees, the Company's indebtedness and potential actions by its lending bank or the holders of its convertible securities, financial and credit markets and the availability of capital, actions by shareholders, competition, regulatory constraints, changes in health care laws and other laws or regulations concerning the practice of dentistry or dental service organizations, the availability of suitable locations within the Company's markets, changes in the Company's strategy, the general economy of the United States and the specific markets in which the Company's dental practices are located, trends and other developments in the health care, dental care and managed care industries, as well as the risk factors set forth in Item 1A. "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2017, and other factors as may be identified from time to time in the Company's filings with the Securities and Exchange Commission ("SEC") or in the Company's press releases.

General

The following discussion relates to factors that have affected the results of operations and financial condition of the Company for the quarters and six months ended June 30, 2018 and 2017. This information should be read in conjunction with the Company's condensed consolidated financial statements and related notes thereto included elsewhere in this report.

Overview

The Company was formed in May 1995 and currently manages 68 Offices in Colorado, New Mexico and Arizona staffed by 78 general dentists and 26 specialists. The Company derives all of its revenue from its Management Agreements with professional corporations ("P.C.s"), which conduct the practice at each Office. In addition, the Company assumes a number of responsibilities when it develops a *de novo* Office or acquires an existing dental practice. These responsibilities are set forth in a Management Agreement, as described below.

The Company was formed with the intention of becoming the leading provider of business services to dental practices in Colorado. The Company's growth and success in the Colorado market led to its expansion into the New Mexico and Arizona markets. The Company's growth strategy is to focus on greater utilization of existing physical capacity through recruiting more dentists and support staff and through development of *de novo* Offices and selective acquisitions.

Recent Business Developments

The Company's management and Board, which now includes three representatives of the Palm Investors, including one newly appointed director with 22 years of experience with dental service organizations, and two directors who were appointed in 2017 in connection with settlement of a potential proxy contest, are intensely focused on improving the Company's financial performance and otherwise enhancing shareholder value. In addition to promoting GOLD STANDARD patient care and service every day with every patient throughout the organization, management and the Board are actively supporting efforts not only to recruit dentists to increase the dentist count but also to retain the best dental professionals in the country through attractive compensation and benefits arrangements and support of dentists to grow their practices. The Company also is looking to improve dentist and hygiene productivity through focused scheduling, training and extended office hours. In June 2018, the Company hired an experienced Director of Hygiene to enhance the growth and profitability of the Company's hygiene practice. The Company also is undertaking targeted technology improvements and capital expenditures, including converting all Offices to digital radiography and a complete redesign of the Company's website scheduled to launch in September 2018. To further improve Office productivity, the Company has recently implemented a new formalized training program for its Office operations managers and has made improvements to its accounts receivable and collections processes.

As of June 30, 2018 the Company had 104 dentists in its network compared to 99 at June 30, 2017 and 112 at December 31, 2017. The Company remains focused on seeking to increase its dentist count to more fully utilize its Office capacity.

Management and the Board are also continuously seeking to reduce expenses. On February 1, 2017, the Company's Chief Executive Officer, Chief Financial Officer and outside directors all took 20 percent reductions in base salary and director fees, respectively, amounting to approximately $175,000 in annual expense savings. On July 1, 2018, the Company's Chief Executive Officer, Chief Financial Officer and Chief Dental Officer took further reductions in base salary aggregating $100,000 annually. Additionally, one of the Company's two offices in Fort Collins, Colorado that had negative Adjusted EBITDA of $78,000 in 2016 was consolidated with a newer second office at the end of January 2017. The Company has taken other actions to reduce expenses and improve profitability. These efforts, which commenced in September 2017, included suspension of certain bonus programs and the Company's contribution to the 401(k) plan along with the elimination of certain support personnel in the dental offices. The Company and the Board are aggressively considering other actions to reduce expenses and improve profitability including the sale of one of its Colorado Offices that had negative Adjusted EBITDA of $100,000 during the six months ending June 30, 2018 and the closure or sale of other unprofitable Offices, a broad review of the Company's staffing requirements and increasing dentist and hygienist productivity.

The Company continues to experience strong patient flow with new patient visits up 3.2% in the first six months of 2018 compared to the first six months of 2017 and total patient visits up 3.5% in the first six months of 2018 compared to the first six months of 2017.

In January 2016, the Company started the process of credentialing some of its Offices for Medicaid, a revenue source that the Company had not previously accessed. As of June 30, 2018, the Company had 29 Offices credentialed for Medicaid in Colorado and six Offices credentialed for Medicaid in New Mexico. Revenue from Medicaid accounted for 3.4% of the Company's revenue in the six months ended June 30, 2017 and 5.4% of revenue in the six months ended June 30, 2018. The Company expects revenue from Medicaid to continue to increase in 2018.

Critical Accounting Policies

The Company's critical accounting policies are set forth in its Annual Report on Form 10-K for the year ended December 31, 2017. There have been no significant changes to these policies since the filing of that report.

Components of Revenue and Expenses

Revenue represents the revenue of the Offices, reported at estimated realizable amounts, received from third-party payors and patients for dental services rendered at the Offices, net of contractual and other adjustments. Substantially all of the Company's patients are insured under third-party payor agreements. The Company's billing system generates contractual adjustments for each patient encounter based on fee schedules for the patient's insurance plan. The services provided are attached to the patient's fee schedule based on the insurance the patient has at the time the service is provided. Therefore, the revenue that is recorded by the billing system is based on insurance contractual amounts. Additionally, each patient at the time of service signs a form agreeing that the patient is ultimately responsible for the contracted fee if the insurance company does not pay the fee for any reason.

