RADIOLOGIX INC
Form 10-Q
November 14, 2003

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 SEPTEMBER 30, 2003

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

COMMISSION FILE NO. 0-23311

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

DELAWARE	75-2648089
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2200 ROSS AVENUE
3600 JP MORGAN CHASE TOWER
DALLAS, TEXAS 75201-2776
(Address of principal executive offices, including zip code)

(214) 303-2776
(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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes [X] No [ ]

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

Class	Outstanding at November 12, 2003
COMMON STOCK, $0.0001 PAR VALUE	21,761,819 SHARES

RADIOLOGIX, INC.

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PART I: FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

RADIOLOGIX, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS)

ASSETS

	DECEMBER 31, 2002
CURRENT ASSETS:	
Cash and cash equivalents	$ 19,153
Accounts receivable, net of allowances	69,377
Due from affiliates	5,100
Assets held for sale	--
Other current assets	7,225
Total current assets	100,855
PROPERTY AND EQUIPMENT, net	62,103
INVESTMENTS IN JOINT VENTURES	10,149
GOODWILL	28,510
INTANGIBLE ASSETS, net	72,151
DEFERRED FINANCING COSTS, net	9,719
OTHER ASSETS	12,604
Total assets	$ 296,091
LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Accounts payable and accrued expenses	$ 19,145
Accrued physician retention	8,216
Accrued salaries and benefits	8,268
Current portion of long-term debt	266
Current portion of capital lease obligations	4,052
Other current liabilities	458
Total current liabilities	40,405
DEFERRED INCOME TAXES	4,200
LONG-TERM DEBT, net of current portion	160,412
CONVERTIBLE DEBT	11,980
CAPITAL LEASE OBLIGATIONS, net of current portion	1,519
DEFERRED REVENUE	7,721
OTHER LIABILITIES	147
Total liabilities	226,384
COMMITMENTS AND CONTINGENCIES	
MINORITY INTERESTS IN CONSOLIDATED SUBSIDIARIES	1,340
STOCKHOLDERS' EQUITY:	
Preferred stock, $.0001 par value; 10,000,000 shares authorized; no shares issued and outstanding	--
Common stock, $.0001 par value; 50,000,000 shares authorized; 21,695,153 shares issued and outstanding in 2002 and 21,761,819 in 2003	2
Treasury stock	(180)
Additional paid-in capital	13,662

Retained earnings	54,883
Total stockholders' equity	68,367
Total liabilities and stockholders' equity	$ 296,091

See accompanying notes to consolidated financial statements.

RADIOLOGIX, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	FOR THE THREE MONTHS ENDED SEPTEMBER 30,	
	2002	2003
SERVICE FEE REVENUE	$ 69,624	$ 64,365
COSTS AND EXPENSES:		
Salaries and benefits	21,188	21,145
Field supplies	4,190	4,455
Field rent and lease expense	7,495	8,135
Other field expenses	11,184	10,572
Bad debt expense	6,007	5,578
Severance and other related costs	--	--
Corporate general and administrative	3,712	3,560
Depreciation and amortization	6,613	6,820
Interest expense, net	4,560	4,486
Total costs and expenses	64,949	64,751
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF INVESTMENTS, MINORITY INTERESTS IN INCOME OF CONSOLIDATED SUBSIDIARIES, AND INCOME TAXES	4,675	(386)
Equity In Earnings of Investments	1,212	647
Minority Interests In Income of Consolidated Subsidiaries	(286)	(200)
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	5,601	61
Income Tax Expense	2,241	25
INCOME FROM CONTINUING OPERATIONS	3,360	36
Discontinued Operations:		
Loss from discontinued operations before income tax benefit	(282)	(1,137)
Income tax benefit	(113)	(455)

Loss from discontinued operations, net	(169)	(682)	
NET INCOME (LOSS)	$ 3,191	$ (646)	$
EARNINGS (LOSS) PER COMMON SHARE:			
Income from continuing operations - basic	$ 0.16	$ --	$
Loss from discontinued operations - basic	(0.01)	(0.03)	
Net income (loss) - basic	$ 0.15	$ (0.03)	$
Income from continuing operations - diluted	$ 0.14	$ --	$
Loss from discontinued operations - diluted	--	(0.03)	
Net income (loss) - diluted	$ 0.14	$ (0.03)	$
WEIGHTED AVERAGE SHARES OUTSTANDING:			
Basic	21,489	21,741	
Diluted	24,234	22,224	

See accompanying notes to unaudited consolidated financial statements.

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RADIOLOGIX, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(IN THOUSANDS)

	FOR THE NINE MONTHS ENDED SEPTEMBER 30,	
	2002	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ 12,392	$ (4,980)
Adjustments to reconcile net income (loss) to net cash provided by operating activities including discontinued operations:		
Minority interests in income of consolidated subsidiaries	955	730
Equity in earnings of investments	(3,419)	(3,159)
Depreciation and amortization	19,283	20,682
Write-down of goodwill included in discontinued operations	--	7,400
Deferred revenue	--	(307)
Non-cash income from receipt of treasury stock	(180)	--
Changes in operating assets and liabilities; net of acquisitions and dispositions:		
Accounts receivable, net	(1,827)	6,689
Other receivables and current assets	489	(1,655)
Accounts payable and accrued expenses	3,058	(3,950)
Net cash provided by operating activities	30,751	21,450

CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(17,917)	(17,570)
Contributions to joint ventures	(867)	(620)
Distributions from joint ventures	1,339	2,941
Other investments	(3,376)	2,286
Net cash used in investing activities	(20,821)	(12,963)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on long-term debt	(5,213)	(3,176)
Financing costs	(422)	--
Proceeds from exercise of stock options	1,077	250
Other items	--	3
Net cash used in financing activities	(4,558)	(2,923)
NET INCREASE IN CASH AND CASH EQUIVALENTS	5,372	5,564
CASH AND CASH EQUIVALENTS, beginning of year	10,761	19,153
CASH AND CASH EQUIVALENTS, end of period	$ 16,133	$ 24,717

See accompanying notes to unaudited consolidated financial statements.

RADIOLOGIX, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2003
(UNAUDITED)

1. DESCRIPTION OF BUSINESS

Radiologix, Inc. (together with its subsidiaries referred to as "Radiologix", the "Company," "we" or "us"), a Delaware corporation, is a leading national provider of diagnostic imaging services through its ownership and operation of free-standing, outpatient diagnostic imaging centers. Radiologix utilizes sophisticated technology and technical expertise to perform a broad range of imaging procedures, such as magnetic resonance imaging (MRI), computed tomography (CT), positron emission tomography (PET), nuclear medicine, ultrasound, mammography, bone densitometry (DEXA), general radiography (X-ray) and fluoroscopy. As of September 30, 2003, Radiologix owned, operated or maintained an ownership interest in imaging equipment at 110 locations, including five imaging centers that have been designated for sale or closure over the next three months that are included in discontinued operations in the accompanying unaudited consolidated financial statements. In addition, we provided management services to ten radiology practices. As of September 30, 2003, our imaging centers are located in 16 states, with a concentrated geographic coverage in markets located in California, Florida, Kansas, Maryland, New York, Texas and Virginia. Radiologix offers multi-modality imaging services at 64 of its diagnostic imaging centers, which provide patients and referring physicians access to advanced diagnostic imaging services in one convenient

location.

Radiologix also provides administrative, management and information services to certain radiology practices that provide professional services in connection with its diagnostic imaging centers and to hospitals and radiology practices with which the Company operates joint ventures. The Company's services provide leverage to its existing infrastructure and improvement to the efficiency and effectiveness of the radiology practice or joint venture profitability.

Radiologix has two models by which it contracts with radiology practices: a comprehensive services model and a technical services model. Under the comprehensive services model, the Company enters into a long-term agreement with a radiology practice group (typically 40 years). Under this arrangement, in addition to obtaining technical fees for the use of Radiologix's diagnostic imaging equipment and the provision of technical services, we provide management services and receive a fee based on the practice group's professional revenue, including revenue derived from outside of our diagnostic imaging centers.

Under the technical services model, the Company enters into a shorter-term agreement with a radiology practice group (typically 10 to 15 years) and pays them a fee based on cash collections from reimbursements for imaging procedures. In both the comprehensive services and technical services models, the Company owns the diagnostic imaging assets and, therefore, receives 100% of the technical reimbursements associated with imaging procedures. Additionally, in most instances, both the comprehensive services and the technical services models contemplate an incentive technical bonus for the radiology group if the net technical income exceeds specified thresholds. The service agreements generally cannot be terminated by either party without cause, consisting primarily of bankruptcy or material default.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

This quarterly report for Radiologix supplements our annual report to security holders for the fiscal year

ended December 31, 2002. As permitted by the Securities and Exchange Commission for interim reporting, we have omitted certain notes and disclosures that substantially duplicate those in the annual report. In the opinion of management, all adjustments necessary for a fair presentation have been included and are of a normal recurring nature, other than those adjustments related to severance costs and discontinued operations which are discussed separately in Notes 5 and 6. Interim results are not necessarily indicative of the results that may be expected for the year. For further information, refer to the audited consolidated financial statements and notes included in our annual report to security holders for the year ended December 31, 2002.

The unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States and include the accounts of the Company and its wholly owned and majority owned subsidiaries. All significant intercompany transactions have been eliminated. Investments in entities that the Company does not control, but in which it has a substantial ownership interest and can exercise significant influence, are accounted for using the equity method.

Certain prior-year balances in the accompanying consolidated financial statements have been reclassified to conform to the current year's presentation of financial information. These reclassifications have no impact on total assets, liabilities, stockholder's equity, net income (loss), or cash flows.

USE OF ESTIMATES IN THE PREPARATION OF THE FINANCIAL STATEMENTS

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

IMPAIRMENT OF LONG-LIVED ASSETS

During the three months ended September 30, 2003, an additional imaging center was included in discontinued operations in the accompanying unaudited consolidated statements of income. As a result, in accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"), a $500,000 pre-tax charge to write-down the goodwill was recognized during the three months ended September 30, 2003. As of September 30, 2003, eight imaging centers were included in discontinued operations in the accompanying unaudited consolidated statements of income. The nine months ended September 30, 2003 includes a $7.4 million pre-tax charge to write-down the goodwill related to these imaging centers.

GOODWILL AND INTANGIBLE ASSETS

The value of intangible assets (consisting primarily of service agreements and goodwill) is stated at the lower of cost or fair value.

At September 30, 2003, the Company has $21.1 million of goodwill related to the acquired intangible assets of our subsidiary, Questar Imaging, Inc. ("Questar"). During the first quarter of 2003, in accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" we performed the annual impairment test of our Questar operations. We engaged an independent third party valuation specialist to determine the fair value of these operations. Their valuation indicated that the fair value of the Questar operations exceeded the carrying value after considering the write-down of goodwill for discontinued operations. Consequently, no impairment was recorded.

