

Apollo Medical Holdings, Inc.
Form 10-QT
July 08, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended

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

For the transition period from **February 1, 2014** to **March 31, 2014**

Commission File No.

000-25809

Apollo Medical Holdings, Inc.

(Exact name of registrant as specified in its charter)

Delaware **20-8046599**
State of Incorporation IRS Employer Identification No.

700 North Brand Blvd., Suite 220

Glendale, California 91203

(Address of principal executive offices)

(818) 396-8050

(Issuer's telephone number)

January 31, 2014

(Former name, former address and former fiscal year, if changed since last report)

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each Class	Name of each Exchange on which Registered
	None

Securities Registered Pursuant to Section 12(g) of the Act:

Common Stock, \$.001 Par Value

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

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

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

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

As of June 30, 2014, there were 49,134,549 shares of common stock, \$.001 par value per share, issued and outstanding.

Explanatory Note Regarding Change in Fiscal Year End

On May 16, 2014, the Board of Directors of Apollo Medical Holdings, Inc., or the "Company", approved a change to the Company's fiscal year end from January 31 to March 31. The Company elected to change its fiscal year end in order to simplify business processes and to align the Company's fiscal year with the reporting periods for other healthcare services reporting companies to allow for easier comparison and industry coverage. As a result of this change, this Transition Report on Form 10-Q includes the financial information for the two months transition period from February 1, 2014 to March 31, 2014, or "Transition Period". References in this Transition Report on Form 10-Q to fiscal year 2014 or fiscal 2014 refer to the period from February 1, 2014 through March 31, 2014 and references to fiscal year 2013 or fiscal 2013 refer to the period from February 1, 2013 through March 31, 2013. Prior to this Transition Report on Form 10-Q, our Annual Reports on Form 10-K cover the fiscal year from February 1 to January 31.

APOLLO MEDICAL HOLDINGS, INC.

INDEX TO FORM 10-Q FILING

TABLE OF CONTENTS

	PAGE
<u>PART I</u>	
<u>FINANCIAL INFORMATION</u>	
Item 1. <u>Condensed Consolidated Financial Statements – Unaudited</u>	
<u>Balance Sheets As of March 31, 2014 and January 31, 2014</u>	3
<u>Statements of Operations for the two months ended March 31, 2014 and 2013</u>	4
<u>Statements of Changes in Stockholders’ Deficit for the two months ended March 31, 2014</u>	5
<u>Statements of Cash Flows for the two months ended March 31, 2014 and 2013</u>	6
<u>Notes to Condensed Consolidated Financial Statements - Unaudited</u>	7
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	19
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	22
Item 4. <u>Control and Procedures.</u>	22
<u>PART II</u>	
<u>OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	23
Item 1A <u>Risk Factors</u>	23
Item 2. <u>Unregistered Sales of Equity Securities and the Use of Proceeds</u>	23
Item 3. <u>Defaults upon Senior Securities</u>	23
Item 4. <u>Mine Safety Disclosures</u>	23
Item 5. <u>Other Information</u>	23
Item 6. <u>Exhibits</u>	23

PART I FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS**

APOLLO MEDICAL HOLDINGS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

	March 31, 2014	January 31, 2014
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$6,831,478	\$1,451,407
Restricted cash	20,000	20,000
Accounts receivable, net	1,508,461	1,509,589
Due from affiliates	24,041	1,599
Prepaid expenses	42,200	53,543
Deferred financing costs, net, current	-	97,806
Total current assets	8,426,180	3,133,944
Deferred financing costs, net, non-current	366,286	144,345
Property and equipment, net	94,948	85,685
Intangible assets, net	59,627	62,427
Goodwill	494,700	494,700
Other assets	41,636	38,681
TOTAL ASSETS	\$9,483,377	\$3,959,782
LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	\$1,999,601	\$1,373,285
Notes and lines of credit payable, net of discount - current portion	444,764	3,178,693
Total current liabilities	2,444,365	4,551,978
Warrant liability	2,354,624	-
Notes payable, net of discount – non-current portion	5,344,565	-
Convertible notes payable, net	962,978	1,100,522
Total liabilities	11,106,532	5,652,500
STOCKHOLDERS' DEFICIT		
Preferred stock, par value \$0.001; 5,000,000 shares authorized; none issued	-	-
	49,135	46,953

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Common Stock, par value \$0.001; 100,000,000 shares authorized, 49,134,519 and 46,952,469 shares issued and outstanding as of March 31, 2014 and January 31, 2014, respectively

Additional paid-in-capital	15,083,365	14,105,376
Accumulated deficit	(16,347,588)	(15,581,146)
Stockholders' Deficit Attributable to Apollo Medical Holdings, Inc.	(1,215,088)	(1,428,817)
Non-controlling interest	(408,067)	(263,901)
Total stockholders' deficit	(1,623,155)	(1,692,718)
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	\$9,483,377	\$3,959,782

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

APOLLO MEDICAL HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

	Two months ended March 31,	
	2014	2013
Net revenues	\$ 2,336,522	\$ 1,662,951
Costs and expenses		
Cost of services	2,050,913	1,184,786
General and administrative	826,870	531,120
Depreciation and amortization	5,765	4,506
Total costs and expenses	2,883,548	1,720,412
Loss from operations	(547,026)	(57,461)
Other income (expense)		
Interest expense	(184,578)	(86,114)
Other income	28,816	1,476
Total other expenses	(155,762)	(84,638)
Loss before provision for income taxes	(702,788)	(142,099)
Provision for income taxes	7,820	3,004
Net loss	(710,608)	(145,103)
Net income attributable to non-controlling interest	(55,834)	-
Net loss attributable to Apollo Medical Holdings, Inc.	\$ (766,442)	\$ (145,103)
WEIGHTED AVERAGE SHARES OF COMMON STOCK OUTSTANDING - BASIC AND DILUTED	47,175,211	34,843,441
BASIC AND DILUTED NET LOSS PER SHARE	\$ (0.02)	\$ (0.00)

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

APOLLO MEDICAL HOLDINGS, INC.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIT

FOR THE TWO MONTHS ENDED MARCH 31, 2014

(UNAUDITED)

	Shares	Amount	Additional Paid-In Capital	Accumulated Deficit	Stockholders' Deficit Attributable to Apollo Medical Holdings, Inc.	Non- controlling Interest	Total
Balance							
-beginning of period	- - 46,952,469	\$46,953	\$14,105,376	\$(15,581,146)	\$(1,428,817)	\$(263,901)	\$(1,692,718)
Net income (loss)	- - -	-	-	(766,442)	(766,442)	55,834	(710,608)
Stock grant compensation expense	- - -	-	60,187	-	60,187	-	60,187
Shares issued in NNA financing	- - 2,000,000	2,000	866,236	-	868,236	-	868,236
8% notes share conversion	- - 182,080	182	51,566	-	51,748	-	51,748
Distributions to non-controlling interest	- - -	-	-	-	-	(200,000)	(200,000)
Balance - end of period	- - 49,134,549	\$49,135	\$15,083,365	\$(16,347,588)	\$(1,215,088)	\$(408,067)	\$(1,623,155)

