RADIOLOGIX INC
Form 10-Q
August 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 JUNE 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 June 30, 2003
COMMON STOCK, $0.0001 PAR VALUE	21,695,153 SHARES

RADIOLOGIX, INC.

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FORM 10-Q ITEM

PART I: FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

RADIOLOGIX, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS)

ASSETS	DECEMBER 2002
CURRENT ASSETS:	
Cash and cash equivalents	$ 19,1
Accounts receivable, net of allowances	69,3
Due from affiliates	5,1
Assets held for sale	
Other current assets	7,2
Total current assets	100,8
PROPERTY AND EQUIPMENT, net	62,1
INVESTMENTS IN JOINT VENTURES	10,1
GOODWILL	28,5
INTANGIBLE ASSETS, net	72,1
DEFERRED FINANCING COSTS, net	9,7
OTHER ASSETS	12,6
Total assets	$ 296,0
LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Accounts payable and accrued expenses	$ 19,1
Accrued physician retention	8,2
Accrued salaries and benefits	8,2
Current portion of long-term debt	2
Current portion of capital lease obligations	4,0
Other current liabilities	4
Total current liabilities	40,4
DEFERRED INCOME TAXES	4,2
LONG-TERM DEBT, net of current portion	160,4
CONVERTIBLE DEBT	11,9
CAPITAL LEASE OBLIGATIONS, net of current portion	1,5
DEFERRED REVENUE	7,7
OTHER LIABILITIES	1
Total liabilities	226,3
COMMITMENTS AND CONTINGENCIES	
MINORITY INTERESTS IN CONSOLIDATED SUBSIDIARIES	1,3
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 2003	
Treasury stock	(1
Additional paid-in capital	13,6
Retained earnings	54,8
Total stockholders' equity	68,3
Total liabilities and stockholders' equity	$ 296,0

See accompanying notes to consolidated financial statements.

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RADIOLOGIX, INC. AND SUBSIDIARIES

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

	FOR THE THREE ENDED JUN
	2002
SERVICE FEE REVENUE	$ 71,495
COSTS AND EXPENSES:	
Salaries and benefits	20,130
Field supplies	4,508
Field rent and lease expense	7,624
Other field expenses	11,096
Bad debt expense	6,065
Severance and other related costs	--
Corporate general and administrative	3,960
Depreciation and amortization	6,244
Interest expense, net	4,755
Total costs and expenses	64,382
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF INVESTMENTS, MINORITY INTERESTS IN CONSOLIDATED SUBSIDIARIES, AND INCOME TAXES	7,113
Equity In Earnings of Investments	1,086
Minority Interests In Income of Consolidated Subsidiaries	(308)
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	7,891
Income Tax Expense	3,157
INCOME FROM CONTINUING OPERATIONS	4,734
Discontinued Operations:	
Income (loss) from discontinued operations	63
Income tax expense (benefit)	25
Income (loss) from discontinued operations	38
NET INCOME (LOSS)	$ 4,772
EARNINGS (LOSS) PER COMMON SHARE	
Income from continuing operations - basic	$ 0.23
Loss from discontinued operations - basic	--

Net income (loss) - basic	$ 0.23	$
Income from continuing operations - diluted	$ 0.21	$
Income (loss) from discontinued operations - diluted	--	
Net income (loss) - diluted	$ 0.21	$
WEIGHTED AVERAGE SHARES OUTSTANDING		
Basic	20,712	
Diluted	24,256	

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 SIX MONTHS ENDED JUNE 30,	
	2002	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ 9,201	$ (4,334)
Adjustments to reconcile net income (loss) to net cash provided by operating activities; including discontinued operations:		
Minority interests	669	530
Depreciation and amortization	12,555	13,860
Equity in earnings of investments	(2,207)	(2,512)
Write-down of goodwill included in discontinued operations	--	6,900
Deferred revenue	--	(204)
Non-cash income from receipt of treasury stock	(180)	--
Changes in operating assets and liabilities; net of acquisitions and dispositions:		
Accounts receivable, net	(1,424)	3,720
Other receivables and current assets	2,569	(203)
Accounts payable and accrued expenses	(751)	(7,655)
Net cash provided by operating activities	20,432	10,102
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(10,103)	(12,357)
Contributions to joint ventures	(282)	(460)
Distributions from joint ventures	1,114	2,116
Other investments	(341)	1,888
Net cash used in investing activities	(9,612)	(8,813)
CASH FLOWS FROM FINANCING ACTIVITIES:		

Payments on long-term debt	(3,770)	(2,007)
Financing costs	(373)	--
Proceeds from exercise of stock options	945	--
Other items	--	3
Net cash used in financing activities	(3,198)	(2,004)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	7,622	(715)
CASH AND CASH EQUIVALENTS, beginning of year	10,761	19,153
CASH AND CASH EQUIVALENTS, end of period	$ 18,383	$ 18,438

See accompanying notes to unaudited consolidated financial statements.

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RADIOLOGIX, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 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. Radiologix operates 115 diagnostic imaging centers, including seven imaging centers that are included in discontinued operations in the accompanying financial statements, located in 17 states, with a concentration of diagnostic imaging centers 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. One physician of two of the contracted radiology practices are members of the board of directors of the Company.

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 footnotes 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 Note 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 footnotes 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

We have identified seven imaging centers that have been designated for sale or closure over the next 9 months. These imaging centers do not represent centers around which we can build a market concentration. In accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" the financial results from these seven imaging centers are reported in discontinued operations for the three and six months ended June 30, 2002 and 2003. The six months ended June 30, 2003 includes a $6.9 million pre-tax charge to write down the goodwill related to these centers. For the three and six months ended June 30, 2002, the consolidated statement of income in the accompanying financial statements has been restated to reflect the results of operations for the seven imaging centers as discontinued operations.