The intangible asset related to a service agreement is recorded on the date of acquisition, and represents the difference between the cost of purchasing the right to manage a radiology practice and the net assets acquired. Under the initial 40-year term of the agreements, the contracted radiology practices have agreed to provide medical services to facilities managed by Radiologix. In the event a contracted radiology practice breaches the service agreement, or if Radiologix terminates with cause, the contracted radiology practice is required to purchase all related tangible and intangible assets, including the unamortized portion of the service agreement intangible asset, at the then net book value. The Company's service agreements, included in the consolidated balance sheets as intangible assets, net, are not considered to have an indefinite useful life and will continue to be amortized over a useful life of 25 years. In connection with the restructuring of certain service agreements during 2002, $6.0 million was capitalized as an addition to service

agreements. Accumulated amortization of intangible assets at September 30, 2002 and 2003 amounted to $17.6 and $16.9 million, respectively. Amortization expense for the three months ended September 30, 2002 and 2003 equated to $848,000 and $953,000, respectively. Amortization expense for the nine months ended September 30, 2002 and 2003 equated to $2.5 million and $2.9 million, respectively. We expect amortization expense to approximate $16.2 million in total over the next five years.

We regularly evaluate the carrying value of our finite lived intangible assets in light of any events or circumstances that may indicate that the carrying amount or amortization period should be adjusted. As of September 30, 2003, we do not believe there are any indicators that the carrying values or the useful lives of these assets need to be adjusted. Future disposals or terminations of Questar operations may result in additional goodwill impairment charges.

STOCK-BASED AWARDS

In December 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" ("SFAS No. 148"). SFAS No. 148 provides companies alternative methods of transitioning to Statement of Financial Accounting Standards No. 123 "Accounting for Stock-Based Compensation" ("SFAS No. 123") fair value of accounting for stock-based employee compensation. It also requires certain disclosure in both annual and quarterly financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS No. 148 does not mandate fair value accounting for stock-based employee compensation, but does require all companies to meet the disclosure requirements. We do not recognize compensation expense for our stock option grants, which are issued at fair value at the date of grant. During the three months ended March 31, 2003, 500,000 options were issued which vest based on the Company's common stock exceeding various stock closing sales prices for 20 consecutive days. During the three months ended June 30, 2003, 125,000 options were issued that vest based on the Company's common stock exceeding various stock closing sales prices for 20 consecutive days. None of these options vested during the nine months ended September 30, 2003. Due to the volatility of the Company's most recent stock prices, the Company was not able to estimate the fair value of the 500,000 options granted during the three months ended March 31, 2003 or the 125,000 options granted during the three months ended June 30, 2003 that vest at a determined sales price and therefore, did not recognize compensation expense. Upon vesting, the Company will recognize compensation expense for these variable options. The Company has not adopted fair value accounting for its employee stock options. In addition, 125,000 options were issued as incentive compensation at the time of employment and were not under the Company's 1996 Stock Option Plan and have similar vesting as options issued under the Company's 1996 Stock Option Plan.

The Company currently accounts for its employee stock-based compensation arrangements under the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees"

("APB No. 25"). The Company accounts for stock-based compensation of non-employees under the provisions of SFAS No. 123. The Company did not have any stock-based compensation to non-employees during 2002 and 2003.

SFAS No. 123 also requires that companies electing to continue to use

the intrinsic value method to make pro forma disclosure of net income (loss) and net income (loss) per share as if the fair value method of accounting had been applied. The effects of applying SFAS No. 123 during the nine months ended September 30, 2002 and 2003 are as follows (in thousands, except per share amounts):

	2002	2003
Income from continuing operations	$ 12,644	$ 301
Loss from discontinued operations, net of tax benefit	(252)	(5,281)
Net income (loss)	12,392	(4,980)
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	(1,348)	(1,290)
Pro forma net income (loss)	$ 11,044	$ (6,270)
Earnings (loss) per common share:		
Income from continuing operations - basic	$ 0.61	$ 0.01
Loss from discontinued operations - basic	(0.01)	(0.24)
Net income (loss) - basic	$ 0.60	$ (0.23)
Proforma net income (loss) - basic	$ 0.53	$ (0.29)
Income from continuing operations - diluted	$ 0.55	$ 0.01
Loss from discontinued operations - diluted	(0.01)	(0.24)
Net income (loss) - diluted	$ 0.54	$ (0.23)
Proforma net income (loss) - diluted	$ 0.48	$ (0.29)

The fair value of each option grant is estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions for grants during the nine months ended September 30, 2002 and 2003, respectively: risk-free interest rate of 3.87% and 4.27%; expected life of 6.93 and 7.50 years; expected volatility of 83.1%, and 67.5%; and dividend yield of zero in 2002 and 2003, respectively. The weighted-average grant-date fair value of new grants during the nine months ended September 30, 2002 and 2003 was $11.65 per share, and $2.56 per share, respectively.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

REVENUE PRESENTATION

The Financial Accounting Standards Board's Emerging Issues Task Force issued its abstract, Issue 97-2, "Application of FASB Statement No. 94 and APB Opinion No. 16 to Physician Practice Management Entities

and Certain Other Entities with Contractual Arrangements" ("EITF 97-2"). Since Radiologix has not established a "controlling financial interest" under EITF 97-2, Radiologix does not consolidate the contracted radiology practices.

The following table sets forth the amounts of revenue for the contracted radiology practices and diagnostic imaging centers that would have been presented in the consolidated statements of operations had Radiologix met the provisions of EITF 97-2 (in thousands):

	FOR THE THREE MONTHS ENDED SEPTEMBER 30,		FOR THE NIN SEP
	2002	2003	2002
Revenue for contracted radiology practices and diagnostic imaging centers, net of contractual adjustments	$ 96,078	$ 90,295	$ 291,224
Less: amounts retained by contracted radiology practices	(26,454)	(25,930)	(79,554)
Service fee revenue	$ 69,624	$ 64,365	$ 211,670

Revenue of the contracted radiology practices and diagnostic imaging centers is recorded when services are rendered by the contracted radiology practice and diagnostic imaging center based on established charges and reduced by contractual allowances. In addition, bad debt expense related to established charges is recognized as costs and expenses rather than a deduction of net revenue. We use historical collection experience in estimating our contractual adjustments and bad debt expense. The factors influencing the historical collection experience include the contracted radiology practices' and diagnostic imaging centers' patient mix, impact of managed care contract pricing and contract revenue and the aging of patient accounts receivable balances. As these factors change, the historical collection experience is revised accordingly in the period known.

Service fee revenue represents the contracted radiology practices' and diagnostic imaging centers' revenue less amounts retained by the contracted radiology practices. The amounts retained by the contracted radiology practices represents amounts paid to the physicians pursuant to the service agreements between Radiologix and the contracted radiology practices. Under the service agreements, the Company provides each contracted radiology practice with the facilities and equipment used in its medical practice, assumes responsibility for the management of the operations of the practice, and employs substantially all of the non-physician personnel utilized by the contracted radiology practice.

The Company's service fee revenue is dependent upon the operating results of the contracted radiology practices and diagnostic imaging centers. Where state law allows, service fees due under the service agreements for the contracted radiology practices are derived from two distinct revenue streams: (1) a negotiated percentage (up to 30%) of the adjusted professional revenues as

defined in the service agreements; and (2) 100% of the adjusted technical revenues as defined in the service agreements. In states where the law requires a flat fee structure, Radiologix has negotiated a base service fee, which is equal to the estimated fair market value of the services provided under the service agreements and which is renegotiated each year to equal the fair market value of the services provided under the service agreements. Adjusted professional revenues and adjusted technical revenues are determined by deducting certain contractually agreed-upon expenses (non-physician salaries and benefits, rent, depreciation, insurance, interest and other physician costs) from the contracted radiology practices' revenue. Revenues of Questar are primarily derived from technical revenues generated from those imaging centers. Service fee revenue consists of the following (in thousands):

	FOR THE THREE MONTHS ENDED SEPTEMBER 30,		FOR THE NINE MONTHS ENDED SEPTEMBER 30,	
	2002	2003	2002	2003
Professional component	$ 12,804	$ 11,952	$ 42,371	$ 35,325
Technical component	56,820	52,413	169,299	158,040
Service fee revenue	$ 69,624	$ 64,365	$ 211,670	$ 193,365

SEVERANCE AND OTHER RELATED COSTS

During the nine months ended September 30, 2003, we recorded severance costs of $1,280,000. These costs include severance incurred in connection with changes in the Company's senior management team and a cost reduction program that resulted in a workforce reduction at the corporate office and among certain field employees. The following table provides a reconciliation of the beginning and ending liability balances in connection with severance and other related costs recorded in the current and prior periods as of September 30, 2003 (in thousands):

Balance at December 31, 2002	$ 773
Expense	1,280
Cash payments	(1,982)
Balance at September 30, 2003	$ 71

The above liability balances are included in accounts payable and accrued expenses in the accompanying consolidated balance sheets.

RECENT ACCOUNTING PRONOUNCEMENTS

In March 2003, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards Board Interpretation No. 46 "Consolidation of Variable Interest Entities" ("FIN 46"), effective December 15, 2003. FIN 46 requires that a company consolidate or disclose information about a

variable interest entity. FIN 46 applies prospectively to all enterprises with variable interests in variable interest entities created after January 31, 2003. The disclosure provisions are effective for financial statements of interim periods after December 15, 2003. The effect of FIN 46 on the Company has not yet been determined.

In May 2003, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 150 "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" ("FAS 150"). Radiologix consolidates three finite-lived joint ventures that qualify as mandatorily redeemable non-controlling interests, as defined by SFAS 150. Upon termination of these joint ventures at a contractually designated future date, all net assets will be distributed to the joint venture partners, including Radiologix, in accordance with the partners' ownership percentage, and at settlement amounts that are comparable to book values. Upon adoption of the measurement and recognition provisions of SFAS 150 (currently deferred indefinitely for mandatorily redeemable non-controlling interests), Radiologix will measure the non-controlling interests in these ventures at settlement value and recognize the non-controlling interests as liabilities.

3. LONG TERM DEBT

Senior Notes

The Company's $160 million senior notes due December 15, 2008 bear interest at an annual rate of 10 1/2% payable semiannually in arrears on June 15 and December 15 of each year, commencing June 15, 2002. The senior notes are redeemable on or after December 15, 2005 at various redemption prices, plus accrued and unpaid interest to the date of redemption. The senior notes are unsecured obligations, which rank senior in right of payment to all of our subordinate indebtedness and equal in right of payment with all other senior indebtedness. The senior notes are unconditionally guaranteed on a senior unsecured basis by certain restricted existing and future subsidiaries.

Credit Facility

At September 30, 2003, no borrowings were outstanding under our credit facility of $35 million. Under the credit facility, the interest rate is (i) an adjusted LIBOR rate, plus an applicable margin which can vary from 3.0% to 3.5% dependent on certain financial ratios or (ii) the prime rate, plus an applicable margin which can vary from 1.75% to 2.25%. In each case, the applicable margin varies based on financial ratios maintained by the Company. The credit facility includes certain restrictive covenants including prohibitions on the payment of dividends and the maintenance of certain financial ratios (including minimum fixed charge coverage ratio and maximum leverage ratio, as defined). At September 30, 2003, the Company was in compliance with these covenants. At September 30, 2003, certain financial ratios have restricted the Company's ability to borrow up to $35 million. As a result of the financial covenant ratios, at September 30, 2003, the Company has available up to $11.6 million under the credit facility. Borrowings under the credit facility are secured by all service agreements that the Company is or becomes a party to, a pledge of the stock of the Company's subsidiaries and all of the Company's and its wholly-owned subsidiaries' assets.