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

APOLLO MEDICAL HOLDINGS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Two months ended March 31,	
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (710,608) \$ (145,103)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Gain on extinguishment of debt	(23,000) -
Depreciation and amortization expense	5,765	4,506
Stock-based compensation expense	60,187	45,286
Amortization of financing costs	25,965	9,511
Amortization of debt discount	19,406	15,170
Changes in assets and liabilities:		
Accounts receivable	1,128	(158,634)
Due from affiliates	(22,442) (12,058)
Prepaid expenses and advances	11,342	12,392
Other assets	(2,952) -
Accounts payable and accrued liabilities	626,314	50,376
Net cash used in operating activities	(8,895) (178,554)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Property and equipment acquired	(12,228) (3,199)
Net cash used in investing activities	(12,228) (3,199)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from notes and line of credit payable	7,000,000	-
Payment of line of credit payable	(2,811,878) -
Payment of medical clinic acquisition notes payable	(256,000) -
Distributions to non-controlling interest shareholder	(200,000) -
Proceeds from issuance of common stock	2,000,000	-
Proceeds from issuance of convertible notes payable	-	100,000
Cash payments in connection with convertible note redemption	(98,252) -
Debt and equity issuance costs	(232,676) -
Net cash provided by financing activities	5,401,194	100,000
NET INCREASE (DECREASE) IN CASH & CASH EQUIVALENTS	5,380,071	(81,753)
CASH & CASH EQUIVALENTS, BEGINNING OF PERIOD	1,451,407	1,176,727
CASH & CASH EQUIVALENTS, END OF PERIOD	\$ 6,831,478	\$ 1,094,974

SUPPLEMENTARY DISCLOSURES OF CASH FLOW INFORMATION

Interest paid	\$ 84,720	\$ 18,062
Income taxes paid	\$ 3,824	\$ 9,404
Non-Cash Financing Activities:		
Warrants issued in connection with convertible note issuance	\$ -	\$ 6,724
Shares issuable and issued for note payable financing fees	\$ -	45,000
NNA term loan discount	\$ 1,254,363	\$ -
Shares issued in connection with convertible notes redemption	\$ 51,748	\$ -
Fair value of warrant liabilities	\$ 2,354,624	\$ -
NNA shares issuance discount	\$ 1,100,261	\$ -

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

APOLLO MEDICAL HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. Description of Business

Apollo Medical Holdings, Inc. (the "Company" or "ApolloMed") and its affiliated physician groups are a physician-centric, integrated healthcare delivery system serving Medicare, Commercial and Medi-Cal beneficiaries in California. As of March 31, 2014, ApolloMed's physician network consisted of hospitalists, primary care physicians and specialist physicians primarily through the Company's owned and affiliated physician groups. ApolloMed operates as a medical management holding company through the following wholly-owned subsidiary management companies: Apollo Medical Management, Inc. ("AMM"), Pulmonary Critical Care Management, Inc. ("PCCM"), Verdugo Medical Management, Inc. ("VMM") and ApolloMed ACO, Inc. ("ApolloMed ACO"). Through AMM, PCCM, and VMM, the Company manages affiliated medical groups, which consisted of ApolloMed Hospitalists ("AMH"), ApolloMed Care Clinic ("ACC"), Maverick Medical Group, Inc. ("MMG"), Los Angeles Lung Center ("LALC"), and Eli Hendel, M.D., Inc. ("Hendel.") AMM, PCCM and VMM each operate as a physician practice management company ("PPM") and are in the business of providing management services to physician practice corporations ("PPC") under long-term management service agreements. ApolloMedACO participates in the Medicare Shared Savings Program ("MSSP"), the goal of which is to improve the quality of patient care and outcomes through more efficient and coordinated approach among providers.

Change in Fiscal Year

On May 16, 2014, the board of directors of Apollo Medical Holdings, Inc., or the "Company", approved a change to the Company's fiscal year end from January 31 to March 31. The Company elected to change its fiscal year end in order to simplify business processes and to align the Company's fiscal year with the reporting periods for other healthcare services reporting companies to allow for easier comparison and industry coverage. As a result of this change, this Transition Report on Form 10-Q includes the financial information for the two months transition period from February 1, 2014 to March 31, 2014, or "Transition Period". References in this Transition Report on Form 10-Q to fiscal year 2014 or fiscal 2014 refer to the period from February 1, 2014 through March 31, 2014 and references to fiscal year 2013 or fiscal 2013 refer to the period from February 1, 2013 through March 31, 2013. Prior to this Transition Report on Form 10-Q, the Company's Annual Reports on Form 10-K covered the fiscal year from February 1 to January 31.

2. Summary of Significant Accounting Policies

Accounting Principles

These condensed consolidated statements reflect all adjustments, consisting of normal recurring adjustments, which, in management's opinion, are necessary, and should be read in conjunction with the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2014 as filed with the Securities and Exchange Commission ("SEC") on May 8, 2014.

Principles of Consolidation

The Company's consolidated financial statements include the accounts of Apollo Medical Holdings, Inc. and its wholly owned subsidiaries AMM, ApolloMed ACO, PCCM, and VMM, its controlling interest in Aligned Healthcare, Inc. ("AHI"), and PPCs managed under long-term management service agreements including AMH, MMG, ACC, LALC and Hendel. Some states have laws that prohibit business entities, such as ApolloMed, from practicing medicine, employing physicians to practice medicine, exercising control over medical decisions by physicians (collectively known as the corporate practice of medicine), or engaging in certain arrangements with physicians, such as fee-splitting. In California, the Company operates by maintaining long-term management service agreements with the PPCs, which are each owned and operated by physicians, and which employ or contract with additional physicians to provide hospitalist services. Under the management agreements, the Company provides and performs all non-medical management and administrative services, including financial management, information systems, marketing, risk management and administrative support. The management agreements typically range from 10 to 20 years unless terminated by either party for cause. The management agreements are not terminable by the PPCs, except in the case of material breach or bankruptcy of the respective PPM.

Through the management agreements and the Company's relationship with the stockholders of the PPCs, the Company has exclusive authority over all non-medical decision making related to the ongoing business operations of the PPCs. Consequently, the Company consolidates the revenue and expenses of the PPCs from the date of execution of the management agreements.

All intercompany balances and transactions have been eliminated in consolidation.

Revenue Recognition

Revenue consists of contracted, fee-for-service, and capitation revenue. Revenue is recorded in the period in which services are rendered. Revenue is principally derived from the provision of healthcare staffing services to patients within healthcare facilities. The form of billing and related risk of collection for such services may vary by customer. The following is a summary of the principal forms of the Company's billing arrangements and how net revenue is recognized for each.

7

Contracted revenue

Contracted revenue represents revenue generated under contracts for which the Company provides physician and other healthcare staffing and administrative services in return for a contractually negotiated fee. Contract revenue consists primarily of billings based on hours of healthcare staffing provided at agreed-to hourly rates. Revenue in such cases is recognized as the hours are worked by the Company's staff and contractors. Additionally, contract revenue also includes supplemental revenue from hospitals where the Company may have a fee-for-service contract arrangement or provide physician advisory services to the medical staff at a specific facility. Contract revenue for the supplemental billing in such cases is recognized based on the terms of each individual contract. Such contract terms generally either provides for a fixed monthly dollar amount or a variable amount based upon measurable monthly activity, such as hours staffed, patient visits or collections per visit compared to a minimum activity threshold. Such supplemental revenues based on variable arrangements are usually contractually fixed on a monthly, quarterly or annual calculation basis considering the variable factors negotiated in each such arrangement. Such supplemental revenues are recognized as revenue in the period when such amounts are determined to be fixed and therefore contractually obligated as payable by the customer under the terms of the respective agreement. Additionally, the Company derives a portion of the Company's revenue as a contractual bonus from collections received by the Company's partners and such revenue is contingent upon the collection of third-party billings. These revenues are not considered earned and therefore not recognized as revenue until actual cash collections are achieved in accordance with the contractual arrangements for such services.