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 June 30, 2003, the Company has $21.6 million of goodwill related to the acquired intangible assets of our Questar operations. 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 and 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 management agreements during 2002, $6.0 million has been capitalized as an addition to service agreements. Accumulated amortization of intangible assets at June 30, 2002 and 2003 amounted to $13.0 and $16.7 million, respectively. Amortization expense for the three months ended June 30, 2002 and 2003 equated to $848,000 and $953,000, respectively. Amortization expense for the six months ending June 30, 2002 and 2003 equated to $1.7 million and $1.9 million, respectively. We expect amortization expense to approximate $19.1 million 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 June 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 good will 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 six months ended June 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 in the first quarter or the 125,000 options granted in the second quarter 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 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 six months ended June 30, 2002 and 2003 are as follows (in thousands, except per share amounts):

	2002	2003
Income from continuing operations	$ 9,299	$ 274
Loss from discontinued operations, net of tax benefit	(98)	(4,608)
Net income (loss)	9,201	(4,334)
Deduct: Total stock-based compensation expense determined under fair value based method for all		

awards, net of related tax effects	(823)	(1,054)
Pro forma net income (loss)	$ 8,378	$ (5,388)
Earnings (loss) per common share:		
Income from continuing operations - basic	$ 0.46	$ 0.01
Loss from discontinued operations - basic	(0.01)	(0.21)
Net income (loss) - basic	$ 0.45	$ (0.20)
Proforma - basic	$ 0.41	$ (0.25)
Income from continuing operations - diluted	$ 0.39	$ 0.01
Loss from discontinued operations - diluted	--	(0.21)
Net income (loss) - diluted	$ 0.39	$ (0.20)
Proforma - diluted	$ 0.36	$ (0.25)

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 six months ended June 30, 2002 and 2003, respectively: risk-free interest rate of 4.61% and 3.33%; expected life of 7.09 and 7.52 years; expected volatility of 34.1%, and 78.8%; and dividend yield of zero in 2002 and 2003, respectively. The weighted-average grant-date fair value of new grants during the six months ended June 30, 2002 and 2003 was $11.65 per share, and $5.68 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 JUNE 30,		FOR THE SIX JUNE
	2002	2003	2002

Revenue for contracted radiology practices and diagnostic imaging centers, net of contractual adjustments	$ 98,194	$ 90,620	$ 195,668
Less: amounts retained by contracted radiology practices	(26,699)	(25,606)	(53,182)
Service fee revenue	$ 71,495	$ 65,014	$ 142,486

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 (typically 20% 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 our subsidiary, Questar Imaging, Inc. ("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 FOR THE SIX MONTHS ENDED

	JUNE 30,		JUNE 30,	
	2002	2003	2002	2003
Professional component	$ 14,773	$ 11,853	$ 29,567	$ 23,373
Technical component	56,722	53,161	112,919	106,037
Service fee revenue	$ 71,495	$ 65,014	$142,486	$129,410

SEVERANCE AND OTHER RELATED COSTS

During the six months ended June 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. We may incur additional severance costs of approximately $440,000 as we move forward with our plans to reduce operating expenses. 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 June 30, 2003 (in thousands):

Balance at December 31, 2002	$ 773
Expense	1,280
Cash payment	(1,595)
Balance at June 30, 2003	$ 458

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 July 1, 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 July 1, 2003. The effect of FIN 46 on the Company has not yet been determined.

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 June 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 June 30, 2003, the Company was in compliance with these covenants. At June 30, 2003 certain financial ratios have restricted the Company's ability to borrow $35 million. As a result of the financial covenant ratios, the Company has available up to $25 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%. On August 1, 2003, the closing price of Radiologix's common stock had not exceeded $7.52 for 45 of the 60 days of the determination period under the convertible junior subordinated note agreement. Therefore, the interest rate will be increased to 8.5% from 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. 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.

5. COMMITMENTS AND CONTINGENCIES

On May 12, 2003, the doctors currently employed by M&S Imaging Associates, Inc. ("M&S") in San Antonio, Texas, served us with a lawsuit filed in the 224th District Court, Bexar County, Texas, in a case styled Elaine L. Brown, M.D., et al v. Radiologix, Inc. (Formerly American Physician Partners, Inc.) Cause No. 2003-CI06759 (the "Lawsuit"). The plaintiffs request the court to enter a declaratory judgment that the non-competition covenants contained in each of the plaintiffs' employment agreements with M&S (i.e., the doctors' agreements with their own professional association) is unenforceable in Texas by M&S or by Radiologix as a third party beneficiary of those employment agreements. On May 30, 2003, Radiologix filed its answer to the Lawsuit denying all allegations contained in the plaintiffs' original petition. In addition, Radiologix asserted counterclaims against the doctors who filed the Lawsuit and also joined M&S as a third party defendant, for fraud, interference with contractual and business relations, civil conspiracy, and breach of contract and of nonsolicitation agreement (the "Countersuit"). Radiologix has also served M&S

with a separate notice of default and demand for indemnification under the November 1997 service agreement (the "Service Agreement") from the doctors and M&S for all of Radiologix's damages caused by the wrongful actions or omissions of the doctors and M&S, as well as punitive and exemplary damages. The trial date is currently scheduled for May 3, 2004. Given the number of outstanding issues and the uncertainty of their ultimate disposition, management does not believe that it is currently possible to estimate the impact, if any, that the

ultimate resolution of these matters will have on Radiologix's results of operations, financial position or cash flows.