Direct expenses consist of clinical salaries and benefits paid to dentists, dental hygienists and dental assistants and the expenses incurred by the Company in connection with managing the Offices, including salaries and benefits of other employees at the Offices, supplies, laboratory fees, occupancy costs, advertising and marketing, depreciation and amortization and general and administrative expenses (including office supplies, equipment leases, management information systems and other expenses related to dental practice operations). The Company also incurs personnel and administrative expenses in connection with maintaining a corporate function that provides management, administrative, marketing, development and professional services to the Offices.

Under each of the Management Agreements, the Company provides business and marketing services at the Offices, including (i) providing capital, (ii) designing and implementing advertising and marketing programs, (iii) negotiating for the purchase of supplies, (iv) staffing, (v) recruiting, (vi) training of non-dental personnel, (vii) billing and collecting patient fees, (viii) arranging for certain legal and accounting services and (ix) negotiating with managed care organizations. The P.C. is responsible for, among other things, (i) supervision of all dentists, dental hygienists and dental assistants, (ii) complying with all laws, rules and regulations relating to dentists, dental hygienists and dental assistants and (iii) maintaining proper patient records. The Company has made, and intends to make in the future, loans to P.C.s to fund their acquisition of dental assets from third parties in order to comply with state dental practice laws. Because the Company's financial statements are consolidated with the financial statements of the P.C.s, these loans are eliminated in consolidation.

Under the typical Management Agreement, the P.C. pays the Company a management fee equal to the Adjusted Gross Center Revenue of the P.C. less compensation paid to the dentists, dental hygienists and dental assistants employed at the Office of the P.C. Adjusted Gross Center Revenue is comprised of all fees and charges booked each month by or on behalf of the P.C. as a result of dental services provided to patients at the Office, less any adjustments for uncollectible accounts, professional courtesies and other activities that do not generate a collectible fee. The Company's costs include all direct and indirect costs, overhead and expenses relating to the Company's provision of management services to the Office under the Management Agreement, including (i) salaries, benefits and other direct costs of Company employees who work at the Office, (ii) direct costs of all Company employees or consultants who provide services to or in connection with the Office, (iii) utilities, janitorial, laboratory, supplies, advertising and other expenses incurred by the Company in carrying out its obligations under the Management Agreement, (iv) depreciation expense associated with the P.C.'s assets and the assets of the Company used at the Office, and the amortization of intangible asset value relating to the Office, (v) interest expense on indebtedness incurred by the Company to finance any of its obligations under the Management Agreement, (vi) general and malpractice insurance expenses, lease expenses and dentist recruitment expenses, (vii) personal property and other taxes assessed on the Company's or the P.C.'s assets used in connection with the operation of the Office, (viii) out-of-pocket expenses of the Company's personnel related to mergers or acquisitions involving the P.C., (ix) corporate overhead charges or any other expenses of the Company including the P.C.'s pro rata share of the expenses of the accounting and computer services provided by the Company, and (x) a collection reserve in the amount of 5.0% of Adjusted Gross Center Revenue. As a result, substantially all costs associated with the provision of dental services at the Office are borne by the Company, except for the compensation of the dentists, dental hygienists and dental assistants who work at the Office. This enables the Company to manage the profitability of the Offices. Each Management Agreement is for a term of 40 years. Each Management Agreement generally may be terminated by the P.C. only for cause, which includes a material default by or bankruptcy of the Company. Upon expiration or termination of a Management Agreement by either party, the P.C. must satisfy all obligations it has to the Company.

Revenue is derived principally from fee-for-service revenue and revenue from capitated managed dental care plans. Fee-for-service revenue consists of P.C. revenue received from indemnity dental plans, preferred provider plans and direct payments by patients not covered by any third-party payment arrangement. Managed dental care revenue consists of P.C. revenue received from capitated managed dental care plans, including capitation payments and patient co-payments. Capitated managed dental care contracts are between dental benefits organizations and the P.C.s. Under the Management Agreements, the Company negotiates and administers these contracts on behalf of the P.C.s. Under a capitated managed dental care contract, the dental group practice provides dental services to the members of the dental benefits organization and receives a fixed monthly capitation payment for each plan member covered for a specific schedule of services regardless of the quantity or cost of services to the participating dental group practice obligated to provide them. This arrangement shifts the risk of utilization of these services to the dental group practice providing the dental services. Because the Company assumes responsibility under the Management Agreements for all aspects of the operation of the dental practices (other than the practice of dentistry) and thus bears all costs of the P.C.s associated with the provision of dental services at the Office (other than compensation of dentists, dental hygienists and dental assistants), the risk of over-utilization of dental services at the Office under capitated managed dental care plans is effectively shifted to the Company. In addition, dental group practices participating in a capitated managed dental care plan often receive supplemental payments for more complicated or elective procedures. In contrast, under traditional indemnity insurance arrangements, the insurance company pays whatever reasonable charges are billed by the dental group practice for the dental services provided.

The Company seeks to increase its revenue by increasing the patient volume at existing Offices through effective advertising and marketing programs and by adding additional specialty services. The Company in the past also sought to increase revenue by opening *de novo* Offices and by making selective acquisitions of dental practices. The Company seeks to supplement fee-for-service revenue with revenue from contracts with capitated managed dental care plans. Although the Company's fee-for-service business generally provides a greater margin than its capitated managed dental care business, capitated managed dental care business increases facility utilization and dentist productivity. The relative percentage of the Company's revenue derived from fee-for-service business and capitated managed dental care contracts varies from market to market depending on the availability of capitated managed dental care contracts in any particular market and the Company's ability to negotiate favorable contractual terms. In addition, the profitability of capitated managed dental care revenue varies from market to market depending on the level of capitation payments and co-payments in proportion to the level of benefits required to be provided.

The Company's policy is to collect any patient co-payments at the time the service is provided. If the patient owes additional amounts that are not covered by insurance, Offices collect by sending monthly invoices, placing phone calls and sending collection letters. Interest at 18% per annum is charged on all account balances greater than 90 days old. Patient accounts receivable that are over 120 days past due and that appear to not be collectible are written off as bad debt, and those in excess of $100 are sent to an outside collections agency.