Fee-for-service revenue

Fee-for-service revenue represents revenue earned under contracts in which the Company bills and collects the professional component of charges for medical services rendered by the Company's contracted and employed physicians. Under the fee-for-service arrangements, the Company bills patients for services provided and receives payment from patients or their third-party payers. Fee-for-service revenue is reported net of contractual allowances and policy discounts. All services provided are expected to result in cash flows and are therefore reflected as net revenue in the financial statements. Fee-fo:10pt;font-weight:bold;">Assignment

Roy A. Bauer

Aug. 2008

April 21, 2011

No

Rick Rickenbach

Sept. 2009

July 22, 2011

Yes

Compensation Committee
Governance and Nominating Committee
Karen Gilles Larson

May 2009

July 1, 2011

Yes

Governance and Nominating Committee (Chair)
Audit Committee
Kedar Belhe

May 2009

Yes

Compensation Committee (Chair)
Governance and Nominating Committee (Chair)
Audit Committee
Benno G. Sand

Sept. 2009

Aug. 24, 2011

Yes

Audit Committee (Chair)
Compensation Committee

The resignation of Roy A. Bauer, Rick Rickenbach, Karen Gilles Larson and Benno G. Sand did not involve any disagreements with the Company.

Director Independence

Our Board of Directors has determined that two of our four current directors-Messrs. Belhe and Lillemoe-are independent under the applicable standards of the Nasdaq Stock Market, and each member of our Audit and Finance Committee is independent pursuant to Rule 10A-3 of the Securities and Exchange Act of 1934.

Board Meetings

Our Board of Directors held six regularly scheduled meetings and two special meetings during 2010, and acted by unanimous written consent in lieu of a meeting eight times, as permitted by the applicable state law, during 2010. During 2010, all directors attended 75% or more of the meetings of the Board of Directors and committees to which they were assigned.

In order to control expenses, and in light of the fact that very few stockholders attend our annual or special meetings of stockholders in person, we do not require directors to attend stockholder meetings. Our directors are invited, and frequently one or more of our directors is in attendance at such meetings. At the 2010 annual meeting of stockholders, all five of our then acting directors were present.

We have a standing Audit and Finance Committee, Compensation Committee and Corporate Governance and Nomination Committee, each of which is more fully described below.

Committees

Audit and Finance Committee.

The Board of Directors established an Audit and Finance Committee in accordance with Section 3(a)(58)(A) of the Exchange Act. The Audit and Finance Committee currently consists of Board members Kedar R. Belhe, David F. Dalvey and Kent E. Lillemoe, with Mr. Lillemoe serving as chair of the committee since August 25, 2011. Committee members Messrs. Lillemoe and Belhe are independent as defined in Rule 5605(a)(2) of the Nasdaq Marketplace Rules and as defined by the Sarbanes-Oxley Act of 2002. Our Board of Directors has determined that we have three Audit and Finance Committee financial experts as defined in Item 407(d)(5)(ii) of Regulation S-K: Messrs. Lillemoe, Belhe and Dalvey.

The committee was established for the purpose of overseeing our accounting and financial reporting and disclosure processes and the audits of our financial statements. The committee recommends for approval by our Board of Directors an independent registered public accounting firm to audit our consolidated financial statements for the fiscal year in which they are appointed, and monitors the effectiveness of the audit effort, the internal and financial accounting organization and controls and financial reporting. The duties of the committee are also to oversee and evaluate the independent registered public accounting firm, to meet with the independent registered public accounting firm to review the scope and results of the audit, to approve non-audit services provided to us by our independent certified public accountants, and to consider various accounting and auditing matters related to our system of internal controls, financial management practices and other matters. The committee complies with the provisions of the Sarbanes-Oxley Act of 2002. A copy of the Audit and Finance Committee charter is available on our website at www.digitiliti.com.

The Audit and Finance Committee commonly meets at least quarterly to review and approve the financial reports and to discuss accounting, reporting and internal control matters, and other pertinent matters as they arise. The Audit and Finance Committee also discusses auditing issues via telephone conference and during regularly scheduled Board meetings, as appropriate, after which time the conversations are incorporated into Board's minutes. The committee held five meetings during 2010.

Compensation Committee.

The Board of Directors established a Compensation Committee. The Compensation Committee currently consists of Board members Kent E. Lillemoe, David F. Dalvey, and Kedar R. Belhe, who serves as Chair. Messrs. Lillemoe and Belhe are independent as defined in Rule 5605(a)(2) of the Nasdaq Marketplace Rules and as defined by the Sarbanes-Oxley Act of 2002.

The committee was established for the purpose of overseeing that the executive officers of Digitiliti and its wholly owned subsidiary, Storage Elements, and directors of Digitiliti are compensated effectively in a manner consistent with the compensation strategy of Digitiliti, internal equity considerations, competitive practice, and the requirements of the appropriate regulatory bodies. The Compensation Committee sets all levels of compensation for the executive officers. For executive officers other than the CEO, this committee reviews, analyzes and makes a determination of compensation based on recommendations from the CEO. Determinations are based on criteria which include the performance of Digitiliti's accomplishment of key financial and strategic objectives, and the successful development of management. This committee is responsible for conducting an assessment of the performance of the Chief Executive Officer at least annually, reviewing and approving Digitiliti's variable pay plans, overseeing any incentive compensation and equity-based compensation plans for employees, review and approve employment agreements or severance agreements and other duties as may be assigned. A copy of the Compensation Committee charter is available on our website at www.digitiliti.com.

The committee has the authority to delegate any of its responsibilities to one or more subcommittees made up solely of Board members as the committee may from time to time deem appropriate. The committee may ask members of management, employees, outside counsel, or others whose advice and counsel are relevant to the issues then being considered by the committee to attend any meetings and to provide such pertinent information as the committee may request. The committee did not engage compensation consultants during the year 2010 to determine or recommend the amount or form of executive and director compensation. The committee has read consultant reports prepared for similar companies and has spoken with experts regarding compensation in the past.

This committee commonly meets prior to Board meetings, pending pertinent agenda items. This committee also discusses compensation issues via telephone conference and during regularly scheduled Board meetings, after which time the conversations are incorporated into Board's minutes. The committee held four meetings during 2010.

Corporate Governance and Nomination Committee.

The Board of Directors established a Corporate Governance and Nomination Committee. The Corporate Governance and Nomination Committee currently consists of Board members Kent E. Lillemoe, Kedar R. Belhe, and David F. Dalvey, who serves as Chair. Messrs. Lillemoe and Belhe are independent as defined in Rule 5605(a)(2) of the Nasdaq Marketplace Rules and as defined by the Sarbanes-Oxley Act of 2002. The current slate of director nominees were recommended to the Corporate Governance and Nomination Committee by our Chief Executive Officer, security holders and independent investment advisors.

The committee was established for the purpose of overseeing the identification, evaluation, and nomination of Board members for election. The committee also has the responsibility for evaluating the performance of the Board and Board committees. The committee oversees all matters of corporate governance. Currently, the committee submits nominations for election to fill vacancies on the Board to the entire Board of Director for its consideration. A copy of the Corporate Governance and Nomination Committee charter is available on our website at www.digitiliti.com.