On July 16, 2003, M&S served Radiologix with a demand for arbitration in the amount of approximately $10 million under the Service Agreement alleging certain acts of mismanagement vis-a-vis its billing and collection operations on behalf of M&S. Although Radiologix has not yet responded to this demand, it intends to vigorously deny and defend itself against M&S's allegations. Given the preliminary nature of this matter, Radiologix can give no assurances that the results of the arbitration proceedings will not have a material adverse impact on its financial position, cash flow and results of operations.

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. 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

We have identified seven imaging centers that have been designated for sale or closure over the next 9 months. These imaging centers do not represent centers around which we can build a market concentration. The seven imaging centers are reported in discontinued operations for the three and six months ended June 30, 2002 and 2003. The six months ended June 30, 2003 includes a $6.9 million pre-tax charge to write down the related goodwill of these centers.

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

	FOR THE THREE MONTHS ENDED JUNE 30,	
	2002	2003
Service fee revenue	$ 1,864	$ 1,255
Income (loss) from discontinued operations before income taxes	$ 63	$ (327)
Income tax expense (benefit)	25	(131)

Income (loss) from discontinued operations	$ 38	$ (196)
	=======	=======

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

	2002	2003
Assets	$2,106	$ -
Liabilities	1,585	1,093
Net assets	$ 521	$(1,093)
	======	=======

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 June 30, 2003, approximately $144,000 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 June 30, 2002, approximately $208,000 of tax-effected interest savings and 2,153,802 weighted average shares related to the convertible junior subordinated note were included in the computation of diluted EPS. For the three months ended June 30, 2002 and 2003, 1,390,471 shares and 128,255 shares, respectively, related to stock options were included in diluted EPS.

For the six months ended June 30, 2003, approximately $288,000 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 six months ended June 30, 2002, approximately $470,000 of tax-effected interest savings and 2,468,717 weighted average shares related to the convertible junior subordinated note were included in the computation of diluted EPS. For the six months ended June 30, 2002 and 2003, 1,275,008 shares and 73,288 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 SIX MONTHS ENDE			
	Mid-Atlantic Region (1)	Northeastern Region (2)	Central Region (3)	Wes Regi
Service fee revenue	$ 62,188	32,269	17,689	1
Total costs and expenses	$ 46,535	25,316	13,055	1
Income from continuing operations before equity in earnings of investments and minority interests in consolidated subsidiaries, and income taxes	$ 15,653	6,953	4,634	
Equity in earnings of investments	$ 1,707	--	500	
Minority interests in income of consolidated subsidiaries	$ (445)	--	(222)	
Income from continuing operations before income taxes	$ 16,915	6,953	4,912	
Loss from discontinued operations	$ --	--	--	
Income before income taxes	$ 16,915	6,953	4,912	
Assets	$ 68,297	43,856	25,175	1
Purchases of property and equipment	$ 5,142	2,786	1,306	

	FOR THE SIX MONTHS ENDED JUN			
	Mid-Atlantic Region (1)	Northeastern Region (2)	Central Region (3)	Western Region (4)

Service fee revenue	$ 57,591	24,886	17,221	18,188
Total costs and expenses	$ 47,735	24,529	13,281	16,479
Income from continuing operations before equity in earnings of investments and minority interests in consolidated subsidiaries, and income taxes	$ 9,856	357	3,940	1,709
Equity in earnings of investments	$ 1,995	--	517	--
Minority interests in income of consolidated subsidiaries	$ (293)	--	(197)	--
Income from continuing operations before income taxes	$ 11,558	357	4,260	1,709
Loss from discontinued operations	$ --	--	--	--
Income (loss) before income taxes	$ 11,558	357	4,260	1,709
Assets	$ 74,577	37,286	25,104	20,793
Purchases of property and equipment	$ 6,391	2,039	611	559

(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).

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Corporate assets, including intangible assets, as of June 30, 2002 and 2003 were $113,142 and $81,867, 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 six months ended June 30, 2002 and 2003 (in thousands):

	FOR THE SIX MONTHS ENDED JUNE 30,	
	2002	2003
Segment income before income taxes	$ 32,954	$ 10,659
Unallocated amounts:		
Corporate general and administrative	(7,865)	(7,016)
Corporate severance and other related costs	--	(1,027)
Corporate other income	180	--
Corporate depreciation and amortization	(2,808)	(3,165)

Corporate interest expense	(7,126)	(6,675)
Consolidated income (loss) before income taxes	$ 15,335	$ (7,224)

	FOR THE SIX MONTHS ENDED JUNE 30,	
	2002	2003
Purchases of property and equipment		
Segment amounts	$ 9,810	$12,139
Corporate amount	293	218
Total purchases of property and equipment	$10,103	$12,357

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 such 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	JUNE 30, 2003
Current assets	$18,873	$19,504
Noncurrent assets	14,184	15,489
Current liabilities	6,263	7,324
Noncurrent liabilities	653	503

	FOR THE THREE MONTHS ENDED JUNE 30,		FOR THE SIX MONTHS E JUNE 30,	
	2002	2003	2002	2
Minority interest	$ 1,086	$ 1,314	$ 2,207	$ 2
Net revenue	11,390	12,272	24,978	27
Net income	3,257	3,660	6,586	7

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 June 30, 2003, and the statements of operations and cash flows for the six months ended June 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)

JUNE 30, 2003
(IN THOUSANDS)