Convertible Subordinated Debt

The Company has a $12.0 million convertible junior subordinated note,

which matures July 31, 2009, and bears interest, payable quarterly in cash or payment in kind securities, at an annual rate of 8.00%.

4. DEFERRED REVENUE

In connection with the amendment of a service agreement in July 2002 with one of the contracted radiology practices, we have recorded deferred revenue of $3.3 million in consideration recognized for the amended agreement, which will be amortized over a 20-year period, representing the remaining life of the agreement. In December 2002, we amended a service agreement of another contracted radiology practice and recorded deferred revenue of $4.8 million in consideration recognized for the amended agreement. Beginning January 2003, the deferred revenue is being amortized over approximately a 19-year period, representing the remaining life of the agreement.

5. COMMITMENTS AND CONTINGENCIES

As previously disclosed in the Report on Form 10-Q for the quarterly period ended June 30, 2003, the Company has been subject to a lawsuit and a demand for arbitration with physicians in San Antonio, Texas. On September 29, 2003, the parties executed a comprehensive agreement to settle by arbitration all disputes between the parties for all claims arising in the lawsuit and demand for arbitration. The arbitration was conducted and completed on October 8, 2003 and mutual general releases became effective as of that date. The management service agreement shall terminate and the parties shall separate their business dealings commencing on June 30, 2004. The lawsuits have been dismissed and the matter has now been concluded. The service fee revenue and income from continuing operations before income taxes of the Central region will be decreased by approximately 15% and 32%, respectively, as a result of the portion of the business to be severed June 30, 2004.

As part of a routine, ongoing compliance and legal review, Radiologix has found that rents negotiated for the subletting of space from physician landlords of several Radiologix locations may have exceeded fair market value. Radiologix sent a letter to the U.S. Department of Health & Human Services' Office of the Inspector General ("OIG"), informing them of the preliminary findings and seeking their guidance and assistance to remedy this situation. Accordingly, in the second quarter of 2003, we recorded $500,000 as an estimate for potential payments we may incur directly or indirectly. Subsequently, Radiologix has qualified for the Provider Self-disclosure Protocol of the Department of Health and Human Services' Office of the Inspector General ("OIG"). The Provider Self-disclosure Protocol is a self-reporting program that provides for minimizing the cost and disruption associated with on-going investigations of the OIG. Since the inquiry is in its very early stages, it is not yet possible for Radiologix to give any assurances that the OIG will not impose fines in excess of our estimate or that any potential payments or findings would not have a material adverse effect on its financial position, cash flow and results of operations.

6. DISCONTINUED OPERATIONS

As of September 30, 2003, the Company has five imaging centers that have been designated for sale or closure over the next three months that are included in discontinued operations in the accompanying unaudited consolidated statements of income. These imaging centers do not represent centers around which we can build a market concentration. During the three months ended September 30, 2003 an additional imaging center was included in discontinued operations. As a result, in accordance with SFAS No. 144, a $500,000 pre-tax

charge to write-down the goodwill was recognized during the three months ended September 30, 2003. This imaging center was subsequently sold effective September 30, 2003 along with two other imaging centers for the assumption of certain obligations. A $300,000 pre-tax charge for an equipment lease buy-out for one of the imaging centers sold was recognized during the three months ended September 30, 2003. The five imaging centers designated for sale or closure and three imaging centers sold are reported in discontinued operations in the accompanying unaudited consolidated statements of income for the three and nine months ended September 30, 2002 and 2003. The nine months ended September 30, 2003 include a $7.4 million pre-tax charge to write-down the related goodwill of these imaging centers in accordance with SFAS No. 144. For the three and nine months ended September 30, 2002, the accompanying unaudited consolidated statements of income have been restated to reflect the results of operations of the eight imaging centers as discontinued operations.

Service fee revenue and loss from discontinued operations were as follows (in thousands):

	FOR THE THREE MONTHS ENDED SEPTEMBER 30,		FOR THE NINE MONTH SEPTEMBER 30	
	2002	2003	2002	
Service fee revenue	$ 1,650	$ 1,535	$ 5,685	$
Loss from discontinued operations before income taxes	$ (282)	$ (1,137)	$ (420)	$
Income tax benefit	(113)	(455)	(168)	
Loss from discontinued operations	$ (169)	$ (682)	$ (252)	$

Assets and liabilities of discontinued operations as of September 30, 2002 and 2003 were as follows (in thousands):

	2002	2003
Assets	$3,556	$1,762
Liabilities	1,833	1,508
Net assets	$1,723	$ 254

7. EARNINGS PER SHARE

Basic earnings per share ("EPS") is calculated by dividing income available to common stockholders by the weighted average number of common shares outstanding during the period (including shares to be issued). Options, warrants, and other potentially dilutive securities are excluded from the calculation of basic EPS. Diluted EPS includes the options, warrants, and other potentially dilutive securities that are excluded from basic EPS using the

treasury stock method to the extent that these securities are not anti-dilutive. Diluted EPS also includes the effect of the convertible junior subordinated note using the "if converted" method to the extent the securities are not anti-dilutive. For the three months ended September 30, 2003, approximately $145,000 of tax-effected interest savings and 1,593,098 weighted average shares related to the convertible junior subordinated note were not included in the computation of diluted EPS because to do so would be anti-dilutive for the period. For the three months ended September 30, 2002, approximately $144,000 of tax-effected interest savings and 1,613,898 weighted average shares related to the convertible junior subordinated note were included in the computation of diluted EPS. For the three months ended September 30, 2002 and 2003, 1,131,534 shares and 482,592 shares, respectively, related to stock options were included in diluted EPS.

For the nine months ended September 30, 2003, approximately $435,000 of tax-effected interest savings and 1,593,098 weighted average shares related to the convertible junior subordinated note were not included in the computation of diluted EPS because to do so would be anti-dilutive for the period. For the nine months ended September 30, 2002, approximately $614,000 of tax-effected interest savings and 2,183,777 weighted average shares related to the convertible junior subordinated note were included in the computation of diluted

EPS. For the nine months ended September 30, 2002 and 2003, 1,227,184 shares and 196,079 shares, respectively, related to stock options were included in diluted EPS.

8. SEGMENT REPORTING

The Company reports the results of its operations through four designated regions of the United States: Mid-Atlantic, Northeastern, Central and Western. In addition, the Company reports the results of its operations of the imaging centers of its subsidiary, Questar. The Company's operations in each of the four designated regions are comprised of the ownership and operation of diagnostic imaging centers and the provision of administrative, management and information services to the contracted radiology practices that provide professional interpretation and supervision services in connection with its diagnostic imaging centers and to hospitals and radiology practices with which the Company operates joint ventures. The Company's services provide leverage to its existing infrastructure and improvement to the efficiency and effectiveness of the radiology practice or joint venture profitability. The Company has divided the operations into the four regions and Questar only for purposes of the division of internal management responsibilities, but does not focus on each of these regions as a separate product line or make financial decisions as if they were separate product lines. The Questar operations are looked at as a separate group only from the perspective that the imaging centers of Questar do not have the same type of management service agreement with physicians as we have with each of the contracted radiology practices in the four designated regions. In addition, any imaging centers of Questar that are in the same market as the operations of the contracted radiology practices in the four designated regions are not included in the service agreements of the contracted radiology practices.

The following table summarizes the operating results and assets by the five reportable segments (dollars in thousands):

	FOR THE NINE MONTHS ENDED SEPTEM			
	Mid-Atlantic Region (1)	Northeastern Region (2)	Central Region (3)	Western Region (4
Service fee revenue	$ 92,967	48,136	26,444	24,83
Total costs and expenses	$ 70,958	37,779	19,736	22,80
Income from continuing operations before equity in earnings of investments and minority interests in income of consolidated subsidiaries, and income taxes	$ 22,009	10,357	6,708	2,03
Equity in earnings of investments	$ 2,683	--	736	-
Minority interests in income of consolidated subsidiaries	$ (631)	--	(319)	-
Income from continuing operations before income taxes	$ 24,061	10,357	7,125	2,03
Loss from discontinued operations	$ --	--	--	-
Income before income taxes	$ 24,061	10,357	7,125	2,03
Assets	$ 77,847	39,129	27,012	21,47
Purchases of property and equipment	$ 9,286	2,878	1,991	3,10

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	FOR THE NINE MONTHS ENDED SEPTEMB			
	Mid-Atlantic Region (1)	Northeastern Region (2)	Central Region (3)	Western Region (4
Service fee revenue	$ 87,083	36,374	25,106	28,1
Total costs and expenses.................	$ 72,324	36,277	19,383	25,1
Income from continuing operations before equity in earnings of investments and minority interests in income of consolidated subsidiaries, and income taxes	$ 14,759	97	5,723	3,0
Equity in earnings of investments	$ 2,819	--	340	
Minority interests in income of consolidated subsidiaries	$ (449)	--	(240)	
Income from continuing operations before income taxes	$ 17,129	97	5,823	3,0
Loss from discontinued operations	$ --	--	--	
Income (loss) before income taxes	$ 17,129	97	5,823	3,0
Assets	$ 71,176	36,081	24,987	22,2
Purchases of property and equipment	$ 7,399	3,411	764	2,9

(1) Includes the Baltimore/Washington, D.C. Metropolitan area.

(2) Includes Rochester, New York, Rockland County, New York and the surrounding areas.

(3) Includes San Antonio, Texas, St. Lucie County, Florida, Topeka, Kansas, Northeast Kansas and the surrounding areas.

(4) Includes San Francisco/Oakland/San Jose, California and surrounding areas.

(5) Includes diagnostic imaging centers in Arizona, California, Colorado, Delaware, Florida, Georgia, Illinois, Kansas, Minnesota, Missouri, Nebraska, Nevada, Ohio and Pennsylvania that were acquired as part of the Questar acquisition and that have not been integrated into pre-existing Radiologix market areas and discontinued operations (See Note 6).

Corporate assets, including intangible assets, as of September 30, 2002 and 2003 were $110,623 and $88,918, respectively.