Our goal is to assemble a Board of Directors that brings together a diverse variety of perspectives and skills derived from high quality business and professional experience. In evaluating potential directors, the committee considers the following factors:

- the appropriate size of our Board of Directors;
- our needs with respect to the particular talents and experience of our directors;
- the knowledge, skills and experience of nominees, including experience in desirable vertical markets such as financial, legal, medical or education or public companies, in light of prevailing business conditions and the knowledge, skills and experience already possessed by other members of the Board of Director;
- educational and practical experience;
- familiarity with the information technology industry; and
- the desire to balance the benefit of continuity with the periodic injection of a fresh perspective that can be provided by new Board members.

This committee meets at least twice a year, and holds additional meetings when pertinent matters arise. This committee also discusses governance issues via telephone conference and during regularly scheduled Board meetings, after which time the conversations are incorporated into the Board's minutes. The committee held four meetings during 2010.

Qualifications of Candidates for Election to the Board

Our Board of Directors takes a critical role in guiding our strategic direction, and it oversees the management of us. When candidates for our Board of Directors are considered, they are evaluated based upon various criteria. Director candidates for our Board of Directors are considered for vacant seats if they (i) are independent, in accordance with applicable law and stock exchange listing standards, (ii) demonstrate high ethical standards, professionalism, and integrity in their personal and professional dealings, (iii) are willing to commit themselves to their duties as members of our Board of Directors and its various committees and to their responsibilities to us, (iv) possess the appropriate knowledge and understanding of fundamental financial statements, (v) have substantial relevant business and technological experience, (vi) provide a diverse set of skills, backgrounds and experiences in order to provide varying perspectives, (vii) have no identified conflicts of interest with us, (viii) have not been convicted in a criminal proceeding other than traffic violations during the ten years before the date of selection, and (ix) are willing to comply with our code of ethics. We retain the right to modify these minimum qualifications from time to time. Exceptional candidates who do not meet all of these criteria may still be considered.

Process for Identifying and Evaluating Candidates for Election to the Board

The role of the Corporate Governance and Nomination Committee is to review the qualifications and backgrounds of any candidates for our Board of Directors, its current members, as well as the overall composition of the Board. In the case of any director candidates, the questions of independence and financial expertise are important to determine what roles the candidate can perform, and the Corporate Governance and Nomination Committee will consider whether the candidate meets the applicable independence standards and the level of the candidate's financial expertise. Any new candidates will be interviewed, and the Corporate Governance and Nomination Committee will approve the final nominations. Our chairman of the Board, or other Board members, acting on behalf of the Corporate Governance and Nomination Committee, will extend the formal invitation to the selected candidates.

Stockholder Nominations

Stockholders may nominate director candidates for consideration by the Corporate Governance and Nominating Committee by writing to our Secretary, who will forward the nomination to the chairman of the Corporate Governance and Nominating Committee. The submission must provide the candidate's name, biographical data and qualifications, including five-year employment history with employer names and a description of the employer's business; whether such individual can read and understand fundamental financial statements; other board memberships (if any); and such other information as is reasonably available and sufficient to enable the Corporate Governance and Nominating Committee to evaluate the minimum qualifications stated above under the section of this proxy statement entitled "Qualifications of Candidates for Election to the Board." The submission must be accompanied by a written consent of the individual to stand for election if nominated by the Corporate Governance and Nominating Committee and to serve if elected by the stockholders. If a stockholder nominee is eligible, and if the nomination is proper, the Corporate Governance and Nominating Committee then will deliberate and make a decision as to whether the candidate will be appointed and subsequently submitted to our stockholders for a vote. The Corporate Governance and Nominating Committee will not change the manner in which it evaluates candidates, including the applicable minimum criteria set forth above, on the basis of whether the candidate was recommended by a stockholder.

Executive Sessions of the Board

Our Board of Directors has adopted a formal policy of meeting in executive session, with only independent directors being present, on a regular basis and at least two times each year. The Board of Directors met in executive session six times during 2010.

Stockholder Communications

Our Board of Directors believes that it is important for us to have a process whereby our stockholders may send communications to our Board. Accordingly, stockholders who wish to communicate with our Board of Directors or a particular director may do so by sending a letter to William M. McDonald, Secretary, at 266 East 7th Street, St. Paul, MN 55101. The mailing envelope must contain a clear notation indicating that the enclosed letter is a "Stockholder-Board Communication" or "Stockholder-Director Communication." All such letters must identify the author as a stockholder and clearly state whether the intended recipients are all members of our Board of Directors or only certain specified individual directors. Mr. McDonald copies all such letters and circulates them to the appropriate director or directors.

DIRECTOR COMPENSATION

Below is the compensation received by members of our Board of Directors in 2010, except that the compensation for Roy A. Bauer (former director and chairman), and Ehssan Taghizadeh (former director, CEO and executive officer) are disclosed under the section titled "Executive Compensation."

DIRECTOR COMPENSATION FOR FISCAL YEAR 2010

Name	Fees Earned or Paid in Cash (\$)	Stock Awards (\$)	Option Awards (\$) ⁽⁵⁾	Non-Equity Incentive Plan Compensation (\$)	Nonqualified Deferred Compensation Earnings (\$)	All Other Compensation (\$)	Total (\$)
Kedar R. Belhe ⁽¹⁾		52,632	\$721				\$721
Karen Gilles Larson ⁽²⁾⁽⁶⁾	—	52,632	\$721	—	—	—	\$721
R.M.Rickenbach ⁽³⁾⁽⁷⁾	—	52,632	\$721	—	—	—	\$721

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Benno G. Sand ⁽⁴⁾⁽⁸⁾ — 52,632 \$721 — — — \$721

(1) On October 14, 2010, Mr. Belhe was granted a five-year option to purchase 5,000 shares of our common stock, exercisable at \$0.22 per share, and vests over a period of twelve months based on his continued service as a director. On November 12, 2010, Mr. Belhe was issued 52,632 shares of common stock in lieu of cash compensation for services render during 2010 as a non-employee director for the Company.

(2) On October 14, 2010, Ms. Gilles Larson was granted a five-year option to purchase 5,000 shares of our common stock, exercisable at \$0.22 per share, and vests over a period of twelve months based on his continued service as a director. These options were forfeited on July 1, 2011, the date of Ms. Gilles Larson's resignation. On November 12, 2010, Ms. Larson was issued 52,632 shares of common stock in lieu of cash compensation for services render during 2010 as a non-employee director for the Company.

On October 14, 2010, Mr. Rick Rickenbach was granted a five-year option to purchase 5,000 shares of our common stock, exercisable at \$0.22 per share, and vests over a period of twelve months based on his continued (3) service as a director. These options were forfeited on July 22, 2011, the date of Mr. Rickenbach's resignation. On November 12, 2010, Mr. Rickenbach was issued 52,632 shares of common stock in lieu of cash compensation for services rendered during 2010 as a non-employee director for the Company.

On October 14, 2010, Mr. Sand was granted a five-year option to purchase 5,000 shares of our common stock, exercisable at \$0.22 per share, and vests over a period of twelve months based on his continued service as a (4) director. These options were forfeited on August 24, 2011, the date of Mr. Sand's resignation. On November 12, 2010, Mr. Sand was issued 52,632 shares of common stock in lieu of cash compensation for services rendered during 2010 as a non-employee director for the Company.