	PARENT	SUBSIDIARY GUARANTORS	NON-GUARANTOR SUBSIDIARIES
ASSETS:			
Cash and cash equivalents	$ 15,985	$ 127	$ 2,326
Accounts receivable, net of allowances	--	62,706	2,950
Other current assets	505	14,295	(987)
Total current assets	16,490	77,128	4,289
Property and equipment, net	2,526	58,214	2,424
Investment in subsidiaries	146,354	--	--
Goodwill	--	21,610	--
Intangible assets, net	--	62,296	7,994
Other assets	14,434	12,829	118
	$ 179,804	$ 232,077	$ 14,825
LIABILITIES AND STOCKHOLDERS' EQUITY:			
Accounts payable and accrued expenses	$ 4,260	$ 16,870	$ 7,607
Current portion of long-term obligations	13	2,782	639
Other current liabilities	70	390	--
Total current liabilities	4,343	20,042	8,246
Long-term obligations, net of current portion	171,527	309	901
Other noncurrent liabilities	(60,102)	74,763	(5,122)
Minority interests in consolidated subsidiaries	--	--	1,409
Stockholders' equity	64,036	136,963	9,391
	$ 179,804	$ 232,077	$ 14,825

RADIOLOGIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS (UNAUDITED)

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

	PARENT	SUBSIDIARY GUARANTORS	NON-GUARANTOR SUBSIDIARIES
Service fee revenue	$ --	$ 65,725	$ 5,770
Costs and expenses:			
Salaries and benefits	--	19,399	731
Field supplies	--	4,212	296
Field rent and lease expense	--	7,133	491
Other field expenses	--	9,333	1,763
Bad debt expense	--	5,662	403
Corporate general and administrative	3,960	--	--
Depreciation and amortization	692	5,301	251
Interest expense, net	3,501	1,216	38
Total costs and expenses	8,153	52,256	3,973
Income (loss) from continuing operations before equity in earnings of investments, minority interests in consolidated subsidiaries, and income taxes	(8,153)	13,469	1,797
Equity in earnings of investments	--	1,086	--
Minority interests in income of consolidated subsidiaries	--	--	(308)
Income (loss) from continuing operations before income	(8,153)	14,555	1,489
Income tax expense (benefit)	(3,261)	5,822	596
Income (loss) from continuing operations	(4,892)	8,733	893
Discontinued operations:			
Income from discontinued operations	--	63	--
Income tax expense	--	25	--
Income from discontinued operations	--	38	--
Net income (loss)	$ (4,892)	$ 8,771	$ 893

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RADIOLOGIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS (UNAUDITED)

FOR THE SIX MONTHS ENDED JUNE 30, 2002
(IN THOUSANDS)

	PARENT	SUBSIDIARY GUARANTORS	NON-GUARANTOR SUBSIDIARIE
Service fee revenue	$ --	$ 131,019	$ 11,467
Costs and expenses:			
Salaries and benefits	--	38,759	1,490
Field supplies	--	8,086	589
Field rent and lease expense	--	14,086	993
Other field expenses	(180)	19,507	3,396
Bad debt expense	--	11,187	790
Corporate general and administrative	7,865	--	--
Depreciation and amortization	1,351	10,491	500
Interest expense, net	7,126	2,349	141
Total costs and expenses	16,162	104,465	7,899
Income (loss) from continuing operations before equity in earnings of investments, minority interests in consolidated subsidiaries, and income taxes	(16,162)	26,554	3,568
Equity in earnings of investments	--	2,207	--
Minority interests in income of consolidated subsidiaries	--	--	(669
Income (loss) from continuing operations before income	(16,162)	28,761	2,899
Income tax expense (benefit)	(6,465)	11,504	1,160
Income (loss) from continuing operations	(9,697)	17,257	1,739
Discontinued operations:			
Loss from discontinued operations	--	(163)	--
Income tax benefit	--	(65)	--
Loss from discontinued operations	--	(98)	--
Net income (loss)	$ (9,697)	$ 17,159	$ 1,739

RADIOLOGIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS (UNAUDITED)

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

PARENT	SUBSIDIARY GUARANTORS	NON-GUARANTOR SUBSIDIARIES

Service fee revenue	$ --	$ 60,363	$ 4,651
Costs and expenses:			
Salaries and benefits	--	19,992	700
Field supplies	--	4,297	282
Field rent and lease expense	--	7,642	500
Other field expenses	--	9,534	1,449
Bad debt expense	--	5,269	326
Severance and other related costs	281	30	--
Corporate general and administrative	3,375	--	--
Depreciation and amortization	744	6,012	211
Interest expense, net	3,260	1,267	40
Total costs and expenses	7,660	54,043	3,508
Income (loss) from continuing operations before equity in earnings of investments, minority interests in consolidated subsidiaries, and income taxes	(7,660)	6,320	1,143
Equity in earnings of investments	--	1,314	--
Minority interests in income of consolidated subsidiaries	--	--	(331)
Income (loss) from continuing operations before income	(7,660)	7,634	812
Income tax expense (benefit)	(3,064)	3,054	324
Income (loss) from continuing operations	(4,596)	4,580	488
Discontinued operations:			
Loss from discontinued operations	--	(327)	--
Income tax benefit	--	(131)	--
Loss from discontinued operations	--	(196)	--
Net income (loss)	$ (4,596)	$ 4,384	$ 488

RADIOLOGIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS (UNAUDITED)

FOR THE SIX MONTHS ENDED JUNE 30, 2003
(IN THOUSANDS)

	PARENT	SUBSIDIARY GUARANTORS	NON-GUARANTOR SUBSIDIARI
Service fee revenue	$ --	$ 120,179	$ 9,231
Costs and expenses:			
Salaries and benefits	--	40,524	1,476