Results of Operations

For the quarter ended June 30, 2018, revenue increased $575,000, or 3.9%, to $15.4 million compared to $14.8 million for the quarter ended June 30, 2017. For the quarter ended June 30, 2018, net loss increased $370,000 to $(1.3 million), or $(.68) per share, compared to $(901,000), or $(0.48) per share, for the quarter ended June 30, 2017. The quarter ended June 30, 2018 was negatively impacted by a remeasurement and subsequent increase in value of $250,000 of the Embedded Derivatives, which the Company recognized as other expense, and an allowance for the deferred tax asset amount of $243,000.

For the six months ended June 30, 2018, revenue increased $735,000, or 2.4%, to $31.2 million compared to $30.4 million for the six months ended June 30, 2017. For the six months ended June 30, 2018, net loss increased $623,000 to $(1.7 million), or $(.93) per share, compared to $(1.1 million), or $(0.60) per share, for the six months ended June 30, 2017. The six months ended June 30, 2018 was negatively impacted by a remeasurement and subsequent increase in value of $250,000 of the Embedded Derivatives, which the Company recognized as other expense, and an allowance for the deferred tax asset amount of $243,000.

The Company continues to experience strong patient flow with new patient visits up 3.2% in the first six months of 2018 compared to the first six months of 2017 and total patient visits up 3.5% in the first six months of 2018 compared to the first six months of 2017. The Company had 104 dentists at June 30, 2018 compared to 112 dentists at December 31, 2017 and 99 dentists at June 30, 2017.

During the first six months of 2018, the Company used $558,000 of cash from operations. During this period, the Company had capital expenditures of approximately $874,000 and decreased total bank debt by $250,000.

The Company's Adjusted EBITDA decreased $265,000, or 42.0%, to $366,000 for the six months ended June 30, 2018 compared to $632,000 for the six months ended June 30, 2017. Although Adjusted EBITDA is not a GAAP measure of performance or liquidity, the Company believes that it may be useful to an investor in evaluating the Company's ability to meet future debt service, capital expenditures and working capital requirements. However, investors should not consider this measure in isolation or as a substitute for operating income, cash flows from operating activities or any other measure for determining the Company's operating performance or liquidity that is calculated in accordance with GAAP. In addition, because Adjusted EBITDA is not calculated in accordance with GAAP, it may not necessarily be comparable to similarly titled measures employed by other companies. A reconciliation of Adjusted EBITDA to net loss is made by adding depreciation and amortization expense - Offices, depreciation and amortization expense – Corporate, stock-based compensation expense, interest expense, net, stock grant expense, increase in valuation of embedded derivatives and income tax benefit to net loss as in the following table:

	Quarters Ended June 30,		Six Months Ended June 30,	
	2017	2018	2017	2018
RECONCILIATION OF ADJUSTED EBITDA:				
Net loss	($901,274)	($1,271,692)	($1,126,332)	($1,749,684)
Add back:				
Depreciation and amortization - Offices	913,693	755,819	1,878,494	1,534,520
Depreciation and amortization - Corporate	38,864	30,700	84,948	64,074
Stock-based compensation expense	51,019	56,668	86,255	109,644
Interest expense, net	94,414	170,041	166,838	334,184
Stock grant	175,000	-	175,000	-
Increase in valuation of embedded derivatives	-	250,000	-	250,000
Income tax benefit	(516,899)	(17,020)	(633,561)	(176,352)
Adjusted EBITDA	($145,183)	($25,484)	$631,642	$366,386

The following table sets forth the percentages of revenue represented by certain items reflected in the Company's condensed consolidated statements of operations. The information contained in the following table represents the historical results of the Company. The information that follows should be read in conjunction with the Company's condensed consolidated financial statements and related notes thereto contained elsewhere in this report. Percentage amounts may not add due to rounding.

BIRNER DENTAL MANAGEMENT SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Quarters Ended June 30,		Six Months Ended June 30,	
	2017	2018	2017	2018
REVENUE:	100.0 %	100.0 %	100.0 %	100.0 %
DIRECT EXPENSES:				
Clinical salaries and benefits	62.6 %	62.8 %	61.5 %	62.4 %
Dental supplies	4.5 %	4.5 %	4.3 %	4.5 %
Laboratory fees	6.3 %	6.1 %	6.0 %	5.8 %
Occupancy	11.2 %	10.6 %	10.5 %	10.4 %
Advertising and marketing	1.1 %	0.9 %	1.1 %	0.9 %
Depreciation and amortization	6.2 %	4.9 %	6.2 %	4.9 %
General and administrative	8.7 %	8.5 %	8.4 %	8.5 %
	100.7 %	98.4 %	97.9 %	97.4 %
Contribution from dental offices	(0.7)%	1.6 %	2.1 %	2.6 %
CORPORATE EXPENSES:				
General and administrative	6.8 % [1]	7.1 % [1]	6.5 % [2]	6.7 % [2]
Stock grant	1.2 % [3]	-	0.6 % [3]	-
Depreciation and amortization	0.3 %	0.2 %	0.3 %	0.2 %
OPERATING LOSS	(9.0)%	(5.7)%	(5.2)%	(4.3)%
Increase in fair value of embedded derivatives	-	(1.6)%	-	(0.8)%
Interest expense	(0.6)%	(1.1)%	(0.5)%	(1.1)%
LOSS BEFORE INCOME TAXES	(9.6)%	(8.4)%	(5.8)%	(6.2)%
Income tax benefit	(3.5)%	(0.1)%	(2.1)%	(0.6)%
NET LOSS	(6.1)%	(8.3)%	(3.7)%	(5.6)%

[1] Corporate expense - general and administrative includes $51,019 and $56,668 of stock-based compensation expense pursuant to ASC Topic 718 for the quarters ended June 30, 2017 and 2018, respectively.