The following is a reconciliation of income (loss) before income taxes and purchases of property and equipment by the Company's five reportable segments to the Company's consolidated financial statements for the nine months ended September 30, 2002 and 2003 (in thousands):

	FOR THE NINE MONTHS ENDED SEPTEMBER 30,	
	2002	2003
Segment income before income taxes	$ 46,831	$ 17,894
Unallocated amounts:		
Corporate general and administrative	(11,577)	(10,576)
Corporate severance and other related costs	--	(1,027)
Corporate other income	180	--
Corporate depreciation and amortization	(4,267)	(4,646)
Corporate interest expense	(10,513)	(9,945)
Consolidated income (loss) including discontinued operations before income taxes	$ 20,654	$ (8,300)

	FOR THE NINE MONTHS ENDED SEPTEMBER 30,	
	2002	2003
Purchases of property and equipment		
Segment amounts	$ 17,674	$ 17,352
Corporate amount	243	218
Total purchases of property and equipment	$ 17,917	$ 17,570

9. JOINT VENTURE FINANCIAL INFORMATION

The Company has nine unconsolidated joint ventures with ownership interests ranging from 22% to 50%. These joint ventures represent partnerships with hospitals, health systems or radiology practices and were formed for the purpose of owning and operating diagnostic imaging centers. Professional services at the joint venture diagnostic imaging centers are performed by the contracted radiology practices in the market area or a radiology practice that participates in the joint venture. The following table is a summary of key financial data for these joint ventures: (in thousands):

	DECEMBER 31, 2002	SEPTEMBER 30, 2003
Current assets	$ 18,873	$ 20,330
Noncurrent assets	$ 14,184	$ 14,752
Current liabilities	$ 6,263	$ 5,879
Noncurrent liabilities	$ 653	$ 427

	FOR THE THREE MONTHS ENDED SEPTEMBER 30,		FOR THE NINE MONTHS ENDED SEPTEMBER 30,	
	2002	2003	2002	2003
Minority interest	$ 1,212	$ 647	$ 3,419	$ 3,159
Net revenue	$ 11,983	$ 9,866	$ 36,961	$ 37,271
Net income	$ 3,431	$ 2,156	$ 10,017	$ 9,480

10. SUPPLEMENTAL GUARANTOR INFORMATION

In connection with the senior notes, certain of the Company's subsidiaries ("Subsidiary Guarantors") guaranteed, jointly and severally, the Company's obligation to pay principal and interest on the senior notes on a full and unconditional basis.

The following supplemental condensed consolidating financial information presents the balance sheets as of December 31, 2002 and September 30, 2003, and the statements of operations and cash flows for the nine months ended September 30, 2002 and 2003. In the consolidating condensed financial statements, the Subsidiary Guarantors account for their investment in the non-guarantor subsidiaries using the equity method.

The non-guarantor subsidiaries include Advanced PET Imaging of Maryland, L.P., Lakewood OpenScan MR, LLC, Lexington MR, Ltd., Montgomery Community Magnetic Imaging Center Limited Partnership, Tower OpenScan MRI, and MRI at St. Joseph Medical Center LLC. The Subsidiary Guarantors include all wholly owned subsidiaries of Radiologix, Inc. (the "Parent").

RADIOLOGIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING BALANCE SHEET

DECEMBER 31, 2002
(IN THOUSANDS)

	PARENT	SUBSIDIARY GUARANTORS	NON-GUARANTOR SUBSIDIARIES
ASSETS:			
Cash and cash equivalents	$ 15,775	$ (381)	$ 3,759
Accounts receivable, net of allowances	--	66,190	3,187
Other current assets	82	13,099	(856)
Total current assets	15,857	78,908	6,090
Property and equipment, net	2,314	57,071	2,718
Investment in subsidiaries	140,667	--	--
Goodwill	--	28,510	--
Intangible assets, net	--	70,581	1,570
Other assets	17,120	15,318	34
	$ 175,958	$ 250,388	$ 10,412
LIABILITIES AND STOCKHOLDERS' EQUITY:			
Accounts payable and accrued expenses	$ 7,490	$ 26,380	$ 1,759
Current portion of long-term obligations	13	3,681	624
Other current liabilities	--	458	--
Total current liabilities	7,503	30,519	2,383
Long-term obligations, net of current portion	171,567	1,090	1,254
Other noncurrent liabilities	(71,479)	86,638	(3,091)
Minority interests in consolidated subsidiaries	--	--	1,340
Stockholders' equity	68,367	132,141	8,526
	$ 175,958	$ 250,388	$ 10,412

RADIOLOGIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING BALANCE SHEET (UNAUDITED)

SEPTEMBER 30, 2003
(IN THOUSANDS)

	PARENT	SUBSIDIARY GUARANTORS	NON-GUARANTOR SUBSIDIARIES
ASSETS:			
Cash and cash equivalents	$ 21,232	$ 1,542	$ 1,943
Accounts receivable, net of allowances	--	59,871	2,817
Other current assets	1,060	13,588	(914)
Total current assets	22,292	75,001	3,846
Property and equipment, net	2,237	58,113	2,546
Investment in subsidiaries	149,891	--	--
Goodwill	--	21,110	--
Intangible assets, net	--	61,397	7,940
Other assets	15,627	12,289	30
	$ 190,047	$ 227,910	$ 14,362
LIABILITIES AND STOCKHOLDERS' EQUITY:			
Accounts payable and accrued expenses	$ 7,334	$ 17,353	$ 7,641
Current portion of long-term obligations	45	1,853	601
Other current liabilities	47	462	2
Total current liabilities	7,426	19,668	8,244
Long-term obligations, net of current portion	171,526	201	775
Other noncurrent liabilities	(52,545)	67,852	(5,829)
Minority interests in consolidated subsidiaries	--	--	1,470
Stockholders' equity	63,640	140,189	9,702
	$ 190,047	$ 227,910	$ 14,362

RADIOLOGIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS (UNAUDITED)

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2002
(IN THOUSANDS)

	PARENT	SUBSIDIARY GUARANTORS	NON-GUARANTOR SUBSIDIARIES
Service fee revenue	$ --	$ 194,906	$ 16,764
Costs and expenses:			
Salaries and benefits	--	59,084	2,266
Field supplies	--	11,964	877
Field rent and lease expense	--	20,968	1,484
Other field expenses	(180)	29,042	4,936

Bad debt expense	--	16,774	1,166
Corporate general and administrative	11,577	--	--
Depreciation and amortization	2,076	16,108	751
Interest expense, net	10,513	3,352	302
Total costs and expenses	23,986	157,292	11,782
Income (loss) from continuing operations before equity in earnings of investments, minority interests in income of consolidated subsidiaries, and income taxes	(23,986)	37,614	4,982
Equity in earnings of investments	--	3,419	--
Minority interests in income of consolidated subsidiaries	--	--	(955)
Income (loss) from continuing operations before income	(23,986)	41,033	4,027
Income tax expense (benefit)	(9,594)	16,413	1,611
Income (loss) from continuing operations	(14,392)	24,620	2,416
Discontinued operations:			
Loss from discontinued operations	--	(420)	--
Income tax benefit	--	(168)	--
Loss from discontinued operations, net	--	(252)	--
Net income (loss)	$ (14,392)	$ 24,368	$ 2,416

RADIOLOGIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS (UNAUDITED)

FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2002
(IN THOUSANDS)

	PARENT	SUBSIDIARY GUARANTORS	NON-GUARANTOR SUBSIDIARIES
Service fee revenue	$ --	$ 64,327	$ 5,297
Costs and expenses:			
Salaries and benefits	--	20,412	776
Field supplies	--	3,902	288
Field rent and lease expense	--	7,004	491
Other field expenses	--	9,644	1,540
Bad debt expense	--	5,631	376
Corporate general and administrative	3,712	--	--
Depreciation and amortization	725	5,637	251
Interest expense, net	3,387	1,012	161
Total costs and expenses	7,824	53,242	3,883

Income (loss) from continuing operations before equity in earnings of investments, minority interests in income of consolidated subsidiaries, and income taxes	(7,824)	11,085	1,414
Equity in earnings of investments	--	1,212	--
Minority interests in income of consolidated subsidiaries	--	--	(286)
Income (loss) from continuing operations before income	(7,824)	12,297	1,128
Income tax expense (benefit)	(3,129)	4,919	451
Income (loss) from continuing operations	(4,695)	7,378	677
Discontinued operations:			
Loss from discontinued operations	--	(282)	--
Income tax benefit	--	(113)	--
Loss from discontinued operations, net	--	(169)	--
Net income (loss)	$ (4,695)	$ 7,209	$ 677

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RADIOLOGIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS (UNAUDITED)

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2003
(IN THOUSANDS)

	PARENT	SUBSIDIARY GUARANTORS	NON-GUARANTOR SUBSIDIARIES
Service fee revenue	$ --	$ 179,756	$ 13,609
Costs and expenses:			
Salaries and benefits	--	60,883	2,171
Field supplies	--	12,300	844
Field rent and lease expense	--	22,766	1,479
Other field expenses	--	27,285	4,648
Bad debt expense	--	15,686	994
Severance and other related costs	1,027	253	--
Corporate general and administrative	10,576	--	--
Depreciation and amortization	2,129	17,870	658
Interest expense, net	9,945	3,653	125
Total costs and expenses	23,677	160,696	10,919

Income (loss) from continuing operations before equity in earnings of investments, minority interests in

income of consolidated subsidiaries, and income taxes	(23,677)	19,060	2,690
Equity in earnings of investments	--	3,159	--
Minority interests in income of consolidated subsidiaries	--	--	(730)
Income (loss) from continuing operations before income	(23,677)	22,219	1,960
Income tax expense (benefit)	(9,471)	8,888	784
Income (loss) from continuing operations	(14,206)	13,331	1,176
Discontinued operations:			
Loss from discontinued operations	--	(8,802)	--
Income tax benefit	--	(3,521)	--
Loss from discontinued operations, net	--	(5,281)	--
Net income (loss)	$ (14,206)	$ 8,050	$ 1,176

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RADIOLOGIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS (UNAUDITED)

FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2003
(IN THOUSANDS)

	PARENT	SUBSIDIARY GUARANTORS	NON-GUARANTOR SUBSIDIARIES
Service fee revenue	$ --	$ 59,987	$ 4,378
Costs and expenses:			
Salaries and benefits	--	20,450	695
Field supplies	--	4,185	270
Field rent and lease expense	--	7,664	471
Other field expenses	--	8,936	1,636
Bad debt expense	--	5,253	325
Severance and other related costs	--	--	--
Corporate general and administrative	3,560	--	--
Depreciation and amortization	642	5,962	216
Interest expense, net	3,270	1,170	46
Total costs and expenses	7,472	53,620	3,659
Income (loss) from continuing operations before equity in earnings of investments, minority interests in income of consolidated subsidiaries, and income taxes	(7,472)	6,367	719
Equity in earnings of investments	--	647	--
Minority interests in income of			

consolidated subsidiaries	--	--	(200)
Income (loss) from continuing operations			
before income	(7,472)	7,014	519
Income tax expense (benefit)	(2,989)	2,806	208
Income (loss) from continuing operations	(4,483)	4,208	311
Discontinued operations:			
Loss from discontinued operations	--	(1,137)	--
Income tax benefit	--	(455)	--
Loss from discontinued operations, net	--	(682)	--
Net income (loss)	$ (4,483)	$ 3,526	$ 311

RADIOLOGIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS (UNAUDITED)

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2002
(IN THOUSANDS)

	PARENT	SUBSIDIARY GUARANTORS	NON-GUARAN SUBSIDIAR
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	$ (7,630)	$ 37,165	$ 1,2
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of property and equipment, net	(2,431)	(15,269)	(2
Joint ventures	--	472	
Other items	(2,751)	(697)	
Net cash used in investing activities	(5,182)	(15,494)	(1
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds (payments) on long-term debt	(4,049)	(1,784)	6
Due to/from parent/subsidiaries	17,586	(17,663)	
Other items	3,247	(2,608)	
Net cash provided by (used in) financing activities	16,784	(22,055)	7
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	3,972	(384)	1,7
CASH AND CASH EQUIVALENTS, beginning of period	7,670	(953)	4,0

CASH AND CASH EQUIVALENTS, end of period	$ 11,642	$ (1,337)	$ 5,8

RADIOLOGIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS (UNAUDITED)

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2003
(IN THOUSANDS)

	PARENT	SUBSIDIARY GUARANTORS	NON-GUARANTOR SUBSIDIARIES
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	$ (14,310)	$ 26,884	$ 8,876
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of property and equipment	(2,052)	(15,032)	(486)
Joint ventures	--	2,321	--
Other investments	285	8,967	(6,966)
Net cash used in investing activities	(1,767)	(3,744)	(7,452)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Payments on long-term debt	(9)	(2,665)	(502)
Due to/from parent/subsidiaries	21,289	(18,536)	(2,753)
Other items	254	(16)	15
Net cash provided by (used in) financing activities	21,534	(21,217)	(3,240)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	5,457	1,923	(1,816)
CASH AND CASH EQUIVALENTS, beginning of period	15,775	(381)	3,759
CASH AND CASH EQUIVALENTS, end of period	$ 21,232	$ 1,542	$ 1,943

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

The following discussion of the results of operations and financial condition of the Company should be read in conjunction with the Company's consolidated financial statements and notes thereto included in the Annual Report on Form 10-K for the year ended December 31, 2002, and with the Company's consolidated financial statements and notes included in this Form 10-Q.