Field supplies	--	8,133	574
Field rent and lease expense	--	15,226	1,008
Other field expenses	--	18,462	3,012
Bad debt expense	--	10,476	669
Severance and other related costs	1,027	253	--
Corporate general and administrative	7,016	--	--
Depreciation and amortization	1,487	11,908	442
Interest expense, net	6,675	2,489	79
Total costs and expenses	16,205	107,471	7,260
Income (loss) from continuing operations before equity in earnings of investments, minority interests in consolidated subsidiaries, and income taxes	(16,205)	12,708	1,971
Equity in earnings of investments	--	2,512	--
Minority interests in income of consolidated subsidiaries	--	--	(530
Income (loss) from continuing operations before income	(16,205)	15,220	1,441
Income tax expense (benefit)	(6,482)	6,088	576
Income (loss) from continuing operations	(9,723)	9,132	865
Discontinued operations:			
Loss from discontinued operations	--	(7,680)	--
Income tax benefit	--	(3,072)	--
Loss from discontinued operations	--	(4,608)	--
Net income (loss)	$ (9,723)	$ 4,524	$ 865

RADIOLOGIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS (UNAUDITED)

FOR THE SIX MONTHS ENDED JUNE 30, 2002
(IN THOUSANDS)

	PARENT	SUBSIDIARY GUARANTORS	NON-GUARANTOR SUBSIDIARIES
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	$ (6,962)	$ 27,681	$ (287)
CASH FLOWS FROM INVESTING ACTIVITIES:			

Purchases of property and equipment	(1,579)	(8,367)	(157)
Joint ventures	--	832	--
Other investments	117	(360)	(98)
Net cash used in investing activities	(1,462)	(7,895)	(255)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds (payments) on long-term debt	(1,249)	(3,235)	714
Due to/from parent/subsidiaries	16,492	(16,598)	106
Other items	489	409	(326)
Net cash provided by (used in) financing activities	15,732	(19,424)	494
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	7,308	362	(48)
CASH AND CASH EQUIVALENTS, beginning of period	7,670	(953)	4,044
CASH AND CASH EQUIVALENTS, end of period	$ 14,978	$ (591)	$ 3,996

RADIOLOGIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS (UNAUDITED)

FOR THE SIX MONTHS ENDED JUNE 30, 2003
(IN THOUSANDS)

	PARENT	SUBSIDIARY GUARANTORS	NON-GUARANTOR SUBSIDIARIE
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	$(12,108)	$ 14,157	$ 8,053
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of property and equipment	(1,699)	(10,510)	(148)
Joint ventures	--	1,656	--
Other investments	321	8,536	(6,969)
Net cash used in investing activities	(1,378)	(318)	(7,117)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds (payments) on long-term debt	(40)	(1,630)	(338)
Due to/from parent/subsidiaries	13,732	(11,691)	(2,041)
Other items	4	(10)	10

Net cash provided by (used in) financing activities	13,696	(13,331)	(2,369)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	210	508	(1,433)
CASH AND CASH EQUIVALENTS, beginning of period	15,775	(381)	3,759
CASH AND CASH EQUIVALENTS, end of period	$ 15,985	$ 127	$ 2,326

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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 six months ended June 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 June 30, 2003, we owned, operated or maintained an ownership interest in imaging equipment at 115 locations, including seven imaging centers that are included in discontinued operations in the accompanying financial statements. In addition, we provided management services to ten radiology practices. As of June 30, 2003, our imaging centers are located in 17 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 six months ended June 30, 2003, payment for diagnostic imaging services came primarily from commercial third-party payors (65%), governmental payors (28%, including Medicare and Medicaid) and private and other payors (7%). 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. 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 six months ended June 30, 2003, approximately 5% 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 six months ended June 30, 2003 was affected by such factors as increased competition, the current recession, increased payor pre-authorization activity, a shortage of technologists, and harsh weather conditions during January and February. Although we continue to be faced with such factors other than weather conditions, we believe the affect on our results of operations is beginning to stabilize. 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 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. The combined effect of increased salaries and benefits and lower revenues decreased our operating margins during the six months ended June 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, excluding the Western region, and Questar decreased from the six months ended June 30, 2002 to the six months ended June 30, 2003. For the six months ended June 30, 2002 and 2003, the Mid Atlantic region decreased from $16.9 million to $11.6 million, respectively, the Northeastern region decreased from $7.0 million to $357,000, respectively, the Central region decreased from $4.9 million to $4.3 million, respectively, and Questar decreased from $2.7 million to a loss of $7.2 million, respectively. For the six months ended June 30, 2002 and 2003 for the Western region income before income taxes increased from $1.5 million to $1.7 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 each of the above factors due to 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 seven imaging centers of the Questar subsidiary that have been designated for sale or closure over the next 9 months. These imaging centers do not represent centers around which we can build a market concentration. In accordance with Financial Accounting Standards Board Statement 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," the financial results from these seven imaging centers are included in discontinued operations in the accompanying consolidated financial statements. The six months ended June 30, 2003 includes a $6.9 million pre-tax charge to write down the related goodwill of these centers.

We completed no acquisitions or dispositions in the six months ended June 30, 2002 and June 30, 2003, respectively.

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THREE MONTHS ENDED JUNE 30, 2002 COMPARED TO THREE MONTHS ENDED JUNE 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 MONT JUNE 30,	
	2002	2003
Revenue from contracted radiology practices and diagnostic imaging centers, net of contractual allowances........	$ 98,194	$ 90,620
Less: amounts retained by contracted radiology practices...........	(26,699)	(25,606
Service fee revenue..	$ 71,495	$ 65,014

Revenue from contracted radiology practices and diagnostic imaging centers, net of contractual allowances, decreased $7.6 million, from $98.2 million for the three months ended June 30, 2002 to $90.6 million for the three months ended June 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 $26.7 million for the three months ended June 30, 2002 to $25.6 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 $6.5 million, from $71.5 million for the three months ended June 30, 2002 to $65.0 million for the three months ended June 30, 2003.