(5) The value of the stock options is calculated in accordance with FASB ASC Topic 718.

(6) On July 1, 2011, Ms. Gilles Larson resigned from the board of directors of the Company.

(7) On July 22, 2011, Mr. Rickenbach resigned from the board of directors of the Company.

(8) On August 24, 2011, Mr. Sand resigned from the board of directors of the Company.

Recently elected Board members, Messrs Scheetz, Lillemoe and Dalvey did not earn any compensation from the Company during 2011.

EXECUTIVE OFFICERS

As of the date of this report, each of the persons below currently serves as one of our executive officers:

Name	Age	Positions	Officer Since
Jack B. Scheetz	64	Interim President and Chief Executive Officer	Appointed as President & CEO June 2010
William M. McDonald	47	Chief Financial Officer and Secretary	April 2008

The following is a summary of the background and business experience of our executive officers other than Mr. Scheetz (whose background and business experience is described in connection with his status as a director):

William M. McDonald. Mr. McDonald has over 25 years experience in public accounting. Having assumed the position of Controller in June 2007, the Company promoted him to the position of Chief Financial Officer in April 2008. Prior to joining Digitiliti, Mr. McDonald held a senior level position in the Commercial Loan division of North Star bank in St. Paul, Minnesota, and served as Chief Financial Officer for Kath Fuel Oil Co. Mr. McDonald holds a Public Accounting certificate (inactive status), as well as a degree of Juris Doctor from William Mitchel College of Law.

EXECUTIVE COMPENSATION

The following table provides information relative to compensation paid to each person who served as a named executive officer anytime during the fiscal years ended December 31, 2009 and December 31, 2010.

Name and Principal Position	Year	Salary (\$)	Bonus (\$)	Stock Awards (\$)	Option Awards (\$) ⁽¹⁾	Non-Equity Incentive Plan Compensation (\$)	Nonqualified Deferred Compensation (\$)	All Other Compensation (\$)	Total (\$)
Roy A. Bauer, CEO	12/31/10	\$131,250	0	0	\$109,998 ⁽⁵⁾	0	0	0	\$241,246
	12/31/09	\$175,000 ⁽²⁾	\$10,000 ⁽³⁾	0	\$240,053 ⁽⁴⁾	\$40,000 ⁽³⁾	0	0	\$465,053
Ehssan Taghizadeh, Former CEO, Director and Executive Officer ⁽⁶⁾	12/31/2010	\$44,708	—	—	\$105,524 ⁽⁶⁾	—	—	—	\$150,232
William McDonald, CFO	12/31/10	\$103,053	0	0	0	0	0	0	\$103,053
	12/31/09	\$84,977	0	0	0	0	0	12,879 ⁽⁷⁾	\$97,856

(1)The value of the stock options and warrants are calculated in accordance with FASB ASC Topic 718.

(2)

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Under the terms of his employment agreement, Mr. Bauer was paid an annual salary of \$175,000. In 2009, \$131,222.85 of his salary was paid in common stock of Digitiliti, or 656,249 shares, at \$0.20 per share, pursuant to the terms of his employment agreement. Starting October 1, 2009, his agreement provided that his salary would be payable monthly half in cash (\$7,291.67) and half in shares of common stock at \$.20 per share (36,458 shares). The price at which the shares were issued to Mr. Bauer in 2009, as described above, was above the fair market value of the shares on each date the shares were issued.

(3) Under the terms of his employment agreement, Mr. Bauer was granted a one time performance bonus of \$50,000, earned if Mr. Bauer was Chief Executive Officer of Digitiliti on December 31, 2009. A portion of the bonus, \$10,000, was paid to Mr. Bauer in 2010 pursuant to his request. However, we are still obligated to pay Mr. Bauer the remaining \$40,000.

(4) On February 6, 2009, Mr. Bauer was granted a ten-year option (valued at \$25,836) to purchase 225,000 shares of our common stock, exercisable at \$0.385 per share, and vests over a period of three years based on his continued service

as a director. Under the terms of his employment agreement, Mr. Bauer was granted a signing bonus of a ten-year warrant (valued at \$82,432) to purchase 500,000 shares of our common stock at \$0.20 per share (which was above the market value of our stock at the time of grant), vested in full. In addition, if Mr. Bauer achieved various performance goals by certain dates in 2010, Mr. Bauer would be granted three additional warrants to purchase: 250,000 shares at \$0.35 per share (valued at \$44,313) that were met by Mr. Bauer's performance, 250,000 shares at \$0.50 per share (valued at \$43,736) that were not met by Mr. Bauer's performance and 250,000 shares at \$.50 per share (valued at \$43,736) that were not met by Mr. Bauer's performance. Two of the warrant incentives were not granted due to the performance goals not being achieved by the deadline, but one warrant incentive is still outstanding.

On October 14, 2010, citing Mr. Bauer's exceptional service to the Company under extremely difficult (5) circumstances, Mr. Bauer was granted 500,000 warrants to purchase the Company's common stock at \$.22 per share (valued at \$109,998).

Under the terms of his employment agreement. Mr. Taghizadeh was paid an annual salary of \$185,000. In addition, the terms of Mr. Taghizadeh's employment agreement included the grant of options on October 14, 2010 to purchase 600,000 shares of the Company's common stock that have a five-year life and a \$.22 per share exercise (6) price (valued at \$105,524). Also, Mr. Taghizadeh was granted an option exercisable on December 31, 2011, provided Mr. Taghizadeh is still employed by the Company on that date, to purchase 600,000 shares of the Company' common stock reflecting a five-year term and an exercise price equal to the fair market value on the date of grant. On June 29, 2011, Mr. Taghizadeh employment with the Company was terminated resulting in a \$117,500 payment to Mr. Taghizadeh under the terms of a Separation Agreement.

(7) In 2009, we paid McDonald Professional Services \$3,850. McDonald Professional Services is owned by William M. McDonald, and the amount paid represents fees for professional services rendered during the year.

Executive Employment Arrangements with Named Executive Officers

On October 30, 2009, we entered into an employment agreement with Roy A. Bauer, our former Chief Executive Officer. Under this agreement, we agreed to pay Mr. Bauer an annual base salary of \$175,000; a one-time performance bonus of \$50,000 based on Mr. Bauer continuing to be our Chief Executive Officer on December 31, 2009; signing bonus of a fully-vested, five-year warrant to purchase 500,000 shares of our common stock, exercisable at \$0.20 per share. In addition, contingent on achieving certain performance goals in 2010, we agreed to issue Mr. Bauer three warrants to purchase 250,000 shares of our common stock each. Conditions for two of the warrants were not met within the required deadlines, and so were not issued. The last warrant, conditioned on building management capabilities and implementing an orderly CEO transition plan by December 31, 2010, would be exercisable at \$.50 per share if issued. The agreement also provided that Mr. Bauer's salary from February 9, 2009 through September 30, 2009 would be paid in shares of our common stock (546,875 shares) based on \$0.20 per share, and that from October 1, 2009 onward, his monthly salary would be payable half in cash and half in shares of common stock, based on \$0.20 per share. On October 4, 2010, Mr. Bauer resigned as the President and Chief Executive Officer of the Company, yet retained the position of Chairman of the Board of Directors throughout the remainder of 2010. And October 14, 2010, citing Mr. Bauer's exceptional service to the Company under extremely difficult circumstances, Mr. Bauer was granted 500,000 warrants to purchase the Company's common stock at \$.22 per share (valued at \$109,998).