OVERVIEW

We are a leading national provider of diagnostic imaging services through our ownership and operation of free-standing, outpatient diagnostic imaging centers. We utilize sophisticated technology and technical expertise to perform a broad range of imaging procedures, such as magnetic resonance imaging (MRI), computed tomography (CT), positron emission tomography (PET), nuclear medicine, ultrasound, mammography, bone densitometry (DEXA), general radiography (X-ray) and fluoroscopy. For the nine months ended September 30, 2003, we derived 82% of our service fee revenue from the ownership, management and operation of our radiology and imaging center network and 18% of our service fee revenue from administrative, management and information services provided to contracted radiology practices. As of September 30, 2003, we owned, operated or maintained an ownership interest in imaging equipment at 110 locations, including five imaging centers that have been designated for sale or closure over the next three months that are included in discontinued operations in the accompanying financial statements. In addition, we provided management services to ten radiology practices. As of September 30, 2003, our imaging centers are located in 16 states, with concentrated geographic coverage in markets located in California, Florida, Kansas, Maryland, New York, Texas and Virginia.

We focus on providing quality patient care and service to ensure patient and referring physician satisfaction. Our development of comprehensive radiology networks permits us to invest in technologically advanced imaging equipment, including MRI, open MRI, spiral CT and PET. Our consolidation of diagnostic imaging centers into coordinated networks improves response time, increases overall patient accessibility, permits us to standardize certain customer relations procedures and permits us to develop "best practices" for our diagnostic imaging centers. We seek the input and participation of the contracted radiology practices to which we provide administrative, management and information services to develop best practices and to improve productivity and the quality of services. By focusing on further improving and, where appropriate, standardizing the operations of our diagnostic imaging centers, we believe that we can increase patient and referring physician satisfaction, which should lead to increased referrals and increased utilization of our diagnostic imaging centers.

We contract with radiology practices to provide professional services, including the supervision and interpretation of diagnostic imaging procedures performed in our diagnostic imaging centers. We believe that we do not engage in the practice of medicine nor do we employ physicians. The radiology practices maintain full control over the provision of professional radiological services. The contracted radiology practices generally have outstanding physician and practice credentials and reputations; strong competitive market positions; a broad sub-specialty mix of physicians; a history of growth and potential for continued growth; and a willingness to embrace our strategy for the delivery of diagnostic imaging services.

For the nine months ended September 30, 2003, payment for diagnostic imaging services came primarily from commercial third-party payors (66%), governmental payors (28%, including Medicare and Medicaid) and private and other payors (6%). In January 2002, Medicare decreased the payment rates for physician and outpatient services, including diagnostic imaging services, by approximately 5.4%. This payment rate schedule was effective through February 2003. Effective March 1, through December 31, 2003, Congress legislated an increase of

approximately 1.6% in the overall reimbursement rates for physician and outpatient services,

including diagnostic imaging services. The Centers for Medicare and Medicaid Services ("CMS") proposed in October 2003 a decrease in the payment rates for physician and outpatient services, including diagnostic imaging services, by approximately 4.5% beginning January 1, 2004. The Medicare reform package is now pending before Congress to pass the legislation.

Our diagnostic imaging centers are principally dependent on our ability to attract referrals from primary care physicians, specialists and other healthcare providers. The referral often depends on the existence of a contractual arrangement with the referred patient's health benefit plan. For the nine months ended September 30, 2003, approximately 6% of our revenue generated at our diagnostic imaging centers was generated from capitated arrangements.

Revenue of the contracted radiology practices and diagnostic imaging centers is recorded when services are rendered by the contracted radiology practices and diagnostic imaging centers based on established charges and reduced by contractual allowances. In addition, bad debt expense related to established charges is recognized as costs and expenses rather than a deduction from revenue. We use historical collection experience in estimating contractual adjustments and bad debt expense. The factors influencing the historical collection experience include the contracted radiology practices' and diagnostic imaging centers' patient mix, impact of managed care contract pricing and contract revenue and the aging of patient accounts receivable balances. As these factors change, the historical collection experience is revised accordingly in the period known. Service fee revenue represents the contracted radiology practices' and diagnostic imaging centers' revenue less amounts retained by the contracted radiology practices. The amounts retained by the contracted radiology practices represent amounts paid to the physicians pursuant to the service agreements between us and the contracted radiology practices. Under the service agreements, we provide each contracted radiology practice with the facilities and equipment used in its medical practice, assume responsibility for managing the operations of the practice, and employ substantially all of the non-physician personnel utilized by the contracted radiology practice. Although we assist in negotiating managed care contracts for the contracted radiology practices, we assume no risk under these arrangements.

Our service fee revenue is dependent upon the operating results of the contracted radiology practices and diagnostic imaging centers. Where state law allows, service fees due under the service agreements for the contracted radiology practices are derived from two distinct revenue streams: (1) a negotiated percentage (up to 30%) of the adjusted professional revenues as defined in the service agreements; and (2) 100% of the adjusted technical revenues as defined in the service agreements. In states where the law requires a flat fee structure, we have negotiated a base service fee, which is equal to the estimated fair market value of the services provided under the service agreements and which is renegotiated each year to equal the fair market value of the services provided under the service agreements. Adjusted professional revenues and adjusted technical revenues are determined by deducting contractually agreed-upon expenses (non-physician salaries and benefits, rent, depreciation, insurance, interest and other physician costs) from the contracted radiology practices' revenue. Revenues of our subsidiary, Questar Imaging, Inc. ("Questar") are primarily derived from technical revenues generated from those imaging centers.

RESULTS OF OPERATIONS

We report the results of our operations through four designated regions of the United States: Mid-Atlantic, Northeastern, Central and Western regions. In addition, we report separately the results of our operations of the imaging centers of our subsidiary, Questar. Our operations in each of the four designated regions are comprised of the ownership and operation of diagnostic imaging centers and the provision of administrative, management and information services to the contracted radiology practices that provide professional interpretation and supervision services in connection with our diagnostic imaging centers and to hospitals and radiology practices with which we operate joint ventures. Our services provide leverage to its existing

infrastructure and improvement to the efficiency and effectiveness of the radiology practice or joint venture profitability. We have divided the operations into the four regions and Questar only for purposes of the division of internal management responsibilities, but do not focus on each of these regions as a separate product line or make financial decisions as if they were separate product lines. The Questar operations are treated as a separate group only from the perspective that the imaging centers of Questar do not have the same type of management service agreement with physicians as we have with each of the contracted radiology practices in the four designated regions. In addition, any imaging centers of Questar that are in the same region as the operations of the contracted radiology practices in the four designated regions are not included in the service agreements of the contracted radiology practices.

Our results of operations during the nine months ended September 30, 2003 were affected by such factors as increased competition, the current recession, increased payor pre-authorization activity, a shortage of technologists, harsh weather conditions during January and February and most recently, a hurricane in the Mid-Atlantic region. Although we continue to be challenged by these factors, our results of operations are beginning to stabilize in some of our key markets. Beginning in the second half of 2002, and continuing into 2003, increased competition resulted in lower volumes of diagnostic imaging procedures performed. Pre-authorization programs implemented by many of our larger payors and the recruitment and retention of additional technologists have impacted our operating margin. An increasing number of payors with which we do business have instituted during 2003 more comprehensive pre-authorization programs on certain procedures. Under pre-authorization programs, the referring physician must justify medical necessity based on the payor's specific guidelines prior to the services being rendered. The current recession in the United States' economy has contributed to the decline in our volumes of diagnostic imaging procedures performed due to the decrease in the demand for elective procedures within the general population who are no longer covered by health insurance or have higher deductibles and coinsurance. Also, in early fiscal 2002 the shortage of qualified technologists resulted in scheduling backlogs and lost procedure volumes. As many of the open technologist positions were filled by mid-2002, salaries and benefits increased. These costs continued to increase or remained stable, while volume began to decline resulting in lower revenues from contracted radiology practices and diagnostic imaging centers. In September 2003, many of our imaging centers in the Mid-Atlantic regions were closed up to three days due to a hurricane in the geographical area. Therefore, we experienced lower revenues from contracted radiology practices and diagnostic imaging centers in the Mid-Atlantic region during this period. The combined effect of increased salaries and benefits and lower revenues from contracted radiology practices and diagnostic imaging centers decreased our operating

margins during the nine months ended September 30, 2003. We cannot give any assurance that any of the factors discussed above will not continue to have an adverse effect on our business, results of operations or financial condition.

Income before income taxes for each of the regions except the Western region decreased from the nine months ended September 30, 2002 to the nine months ended September 30, 2003. For the nine months ended September 30, 2002 and 2003, the Mid-Atlantic region decreased from $24.1 million to $17.1 million, respectively, the Northeastern region decreased from $10.4 million to $97,000, respectively, the Central region decreased from $7.1 million to $5.8 million, respectively, and Questar decreased from $3.3 million to a loss of $8.2 million, respectively. For the nine months ended September 30, 2002 and 2003 for the Western region income before income taxes increased from $2.0 million to $3.0 million, respectively. The decline in the income before income taxes for three of the four regions and Questar was primarily affected by each of the factors discussed above. Additional factors in specific regions also contributed to the decrease in income before income taxes. Questar's income (loss) before income taxes was also affected by the relative fixed salaries and benefits costs. Due to the relative fixed cost structure of Questar, the decline in volume and therefore, lower revenue for diagnostic imaging centers resulted in a decline in the income (loss) before taxes. In addition, we have identified five imaging centers of Questar that have been designated for sale or closure over the next three months and have sold three imaging centers of Questar during the nine months ended September 30, 2003.