Salaries and Benefits

Salaries and benefits increased $600,000, from $20.1 million for the three months ended June 30, 2002 to $20.7 million for the three months ended June 30, 2003. Salaries and benefits increased as the cost of salaries and benefits for technologists increased. As a percentage of service fee revenue, salaries and benefits were 28.2% and 31.8% for the three months ended June 30, 2002 and 2003, respectively.

Field Supplies

Field supplies of $4.6 million for the three months ended June 30, 2003 remained relatively the same as for the three months ended June 30, 2002. As a percentage of service fee revenue, these costs were 6.3% and 7.0% for the three months ended June 30, 2002 and 2003, respectively.

Field Rent and Lease

Field rent and lease costs increased $500,000, from $7.6 million for the three months ended June 30, 2002 to $8.1 million for the three months ended June 30, 2003. The increase in field rent and lease costs is primarily related to higher facility costs for existing locations as well as new locations. As a percentage of service fee revenue, these costs were 10.7% and 12.5% for the three months ended June 30, 2002 and 2003, respectively.

Other Field Costs

Other field costs decreased $600,000, from $11.1 million for the three months ended June 30, 2002 to $10.5 million for the three months ended June 30, 2003. As a percentage of service fee revenue, these costs were 15.5% for the three months ended June 30, 2002 to 16.1% 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.

As part of a routine, ongoing compliance and legal review, Radiologix has found that rents negotiated for

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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. 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 $500,000, from $6.1 million for the three months ended June 30, 2002 to $5.6 million for the three months ended June 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 8.5% and 8.6% for the three months ended June 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 June 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 6.2% for the three months ended June 30, 2002 and 2003.

Severance and Other Related Costs

During the three months ended June 30, 2003, we recorded $311,000 in severance and other related costs. These costs include severance costs 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 May 2003, the former general counsel resigned from his position, effective July 31, 2003. We may incur additional severance costs of approximately $440,000 as we move forward with our plans to reduce operating expenses.

Corporate, General and Administrative

Corporate, general and administrative expenses decreased $600,000, from $4.0 million for the three months ended June 30, 2002 to $3.4 million for the three months ended June 30, 2003. As a percentage of service fee revenue, these costs were 5.5% and 5.2% for the three months ended June 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.

Depreciation and Amortization

Depreciation and amortization expense increased $800,000, from $6.2 million for the three months ended June 30, 2002 to $7.0 million for the three months ended June 30, 2003. As a percentage of service fee revenue, these costs were 8.7% and 10.7% for the three months ended June 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 $4.3 million in the first quarter of 2003.

Interest Expense, Net

Interest expense, net, decreased $200,000, from $4.8 million for the three months ended June 30, 2002 to $4.6 million for the three months ended June 30, 2003.

Discontinued Operations

We have identified seven imaging centers that have been designated for sale or closure over the next 9 months. These imaging centers do not represent centers around which we can build a market concentration. In accordance with Financial Accounting Standards Board Statement 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," the financial results from these seven imaging centers are included in discontinued operations in the accompanying consolidated financial statements for the three months ended June 30, 2002 and 2003. For the three months ended June 30, 2002, the accompanying consolidated unaudited financial statements have been restated to reflect the results of operations for the seven imaging centers as discontinued operations. Income from discontinued operations for the three months ended June 30, 2002 was $63,000 ($38,000 net of tax expense). Loss from discontinued operations for the three months ended June 30, 2003 was $327,000 ($196,000 net of tax benefit).

Income Tax Expense

Income tax expense of $3.2 million for the three months ended June 30, 2002 and $183,000 for the three months ended June 30, 2003 remained comparable based on a 40% effective tax rate.

Net Income

Net income decreased from $4.8 million for the three months ended June 30, 2002 to $276,000 for the three months ended June 30, 2003. Included in net income for the three months ended June 30, 2002 is income from discontinued operations of $38,000. Included in net income for the three months ended June 30, 2003 is a loss from discontinued operations of $196,000. In addition, the three months ended June 30, 2003 includes $311,000 ($187,000, net of tax benefit related) to severance and other related costs.

SIX MONTHS ENDED JUNE 30, 2002 COMPARED TO SIX MONTHS ENDED JUNE 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 SIX MONTH JUNE 30,	
	2002	2003
Revenue from contracted radiology practices and diagnostic imaging centers, net of contractual allowances.........	$ 195,668	$ 179,816
Less: amounts retained by contracted radiology practices...........	(53,182)	(50,406
Service fee revenue, as reported..................................	$ 142,486	$ 129,410

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Revenue from contracted radiology practices and diagnostic imaging centers, net of contractual allowances, decreased $15.9 million, from $195.7 million for the six months ended June 30, 2002 to $179.8 million for the six months ended June 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 $53.2 million for the six months ended June 30, 2002 to $50.4 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 $13.1 million, from $142.5 million for the six months ended June 30, 2002 to $129.4 million, for the six months ended June 30, 2003.

Salaries and Benefits

Salaries and benefits increased $1.8 million, from $40.2 million for the six months ended June 30, 2002 to $42.0 million for the six months ended June 30, 2003. Salaries and benefits increased as volume and revenues increased and as salaries and benefits for technologists increased. As a percentage of service fee revenue, these costs increased from 28.2% and 32.5% for the six months ended June 30, 2002 and 2003, respectively. During the first quarter 2003, we initiated cost reduction programs at our corporate office and at our field operations. At our field offices, we began reducing salaries and benefits costs primarily associated with administrative positions. We believe this may result in annual cost savings of approximately $4.0 million.