[2] Corporate expense - general and administrative includes $86,255 and $109,644 of stock-based compensation expense pursuant to ASC Topic 718 for the six months ended June 30, 2017 and 2018, respectively.

[3] The Company issued 12,500 shares of Common Stock under a settlement agreement with an activist shareholder group. The shares were valued at $175,000 based on the closing price of the Common Stock on the date of the grant.

Quarter Ended June 30, 2018 Compared to Quarter Ended June 30, 2017:

Revenue

For the quarter ended June 30, 2018, revenue increased $575,000, or 3.9%, to $15.4 million compared to $14.8 million for the quarter ended June 30, 2017.

Direct expenses

Clinical salaries and benefits. For the quarter ended June 30, 2018, clinical salaries and benefits increased $389,000, or 4.2%, to $9.6 million compared to $9.3 million for the quarter ended June 30, 2017. This increase in clinical salaries and benefits is related to increases of $352,000 in dentist wages, $38,000 in assistant wages, $27,000 in workers compensation expenses and $18,000 in hygienist wages offset by a decrease of $58,000 in 401(k) match. These increases are partially the result of the Company's increased number of dentists during the quarter ended June 30, 2018 compared to the quarter ended June 30, 2017. As a percentage of revenue, clinical salaries and benefits increased to 62.8% for the quarter ended June 30, 2018 compared to 62.6% for the quarter ended June 30, 2017.

Dental supplies. For the quarter ended June 30, 2018, dental supplies increased to $694,000 compared to $672,000 for the quarter ended June 30, 2017, an increase of $22,000, or 3.2%. This increase is directly related to the increase in revenue during the quarter ended June 30, 2018. As a percentage of revenue, dental supplies remained constant at 4.5% for the quarters ended June 30, 2018 and June 30, 2017.

Laboratory fees. For the quarter ended June 30, 2018, laboratory fees increased to $934,000 compared to $932,000 for the quarter ended June 30, 2017, an increase of $2,000, or 0.2%. As a percentage of revenue, laboratory fees decreased to 6.1% for the quarter ended June 30, 2018 compared to 6.3% for the quarter ended June 30, 2017.

Occupancy. For the quarter ended June 30, 2018, occupancy expense decreased $18,000, or 1.1%, to $1.6 million compared to the quarter ended June 30, 2017. This decrease is primarily related to decreases in janitorial expense of $36,000 and personal property taxes of $9,000 offset by an increase in repairs and maintenance of $15,000. As a percentage of revenue, occupancy expense decreased to 10.6% for the quarter ended June 30, 2018 compared to 11.2% for the quarter ended June 30, 2017.

Advertising and marketing. For the quarter ended June 30, 2018, advertising and marketing expenses decreased to $141,000 compared to $167,000 for the quarter ended June 30, 2017, a decrease of $27,000, or 16.1%. The decrease in advertising and marketing expenses is attributable to a decrease in internet and social media advertising. As a percentage of revenue, advertising and marketing expenses decreased to 0.9% for the quarter ended June 30, 2018 compared to 1.1% for the quarter ended June 30, 2017. The Company regularly adjusts its advertising and marketing expenditures in response to market conditions and performance in individual markets.

Depreciation and amortization-Offices. For the quarter ended June 30, 2018, depreciation and amortization expenses attributable to the Offices decreased to $756,000 compared to $914,000 for the quarter ended June 30, 2017, a decrease of $158,000, or 17.3% as additional assets became fully depreciated. As a percentage of revenue, depreciation and amortization expense decreased to 4.9% for the quarter ended June 30, 2018 compared to 6.2% for the quarter ended June 30, 2017.

General and administrative-Offices. For the quarter ended June 30, 2018, general and administrative expenses attributable to the Offices increased $17,000, or 1.3%, to $1.3 million compared to the quarter ended June 30, 2017. The increase in general and administrative expenses is largely related to $26,000 of legal fees associated with settlement of a civil lawsuit. As a percentage of revenue, general and administrative expenses decreased to 8.5% for the quarter ended June 30, 2018 compared to 8.7% for the quarter ended June 30, 2017.

Contribution from dental Offices

As a result of revenue increasing $575,000 and direct expenses increasing $226,000 during the quarter ended June 30, 2018, contribution from dental Offices increased $348,000 to $251,000 for the quarter ended June 30, 2018 compared to $(98,000) for the quarter ended June 30, 2017. As a percentage of revenue, contribution from dental Offices increased to 1.6% for the quarter ended June 30, 2018 compared to (0.7)% for the quarter ended June 30, 2017.

Corporate expenses

Corporate expenses - general and administrative. For the quarter ended June 30, 2018, Corporate expenses – general and administrative increased to approximately $1.1 million compared to approximately $1.0 million for the quarter ended June 30,2017, an increase of approximately $77,000, or 7.6% . Corporate wages increased $51,000, contract labor increased $28,000, professional tax fees increased $20,000 and auditor fees increased $17,000. These increases were offset by decreases in legal fees of $64,000, which were higher in the quarter ended June 30, 2017 due to matters related to an activist shareholder group. As a percentage of revenue, corporate expenses - general and administrative increased to 7.1% for the quarter ended June 30, 2018 compared to 6.8% for the quarter ended June 30, 2017.

Stock grant. For the quarter ended June 30, 2017, the Company issued 12,500 shares of Common Stock as part of a settlement with an activist shareholder group. The shares were valued at $175,000 based on the closing price of the Common Stock on the day of the grant. As a percentage of revenue, stock grant expense was 1.2% for the quarter ended June 30, 2017.