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These imaging centers do not represent centers around which we can build a market concentration. During the nine months ended September 30, 2003, a $500,000 pre-tax charge was recognized to write-down the goodwill related to these imaging centers in accordance with Financial Accounting Standards Board Statement 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No.144"). In addition, a $300,000 pre-tax charge for an equipment lease buy-out for one of the imaging centers sold was recognized in the nine months ended September 30, 2003. The Western region has experienced growth in volume of diagnostic imaging procedures performed and increased reimbursement related to a managed care agreement, resulting in an increase in income before taxes for 2003 compared to 2002.

We completed no acquisitions in the nine months ended September 30, 2002 and September 30, 2003, respectively.

THREE MONTHS ENDED SEPTEMBER 30, 2002 COMPARED TO THREE MONTHS ENDED SEPTEMBER 30, 2003

Service Fee Revenue

The following table sets forth the amounts of revenue from contracted radiology practices and diagnostic imaging centers and the amounts retained by the contracted radiology practices (in thousands):

	FOR THE THREE MONTHS ENDED SEPTEMBER 30,		
	2002	2003	PERCE CHANG

Revenue from contracted radiology practices and diagnostic imaging centers, net of contractual allowances	$ 96,078	$ 90,295	(6.0
Less: amounts retained by contracted radiology practices	(26,454)	(25,930)	(2.0
Service fee revenue	$ 69,624	$ 64,365	(7.6

Revenue from contracted radiology practices and diagnostic imaging centers, net of contractual allowances, decreased $5.8 million, from $96.1 million for the three months ended September 30, 2002 to $90.3 million for the three months ended September 30, 2003. This decrease was primarily due to decreased revenues derived from decreased volume at the diagnostic imaging centers, which decreased our revenue from contracted radiology practices and diagnostic imaging centers. Amounts retained by contracted radiology practices decreased from $26.5 million for the three months ended September 30, 2002 to $25.9 million for the same period in 2003. The decrease in revenue from contracted radiology practices and diagnostic imaging centers, net of contractual allowances, offset by the decrease in amounts retained by contracted radiology practices, resulted in a decrease in service fee revenue of $5.2 million, from $69.6 million for the three months ended September 30, 2002 to $64.4 million for the three months ended September 30, 2003.

Salaries and Benefits

Salaries and benefits decreased $100,000, from $21.2 million for the three months ended September 30, 2002 to $21.1 million for the three months ended September 30, 2003. As a percentage of service fee revenue, salaries and benefits were 30.4% and 32.9% for the three months ended September 30, 2002 and 2003, respectively.

Field Supplies

Field supplies increased $300,000, from $4.2 million for the three months ended September 30, 2002 to $4.5 million for the three months ended September 30, 2003. The increase in field supplies is primarily related to the higher usage of film for certain procedures that have increased in volume for 2003 compared to 2002. As a percentage of service fee revenue, these costs were 6.0% and 6.9% for the three months ended September 30, 2002 and 2003, respectively.

Field Rent and Lease

Field rent and lease costs increased $600,000, from $7.5 million for the three months ended September 30, 2002 to $8.1 million for the three months ended September 30, 2003. The increase in field rent and lease costs is primarily related to entering into operating leases for new equipment and higher facility costs for existing locations as well as new locations. As a percentage of service fee revenue, these costs were 10.8% and 12.6% for the three months ended September 30, 2002 and 2003, respectively.

Other Field Costs

Other field costs decreased $600,000, from $11.2 million for the three months ended September 30, 2002 to $10.6 million for the three months ended September 30, 2003. As a percentage of service fee revenue, these costs were 16.1% for the three months ended September 30, 2002 to 16.4% for the same period

in 2003. In connection with the amendment of two service agreements during the year ended December 31, 2002, certain costs are no longer paid by the Company, which contributed to the decrease in other field expenses.

Bad Debt

Bad debt decreased $400,000, from $6.0 million for the three months ended September 30, 2002 to $5.6 million for the three months ended September 30, 2003. The decrease in bad debt is primarily the result of terminating services performed at certain hospitals. Generally, bad debt experience with reimbursement for hospital services is at a higher percentage of revenues than the experience with reimbursement for imaging center services. As a percentage of service fee revenue, these costs were 8.6% and 8.7% for the three months ended September 30, 2002 and 2003, respectively. Since service fee revenue represents contracted radiology practices' and diagnostic imaging centers' revenue less amounts retained by contracted radiology practices, these percentages are inherently at a higher stated value. Therefore, bad debt expense should be compared for the three months ended September 30, 2002 and 2003 as a percentage of revenue of the contracted radiology practices and diagnostic imaging centers, net of contractual allowances, rather than as a percentage of service fee revenue. As a percentage of revenue of the contracted radiology practices and diagnostic imaging centers, net of contractual allowances, bad debt expense was 6.3% for the three months ended September 30, 2002 and 6.2% for the three months ended September 30, 2003.

Corporate, General and Administrative

Corporate, general and administrative expenses decreased $100,000, from $3.7 million for the three months ended September 30, 2002 to $3.6 million for the three months ended September 30, 2003. As a percentage of service fee revenue, these costs were 5.3% and 5.5% for the three months ended September 30, 2002 and 2003, respectively. During the first quarter of 2003, we initiated cost reduction programs at our corporate office and our field offices. We believe this may result in corporate, general and administrative annual cost savings of approximately $2.0 million. During 2003, these cost savings have been partially offset by additional legal costs and consulting services.

Depreciation and Amortization

Depreciation and amortization expense increased $200,000, from $6.6 million for the three months ended September 30, 2002 to $6.8 million for the three months ended September 30, 2003. As a percentage of service fee revenue, these costs were 9.5% and 10.6% for the three months ended September 30, 2002 and 2003, respectively. The increase in depreciation expense is primarily attributable to the purchases of $26.8 million of property and equipment for replacement, maintenance, and expansion in 2002 and of $12.4 million during the six months ended June 30, 2003.

Interest Expense, Net

Interest expense, net, decreased $100,000, from $4.6 million for the three months ended September 30, 2002 to $4.5 million for the three months ended September 30, 2003.

Discontinued Operations

As of September 30, 2003, the Company has five imaging centers that have been designated for sale or closure over the next three months that are

included in discontinued operations in the accompanying unaudited consolidated statements of income. These imaging centers do not represent centers around which we can build a market concentration. During the three months ended September 30, 2003 an additional imaging center was included in discontinued operations. As a result, in accordance with SFAS No. 144, a $500,000 pre-tax charge was recognized related to a charge to write-down the goodwill during the three months ended September 30, 2003. This imaging center was subsequently sold effective September 30, 2003 along with two other imaging centers for the assumption of certain obligations. A $300,000 pre-tax charge for an equipment lease buy-out for one of the imaging centers sold was recognized in the three months ended September 30, 2003. The five imaging centers designated for sale or closure and three imaging centers sold are included in discontinued operations in the accompanying unaudited consolidated statements of income for the three months ended September 30, 2002 and 2003. For the three months ended September 30, 2002, the accompanying unaudited consolidated statements of income have been restated to reflect the results of operations of the eight imaging centers as discontinued operations. Loss from discontinued operations for the three months ended September 30, 2002 was $282,000 ($169,000 net of tax benefit). Loss from discontinued operations for the three months ended September 30, 2003 was $1.1 million ($682,000 net of tax benefit).

Income Tax Expense (Benefit) on Continuing Operations and Discontinued Operations

Income tax expense on continuing operations was $2.2 million and $25,000 for the three months ended September 30, 2002 and 2003, respectively. The income tax expense on continuing operations is based on a 40% effective tax rate. The income tax benefit on the loss from discontinued operations for the three months ended September 30, 2002 and 2003 was $113,000 and $455,000, respectively. The income tax benefit on discontinued operations is based on a 40% effective tax rate.

Net Income (Loss)

Net income decreased from $3.2 million for the three months ended September 30, 2002 to a loss of $646,000 for the three months ended September 30, 2003. Included in net income for the three months ended September 30, 2002 is a loss from discontinued operations of $169,000. Included in net loss for the three months ended September 30, 2003 is a loss from discontinued operations of $682,000.

NINE MONTHS ENDED SEPTEMBER 30, 2002 COMPARED TO NINE MONTHS ENDED SEPTEMBER 30, 2003

Service Fee Revenue

The following table sets forth the amounts of revenue from the contracted radiology practices and diagnostic imaging centers and the amounts retained by contracted radiology practices (in thousands):

	FOR THE NINE MONTHS ENDED SEPTEMBER 30,		
	2002	2003	PERC CHAN

Revenue from contracted radiology practices and diagnostic imaging centers, net of contractual allowances	$ 291,224	$ 269,626	(7.4
Less: amounts retained by contracted radiology practices	(79,554)	(76,261)	(4.1
Service fee revenue, as reported	$ 211,670	$ 193,365	(8.7

Revenue from contracted radiology practices and diagnostic imaging centers, net of contractual allowances, decreased $21.6 million, from $291.2 million for the nine months ended September 30, 2002 to $269.6 million for the nine months ended September 30, 2003. This decrease was primarily due to decreased revenues derived from decreased volume at the diagnostic imaging centers, which decreased our revenue from contracted radiology practices and diagnostic imaging centers. Amounts retained by contracted radiology practices decreased from $79.6 million for the nine months ended September 30, 2002 to $76.3 million for the same period in 2003. The decrease in revenue from contracted radiology practices and diagnostic imaging centers, net of contractual allowances and the decrease in amounts retained by contracted radiology practices, resulted in service fee revenue decreasing $18.3 million, from $211.7 million for the nine months ended September 30, 2002 to $193.4 million, for the nine months ended September 30, 2003.

Salaries and Benefits

Salaries and benefits increased $1.7 million, from $61.4 million for the nine months ended September 30, 2002 to $63.1 million for the nine months ended September 30, 2003. Salaries and benefits increased due to rising salary costs of technologists and salary pressure related to hiring and retaining technologists. As a percentage of service fee revenue, salaries and benefits were 29.0% and 32.6% for the nine months ended September 30, 2002 and 2003, respectively.

Field Supplies

Field supplies increased $300,000, from $12.8 million for the nine months ended September 30, 2002 to $13.1 million for the nine months ended September 30, 2003. The increase in field supplies is primarily related to the higher usage of film for certain procedures that have increased in volume for 2003 compared to 2002. As a percentage of service fee revenue, these costs were 6.1% and 6.8% for the nine months ended September 30, 2002 and 2003, respectively.

Field Rent and Lease

Field rent and lease costs increased $1.7 million, from $22.5 million for the nine months ended September 30, 2002 to $24.2 million for the nine months ended September 30, 2003. The increase in field rent and lease

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costs is primarily related to entering into operating leases for new equipment and higher facility costs for existing locations as well as new locations. As a percentage of service fee revenue, these costs were 10.6% and 12.5% for the nine months ended September 30, 2002 and 2003, respectively.

Other Field Costs

Other field costs decreased $1.9 million, from $33.8 million for the nine months ended September 30, 2002 to $31.9 million for the nine months ended September 30, 2003. As a percentage of service fee revenue, these costs increased from 16.0% for the nine months ended September 30, 2002 to 16.5% for the nine months ended September 30, 2003. In connection with the amendment of two service agreements during the year ended December 31, 2002, certain costs are no longer paid by the Company, which contributed to the decrease in other field costs.