Field Supplies

Field supplies remained relatively stable at $8.7 million during 2003 and 2002. As a percentage of service fee revenue, these costs were 6.1% and 6.7% for the six months ended June 30, 2002 and 2003, respectively.

Field Rent and Lease

Field rent and lease costs increased $1.1 million, from $15.1 million for the six months ended June 30, 2002 to $16.2 million for the six months ended June 30, 2003. The increase in field rent and lease is primarily related to 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 six months ended June 30, 2002 and 2003, respectively.

Other Field Costs

Other field costs decreased $1.7 million, from $22.7 million for the six months ended June 30, 2002 to $21.0 million for the six months ended June 30, 2003. As a percentage of service fee revenue, these costs increased from 15.9% for the six months ended June 30, 2002 to 16.2% for the six months ended June 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.

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. 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 $900,000, from $12.0 million for the six months ended June 30, 2002 to $11.1 million for the six months ended June 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 8.4% 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 six months ended June 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 6.1% and 6.2% for the six months ended June 30, 2002 and 2003, respectively.

Severance and Other Related Costs

During the six months ended June 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. We may incur additional severance costs of approximately $440,000 as

we move forward with our plans to reduce operating expenses.

Corporate, General and Administrative

Corporate, general and administrative expenses decreased $900,000, from $7.9 million for the six months ended June 30, 2002 to $7.0 million for the six months ended June 30, 2003. As a percentage of service fee revenue, these costs were 5.5% and 5.4% for the six months ended June 30, 2002 and 2003, respectively. During the six months ended June 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. The decrease in costs is primarily due to lower salaries and benefits at the corporate office.

Depreciation and Amortization

Depreciation and amortization expense increased $1.5 million, from

$12.3 million for the six months ended June 30, 2002 to $13.8 million for the six months ended June 30, 2003. As a percentage of service fee revenue, these costs were 8.7% 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 $12.4 million in the six months ended June 30, 2003.

Interest Expense, Net

Interest expense, net, decreased $400,000, from $9.6 million for the six months ended June 30, 2002 to $9.2 million for the six months ended June 30, 2003.

Discontinued Operations

We have identified seven imaging centers that have been designated for sale or closure over the next 9 months. These imaging centers do not represent centers around which we can build a market concentration. In accordance with Financial Accounting Standards Board Statement 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," the financial results from these seven imaging centers are included in discontinued operations in the accompanying consolidated financial statements for the six months ended June 30, 2002 and 2003. For the six months ended June 30, 2002, the accompanying consolidated unaudited financial statements have been restated to reflect the results of operations for the seven imaging centers as discontinued operations. Loss from discontinued operations for the six months ended June 30, 2002 was $163,000 ($98,000 net of tax benefit). Loss from discontinued operations for the six months ended June 30, 2003 was $7.7 million ($4.6 million net of tax benefit). The loss for the six months ended June 30, 2003 includes a charge to write-down the goodwill related to these centers.

Income Tax Expense

Income tax expense of $6.1 million for the six months ended June 30, 2002 and an income tax benefit of $2.9 million for the six months ended June 30, 2003 was based on a 40% effective tax rate.

Net Income

Net income decreased from $9.2 million for the six months ended June 30, 2002 to a net loss of $4.3 million for the six months ended June 30, 2003. Included in net income for the six months ended June 30, 2002 is a loss from discontinued operations of $98,000. Included in net loss for the six months ended June 30, 2003 is a loss from discontinued operations of $4.6 million. In addition, the six months ended June 30, 2003 includes $1.3 million ($768,000, net of tax benefit) related to severance and other related costs.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity for the six months ended June 30, 2003, was derived from cash and cash equivalents and net cash proceeds from operating activities. As of June 30, 2003, we had net working capital of $65.3 million, including cash and cash equivalents of $18.4 million. We had current assets of $97.9 million and current liabilities of $32.6 million, including current maturities of long-term debt and capital lease obligations of $3.4 million. For the six months ended June 30, 2003, we generated $10.1 million in net operating cash flow, invested $8.8 million and used cash of $2.0 million in financing activities.

Net cash from operating activities for the six months ended June 30, 2003 of $10.1 million decreased from $20.4 million for the same period in 2002. The decrease in the results of operations for the six months ended June 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 six months ended June 30, 2003. Accounts receivable days outstanding remained relatively stable at 68 days at June 30, 2002 to 69 days at June 30, 2003.

Net cash used in investing activities for the six months ended June 30, 2002 and 2003 was $9.6 million and $8.8 million, respectively. Purchases of property and equipment during the six months ended June 30, 2002 and 2003 were $10.1 million and $12.4 million, respectively. For the six months ended June 30, 2003, we invested $4.6 million to replace and maintain property and equipment and $7.8 million in the expansion of property and equipment.

Net cash flows used in financing activities for the six months ended June 30, 2002 and 2003 were $3.2 million and $2.0 million, respectively. Borrowings of long-term debt for the six months ended June 30, 2002 and 2003 were used to purchase equipment and capital improvements, as well as for working capital needs.

At June 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 June 30, 2003, the Company was in compliance with these covenants. At June 30, 2003 certain financial ratios have restricted the Company's ability to borrow $35 million. As a result of the financial covenant ratios, the Company has available up to $25 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 the Health Insurance Portability and Accountability Act of 1996 ("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, must comply with the HIPAA electronic data interchange mandates. We are required to be compliant by October 16, 2003.

RISK 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.