We do not have a formal employment agreement or arrangement with William M. McDonald, our Chief Financial Officer.

Severance Arrangements with Named Executive Officers

On June 29, 2011, Ehssan Taghizadeh resigned as the President and Chief Executive Officer of the Company and as a member of the Board of Directors. In connection with his resignation as an officer, the Company entered into a separation agreement with Mr. Taghizadeh, whereby the Company agreed to pay amounts owed to him under his employment agreement, including bonuses previously granted but unpaid, and to grant him a five-year warrant to purchase up to 200,000 shares of common stock at an exercise price of \$0.06 per share (“Separation Agreement”). Under the terms of the Separation Agreement, Mr. Taghizadeh agreed to a discounted payment, that a portion of the payment will be paid with 597,129 shares in lieu of cash.

Pension Benefits

None of our named executive officers are covered by a pension plan or other similar benefit plan that provides for payments or other benefits at, following, or in connection with retirement.

Nonqualified Deferred Compensation

None of our named executive officers are covered by a defined contribution or other plan that provides for the deferral of compensation on a basis that is not tax-qualified.

OUTSTANDING EQUITY AWARDS AT YEAR END 2010

The following table provides information as of December 31, 2010 regarding unexercised stock options, stock awards that have not vested and equity incentive plan awards for each person who served as a named executive officer during the year ended December 31, 2010.

Name	Option Awards ⁽¹⁾			Stock Awards					
	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Equity Incentive Plan Awards Number of Securities Underlying Unexercised Options (#)	Option Exercise Price (\$)	Option Expiration Date	Number of Shares or Units of Stock of That Have Not Vested (#)	Market Value of Stock That Have Not Vested (\$)	Equity Incentive Plan Awards: Number of Shares, Units or Rights That Have Not Vested (#)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Rights That Have Not Vested (\$)
Roy A. Bauer	175,000	50,000 ⁽²⁾	---	\$0.385	02/06/2019	---	---	---	---
	---	---	250,000 ⁽³⁾	\$0.35	---	---	---	---	---
	---	---	250,000 ⁽⁴⁾	\$0.50	---	---	---	---	---
	---	---	250,000 ⁽⁵⁾	\$0.50	---	---	---	---	---
	---	---	500,000 ⁽⁶⁾	\$0.22	---	---	---	---	---
Ehssan Taghizadeh	---	200,000 ⁽⁷⁾	---	\$0.21	12/31/2012 ⁽⁷⁾	---	---	---	---
	---	200,000 ⁽⁷⁾	---	\$0.21	12/31/2011 ⁽⁷⁾	---	---	---	---
	200,000 ⁽⁷⁾	---	---	\$0.21	12/31/2010 ⁽⁷⁾	---	---	---	---
	133,340 ⁽⁸⁾	16,660 ⁽⁸⁾	---	\$0.35	04/17/2018	---	---	---	---
William McDonald	150,000 ⁽⁹⁾	0 ⁽⁹⁾	---	\$0.35	07/23/2017	---	---	---	---
	9,224 ⁽¹⁰⁾	40,776 ⁽¹⁰⁾	---	\$0.08	05/31/2014	---	---	---	---
	13,836 ⁽¹¹⁾	36,164 ⁽¹¹⁾	---	\$0.08	05/31/2013	---	---	---	---
	27,671 ⁽¹²⁾	22,329 ⁽¹²⁾	---	\$0.08	05/31/2012	---	---	---	---

(1) None of our named executive officers exercised options in 2010

(2) The option vests as to 6,250 additional shares each month until it is fully vested on August 31, 2011.

(3) Under Mr. Bauer's employment agreement, if the commercial launch of Pyramid occurred no later than March 31, 2010, Mr. Bauer would receive a warrant to purchase 250,000 shares of our common stock. This

condition was not met within the time frame, and the warrant was not issued to Mr. Bauer.

Under Mr. Bauer's employment agreement, if we raised a minimum of \$3,000,000 of additional capital by June 30, (4)2010, Mr. Bauer would receive a warrant to purchase 250,000 shares of our common stock. This condition was not met within the time frame, and the warrant was not issued to Mr. Bauer.

Under Mr. Bauer's employment agreement, having successfully implemented enhanced management capabilities (5)and implementing an orderly CEO transition plan by December 31, 2010, Mr. Bauer was awarded a warrant to purchase 250,000 shares of our common stock.

On October 14, 2010, citing Mr. Bauer's exceptional service to the Company under extremely difficult (6)circumstances, Mr. Bauer was granted 500,000 warrants to purchase the Company's common stock at \$.22 per share (valued at \$109,998).

(7) Under the terms of his employment agreement. Mr. Taghizadeh was granted options on October 14, 2010 to purchase

600,000 shares of the Company's common stock that have a five-year life and a \$.22 per share exercise price (valued at \$105,524).

(8) The option became fully vested on April 30, 2011.

(9) The option became fully vested on July 31, 2010.

(10) The option vests as to approx. 1,300 additional shares each month until it is fully vested on May 31, 2014.

(11) The option vests as to approx. 2,100 additional shares each month until it is fully vested on May 31, 2013.

(12) The option vests as to approx. 4,200 additional shares each month until it is fully vested on May 31, 2012.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Since the beginning of our fiscal year 2010, there has not been, and there is not currently proposed any transaction or series of similar transactions in which the amount involved exceeded or will exceed the lesser of \$120,000 or 1% of our total assets as of December 31, 2010 and 2009 and in which any related person, including any current director, executive officer, holder of more than 5% of our capital stock, or entities affiliated with them, had a material interest.

Our Audit and Finance Committee's charter requires review of any proposed related party transaction, conflicts of interest and any other transaction for which independent review is necessary or desirable to achieve the highest standards of corporate governance. It is also our unwritten policy, which policy is not otherwise evidenced, for any related party transaction that involves more than a de minimis obligation, expense or payment, to obtain approval by our Board of Directors prior to our entering into any such transaction. During the 2010, there have not been any related party transactions or proposed related party transactions which were not reviewed and approved by our Board of Directors.

Code of Conduct

On May 1, 2009, the Board of Directors approved a Code of Conduct which applies to our president, chief executive officer, chief accounting officer or controller and any other person who performs similar functions for us. The Code of Conduct was filed as an exhibit to our Annual Report on Form 10-K for the fiscal year ended December 31, 2008 and is available on our website at www.digitiliti.com. The Audit and Finance Committee of our Board of Directors is responsible for overseeing the Code of Conduct. Our Board of Directors must approve any waivers of the Code of Conduct.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended, or the Exchange Act, requires our executive officers and directors and persons who own more than ten percent (10%) of our common stock to file initial reports of ownership (Form 3) and reports of changes in ownership (Form 4) with the Securities and Exchange Commission, and to furnish copies of all such reports to us.

Based solely on review of the copies of such forms furnished to us, the following Section 16(a) filings for our executive officers and directors were not timely filed for transactions that occurred during 2010. transaction; Ehssan Taghizadeh, 1 filing for 1 transaction.