During the nine months ended September 30, 2003, the Company has incurred approximately $433,000 in costs related to compliance with the Health Insurance Portability and Accountability Act of 1996 ("HIPAA"). See Health Insurance Portability and Accountability Act of 1996 under Liquidity and Capital Resources.

As part of a routine, ongoing compliance and legal review, Radiologix has found that rents negotiated for the subletting of space from physician landlords of several Radiologix locations may have exceeded fair market value. Radiologix sent a letter to the U.S. Department of Health & Human Services' Office of the Inspector General ("OIG"), informing them of the preliminary findings and seeking their guidance and assistance to remedy this situation. Accordingly, in the second quarter of 2003, we recorded $500,000 as an estimate for potential payments we may incur directly or indirectly. Subsequently, Radiologix has qualified for the Provider Self-disclosure Protocol of the OIG. The Provider Self-disclosure Protocol is a self-reporting program that provides for minimizing the cost and disruption associated with on-going investigations of the OIG. Since the inquiry is in its very early stages, it is not yet possible for Radiologix to give any assurances that the OIG will not impose fines in excess of our estimate or that any potential payments or findings would not have a material adverse effect on its financial position, cash flow and results of operations.

Bad Debt

Bad debt decreased $1.2 million, from $17.9 million for the nine months ended September 30, 2002 to $16.7 million for the nine months ended September 30, 2003. The decrease in bad debt expense is primarily the result of terminating services performed at certain hospitals. Generally, bad debt experience with reimbursement for hospital services is at a higher percentage of revenues than the experience with reimbursement for imaging center service. As a percentage of service fee revenue, these costs were 8.5% and 8.6% in 2002 and 2003, respectively. Since service fee revenue represents contracted radiology practices' and diagnostic imaging centers' revenue less amounts retained by contracted radiology practices, these percentages are inherently at a higher stated value. Therefore, bad debt should be compared for the nine months ended September 30, 2002 and 2003 as a percentage of revenue of the contracted radiology practices and diagnostic imaging centers, net of contractual allowances, rather than as a percentage of service fee revenue. As a percentage of revenue of the contracted radiology practices and diagnostic imaging centers, bad debt expense was 6.2% for the nine months ended September 30, 2002 and 2003.

Severance and Other Related Costs

During the nine months ended September 30, 2003, we recorded $1,280,000 in severance and other related costs. These costs include severance cost incurred in connection with changes in the Company's senior management team and the reduction of employees at the corporate office and among certain field offices. In

February 2003, the former president and chief operating officer resigned from his positions. In March 2003, we began a cost reduction program to reduce administrative positions. In May 2003, the former general counsel resigned from his position, effective July 31, 2003.

Corporate, General and Administrative

Corporate, general and administrative expenses decreased $1.0 million, from $11.6 million for the nine months ended September 30, 2002 to $10.6 million for the nine months ended September 30, 2003. As a percentage of service fee revenue, these costs were 5.4% and 5.5% for the nine months ended September 30, 2002 and 2003. During the nine months ended September 30, 2003, we initiated cost reduction programs at our corporate office and our field offices. We believe this may result in corporate, general and administrative annual cost savings of approximately $2.0 million. During 2003, these cost savings have been partially offset by additional legal costs and consulting services. The decrease in costs is primarily due to lower salaries and benefits at the corporate office.

Depreciation and Amortization

Depreciation and amortization expense increased $1.8 million, from $18.9 million for the nine months ended September 30, 2002 to $20.7 million for the nine months ended September 30, 2003. As a percentage of service fee revenue, these costs were 8.9% and 10.7% in 2002 and 2003, respectively. The increase in depreciation expense is primarily attributable to the purchases of $26.8 million of property and equipment for replacement, maintenance, and expansion in 2002 and of $12.4 million during the six months ended June 30, 2003.

Interest Expense, Net

Interest expense, net, decreased $500,000, from $14.2 million for the nine months ended September 30, 2002 to $13.7 million for the nine months ended September 30, 2003 due to the reduction of the convertible debt outstanding in 2002 compared to 2003.

Discontinued Operations

As of September 30, 2003, the Company has five imaging centers that have been designated for sale or closure over the next three months that are included in discontinued operations in the accompanying unaudited consolidated statements of income. These imaging centers do not represent centers around which we can build a market concentration. During the nine months ended September 30, 2003 an additional imaging center was included in discontinued operations. As a result, in accordance with SFAS No. 144, a $500,000 pre-tax charge was recognized related to a charge to write-down the goodwill during the nine months ended September 30, 2003. This imaging center was subsequently sold effective September 30, 2003 along with two other imaging centers for the assumption of certain obligations. A $300,000 pre-tax charge for an equipment lease buy-out for one of the imaging centers sold was recognized in the nine months ended September 30, 2003. The five imaging centers designated for sale or closure and three imaging centers sold are included in discontinued operations in the accompanying unaudited consolidated statements of income for the nine months ended September 30, 2002 and 2003. The nine months ended September 30, 2003 include a $7.4 million pre-tax charge to write-down the related goodwill of these imaging centers in accordance with SFAS No. 144. For the nine months ended September 30, 2002, the accompanying unaudited consolidated statements of income have been restated to reflect the results of operations for the eight imaging centers as discontinued operations. Loss from discontinued operations for the

nine months ended September 30, 2002 was $420,000 ($252,000 net of tax benefit). Loss from discontinued operations for the nine months ended September 30, 2003 was $8.8 million ($5.3 million net of tax benefit).

Income Tax Expense (Benefit) on Continuing Operations and Discontinued Operations

Income tax expense on continuing operations was $8.4 million, and $200,000 for the nine months ended September 30, 2002 and 2003, respectively. The income tax expense on continuing operations is based on a 40% effective tax rate. The income tax benefit on the loss from discontinued operations for the nine months ended September 30, 2002 and 2003 was $168,000 and $3.5 million, respectively. The income tax benefit on discontinued operations is based on a 40% effective tax rate.

Net Income (Loss)

Net income decreased from $12.4 million for the nine months ended September 30, 2002 to a net loss of $5.0 million for the nine months ended September 30, 2003. Included in net income for the nine months ended September 30, 2002 is a loss from discontinued operations of $252,000. Included in net loss for the nine months ended September 30, 2003 is a loss from discontinued operations of $5.3 million. In addition, the nine months ended September 30, 2003 includes $1.3 million ($768,000, net of tax benefit) related to severance and other related costs.

Future Trends

As discussed in Note 5 to the Company's unaudited consolidated financial statements, the Company settled a lawsuit and demand for arbitration with physicians in San Antonio, Texas. In accordance with the settlement agreement, the management service agreement shall terminate and the parties shall separate their business dealings commencing on June 30, 2004. The service fee revenue and income from continuing operations before income taxes of the Central region will be decreased by approximately 15% and 32%, respectively, as a result of the portion of the business to be severed June 30, 2004.

The Company has received an offer from our joint venture partner in San Antonio, Texas to acquire the Company's minority interest in five imaging centers as well as our wholly owned imaging center in San Antonio, Texas. We are in current negotiations with our joint venture partner to complete the disposition. Although we would be compensated in the event of this disposition, our revenues and financial results could be adversely affected by the disposition unless we receive sufficient capital and can deploy that capital advantageously. In the event that the Company and its joint venture partner cannot agree on terms of the disposition, then, in the alternative, our joint venture partner's offer will be deemed to be notice pursuant to the joint venture agreements to terminate the joint ventures effective December 31, 2003. This notice would entitle our joint venture partner to acquire all of the assets of the joint ventures, without an ongoing agreement not to compete from the Company. In this case, the joint venture agreements set the purchase price for the joint venture assets as their fair market value, computed at liquidation value as determined by an independent appraiser. The Company would continue to operate its wholly owned imaging center in San Antonio, Texas. The difference between the purchase price of all of our San Antonio assets and the liquidation value of our San Antonio joint venture assets could have a material impact on the financial results of the Company. In the event we continue to operate only a single wholly owned imaging center in the San Antonio market, we cannot give any assurance that it will not have an adverse effect on our business, results of

operations or financial condition. As a result of the anticipated disposition of the Company's assets in San Antonio, Texas we expect the amount of service fee revenue to be contributed by the Central region to decline in 2004. While we believe that the decline in service fee revenue in the Central region in 2004 will be material, at this time we cannot determine if the decline in service fee revenue will be material to our overall service fee revenue in 2004.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity for the nine months ended September 30, 2003, was derived from cash and cash equivalents and net cash proceeds from operating activities. As of September 30, 2003, we had net working capital of $65.8 million, including cash and cash equivalents of $24.7 million. We had current assets of $101.1 million and current liabilities of $35.3 million, including current maturities of long-term debt and capital lease obligations of $2.5 million. For the nine months ended September 30, 2003, we generated $21.5 million in net operating cash flow, invested $13.0 million and used cash of $2.9 million in financing activities.

Net cash from operating activities for the nine months ended September 30, 2003 of $21.5 million decreased from $30.8 million for the same period in 2002. The decrease in the results of operations for the nine months ended September 30, 2003 and the timing of payments on accounts payable and accrued expenses as well as severance cost payments, resulted in a decrease in net cash from operating activities for the nine months ended September 30, 2003. Accounts receivable days outstanding decreased from 70 days at September 30, 2002 to 68 days at September 30, 2003.

Net cash used in investing activities for the nine months ended September 30, 2002 and 2003 was $20.8 million and $13.0 million, respectively. Purchases of property and equipment during the nine months ended September 30, 2002 and 2003 were $17.9 million and $17.6 million, respectively. For the nine months ended September 30, 2003, we invested $7.4 million to replace and maintain property and equipment and $10.2 million in the expansion of property and equipment.

Net cash flows used in financing activities for the nine months ended September 30, 2002 and 2003 were $4.6 million and $2.9 million, respectively. Borrowings of long-term debt for the nine months ended September 30, 2002 and 2003 were used to purchase equipment and capital improvements, as well as for working capital needs.

At September 30, 2003, no borrowings were outstanding under a credit facility of $35 million. Under the credit facility, the interest rate is (i) an adjusted LIBOR rate, plus an applicable margin which can vary from 3.0% to 3.5% dependent on certain financial ratios or (ii) the prime rate, plus an applicable margin which can vary from 1.75% to 2.25%. In each case, the applicable margin varies based on financial ratios maintained by the Company. The credit facility includes certain restrictive covenants including prohibitions on the payment of dividends and the maintenance of certain financial ratios (including minimum fixed charge

coverage ratio and maximum leverage ratio, as defined). At September 30, 2003, the Company was in compliance with these covenants. At September 30, 2003, certain financial ratios have restricted the Company's ability to borrow up to $35 million. As a result of the financial covenant ratios, the Company has available up to $11.6 million under the credit facility. Borrowings under the

credit facility are secured by all service agreements that the Company is or becomes a party to, a pledge of the stock of the Company's subsidiaries and all of the Company's and its wholly-owned subsidiaries' assets.

We operate in a capital intensive, high fixed-cost industry that requires significant amounts of capital to fund operations, particularly the initial start-up and development expense of new diagnostic imaging centers and the acquisition of additional centers and new diagnostic imaging equipment. To the extent we are unable to generate sufficient cash from our operations, funds are not available under our credit facility or we are unable to structure or obtain operating leases, we may be unable to meet our capital expenditure requirements. Furthermore, we may not be able to raise any necessary additional funds through bank financing or the issuance of equity or debt securities on terms acceptable to us, if at all.

Health Insurance Portability and Accountability Act

The administrative provisions of HIPAA direct the federal government to adopt national electronic standards for automated transfer of certain healthcare data between healthcare payors, plans and providers. HIPAA is designed to enable the entire healthcare industry to communicate electronic data using a single set of standards, thus eliminating all nonstandard formats currently in use. Our contracted radiology practices and diagnostic imaging centers are "covered entities" under HIPAA, and as such, had to comply with the HIPAA electronic data interchange mandates by the October 16, 2003 deadline. We are able to produce compliant transactions and we continue to test with our trading partners to ensure that there are no unexpected claim or payment delays.

In September 2003, CMS announced that it would implement a contingency plan to accept noncompliant electronic transactions after the October 16, 2003 compliance deadline to ensure processing of claims from providers who would not meet the deadline and otherwise would have had their Medicare claims rejected. CMS will regularly reassess provider readiness and determine how long the contingency plan will be in effect.

As discussed in more detail in Risks and Uncertainties section below, we continue to believe that there may be some cash flow disruption once CMS and other payor contingency plans are no longer in effect.

RISKS AND UNCERTAINTIES

Forward-Looking Statements

Throughout this report we make "forward-looking statements" within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Forward-looking statements include words such as "may," "will," "would," "could," "likely," "estimate," "intend," "plan," "continue," "believe," "expect" or "anticipate" and other similar words and include all discussions about our acquisition and development plans. We do not guarantee that the transactions and events described in this report will happen as described or that any positive trends noted in this report will continue. The forward-looking statements contained in this report are generally located in the material set forth under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations", but may be found in other locations as well. These forward-looking statements generally relate to our plans, objectives and expectations for future operations and are based upon management's reasonable estimates of future results or trends. Although we believe that our plans and objectives reflected in or suggested by such forward-looking statements are reasonable, we may not achieve such plans or objectives

due to various factors, including, but not limited to, the risk factors discussed in this form 10-Q under the caption "Risks and Uncertainties" and in our Annual Report on Form 10-K for the year ended December 31, 2002. You are cautioned not to unduly rely on such forward-looking statements when evaluating the information presented in this report. You should read this report completely and with the understanding that actual future results may be materially different from what we expect. We will not update forward-looking statements even though our situation may change in the future.

Specific factors that might cause actual results to differ from our expectations include, but are not limited to:

- economic, demographic, business and other conditions in our markets;
- the highly competitive nature of the healthcare business;
- a decline in patient referrals;
- changes in the rates, methods or timing of third-party reimbursement for diagnostic imaging services;
- the termination of our contracts with radiology practices;
- the availability of additional capital to fund capital expenditure requirements;
- burdensome lawsuits against our contracted radiology practices and us;
- reduced operating margins due to our managed care contracts and capitated fee arrangements;
- any failure by us to comply with state and federal anti-kickback and anti-self referral laws or any other applicable healthcare regulations;
- changes in business strategy and development plans;
- changes in Federal, state or local regulations affecting the healthcare industry;
- our substantial indebtedness, debt service requirements and liquidity constraints; and
- risks related to our notes and healthcare securities generally.

SALE OF OUR SAN ANTONIO, TEXAS ASSETS COULD ADVERSELY EFFECT OUR REVENUES AND FINANCIAL RESULTS.

We operate six imaging centers in San Antonio, Texas. One imaging center is wholly owned by Radiologix and we conduct operations through five joint ventures with a hospital company. We own a minority interest in each of these joint venture centers. Our joint venture partner has offered to purchase all of our assets in San Antonio and we are currently negotiating terms for the disposition. In the event that Radiologix and its joint venture partner cannot agree on terms of the disposition, then, in the alternative, our joint venture partner's offer will be deemed to be notice, pursuant to the joint venture agreements to terminate the joint ventures effective December 31, 2003. This notice would entitle our joint venture partner to acquire all of the assets of Radiologix's San Antonio joint ventures, without an ongoing agreement not to

compete from Radiologix. The joint venture agreements set the purchase price for the joint venture assets as their fair market value computed at liquidation value as determined by an independent appraiser. The difference between the purchase price of all of our San Antonio assets and the liquidation value of our San Antonio joint venture assets could have a material impact on the financial results of the Company. In the event we continue to operate only a single wholly owned imaging center in the San Antonio market, we cannot give any assurance that it will not have an adverse effect on our business, results of operations or financial condition. Although we would be compensated in the event of a buy-out, our revenues and financial results could be negatively affected by a buy-out unless we receive sufficient capital and can deploy that capital advantageously.

WE COULD BE HARMED IF WE ARE UNABLE TO TIMELY CONTINUE TO COMPLY WITH HIPAA STANDARD TRANSACTION AND CODE SET REQUIREMENTS.

Radiologix has been working diligently to ensure our compliance with HIPAA standard transaction and code set requirements ("the HIPAA EDI requirements") by the October 16, 2003, deadline. These efforts have included contracting with certain third-party vendors and claims clearinghouses to provide certain products and services to facilitate our compliance plans. While we are now able to produce compliant transactions, we continue to believe there may be some cash flow disruption once CMS and other payor contingency plans for noncompliant transactions are no longer in effect. A failure in Radiologix's continued ability to comply with HIPAA Standards or the discontinuance of CMS or payor contingency plans could cause Radiologix to experience a delay in its

claims processing by its payors or lead to a large number of rejected or denied claims. Either of these results may slow our cash collections and increase our accounts receivable days sales outstanding.

WE COULD BE HARMED IF WE EXPERIENCE DELAYED PAYMENTS FROM THIRD-PARTY PAYORS AFTER THE OCTOBER 16, 2003 HIPAA EDI REQUIREMENTS DEADLINE.

In connection with the HIPAA EDI requirements, our payors are also expected to comply with the standard transactions and code set requirements by October 16, 2003. Noncompliance by other providers could cause the healthcare reimbursement system to be flooded with non-compliant claims that will slow down claims processing for all companies. Many non-compliant providers may revert to filing claims in a paper rather than electronic format, thereby causing further delays in the claims processing system. This could cause all healthcare companies including Radiologix to experience a delay in its claims processing by its payors or lead to a large number of rejected or denied claims. Either of these results may slow our cash collections and increase our accounts receivable days sales outstanding.

While Radiologix has taken steps to mitigate this risk by meeting with our payors to assess their HIPAA EDI readiness and discussing payment contingency plans, there can be no assurance that we will be able to maintain sufficient cash on hand and capacity under our existing credit facility to supplement the expected cash-flow shortfalls. If our cash reserves or credit lines prove to be insufficient for our cash flow needs, our business and operations could be adversely affected. This, in turn, may limit our access to capital for growth.

A more comprehensive list of Risk Factors is set forth in the Company's Annual Report on Form 10-K for the year ended December 31, 2002, and our other filings with the Securities and Exchange Commission.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to market risk for changes in interest rates relates primarily to the Company's cash equivalents, credit facility, and its convertible notes. At September 30, 2003, Radiologix had no borrowings outstanding under its senior credit facility. Radiologix's notes bear interest at fixed rates.

ITEM 4. CONTROLS AND PROCEDURES

We have evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of September 30, 2003. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have each concluded that our disclosure controls and procedures are effective to ensure that we record, process, summarize, and report information required to be disclosed by us in our quarterly reports filed under the Securities Exchange Act within the time periods specified by the Securities and Exchange Commission's rules and forms.

During the quarterly period covered by this report, there were no changes in our internal controls over financial reporting that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

We have investments, not material in amount, in certain unconsolidated entities. Since we do not control these entities, our disclosure controls and procedures with respect to these entities are necessarily substantially more limited than those we maintain with respect to our consolidated subsidiaries.

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PART II: OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

As previously disclosed in the Report on Form 10-Q for the quarterly period ended June 30, 2003, the Company has been subject to a lawsuit and a demand for arbitration with physicians in San Antonio, Texas. On September 29, 2003, the parties executed a comprehensive agreement to settle by arbitration, all disputes between the parties for all claims arising in the lawsuit and demand for arbitration. The arbitration was conducted and completed on October 8, 2003 and mutual general releases became effective as of that date. The management service agreement shall terminate and the parties shall separate their business dealings commencing on June 30, 2004. The lawsuits have been dismissed and the matter has now been concluded. The service fee revenue and income from continuing operations before income taxes of the Central region will be decreased by approximately 15% and 32%, respectively, as a result of the portion of the business to be severed June 30, 2004.

ITEM 5. OTHER INFORMATION

As previously disclosed, as part of a routine, ongoing compliance and legal review, Radiologix has found that rents negotiated for the subletting of space from physician landlords of several Radiologix locations may have exceeded fair market value. Radiologix sent a letter to the U.S. Department of Health & Human Services' Office of the Inspector General ("OIG"), informing them of the preliminary findings and seeking their guidance and assistance to remedy this situation. Accordingly, in the second quarter of 2003, we recorded $500,000 as an estimate for potential payments we may incur directly or indirectly. Radiologix has received notification from the OIG that it has qualified for the Provider Self-disclosure Protocol. The Provider Self-disclosure Protocol is a self-reporting program that provides for minimizing the cost and disruption associated with on-going investigations of the OIG. Since the inquiry is in its very early stages, it is not yet possible for Radiologix to give any assurances that the OIG will not impose fines in excess of our estimate or that any potential payments or findings would not have a material adverse effect on its financial position, cash flow and results of operations.

On September 12, 2003, the Board of Directors of Radiologix unanimously approved an amendment to the corporation's bylaws removing the requirement that a number of Radiologix's directors be licensed physicians performing services at a business previously acquired by Radiologix. A copy of this amendment has been filed with this report as Exhibit 3.6.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits. The list of exhibits filed as part of this report is incorporated by reference to the Index to Exhibits at the end of this report.

(b) Reports on Form 8-K. The registrant filed a current report on Form 8-K dated August 7, 2003 announcing the release of its financial results for its second quarter of 2003.

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.

RADIOLOGIX, INC.

Date: November 14, 2003

/s/ STEPHEN D. LINEHAN

Stephen D. Linehan
President and Chief Executive Officer
(Principal Executive Officer)

Date: November 14, 2003

/s/ SAMI S. ABBASI

Sami S. Abbasi
Executive Vice President and

Chief Operating Officer and Chief
Financial Officer
(Principal Accounting Officer)

INDEX TO EXHIBITS

EXHIBIT NUMBER	DESCRIPTION
3.6	Amendment to Restated Bylaws. *
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a), promulgated under the Securities Exchange Act of 1934, as amended. *
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a), promulgated under the Securities Exchange Act of 1934, as amended. *
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. *
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. *

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* Filed herewith.