WE COULD BE HARMED IF OUR TEXAS JOINT VENTURE IMAGING CENTER PARTNERSHIPS ARE TERMINATED.

Five of our imaging centers in Texas conduct operations through our joint ventures with a hospital company. We own a minority interest in each of these centers. The term of each joint venture agreement, as amended, expires on December 31, 2003, with automatic one year extensions unless we or our joint venture partner give a notice to terminate the joint ventures during a thirty day period commencing October 6th of each year. If such a notice to terminate is given by either us or our joint venture partner, then our joint venture partner will have the option to buy our minority ownership interests in the joint ventures at fair market value. Fair market value is computed on the basis of the value of the enterprise as a going concern, if our joint venture partner chooses to acquire the joint ventures' assets and a two year non-competition covenant from us, or at liquidation value as determined by an appraiser, if our joint venture partner chooses to acquire only the joint venture assets. The difference between going concern and liquidation value could be material to us. Although we would be compensated in the event of a buyout, our revenues and financial results could be negatively affected by a buy-out unless we can deploy the capital advantageously.

WE COULD BE HARMED IF WE ARE UNABLE TO TIMELY 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 believe that we will be compliant by that date, we cannot provide assurances that we will ultimately achieve compliance by the deadline. If any of the third-party vendors that we have contracted with to assist us and/or to provide services to us in our plan to comply with the HIPAA EDI requirements are unable to timely deliver the contracted services, we may be unable to meet the October 16, 2003, compliance deadline. While we may still continue to submit claims for services, lack of full compliance with the requirements may compromise timely adjudication and payment by third party payors. This 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 is taking 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 are 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.

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 June 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 June 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.

PART II: OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

On May 12, 2003, the doctors currently employed by M&S Imaging Associates, Inc. ("M&S") in San Antonio, Texas, served us with a lawsuit filed in the 224th District Court, Bexar County, Texas, in a case styled Elaine L. Brown, M.D., et al v. Radiologix, Inc. (Formerly American Physician Partners, Inc.) Cause No. 2003-CI06759 (the "Lawsuit"). The plaintiffs request the court to enter a declaratory judgment that the non-competition covenants contained in each of the plaintiffs' employment agreements with M&S (i.e., the doctors' agreements with their own professional association) is unenforceable in Texas by M&S or by Radiologix as a third party beneficiary of those employment agreements. On May 30, 2003, Radiologix filed its answer to the Lawsuit denying all allegations contained in the plaintiffs' original petition. In addition, Radiologix asserted counterclaims against the doctors who filed the Lawsuit and also joined M&S as a third party defendant, for fraud, interference with contractual and business relations, civil conspiracy, and breach of contract and of nonsolicitation agreement (the "Countersuit"). Radiologix has also served M&S with a separate notice of default and demand for indemnification under the November 1997 service agreement (the "Service Agreement") from the doctors and M&S for all of Radiologix's damages caused by the wrongful actions or omissions of the doctors and M&S, as well as punitive and exemplary damages. The trial date is currently scheduled for May 3, 2004. Given the number of outstanding issues and the uncertainty of their ultimate disposition, management does not believe that it is currently possible to estimate the impact, if any, that the ultimate resolution of these matters will have on Radiologix's results of operations, financial position or cash flows.

On July 16, 2003, M&S served Radiologix with a demand for arbitration in the amount of approximately $10 million under the Service Agreement alleging certain acts of mismanagement vis-a-vis its billing and collection operations on behalf of M&S. Although Radiologix has not yet responded to this demand, it intends to vigorously deny and defend itself against M&S's allegations. Given the preliminary nature of this matter, Radiologix can give no assurances that the results of the arbitration proceedings will not have a material adverse impact on its financial position, cash flow and results of operations.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

Radiologix's 2003 annual stockholders meeting was held on June 10, 2003. The following individuals were elected as directors and the appointment of Ernst & Young LLP as independent public accountants was ratified, by the votes indicated below:

Nominee	For	Withheld
Marvin S. Cadwell	19,064,618	383,742
Paul D. Farrell	18,698,002	750,358
Stephen D. Linehan	18,986,368	461,992
Joseph C. Mello	18,669,002	779,358
Derace L. Schaffer, M.D.	18,536,243	912,117
Michael L. Sherman, M.D.	18,546,324	902,036

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Appointment of Ernst & Young LLP:

For: 19,375,035   Against: 71,093   Abstain: 2,232

At the annual meeting, the stockholders also approved a proposed amendment to Radiologix's Amended and Restated Certificate of Incorporation to permit the Board of Directors to amend or remove a restriction in Radiologix's bylaws on the composition of the Board of Directors:

For: 11,580,891   Against: 338,738   Abstain: 231,554

ITEM 5. OTHER INFORMATION

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. 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.

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 May 6, 2003 announcing the release of its financial results for its first 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: August 14, 2003

/s/ STEPHEN D. LINEHAN

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

Date: August 14, 2003

/s/ SAMI S. ABBASI

Sami S. Abbasi
Executive Vice President and
Chief Financial Officer
(Principal Accounting Officer)

INDEX TO EXHIBITS

EXHIBIT NUMBER	DESCRIPTION
3.5	Certificate of Amendment of the Restated Certificate of Incorporation of Radiologi 2003. *
10.42(M)	Summary of consulting arrangement of Derace L. Schaffer, M.D. *
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-1 the Securities Exchange Act of 1934, as amended. *
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-1 the Securities Exchange Act of 1934, as amended. *
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as ad 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 ad Section 906 of the Sarbanes-Oxley Act of 2002.*

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* Filed herewith.

(M) Management contract or compensatory plan.