PROPOSAL 2

APPROVAL OF AN AMENDMENT TO OUR CERTIFICATE OF INCORPORATION TO INCREASE THE NUMBER OF AUTHORIZED SHARES FROM 135,000,000 TO 200,000,000 SHARES AND ALLOCATE THE ADDITIONAL SHARES AS COMMON STOCK

Our stockholders are asked to act upon a proposal to amend our Certificate of Incorporation, as amended, to increase the number of shares that the Company is authorized to issue from 135,000,000 to 200,000,000, and allocate such additional shares as common stock. A form of the Certificate of Amendment to our Certificate of Incorporation incorporating the amendment proposed in this Proposal 2 is attached to this Proxy Statement as Annex A.

Our Certificate of Incorporation currently authorizes us to issue up to 135,000,000 shares, whereby 100,000,000 shares have been allocated as common stock, 1,200,000 shares have been allocated as Series A Convertible Preferred Stock and 2,000,000 shares have been allocated to Series B Convertible Preferred Stock, with 6,800,000 shares have been allocated as undesignated preferred stock. As of September 16, 2011, we had outstanding 67,942,250 shares of common stock and 668,720 shares of Series A Convertible Preferred Stock and 420,000 shares of Series B Convertible Preferred Stock. Our Board of Directors believes the proposed increase in the authorized number of shares and allocating such shares as common stock is necessary to provide the Company with the flexibility to meet business and compensation needs as they arise, to take advantage of favorable opportunities and to respond to a changing environment.

The additional shares of common stock would be available for issuance from time to time and for such purposes as the Board of Directors may deem advisable without further action by our stockholders, except as may be required by applicable laws or regulations. There are no current plans for use of the additional shares. However, the additional shares could be utilized for additional stock issuances, retirement of indebtedness, employee benefit programs, corporate business combinations or other corporate purposes. In addition, the Board of Directors believes that an increase in the number of authorized shares would provide the Company with the ability to issue such additional new shares of common stock should a business opportunity be presented in the future.

This amendment and the authorization of additional shares of common stock will not alter the current number of issued shares or change the relative rights and limitations of the shares of outstanding common stock or preferred stock. The terms of the additional shares of common stock will be identical to those of the currently outstanding shares of common stock. However, because holders of common stock have no preemptive rights to purchase or subscribe for any unissued stock of the Company, any issuance of additional shares of common stock will reduce the current stockholders' percentage ownership interest in the total outstanding shares of stock of the Company. The authorization and subsequent issuance of additional shares of common stock may, among other things, have a dilutive effect on earnings per share and on the equity and voting power of existing holders of stock of the Company. However, the actual effect on the holders of outstanding stock cannot be ascertained until any additional shares of common stock are issued in the future.

Vote Required

In order to approve this proposal, the affirmative vote of a majority of the voting power of our common stock and Series A Convertible Preferred Stock and Series B Convertible Preferred Stock entitled to vote at the annual meeting of stockholders must be received in favor of this proposal.

Unless a contrary choice is specified, proxies solicited by our Board of Directors will be voted FOR approval of the amendment to the Certificate of Incorporation to increase the number of authorized shares from 135,000,000 shares to

200,000,000 shares and allocate the additional shares as common stock.

Recommendation of Our Board of Directors

Our Board of Directors recommends a vote FOR approval of an amendment to our Certificate of Incorporation to increase the number of authorized shares from 135,000,000 shares to 200,000,000 shares and allocate the additional shares as common stock.

PROPOSAL 3

RATIFICATION OF THE APPOINTMENT OF
MALONE AND BAILEY, LP
AS OUR
INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Audit and Finance Committee has appointed Malone and Bailey, LP (“Malone and Bailey”) to serve as our independent registered public accounting firm for the year ending December 31, 2011, subject to ratification by our stockholders. Malone and Bailey has audited our consolidated financial statements for the years ended December 31, 2008, 2009 and 2010. Lurie Besikof Lapidus & Company, LLP (“Lurie Besikof”) previously served as our independent registered public accounting firm and audited our consolidated financial statements for the year ended December 31, 2007. Our stockholders are asked to act upon a proposal to ratify the appointment of Malone and Bailey as our independent registered public accounting firm for the year ending December 31, 2011.

A representative of Malone and Bailey is expected to be present at the annual meeting, by telephone, and will have an opportunity to make a statement if he or she so desires. The Malone and Bailey representative will also be available to respond to appropriate questions from stockholders.

Audit and Non-Audit Fees

During the fiscal years 2010 and 2009, fees for services provided by Malone and Bailey were as follows:

	2010	2009
Audit Fees	\$64,000	\$86,445
Audit-Related Fees (review of registration statements and other SEC filings)	\$53,500	\$66,775
Tax Fees (tax-related services, including income tax advice regarding income taxes within the United States)	\$2,375	—
All Other Fees	—	—
Total Fees	\$119,875	\$153,220

None of the services described above were approved pursuant to the exception provided in Rule 2-01(c)(7)(i)(C) of Regulation S-X promulgated by the SEC.

Compatibility of Fees

The Audit and Finance Committee of the Board of Directors has considered whether the provision of the services described above is compatible with maintaining the independent registered public accounting firms' independence and has concluded that the services did not interfere with the independent registered public accounting firms' independence.

Pre-Approval Policies and Procedures

The Audit and Finance Committee has a policy for the pre-approval of audit services, requiring its prior approval for all audit and non-audit services provided by our independent registered public accounting firms. Our independent registered public accounting firms may not provide certain prohibited services. The Audit and Finance Committee's prior approval must be obtained before the scope or cost of pre-approved services is increased.

Consistent with these policies and procedures, the Audit and Finance Committee approved all of the services rendered by Malone and Bailey and during fiscal years 2010 and 2009, as described above.

Vote Required

In order to approve this proposal, the affirmative vote of a majority of the votes cast at the annual meeting, in person or by proxy, must be received in favor of this proposal.

Unless a contrary choice is specified, proxies solicited by our Board of Directors will be voted FOR ratification of the appointment of Malone and Bailey, LP as our independent registered public accounting firm for the year ending December 31, 2011.

Recommendation of Our Board of Directors

Our Board of Directors recommends a vote FOR ratification of the appointment of Malone and Bailey, LP as our independent registered public accounting firm for the year ending December 31, 2011.

REPORT OF THE AUDIT AND FINANCE COMMITTEE

The following Audit and Finance Committee Report shall not be deemed “soliciting material” or to be “filed” with the SEC, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933 or Securities Exchange Act of 1934, each as amended, except to the extent that we specifically incorporate it by reference into such filing.

The Audit and Finance Committee oversees our financial reporting process on behalf of our Board of Directors. The committee is comprised of three directors. The committee is currently governed by our Audit and Finance Committee charter. A copy of the charter is available on our website at www.digitilite.com. Other than Messrs. Dalvey, all of the Audit and Finance Committee members are independent within the meaning of Rule 5605(a)(2) of the Nasdaq Marketplace Rules, and are “independent,” as that term is defined in Section 10A of the Exchange Act. Management has the primary responsibility for the financial statements and the reporting process, including our systems of internal controls. In fulfilling its responsibilities, the committee reviewed the financial statements in the quarterly reports on Form 10-Q and the Annual Report on Form 10-K with management, including a discussion of the quality and acceptability of our financial reporting and controls.