Corporate expenses - depreciation and amortization. For the quarter ended June 30, 2018, corporate expenses - depreciation and amortization decreased to $31,000 compared to $39,000 for the quarter ended June 30, 2017, a decrease of $8,000, or 21.0% as additional assets became fully depreciated. As a percentage of revenue, corporate expenses – depreciation and amortization decreased to 0.2% for the quarter ended June 30, 2018 compared to 0.3% for the quarter ended June 30, 2017.

Operating loss

As a result of the matters discussed above, the Company’s operating loss decreased by $455,000 to $(869,000) for the quarter ended June 30, 2018 compared to $(1.3 million) for the quarter ended June 30, 2017. As a percentage of revenue, operating loss decreased to (5.7%) for the quarter ended June 30, 2018 compared to (9.0%) for the quarter ended June 30, 2017.

Other Expense

Increase in fair value of embedded derivative

Increase in fair value of embedded derivative of $250,000 for the quarter ended June 30, 2018 is related to re-valuing the Embedded Derivatives based on current information available. See Note 8 to the condensed consolidated financial statements.

Interest expense, net

For the quarter ended June 30, 2018, interest expense, net increased to $170,000 compared to $94,000 for the quarter ended June 30, 2017, an increase of $76,000, or 80.1%. The increase in interest expense, net is related to $64,000 of interest expense on the Notes and higher interest rates on the Credit Facility. As a percentage of revenue, interest expense increased to 1.1% for the quarter ended June 30, 2018 compared to 0.6% for the quarter ended June 30, 2017.

Net loss

As a result of the above, the Company’s net loss was $(1.3 million) for the quarter ended June 30, 2018 compared to $(901,000) for the quarter ended June 30, 2017, an increase of $370,000. Net loss for the quarter ended June 30, 2018 was net of income tax benefit of $(17,000), while net loss for the quarter ended June 30, 2017 was net of income tax benefit of $(517,000). The effective tax rate for the quarter ended June 30, 2018 was 1.3%, while the effective tax rate for the quarter ended June 30, 2017 was 36.4%. The income tax benefit for the quarter ended June 30, 2018 was net of an allowance of $243,000 related to deferred tax assets. As a percentage of revenue, net loss increased to (8.3%) for the quarter ended June 30, 2018 compared to (6.1%) for the quarter ended June 30, 2017.

Six Months Ended June 30, 2018 Compared to Six Months Ended June 30, 2017:

Revenue

For the six months ended June 30, 2018, revenue increased $735,000, or 2.4%, to $31.2 million compared to $30.4 million for the six months ended June 30, 2017.

Direct expenses

Clinical salaries and benefits. For the six months ended June 30, 2018, clinical salaries and benefits increased $742,000, or 4.0%, to $19.5 million compared to $18.7 million for the six months ended June 30, 2017. This increase in clinical salaries and benefits is related to increases of $634,000 in dentist wages, $75,000 in assistant wages, $41,000 in accrued vacation expense, $19,000 in health insurance expense and $18,000 in payroll tax expense offset by a decrease of $114,000 in 401(k) match. These increases are partially the result of the Company's increased number of dentists during the six months ended June 30, 2018 compared to the six months ended June 30, 2017. As a percentage of revenue, clinical salaries and benefits increased to 62.4% for the six months ended June 30, 2018 compared to 61.5% for the six months ended June 30, 2017.

Dental supplies. For the six months ended June 30, 2018, dental supplies increased $89,000, or 6.9%, to $1.4 million compared to $1.3 million for the six months ended June 30, 2017. This increase is mostly related to the increase in revenue during the six months ended June 30, 2018 compared to the same period in 2017. As a percentage of revenue, dental supplies increased to 4.5% for the six months ended June 30, 2018 compared to 4.3% for the six months ended June 30, 2017.

Laboratory fees. For the six months ended June 30, 2018 and June 30, 2017, laboratory fees remained constant at $1.8 million. As a percentage of revenue, laboratory fees decreased to 5.8% for the six months ended June 30, 2018 compared to 6.0% for the six months ended June 30, 2017.

Occupancy. For the six months ended June 30, 2018, occupancy expense increased to $3.2 million compared to the six months ended June 30, 2017, an increase of $45,000 or 1.4%. Occupancy expense increased approximately $92,000 related to rent increases and other landlord reimbursable expenses such as common area maintenance, insurance and property taxes offset by decreases of $31,000 in janitorial expense and $25,000 in personal property taxes. As a percentage of revenue, occupancy expense decreased to 10.4% for the six months ended June 30, 2018 compared to 10.5% for the six months ended June 30, 2017.

Advertising and marketing. For the six months ended June 30, 2018, advertising and marketing expense decreased to $272,000 compared to $337,000 for the six months ended June 30, 2017, a decrease of $65,000 or 19.4%. The decrease in advertising and marketing expense is attributable to a decrease in internet and social media advertising. As a percentage of revenue, advertising and marketing expense decreased to 0.9% for the six months ended June 30, 2018 compared to 1.1% for the six months ended June 30, 2017.

Depreciation and amortization-Offices. For the six months ended June 30, 2018, depreciation and amortization expenses attributable to the Offices decreased to $1.5 million compared to $1.9 million for the six months ended June 30, 2017, a decrease of $344,000 or 18.3% as additional assets became fully depreciated. As a percentage of revenue, depreciation and amortization expenses attributable to the Offices decreased to 4.9% for the six months ended June 30, 2018 compared to 6.2% for the six months ended June 30, 2017.

General and administrative-Offices. For the six months ended June 30, 2018, general and administrative expenses attributable to the Offices increased to $2.6 million compared to the six months ended June 30, 2017, an increase of $89,000 or 3.5%. The increase in general and administrative expenses is attributable to settlement costs and legal expenses related to settlement of a civil lawsuit totaling $68,000, and increases in repair and maintenance expense of $24,000, recruiting expense of $24,000, offset by a decrease of $25,000 in travel expenses. As a percentage of revenue, general and administrative expenses attributable to the Offices increased to 8.5% for the six months ended June 30, 2018 compared to 8.4% for the six months ended June 30, 2017.

Contribution from dental Offices

As a result of revenue increasing $735,000 and direct expenses increasing $562,000 during the six months ended June 30, 2018, contribution from dental Offices increased to $812,000 for the six months ended June 30, 2018 compared to $638,000 for the six months ended June 30, 2017, an increase of $174,000 or 27.2%. As a percentage of revenue, contribution from dental Offices increased to 2.6% for the six months ended June 30, 2018 compared to 2.1% for the six months ended June 30, 2017.

Corporate expenses

Corporate expenses - general and administrative. For the six months ended June 30, 2018, corporate expenses – general and administrative increased to $2.1 million compared to $2.0 million for the six months ended June 30, 2017, an

increase of $118,000 or 6.0%. Health insurance expense increased $71,000 largely due to an incentive credit of $60,000 in the first quarter of 2017, corporate wages increased $64,000, auditor fees increased $52,000, contract labor increased $37,000, professional tax fees increased $21,000 and rent increased $14,000. These increases were offset by decreases in legal fees of $90,000 and other professional fees of $86,000. During the quarter ended March 31,2018, the Company had $66,000 in one-time expenses associated with accounting and valuation consulting services related to the $5 million financing completed in December 2017. As a percentage of revenue, corporate expenses - general and administrative increased 6.7% for the six months ended June 30, 2018 compared to 6.5% for the six months ended June 30, 2017.

Stock grant. For the six months ended June 30, 2017, the Company issued 12,500 shares of Common Stock as part of a settlement with an activist shareholder group. The shares were valued at $175,000 based on the stock price on the day of the grant. As a percentage of revenue, stock grant expense was 0.6% for the six months ended June 30, 2017.

Corporate expenses - depreciation and amortization. For the six months ended June 30, 2018, corporate expenses - depreciation and amortization decreased to $64,000 compared to $85,000 for the six months ended June 30, 2017, a decrease of $21,000, or 24.6% as additional assets became fully depreciated. As a percentage of revenue, corporate expenses – depreciation and amortization decreased to 0.2% for the six months ended June 30, 2018 compared to 0.3% for the six months ended June 30, 2017.

Operating loss

As a result of the matters discussed above, the Company’s operating loss decreased by $251,000 to $(1.3 million) for the six months ended June 30, 2018 compared to $(1.6 million) for the six months ended June 30, 2017. As a percentage of revenue, operating loss decreased to (4.3)% for the six months ended June 30, 2018 compared to (5.2)% for the six months ended June 30, 2017.

Other Expense

Increase in fair value of embedded derivative

Increase in fair value of embedded derivative of $250,000 for the six months ended June 30, 2018 is related to re-valuing the Embedded Derivatives based on current information available. See Note 8 to the condensed consolidated financial statements.

Interest expense, net

For the six months ended June 30, 2018, interest expense, net increased to $334,000 compared to $167,000 for the six months ended June 30, 2017, an increase of $167,000 or 100.3%. The increase in interest expense, net is related to $126,000 of interest expense on the Notes and higher interest rates on the Credit Facility. As a percentage of revenue, interest expense, net increased to 1.1% for the six months ended June 30, 2018 compared to 0.5% for the six months ended June 30, 2017.

Net loss

As a result of the above, the Company’s net loss was $(1.7 million) for the six months ended June 30, 2018 compared to net loss of $(1.1 million) for the six months ended June 30, 2017, an increase of $623,000. Net loss for the six months ended June 30, 2018 was net of income tax benefit of $(176,000), while net loss for the six months ended June 30, 2017 was net of income tax benefit of $(634,000). The effective tax rate for the six months ended June 30, 2018 was 9.2% while the effective tax rate for the six months ended June 30, 2017 was 36.0%. The income tax benefit for the six months ended June 30, 2018 was net of an allowance of $243,000 related to deferred tax assets. As a percentage of revenue, net loss increased to (5.6%) for the six months ended June 30, 2018 compared to (3.7)% for the six months ended June 30, 2017.

Liquidity and Capital Resources

The Company has financed its operations and growth primarily through a combination of cash provided by operating activities and bank credit facilities and term loans. During 2016 and 2017, the Company experienced losses and decreasing liquidity. The factors that contributed to the losses, along with the events leading up to the Company’s events of default under the Credit Facility in July 2017 and the private placement and the restructuring of the Credit Facility to cure the defaults in December 2018, along with the terms of the private placement and restructuring, are discussed in “Management’s Discussion and Analysis of Financial Condition and Results of Operations--Recent Developments” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017 and Form 10-Q for the quarter

ended March 31, 2018. As of June 30, 2018, the Company had a working capital deficit of approximately $7.5 million, an accumulated deficit of $5.4 million and a cash balance of $350,000.

Net cash used by operating activities was approximately $558,000 for the six months ended June 30, 2018, and net cash provided by operating activities was approximately $1.3 million for the six months ended June 30, 2017. During the six months ended June 30, 2018, excluding net loss and after adding back non-cash items, the Company's cash used by operating activities consisted of a decrease in accounts payable and accrued expenses of approximately $426,000, an increase in accounts receivable of approximately $369,000, an increase in prepaid expenses and other assets of approximately $211,000 and a decrease in other long-term obligations of approximately $17,000. During the six months ended June 30, 2017, excluding net loss and after adding back non-cash items, the Company's cash provided by operating activities consisted of an increase in accounts payable and accrued expenses of approximately $1.4 million and a decrease in prepaid expenses and other assets of approximately $15,000, offset by an increase in accounts receivable of $966,000, an increase in income tax receivable of approximately $47,000, a decrease of other long-term obligations of approximately $19,000 and an increase in deferred charges and other assets of approximately $8,000.

Net cash used in investing activities was approximately $857,000 and $310,000 for the six months ended June 30, 2018 and 2017, respectively. For the six months ended June 30, 2018, the Company invested approximately $874,000 in capital expenditures, including $498,000 to add digital x-rays to six offices, offset by a decrease in a note receivable of $16,000. For the six months ended June 30, 2017, the Company invested approximately $326,000 in capital expenditures offset by a decrease in a note receivable of $16,000.

Net cash used in financing activities was approximately $124,000 and $954,000 for the six months ended June 30, 2018 and 2017, respectively. During the six months ended June 30, 2018, net cash used in financing activities was comprised of approximately $250,000 used to pay down the Credit Facility offset by approximately $126,000 of accrued interest on the Notes. During the six months ended June 30, 2017, net cash used in financing activities was comprised of approximately $954,000 used to pay down the Credit Facility.

As of June 30, 2018, the Company had the following debt and lease obligations:

		Payments due by Period			
	Total	1 year	2-3 years	4-5 years	More than 5 years
Debt obligations	$ 11,366,441	$ 6,250,000	$ -	$ -	$ 5,116,441
Operating lease obligations	14,922,259	4,334,965	6,238,885	2,717,458	1,630,951
Total	$ 26,288,700	$ 10,584,965	$ 6,238,885	$ 2,717,458	$ 6,747,392

The Company has historically operated with negative working capital and prior to 2017 was able to meet its current obligations through operating cash flows and availability on its revolving lines of credit. The Company believes that the net proceeds from the private placement completed in December 2017, cash generated from operations and borrowings under the revolving line of credit, which was increased from $1.1 million to $2.0 million under the Fifth Amendment, will be sufficient to fund its anticipated working capital needs and capital expenditures for at least the next 12 months. The Company was not in compliance with a required EBITDA covenant under the Loan Agreement at June 30, 2018. On or before August 15, 2018, an affiliate of the Palm Investors will purchase $468,000 principal amount of additional Notes and attached Series A Preferred Stock to permit the Company to regain compliance with the EBITDA covenant as permitted under the Fifth Amendment. The Company also exceeded the capital expenditures covenant for the quarter ended June 30, 2018, and received a Bank waiver on August 14, 2018 in this regard. There can be no assurance that the Company will meet all of the covenants under the Credit Facility in the future. If this occurs, the Company may need to take actions, including the sale of certain dental practices, the issuance of additional equity or debt securities or other borrowings or financing activities. The Credit Facility and the Investment Documents contain covenants that, among other things, significantly limit the Company's ability to incur or issue debt or equity securities. There can be no assurance that that the Palm Investors or others will, or will be permitted to, make additional infusions of capital into the Company if needed. The failure to raise the funds necessary to finance its future cash requirements could adversely affect the Company's ability to pursue its strategy and could negatively affect its operations in future periods.

Future events of default by the Company also could cause the Bank to exercise its remedies under the Loan Agreement, including foreclosure on the Company's assets or other actions.

Due to the above issues, there is substantial doubt about the Company's ability to continue as a going concern. The Company is implementing a plan to reduce expenses including wages through staff reductions and is considering the closure or sale of some of its Offices with larger losses. This plan also considers certain revenue enhancing features including increasing the productivity of its hygiene program and adding ancillary orthodontic procedures. Although the Company expects it may miss the Bank EBITDA covenant in the third quarter of 2018, the Company is currently working on contingency plans to cure the Bank EBITDA covenant if such covenant is violated. The contingency plans include amending the Credit Facility to allow for consecutive quarterly cure payments and additional private funding to make such cure payment. The Company believes its action plans will allow the Company to meet its Bank covenants beginning with the fourth quarter of 2018. The Company has prepared its business plan for the ensuing 12 months and believes that management's plans, when implemented, will allow the Company sufficient liquidity and financial resources to operate for the ensuing 12 month period.

ITEM 4. CONTROLS AND PROCEDURES

Under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, the Company evaluated the design and operation of its disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act as of June 30, 2017. On the basis of this review, the Company's management, including the Chief Executive Officer and Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective as of June 30, 2018.

There has been no change in the Company's internal control over financial reporting during the three months ended June 30, 2018 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

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

Issuer Purchases of Equity Securities

The Company's stock repurchase program has been in place for more than ten years, and there is no expiration date for the program. As of June 30, 2018, the dollar value of shares that may be purchased under the stock repurchase program was approximately $876,000. However, Common Stock repurchases are prohibited under the Credit Facility and the Company did not purchase any shares of its Common Stock during the quarter ended June 30, 2018.

ITEM 6. EXHIBITS

Exhibit Number	Description of Document
3.1P	Amended and Restated Articles of Incorporation, incorporated herein by reference to Exhibit 3.1 to the Company's Registration Statement on Form S-1 (SEC File No. 333-36391), as filed with the Securities and Exchange Commission on September 25, 1997.
3.2	Second Amended and Restated Bylaws, incorporated herein by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K (SEC File No. 000-23367), as filed with the Securities and Exchange Commission on July 15, 2016.
3.3	Articles of Amendment to the Articles of Incorporation, relating to the Series A Convertible Preferred Stock, incorporated herein by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K, as filed with the Securities and Exchange Commission on January 2, 2018.
3.4	Articles of Amendment to the Articles of Incorporation, relating to the Series B Convertible Preferred Stock, incorporated herein by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K, as filed with the Securities and Exchange Commission on January 2, 2018.
4.1P	Specimen Stock Certificate, incorporated herein by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-1 (SEC File No. 333-36391), as filed with the Securities and Exchange Commission on November 25, 1997.
4.2	Form of Convertible Senior Subordinated Secured Loan Note, incorporated herein by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K, as filed with the Securities and Exchange Commission on January 2, 2018.
10.1P*	Form of Indemnification Agreement entered into between the Company and its Directors and Executive Officers, incorporated herein by reference to Exhibit 10.1 to the Company's Registration Statement on Form S-1 (SEC File No. 333-36391), as filed with the Securities and Exchange Commission on September 25, 1997.
10.2*	Form of Restricted Stock Agreement and Grant Notice under 2005 Equity Incentive Plan, incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K (SEC File No. 000-23367), as filed with the Securities and Exchange Commission on July 19, 2005.
10.3*	Birner Dental Management Services, Inc. 2005 Equity Incentive Plan, incorporated herein by reference to Exhibit 99 of the Company's Definitive Proxy Statement, as filed with the Securities and Exchange Commission on April 27, 2005.
10.4*	Birner Dental Management Services, Inc. 2005 Equity Incentive Plan, as amended as of June 5, 2014, incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, as filed with the Securities and Exchange Commission on June 10, 2014.
10.5*	Birner Dental Management Services, Inc. 2015 Equity Incentive Plan, incorporated herein by reference to Appendix A to the Company's Amendment No. 1 to Definitive Proxy Statement on Schedule 14A, as filed with the Securities and Exchange Commission on May 7, 2015.
10.20P	Form of Stock Transfer and Pledge Agreement, incorporated herein by reference to Exhibit 10.20 to the Company's Registration Statement on Form S-1 (SEC File No. 333-36391), as filed with the Securities and Exchange Commission on September 25, 1997.
10.25P*	Profit Sharing 401(k)/Stock Bonus Plan of the Company, incorporated herein by reference to Exhibit 10.25 to the Company's Registration Statement on Form S-1 (SEC File No. 333-36391), as filed with the Securities and Exchange Commission on September 25, 1997.
10.26P	Form of Stock Transfer and Pledge Agreement, incorporated herein by reference to Exhibit 10.26 of Pre-Effective Amendment No. 1 to the Company's Registration Statement on Form S-1 (SEC File No. 333-36391), as filed with the Securities and Exchange Commission on November 7, 1997.
10.45	Loan and Security Agreement, dated March 29, 2016, between the Company and Guaranty Bank and Trust Company, incorporated herein by reference to Exhibit 10.47 to the Company's Annual Report on Form 10-K, as filed with the Securities and Exchange Commission on March 30, 2016.
10.46	Amendment to Loan and Security Agreement, dated July 29, 2016, by and between the Company and Guaranty Bank and Trust Company, incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, as filed with the Securities and Exchange Commission on August 4, 2016.
10.47	Second Amendment to Loan and Security Agreement, dated November 14, 2016, between the Company and Guaranty Bank and Trust Company, incorporated herein by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q, as filed with the Securities and Exchange Commission on November 14, 2016.
10.48	Third Amendment to Loan and Security Agreement, dated December 9, 2016, between the Company and Guaranty Bank and Trust Company, incorporated herein by reference to Exhibit 10.48 to the Company's Annual Report on Form 10-K, as filed with the Securities and Exchange Commission on March 31, 2017.
10.49	Fourth Amendment to Loan and Security Agreement and Forbearance Agreement, dated March 30, 2017, between the Company and Guaranty Bank and Trust Company, incorporated herein by reference to Exhibit 10.49 to the Company's Annual Report on Form 10-K, as filed with the Securities and Exchange Commission on March 31, 2017.

Exhibit Number	Description of Document
10.50	Nomination and Standstill Agreement, dated May 11, 2017, among the Company, Digirad Corporation, the other members of the Digirad Group, Frederic W.J. Birner and Dennis N. Genty, incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, as filed with the Securities and Exchange Commission on May 12, 2017 .
10.51	Fifth Amendment to Loan and Security Agreement, dated December 28, 2017, between the Company and Guaranty Bank and Trust Company, incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, as filed with the Securities and Exchange Commission on January 2, 2018.
10.52	Subordination Agreement, dated December 28, 2017, among the Company, Palm Global Small Cap Master Fund LP, Palm Active Dental, LLC and Guaranty Bank and Trust Company, incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K, as filed with the Securities and Exchange Commission on January 2, 2018.
10.53	Securities Purchase Agreement, dated December 28, 2017, among the Company, Palm Global Small Cap Master Fund LP and Palm Active Dental, LLC, incorporated herein by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K, as filed with the Securities and Exchange Commission on January 2, 2018.
10.54	Security Agreement, dated December 28, 2017, by the Company in favor of Palm Global Small Cap Master Fund LP and Palm Active Dental, LLC, incorporated herein by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K, as filed with the Securities and Exchange Commission on January 2, 2018.
10.55	Registration Rights Agreement, dated December 28, 2017, among the Company, Palm Global Small Cap Master Fund LP and Palm Active Dental, LLC, incorporated herein by reference to Exhibit 10.5 to the Company's Current Report on Form 8-K, as filed with the Securities and Exchange Commission on January 2, 2018.
31.1	Rule 13a-14(a) Certification of the Chief Executive Officer.
31.2	Rule 13a-14(a) Certification of the Chief Financial Officer.
32.1*	Section 1350 Certifications of the Chief Executive Officer and the Chief Financial Officer.

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

* Furnished herewith.

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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.

BIRNER DENTAL MANAGEMENT SERVICES, INC.

Date: August 14, 2018

By: /s/ Frederic W.J. Birner
Name: Frederic W.J. Birner
Title: Chairman of the Board and Chief Executive Officer
(Principal Executive Officer)

Date: August 14, 2018

By: /s/ Dennis N. Genty
Name: Dennis N. Genty
Title: Chief Financial Officer and Secretary
(*Principal Financial and Accounting Officer*)