The committee reviewed with our independent registered public accounting firm, who are responsible for expressing an opinion on the conformity of our audited financial statements with generally accepted accounting standards, their judgments as to the quality and acceptability of our financial reporting and such other matters as are required to be discussed with the committee under generally accepted auditing standards, including the matters required to be discussed by the statement on Auditing Standards No.61, as adopted by the Public Company Accounting Oversight Board (“PCAOB”). In addition, the committee has discussed with the independent registered public accounting firm the auditors' independence from management and us, including the matters in the registered public accounting firm's written disclosures and the letter required by the applicable requirements of the PCAOB. Furthermore, the committee has considered whether the provision of non-audit services by the independent registered public accounting firm for the fiscal year ended December 31, 2010, is compatible with maintaining their independence.

The committee also discussed with our independent registered public accounting firm the overall scope and plans for its audit. At least once a quarter, the committee meets with members of the independent registered public accounting firm, with and without management present, to discuss the results of its examination, its evaluation of our internal controls and the overall quality of our financial reporting.

In reliance on the reviews and discussions referred to above, the committee recommended to our Board of Directors that the audited financial statements be included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 for filing with the SEC. The committee has appointed Malone and Bailey, LP to serve as our principal independent public accountants for the year ending December 31, 2011.

Management is responsible for our financial reporting process including its system of internal control, and for the preparation of consolidated financial statements in accordance with generally accepted accounting principles. Our independent registered public accounting firm is responsible for auditing those financial statements. The committee's responsibility is to monitor and review these processes. It is not the committee's duty or responsibility to conduct auditing or accounting reviews or procedures. The members of the committee may not be, and, except for our Audit and Finance Committee financial experts, do not represent themselves to be or to serve as, accountants or auditors by

profession or experts in the fields of accounting or auditing. Therefore, the committee has relied, without independent verification, on management's representation that the financial statements have been prepared with integrity and objectivity and in conformity with U.S. generally accepted accounting principles and on the independent registered public accounting firm's report on our financial statements. The committee's oversight does not provide it with an independent basis to determine that management has maintained appropriate accounting and financial reporting principles or policies, or appropriate internal controls and procedures designed to assure compliance with accounting standards and applicable laws and regulations. Furthermore, the committee's considerations and discussions with management and the independent registered public accounting firm do not assure that our financial statements are presented in accordance with generally accepted accounting principles, that the audit of our financial statements has been carried out in accordance with U.S. generally accepted auditing standards or that our independent accountants are in fact "independent."

In addition to the responsibilities discussed in the preceding paragraphs, the committee's responsibilities include reviewing

significant accounting policies, policy decisions and changes, along with significant accounting, reporting and operational issues. The committee also reviews corporate policies and significant instances (if any) of the lack of compliance with laws and regulations, ethics, conflicts of interest and the investigation of misconduct or fraud. The committee is responsible for the resolution of any disagreements between management and the independent registered public accounting firm regarding financial reporting, review and approval of the annual internal audit plan and reports of the internal audit function and the establishment of procedures to receive, retain and treat complaints and whistle-blower information regarding questionable accounting or auditing matters.

The committee is pleased to submit this report to the stockholders with regard to the above matters.

Kent E. Lillemoe, Chair
Kedar R. Belhe
David F. Dalvey

The form of proxy and this proxy statement have been approved by our Board of Directors and are being mailed and delivered to stockholders by its authority.

/s/ Jack B. Scheetz
JACK B. SCHEETZ
Chief Executive Officer and President

Saint Paul, Minnesota
September __, 2011

PROXY
FOR THE ANNUAL MEETING
OF STOCKHOLDERS TO BE HELD NOVEMBER 15, 2011

This Proxy is solicited on behalf of the Board of Directors of Digitiliti, Inc. (“Digitiliti”).

The undersigned, revoking all prior proxies, hereby appoints Jack B. Scheetz and William M. McDonald, or either of them, as proxy or proxies, with full power of substitution and revocation, to vote all shares of common stock, Series A Convertible Preferred Stock or Series B Convertible Preferred Stock of Digitiliti of record in the name of the undersigned at the close of business on September 16, 2011 at the Annual Meeting of Stockholders to be held on November 15, 2011 at 1:00 p.m., Central Daylight Time, at the primary office of Digitiliti located at 266 East 7th Street, St. Paul, Minnesota, or any adjournment thereof, upon matters listed below. I authorize the proxy to vote as his discretion may dictate on the transaction of such other business as may properly come before the Annual Meeting of Stockholders or any adjournment thereof.

Please mark, sign and date your proxy card and return it in the postage-paid envelope we have provided or return it to Digitiliti, Inc., 266 East 7th Street, St. Paul, MN 55101, attention: William M. McDonald.

Important Notice Regarding the Availability of Proxy Materials for the Shareholder Meeting To Be Held on November 15, 2011: The Notice, Proxy Statement, 2011 Annual Report and form of Proxy will be available at www.digitiliti.com/proxy2011 beginning on or about October 4, 2011.

Proposal No. 1:

The Board of Directors recommends that you vote “For” the following director nominees.

Election of the following to the Board of Directors until the next annual meeting and until their successors are duly elected and qualified:

For All _____ Withhold All _____ For all Except _____

-) Jack B. Scheetz
-) Kent E. Lillemoe
-) Kedar R. Belhe
-) David F. Dalvey

To withhold authority to vote for any individual nominee(s), mark “For All Except” and write the number(s) of the nominee(s) above.

The Board of Directors recommends you vote FOR the following proposal(s):

Proposal No. 2:

To approve an amendment to our Certificate of Incorporation to increase the number of authorized shares from 135,000,000 to 200,000,000 shares and allocate the additional shares as common stock.

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_____ For _____ Against _____ Abstain

Proposal No. 3:

To ratify the appointment of Malone and Bailey, LP to serve as independent registered public accounting firm for the year ending December 31, 2011.

_____ For _____ Against _____ Abstain

When signing as attorney, executor, administrator, trustee, or other fiduciary, please give full title as such. Joint owner should each sign personally. All holders must sign. If a corporation or partnership, please sign in full corporate or partnership name, by authorized officer.

Print Name of Stockholder Number of Shares

Signature of Stockholder [SIGN WITHIN BOX]

Date

Signature of Joint Owner (if any) [SIGN WITHIN BOX]

Date

6313230v2



ANNEX A
CERTIFICATE OF AMENDMENT
OF CERTIFICATE OF INCORPORATION
OF DIGITILITI, INC.

Digitiliti, Inc., a corporation organized and existing under the laws of the State of Delaware, hereby certifies as follows:

1. The Certificate of Incorporation of the Corporation is hereby amended by changing the paragraph numbered "Fourth" so that, as amended, said paragraph shall be and read in its entirety as follows:

"The aggregate number of shares that the corporation shall have authority to issue is 200,000,000 shares, divided into two classes: 190,000,000 shares of common stock, \$0.001 par value per share, and 10,000,000 shares of preferred stock, \$0.001 par value per share. The Board of Directors has the right to set the series, classes, rights, privileges and preferences of the preferred or any class or series thereof, by amendment hereto, without shareholder approval, as provided in the General Corporation Law of the State of Delaware or as hereafter amended."

2. Pursuant to a resolution of its Board of Directors, a meeting of stockholders of the Corporation was duly called and held, on November 15, 2011 upon notice in accordance with Section 222 of the General Corporation Law of the State of Delaware, at which meeting the necessary number of shares as required by statute were voted in favor of the amendment.

3. The foregoing amendment was duly adopted in accordance with the provisions of Section 242 of the General Corporation Law of the State of Delaware.

IN WITNESS WHEREOF, the Corporation has caused this certificate to be signed by its Secretary as of the ____ day of _____, 2011.

By:
Title:
Name: