RADIOLOGIX INC
Form 10-Q
August 14, 2002

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, 2002

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

Class	Outstanding at August 9, 2002

COMMON STOCK, $0.0001 PAR VALUE 21,461,479 SHARES

RADIOLOGIX, INC.

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FORM 10-Q ITEM

RADIOLOGIX, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS)

	DECEMBER 31, 2001	JUNE 30, 2002 (UNAUDITED)
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 10,761	$ 18,383
Accounts receivable, net of allowances	71,325	69,947
Due from affiliates	2,673	4,990
Income tax receivable	350	350
Other current assets	10,517	8,355
Total current assets	95,626	102,025
PROPERTY AND EQUIPMENT, net	60,339	59,464
INVESTMENTS IN JOINT VENTURES	7,095	8,331
GOODWILL	28,510	28,510
INTANGIBLE ASSETS, net	69,583	67,898
DEFERRED FINANCING COSTS, net	10,837	10,450
OTHER ASSETS		
Deferred income tax asset	3,867	3,867
Notes receivable	6,184	6,093
Other assets, net	2,684	3,927
Total assets	$ 284,725	$ 290,565
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable and accrued expenses	$ 17,743	$ 15,789
Accrued physician retention	8,832	9,909
Accrued salaries and benefits	8,318	8,654
Current portion of long term debt	398	275
Current portion of capital lease obligations	5,066	4,331
Other current liabilities	55	59
Total current liabilities	40,412	39,017
DEFERRED INCOME TAXES	6,619	6,619
LONG-TERM DEBT, net of current portion	184,905	175,260
CAPITAL LEASE OBLIGATIONS, net of current portion	6,783	3,861
OTHER LIABILITIES	348	167
Total liabilities	239,067	224,924
COMMITMENTS AND CONTINGENCIES		
MINORITY INTERESTS IN CONSOLIDATED SUBSIDIARIES	1,182	1,710
STOCKHOLDERS' EQUITY:		
Common stock	2	2
Additional paid-in capital	347	10,781
Treasury stock	--	(180)
Retained earnings	44,127	53,328
Total stockholders' equity	44,476	63,931
Total liabilities and stockholders' equity	$ 284,725	$ 290,565

See accompanying notes to unaudited consolidated financial statements.

RADIOLOGIX, INC. AND SUBSIDIARIES

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

	FOR THE THREE MONTHS ENDED JUNE 30,	
	2002	2001
		(UN
SERVICE FEE REVENUES	$ 73,359	$ 68,236
COSTS AND EXPENSES:		
Salaries and benefits	20,523	18,679
Field supplies	4,605	4,065
Field rent and lease expense	8,193	8,538
Other field expenses	11,511	11,493
Bad debt expense	6,259	6,326
Corporate general and administrative	3,960	3,540
Depreciation and amortization	6,349	5,863
Interest expense, net	4,783	4,102
Total costs and expenses	66,183	62,606
INCOME BEFORE TAXES, EQUITY IN EARNINGS OF INVESTMENTS AND MINORITY INTERESTS IN CONSOLIDATED SUBSIDIARIES	7,176	5,630
Equity In Earnings Of Investments	1,086	1,234
Minority Interests In Income Of Consolidated Subsidiaries	(308)	(278)
INCOME BEFORE TAXES	7,954	6,586
Income Tax Expense	3,182	2,634
NET INCOME	$ 4,772	$ 3,952
NET INCOME PER COMMON SHARE		
Basic	$ 0.23	$ 0.20
Diluted	$ 0.21	$ 0.19
WEIGHTED AVERAGE SHARES OUTSTANDING		

Basic	20,712	19,507
Diluted	24,256	22,047

See accompanying notes to unaudited consolidated financial statements.

RADIOLOGIX, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)

	FOR THE SIX MONTHS ENDED JUNE 30, 2002	2001
	(UNAUDITED)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 9,201	$ 7,450
Adjustments to reconcile net income to net cash provided by operating activities:		
Minority interests	669	542
Depreciation and amortization	12,555	11,466
Equity in earnings of investments	(2,207)	(2,726)
Non-cash income from receipt of treasury stock	(180)	--
Changes in assets and liabilities		
Accounts receivable, net	(1,424)	(3,500)
Other receivables and current assets	2,569	4,286
Accounts payable and accrued expenses	(751)	4,477
Net cash provided by operating activities	20,432	21,995
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(10,103)	(3,584)
Distributions to joint ventures	(282)	(493)
Distributions from joint ventures	1,114	2,435
Other investments	(341)	(878)
Net cash used in investing activities	(9,612)	(2,520)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Senior credit facility	--	(12,668)
Payments on long-term debt	(3,770)	(7,028)
Financing costs	(373)	(2,936)
Exercise of stock options	945	--
Net cash used in financing activities	(3,198)	(22,632)

NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	7,622	(3,157)
CASH AND CASH EQUIVALENTS, beginning of period	10,761	3,620
CASH AND CASH EQUIVALENTS, end of period	$ 18,383	$ 463

See accompanying notes to unaudited consolidated financial statements.

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

1. DESCRIPTION OF BUSINESS

Radiologix, Inc. (together with its subsidiaries, "Radiologix" or the "Company"), 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 (or MRI), computed tomography (or CT), positron emission tomography (or PET), nuclear medicine, ultrasound, mammography, bone densitometry (or DEXA), general radiography (or X-ray) and fluoroscopy. Radiologix operates 117 diagnostic imaging centers 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 70 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 services Radiologix provides leverage its existing infrastructure and improve radiology practice or joint venture profitability, efficiency and effectiveness.

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, the Company provides management services and receives 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 cannot be terminated by either party without cause, consisting primarily of bankruptcy or material default. However, under certain conditions, Radiologix can terminate the service agreement if the number of physicians in a practice falls below a certain percentage of the total physicians of the radiology practice. Two physicians 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

We have prepared the consolidated financial statements without audit. In management's opinion, these financial statements include all normal recurring adjustments necessary for a fair presentation of the results of operations for the three months and six month periods ended June 30, 2002 and 2001 in accordance with the rules and regulations of the Securities and Exchange Commission. The 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 accounts and transactions have been eliminated in consolidation.

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

Subsequent to an acquisition, Radiologix continually evaluates whether events and circumstances have occurred that indicate the remaining balance of the intangible assets and property and equipment may not be recoverable or that the remaining useful lives may warrant revision. Radiologix evaluates the potential impairment of intangibles separately from property and equipment. When factors indicate that intangible assets or property and equipment should be evaluated for possible impairment, Radiologix determines whether the intangible assets or property and equipment are recoverable or if impairment exists, in which case an adjustment is made to the carrying value of the related asset. In making this determination, Radiologix uses an estimate of the related contracted radiology practices' and diagnostic imaging services' discounted cash flows over the remaining lives of the intangible assets or the property and equipment and compare it to the contracted radiology practices' and diagnostic imaging centers' intangible assets or property and equipment balances. When an adjustment is required, Radiologix evaluates the remaining amortization periods. An impairment loss recognized would be measured as the amount by which the carrying amount of the asset exceeds the fair value of the asset. Radiologix recorded no impairment charges during 2001 or 2002.

Recent Accounting Pronouncement

Radiologix adopted Statement of Financial Accounting Standards ("SFAS") "Accounting for the Impairment or Disposal of Long-Lived Assets" effective January 1, 2002. SFAS 144 addresses financial accounting and reporting for the impairment of long-lived assets and for long-lived assets to be disposed of. This statement supersedes SFAS 121; however, SFAS 144 retains the fundamental provisions of SFAS 121 for (a) recognition and measurement of the impairment of long-lived assets to be held and used and (b) measurement of long-lived assets to be disposed of by sale. SFAS 144 also supersedes the accounting and reporting provisions of APB Opinion No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions" for segments of a business to be disposed of.

Radiologix adopted SFAS No. 142, "Goodwill and Other Intangible Assets" effective January 1, 2002. Under SFAS 142, goodwill and other intangible assets with an indefinite useful life are no longer amortized as expenses of operations, but rather carried on the balance sheet as permanent assets. These intangible assets are to be subject to at least annual assessments for impairment by applying a fair value based test. 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.

As required by SFAS No. 142, intangible assets that do not meet the criteria for recognition apart from goodwill must be reclassified. As a result, $28.5 million of intangible assets, primarily relating to acquired intangible assets, were transferred to goodwill as of January 1, 2002.

With the adoption of the statement, Radiologix ceased amortization of goodwill as of January 1, 2002. The following table presents the quarterly results on a comparable basis (in thousands):

	FOR THE THREE MONTHS ENDED JUNE 30,		FOR THE SIX MONTHS ENDED JUNE 30,	
	2001	2002	2001	2002
Net Income	$ 3,952	$ 4,772	$ 7,450	$ 9,201
Goodwill (net of tax)	190	--	371	--
Adjusted Net Income	$ 4,142	$ 4,772	$ 7,821	$ 9,201
Basic Earnings Per Share:				
Net Income	$ .20	$ .23	$ .38	$ .45
Goodwill, net of tax	.01	--	.02	--
Adjusted Net Income	$ .21	$ .23	$ .40	$ .45

Diluted Earnings Per Share:				
Net Income	$ .19	$ .20	$ .36	$ .40
Goodwill, net of tax	.01	--	.02	--
Adjusted Net Income	$ .20	$ .20	$ .38	$ .40

As of January 1, 2002, Radiologix completed a goodwill impairment test. This test involved the use of estimates related to the fair market value of Radiologix's reporting units with which the goodwill was associated. No impairment was indicated at that time.

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 Accounting Principles Board ("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 income had Radiologix met the provisions of EITF 97-2 (in thousands):

	FOR THE THREE MONTHS ENDED JUNE 30,		FOR
	2002	2001	20
Revenue for contracted radiology practices and diagnostic imaging centers, net of contractual allowances	$ 100,400	$ 97,153	$ 19
Less: amounts retained by contracted radiology practices	(27,041)	(28,917)	(5
Service fee revenue, as reported	$ 73,359	$ 68,236	$ 14

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 from revenue. The Company uses historical collection experience in estimating its contractual allowances 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 contracted radiology practices' and diagnostic imaging centers' revenue less amounts retained by contracted radiology practices. The amounts retained by 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. Although Radiologix assists in negotiating managed care contracts for the contracted radiology practices, it assumes no risk under these arrangements.

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. The fixed fee structure results in Radiologix receiving substantially the same amount of service fee as it would have received under its negotiated percentage fee structure. 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. Questar revenues are primarily derived from technical revenues generated from its diagnostic imaging centers.

Service fee revenues consists of the following (in thousands):

	FOR THE THREE MONTHS ENDED JUNE 30,		FOR THE SIX MONTHS E JUNE 30,	
	2002	2001	2002	20
Professional component	$ 14,773	$ 15,986	$ 29,567	$
Technical component	58,586	52,250	116,514	1
Service fee, as reported	$ 73,359	$ 68,236	$ 146,081	$ 1

3. LONG TERM DEBT

Senior Notes

In December 2001, the Company terminated its senior credit facility with proceeds from a $160 million senior notes ("Senior Notes") issuance, due December 15, 2008. In connection with the repayment, the Company recorded in December 2001 an extraordinary loss from the early extinguishment of its senior credit facility in the amount of $4.7 million, $2.8 million after tax. The Senior Notes bear interest at an annual rate of 10 1/2% payable semiannually in arrears on June 15 and December 15 of each year, and commenced 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

In addition to the Senior Notes issuance in December 2001, the Company entered into a credit facility whereby the Company can borrow up to $35 million. At June 30, 2002, no borrowings were outstanding under the credit facility. 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% 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, limitations on capital expenditures and the maintenance of certain financial ratios (including minimum fixed charge coverage ratio and maximum leverage ratio, as defined). Borrowings under the senior credit facility are secured by all service agreements, which 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 $14.7 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 8.0%. If by August 1, 2003 the closing price of Radiologix's common stock has not exceeded $7.52 for 45 of the 60 days of the determination period, the interest rate will be increased to 8.25% and 8.5%, respectively. For the three months ended June 30, 2002, approximately $4.5 million of the convertible junior subordinated note was converted into 590,338 shares. For the six months ended June 30, 2002, approximately $9.5 million of the convertible junior subordinated note was converted into 1,261,677 shares.

4. EARNINGS PER SHARE

Radiologix adopted SFAS No. 128, "Earnings per Share" ("EPS") effective December 31, 1997. SFAS No. 128 simplifies the computation of EPS by replacing the presentation of primary EPS with a presentation of basic EPS. Basic 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. For the three months ended June 30, 2001 and 2002, 221,099 and 1,390,471 shares, respectively, related to stock options were included in diluted EPS. In addition, diluted EPS includes the effect of the convertible note (see Note 3) using the "if converted" method to the extent the securities are not anti-dilutive. For the three months ended June 30, 2001, and 2002, under the "if converted" method, $277,000 and $208,000, respectively, of tax effected interest savings and 2,318,841 and 2,153,802, respectively, weighted average shares were included in the calculation of diluted EPS as an addition to net income and weighted average shares outstanding, respectively.

For the six months ended June 30, 2001 and 2002, 268,412 and 1,275,008 shares, respectively, related to stock options were included in diluted EPS. In addition, diluted EPS includes the effect of the convertible note (see Note 3) using the "if converted" method to the extent the securities are not anti-dilutive. For the six months ended June 30, 2001, and 2002, under the "if converted" method, $546,000 and $470,000, respectively, of tax effected interest savings and 2,318,841 and 2,468,717, respectively, weighted average shares were included in the calculation of diluted EPS as an addition to net income and weighted average shares outstanding, respectively.

5. SEGMENT REPORTING

The Company reports the results of its operations through four designated regions of the United States: Mid-Atlantic, Northeastern, Central and Western regions. 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 leverage our existing infrastructure and improve radiology practice or joint venture profitability, efficiency and effectiveness. 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 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. The following is a table, which summarizes the operating results and assets by the five reportable segments (in thousands):

	FOR THE SIX MONTHS ENDED JUNE 30, 2002				
	Mid-Atlantic Region (1)	Northeastern Region (2)	Central Region (3)	Western Region (4)	Questa
Service fee revenues	$ 62,188	32,269	17,689	16,338	
Operating expenses	$ 41,564	23,188	11,823	12,618	

Operating income	$	20,624	9,081	5,866	3,720
Operating margin		33%	28%	33%	23%
Equity in earnings of investments	$	1,707	--	500	--
Minority interests	$	(445)	--	(222)	--
Depreciation and amortization expense	$	3,956	1,739	976	1,796
Interest expense	$	1,015	389	256	474
Income before taxes	$	16,915	6,953	4,912	1,450
Assets	$	68,297	43,856	25,175	19,832
Purchases of property and equipment	$	5,142	2,786	1,306	681

FOR THE SIX MONTHS ENDED JUNE 30, 2001

		Mid-Atlantic Region (1)	Northeastern Region (2)	Central Region (3)	Western Region (4)	Quest
Service fee revenues	$	53,580	30,122	17,005	16,528	
Operating expenses	$	37,221	22,216	11,108	12,843	
Operating income	$	16,359	7,906	5,897	3,685	
Operating margin		31%	26%	35%	22%	
Equity in earnings of investments	$	1,967	--	759	--	
Minority interests	$	(320)	--	(226)	--	
Depreciation and amortization expense	$	3,294	1,481	719	1,351	
Interest expense	$	852	355	198	286	
Income before taxes	$	13,860	6,070	5,513	2,048	
Assets	$	54,910	41,996	23,423	19,122	
Purchases of property and equipment	$	2,096	835	251	170	

(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 the 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.

Corporate assets, including intangible assets, as of June 30, 2001 and 2002 were $95,051 and $113,142, respectively.

The following is a reconciliation of income before 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 (in thousands):

	For the Six Months Ended June 30, 2001	For the Six Months Ended June 30, 2002
Segment profit	$ 28,436	$ 32,954
Unallocated amounts:		
Corporate general and administrative	(6,510)	(7,865)
Corporate other income	--	180
Corporate depreciation and amortization	(3,289)	(2,808)
Corporate interest expense	(6,221)	(7,126)
Income before taxes	$ 12,416	$ 15,335

	For the Six Months Ended June 30, 2001	For the Six Months Ended June 30, 2002
Expenditures:		
Segment purchases of property and equipment	$ 3,480	$ 9,810
Corporate purchases of property and equipment	104	293
Total purchases of property and equipment expenditures	$ 3,584	$ 10,103

6. 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 sheet as of December 31, 2001 and June 30, 2002, and the statements of income and cash flows for the six months ended June 30, 2001 and

2002. 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 Guarantor Subsidiaries include all wholly owned subsidiaries of Radiologix, Inc. (the "Parent").

RADIOLOGIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING BALANCE SHEET (UNAUDITED)

JUNE 30, 2002
(IN THOUSANDS)

	PARENT	SUBSIDIARY GUARANTORS	NON-GUARANTOR SUBSIDIARIES	E
ASSETS:				
Cash and cash equivalents	$ 14,978	$ (591)	$ 3,996	$
Accounts receivable, net	--	66,818	3,129	
Other current assets	693	13,003	(1)	
Total current assets	15,671	79,230	7,124	
Property and equipment, net	2,182	53,811	3,471	
Investment in subsidiaries	129,534	--	--	
Goodwill	--	28,510	--	
Intangible assets, net	--	66,221	1,677	
Other assets, net	16,876	15,737	55	
	$ 164,263	$ 243,509	$ 12,327	$
LIABILITIES AND STOCKHOLDERS'EQUITY (DEFICIT):				
Accounts payable and accrued expenses	$ 5,553	$ 26,457	$ 2,342	$
Current portion of long-term obligations	75	3,979	552	
Other current liabilities	9	50	--	
Total current liabilities	5,637	30,486	2,894	
Long-term obligations, net of current portion	174,325	3,242	1,554	
Other noncurrent liabilities	(79,630)	87,893	(1,477)	
Minority interests	--	--	1,710	
Stockholders' equity (deficit)	63,931	121,888	7,646	
	$ 164,263	$ 243,509	$ 12,327	$

RADIOLOGIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING BALANCE SHEET (AUDITED)

DECEMBER 31, 2001
(IN THOUSANDS)

	PARENT	SUBSIDIARY GUARANTORS	NON-GUARANTOR SUBSIDIARIES
ASSETS:			
Cash and cash equivalents	$ 7,670	$ (953)	$ 4,044
Accounts receivable, net	--	69,048	2,277
Other current assets	1,713	13,009	(1,182)
Total current assets	9,383	81,104	5,139
Property and equipment, net	1,954	54,571	3,814
Investment in subsidiaries	110,635	--	--
Goodwill	--	28,510	--
Intangible assets, net	--	67,800	1,783
Other assets, net	17,379	13,201	87
	$ 139,351	$ 245,186	$ 10,823
LIABILITIES AND STOCKHOLDERS'EQUITY (DEFICIT):			
Accounts payable and accrued expenses	$ 5,777	$ 25,612	$ 3,504
Current portion of long-term obligations	232	4,659	573
Other current liabilities	--	55	--
Total current liabilities	6,009	30,326	4,077
Long-term obligations, net of current portion	184,905	5,964	819
Other noncurrent liabilities	(96,039)	104,168	(1,162)
Minority interests	--	--	1,182
Stockholders' equity (deficit)	44,476	104,728	5,907
	$ 139,351	$ 245,186	$ 10,823

RADIOLOGIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF INCOME (UNAUDITED)

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

	PARENT	SUBSIDIARY GUARANTORS	NON-GUARANTOR SUBSIDIARIES	EL
Service fee revenue	$ --	$ 134,614	$ 11,467	$
Costs and expenses:				
Salaries and benefits	--	39,569	1,490	
Field supplies	--	8,321	589	
Field rent and lease expense	--	15,278	993	
Other field expenses	(180)	20,370	3,396	
Bad debt expense	--	11,571	790	
Corporate general and administrative	7,865	--	--	
Depreciation and amortization	1,351	10,704	500	
Interest expense, net	7,126	2,410	141	
Total costs and expenses	16,162	108,223	7,899	
Income (loss) before taxes, minority interest in consolidated subsidiaries and equity in earnings of investments ...	(16,162)	26,391	3,568	
Equity in earnings of investments	--	2,207	--	
Minority interests in consolidated subsidiaries	--	--	(669)	
Income (loss) before taxes	(16,162)	28,598	2,899	
Income tax expense (benefit)	(6,465)	11,439	1,160	
Net income (loss)	$ (9,697)	$ 17,159	$ 1,739	$

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RADIOLOGIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF INCOME (UNAUDITED)

FOR THE SIX MONTHS ENDED JUNE 30, 2001
(IN THOUSANDS)

	PARENT	SUBSIDIARY GUARANTORS	NON-GUARANTOR SUBSIDIARIES	E
Service fee revenue	$ --	$ 124,190	$ 9,957	$
Costs and expenses:				
Salaries and benefits	--	35,850	1,258	

Field supplies	--	7,345	562	
Field rent and lease expense	--	15,597	1,169	
Other field expenses	--	19,968	2,956	
Bad debt expense	--	11,950	782	
Corporate general and administrative	6,510	--	--	
Depreciation and amortization	1,302	9,791	373	
Interest expense, net	6,221	2,212	69	
Total costs and expenses	14,033	102,713	7,169	
Income (loss) before taxes, minority interest in consolidated subsidiaries and equity in earnings of investments	(14,033)	21,477	2,788	
Equity in earnings of investments	--	2,726	--	
Minority interests in consolidated subsidiaries	--	--	(542)	
Income (loss) before taxes	(14,033)	24,203	2,246	
Income tax expense (benefit)	(5,613)	9,681	898	
Net income (loss)	$ (8,420)	$ 14,522	$ 1,348	$

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-GUARANTO SUBSIDIARIE
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	$ (6,962)	$ 27,681	$ (28
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of property and equipment, net	(1,579)	(8,367)	(15
Joint ventures	--	832	-
Other items	117	(360)	(9
Net cash used in investing activities ...	(1,462)	(7,895)	(25
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds (payments) on long-term debt	(1,249)	(3,235)	71
Due to/from parent/subsidiaries	16,492	(16,598)	10
Other items	489	409	(32

Net cash provided by (used in) financing activities	15,732	(19,424)	49
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	7,308	362	(4
CASH AND CASH EQUIVALENTS, beginning of period	7,670	(953)	4,04
CASH AND CASH EQUIVALENTS, end of period	$ 14,978	$ (591)	$ 3,99

RADIOLOGIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS (UNAUDITED)

FOR THE SIX MONTHS ENDED JUNE 30, 2001
(IN THOUSANDS)

	PARENT	SUBSIDIARY GUARANTORS	NON-GUARANTOR SUBSIDIARIES
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	$ (1,171)	$ 21,027	$ 2,139
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of property and equipment, net ...	(436)	(2,772)	(376)
Joint ventures	--	1,942	--
Other items	(18)	(462)	(398)
Net cash provided by (used in) investing activities	(454)	(1,292)	(774)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Senior credit facility	(12,668)	--	--
Payments on long-term debt	(3,928)	(2,773)	(327)
Due to/from parent/subsidiaries	20,998	(19,205)	(1,793)
Other items	(3,677)	614	127
Net cash provided by (used in) financing activities	725	(21,364)	(1,993)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(900)	(1,629)	(628)
CASH AND CASH EQUIVALENTS, beginning of period	941	191	2,488
CASH AND CASH EQUIVALENTS,			

end of period	$ 41	$ (1,438)	$ 1,860

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, 2001, 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 (or MRI), computed tomography (or CT), positron emission tomography (or PET), nuclear medicine, ultrasound, mammography, bone densitometry (or DEXA), general radiography (or X-ray) and fluoroscopy. For the six months ended June 30, 2002, we derived 80% of our service fee revenue from the ownership, management and operation of our radiology and imaging center network and 20% of our service fee revenue from the administrative, management and information services provided to contracted radiology practices. As of June 30, 2002, we owned, operated or maintained an ownership interest in imaging equipment at 117 locations and provided management services to ten radiology practices. As of June 30, 2002, 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 2002, payment for diagnostic imaging services comes primarily from commercial third-party payors (65%), governmental payors (27%, including Medicare and Medicaid) and private and other payors (8%). In August 2000, Medicare made significant changes in the reimbursement methodology for hospital outpatient services. We believe that we will have opportunities to increase the use of our diagnostic imaging services through additional joint venture or outsourcing arrangements with hospitals, in part because such federal healthcare regulatory changes favor outpatient centers that are managed or owned in joint venture or outsourcing arrangements with third parties. As of January 2002, Medicare decreased reimbursement rates for physician and outpatient services, including diagnostic imaging services. Our 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, 2002, approximately 5% of our revenue generated at our diagnostic imaging centers was generated from capitated 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 (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, 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. The fixed fee structure results in us receiving substantially the same amount of service fee as we would have received under a negotiated percentage fee structure. 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.

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 leverage our existing infrastructure and improve radiology practice or joint venture profitability, efficiency and effectiveness. 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 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.

For discussion and analysis purposes, the operating margin is defined as service fee revenue less operating expenses ("operating income") as a percent of service fee revenue. The operating margin for the Mid-Atlantic region of 31% for the six months ended June 30, 2001 increased to 33% in 2002. The increase in the operating margin is primarily attributable to further growth in technical volume and, therefore, technical revenues, as well as management of operating expenses. The operating margin of the Northeastern region increased from 26% for the six months ended June 30, 2001 to 28% in 2002. The increase in the operating margin is primarily attributable to the growth in technical volume and, therefore, technical revenues. In addition, the operating margin increased partially as a result of higher reimbursement on a managed care contract and was also impacted by the higher fixed fee recognized at the New York practices compared to 2001. The operating margin for the Central region of 35% for the six months ended June 30, 2001 decreased to 33% in 2002. The decrease in the operating margin is primarily attributable to increased salaries and benefits, as well as malpractice insurance costs. This is partially offset by decreased purchased billing services and by increased technical revenues in the Central region overall. The operating margin for the Western region increased from 22% for the six months ended June 30, 2001 to 23% in 2002. The increase in the operating margin is primarily attributable to the purchase in December 2001 of equipment previously held under operating leases. This is partially offset by an increase in salaries and benefits. The operating margin for Questar increased from 17% for the six months ended June 30, 2001 to 25% for the six months ended June 30, 2002. The increase in the operating margin is primarily attributable to improved collections, which decreased estimated contractual allowances and, therefore, increased service fee revenue.

THREE MONTHS ENDED JUNE 30, 2001 COMPARED TO THREE MONTHS ENDED JUNE 30, 2002

Service Fee Revenue

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 allowances 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 contracted radiology practices' and diagnostic imaging centers' revenue less amounts retained by contracted radiology practices. The amounts retained by contracted radiology practices represents 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.

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 THREE MONTHS ENDED JUNE 30,	
	2001	2002
Revenue from contracted radiology practices and diagnostic imaging centers, net of contractual allowances	$ 97,153	$ 100,400
Less: amounts retained by contracted radiology practices	(28,917)	(27,041)
Service fee revenue, as reported	$ 68,236	$ 73,359

Revenue from contracted radiology practices and diagnostic imaging centers, net of contractual allowances, increased $3.2 million, from $97.2 million in 2001 to $100.4 million in 2002. This increase was primarily due to increased technical revenues. Amounts retained by contracted radiology practices decreased from $28.9 million in 2001 to $27.0 million in 2002. The increase 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 increasing $5.2 million, from $68.2 million in 2001 to $73.4 million, in 2002.

Salaries and Benefits

Salaries and benefits increased $1.8 million, from $18.7 million in 2001 to $20.5 million in 2002. 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 27.4% in 2001 to 28.0% in 2002.

Field Supplies

Field supplies increased $500,000, from $4.1 million in 2001 to $4.6 million in 2002. As a percentage of service fee revenue, these costs remained relatively constant at 6.0% and 6.3% in 2001 and 2002, respectively.

Field Rent and Lease Expense

Field rent and lease expense decreased $300,000, from $8.5 million in 2001 to $8.2 million in 2002. As a percentage of service fee revenue, these costs were 12.5% and 11.2% in 2001 and 2002, respectively. The decrease in the rent and lease expense is primarily attributable to the purchase in December 2001 of equipment previously held under operating leases.

Other Field Expenses

Other field expenses remained constant at $11.5 million in 2001 and 2002, respectively, as these costs do not increase in proportion with increases in volume and revenues. However, as a percentage of service fee revenue, these costs decreased from 16.8% in 2001 to 15.7% in 2002. Purchased billing services decreased approximately $560,000 due to (i) the conversion of these services to an in-house billing department at one of the Northeastern contracted radiology practices at the end of 2001 and (ii) billing services no longer provided for professional services at two of the contracted radiology practices.

Bad Debt Expense

Bad debt expense remained constant at $6.3 million in 2001 and 2002, respectively. As a percentage of service fee revenue, these costs were 9.3% and 8.5% in 2001 and 2002, 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 2001 and 2002 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 6.5% and 6.2% in 2001 and 2002, respectively.

Corporate General and Administrative

Corporate general and administrative expenses increased $500,000, from $3.5 million in 2001 to $4.0 million in 2002. As a percentage of service fee revenue, these costs were 5.2% and 5.4% in 2001 and 2002, respectively. The increase in these costs is primarily due to the further development of our infrastructure at the corporate office during the latter part of 2001, including additional employees and associated employee benefits and incentive compensation.

Depreciation and Amortization

Depreciation and amortization expense increased $400,000, from $5.9 million in 2001 to $6.3 million in 2002. As a percentage of service fee revenue, these costs were relatively constant at 8.6% and 8.7% in 2001 and 2002, respectively. The increase in depreciation expense is primarily attributable to the purchase in December 2001 of equipment previously held under operating leases. This is partially offset by a decrease in amortization due to the adoption at Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" effective January 1, 2002. As a result, $28.5 million of intangible assets, primarily related to acquired intangible assets with an indefinite useful life, are no longer amortized as expenses of operations, but rather carried on the balance sheet as permanent assets.

Interest Expense, net

Interest expense, net, increased $700,000, from $4.1 million in 2001 to $4.8 million in 2002. The increase is due to higher interest costs associated with our senior notes issued in December 2001.

Income Tax Expense

Income tax expense of $2.6 million in 2001 and $3.2 million in 2002 was based on a 40% effective tax rate.

Net Income

Net income increased from $4.0 million in 2001 to $4.8 million in 2002. Net income as a percentage of service fee revenue was 6.5% in 2002, which increased from 5.8% in 2001.

SIX MONTHS ENDED JUNE 30, 2001 COMPARED TO SIX MONTHS ENDED JUNE 30, 2002

Service Fee Revenue

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 allowances 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 contracted radiology practices' and diagnostic imaging centers' revenue less amounts retained by contracted radiology practices. The amounts retained by contracted radiology practices represents 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.

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 MONTHS ENDED JUNE 30,	
	2001	2002
Revenue from contracted radiology practices and diagnostic imaging centers, net of contractual allowances	$ 189,438	$ 199,929
Less: amounts retained by contracted radiology practices	(55,291)	(53,848)

Service fee revenue, as reported	$ 134,147	$ 146,081

Revenue from contracted radiology practices and diagnostic imaging centers, net of contractual allowances, increased $10.5 million, from $189.4 million in 2001 to $199.9 million in 2002. This increase was primarily due to increased technical revenues. Amounts retained by contracted radiology practices decreased from $55.3 million in 2001 to $53.9 million in 2002. The increase 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 increasing $12 million, from $134.1 million in 2001 to $146.1 million, in 2002.

Salaries and Benefits

Salaries and benefits increased $4.0 million, from $37.1 million in 2001 to $41.1 million in 2002. 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 were comparable at 27.7% and 28.1% in 2001 and 2002, respectively.

Field Supplies

Field supplies increased $1.0 million, from $7.9 million in 2001 to $8.9 million in 2002. As a percentage of service fee revenue, these costs remained relatively constant at 5.9% and 6.1% in 2001 and 2002, respectively.

Field Rent and Lease Expense

Field rent and lease expense decreased $500,000, from $16.8 million in 2001 to $16.3 million in 2002. As a percentage of service fee revenue, these costs were 12.5% and 11.1% in 2001 and 2002, respectively. The decrease in the rent and lease expense is primarily attributable to the purchase in December 2001 of equipment previously held under operating leases.

Other Field Expenses

Other field expenses increased $700,000, from $22.9 million in 2001 to $23.6 million in 2002. Generally, these costs do not increase in proportion with increases in volume and revenues. However, as a percentage of service fee revenue, these costs decreased from 17.1% in 2001 to 16.1% in 2002. Purchased billing services decreased approximately $1.1 million due to (i) the conversion of these services to an in-house billing department at one of the Northeastern contracted radiology practices in 2002 and (ii) billing services no longer provided for professional services at two of the contracted radiology practices.

Bad Debt Expense

Bad debt expense decreased $300,000, from $12.7 million in 2001 to $12.4 million in 2002. As a percentage of service fee revenue, these costs were 9.5% and 8.5% in 2001 and 2002, 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 2001 and 2002 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 6.7% and 6.2% in 2001 and 2002, respectively.

Corporate General and Administrative

Corporate general and administrative expenses increased $1.4 million, from $6.5 million in 2001 to $7.9 million in 2002. As a percentage of service fee revenue, these costs were 4.9% and 5.4% in 2001 and 2002, respectively. The increase in these costs is primarily due to the further development of our infrastructure at the corporate office during the latter part of 2001, including additional employees and associated employee benefits and incentive compensation.

Depreciation and Amortization

Depreciation and amortization expense increased $1.1 million, from $11.5 million in 2001 to $12.6 million in 2002. As a percentage of service fee revenue, these costs were 8.5% and 8.6% in 2001 and 2002, respectively. The increase in depreciation expense is primarily attributable to the purchase in December 2001 of equipment previously held under operating leases. This is partially offset by a decrease in amortization due to the adoption at SFAS No. 142, "Goodwill and Other Intangible Assets" effective January 1, 2002. As a result, $28.5 million of intangible assets, primarily related to acquired intangible assets with an indefinite useful life, are no longer amortized as expenses of operations, but rather carried on the balance sheet as permanent assets.

Interest Expense, net

Interest expense, net, increased $1.2 million, from $8.5 million in 2001 to $9.7 million in 2002. The increase is due to higher interest costs associated with our senior notes issued in December 2001.

Income Tax Expense

Income tax expense of $5.0 million in 2001 and $6.1 million in 2002 was based on a 40% effective tax rate.

Net Income

Net income increased from $7.5 million in 2001 to $9.2 million in 2002. Net income as a percentage of service fee revenue was 6.3% in 2002, which increased from 5.6% in 2001.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity for the six months ended June 30, 2002, was derived principally from net cash proceeds from operating activities. As of June 30, 2002, we had net working capital of $63 million, including cash and cash equivalents of $18.4 million. We had current assets of $102 million and current liabilities of $39 million, including current maturities of long-term debt and capital lease obligations of $4.6 million. For the six months ended June 30, 2002, we generated $20.4 million in net operating cash flow, invested $9.6 million and used cash of $3.2 million in financing activities.

Net cash from operating activities for the six months ended June 30, 2002 of $20.4 million decreased slightly from the $22 million for the same period in 2001 due to the effect of higher interest costs paid in 2002 versus 2001. Increased collections of accounts receivable, as well as the implementation of certain cash management strategies, resulted in a decrease in accounts receivable days outstanding from 70 days at June 30, 2001 to 68 days at June 30, 2002.

Net cash used in investing activities for the six months ended June 30, 2002 was $9.6 million. Net cash used in investing activities for the six months ended June 30, 2001 was $2.5 million. Purchases of property and equipment during the six months ended June 30, 2001 and 2002 were $3.6 million and $10.1 million, respectively.

Net cash flows used in financing activities for the six months ended June 30, 2001 and 2002 were $22.6 million and $3.2 million, respectively. At June 30, 2002, we had outstanding borrowings of $160 million under our senior notes, $14.7 million outstanding under our convertible debt obligations and an additional $8.5 million in other debt obligations.

In December 2001, we terminated our senior credit facility with proceeds from a $160 million senior notes ("Senior Notes") issuance, due December 15, 2008. In connection with the repayment at December 2001, we recorded an extraordinary loss from the early extinguishment of our senior credit facility in the amount of $4.7 million, $2.8 million after tax. The Senior Notes bear interest at an annual rate of 10 1/2% payable semiannually in arrears on June 15 and December 15 of each year, and commenced 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 subordinated 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.

In addition to the Senior Notes issuance in December 2001, we entered into a credit facility whereby we can borrow up to $35 million. At June 30, 2002, no borrowings were outstanding under the credit facility. 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%, 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 us. The credit facility includes certain restrictive covenants, including prohibitions on the payment of dividends, limitations on capital expenditures and the maintenance of certain financial ratios (including minimum fixed charge coverage ratio and maximum leverage ratio, as defined). Borrowings under the credit facility are secured by all service agreements to which we are a party, a pledge of the stock of our subsidiaries and all of our 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.

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. 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, competitive, demographic, business and other conditions in our markets;
- a decline in patient referrals;
- changes in the rates or methods 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;
- our substantial indebtedness, debt service requirements and liquidity constraints; and
- risks related to our notes and healthcare securities generally.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's exposure to market risk for changes in interest rates relates primarily to the Company's cash equivalents, Credit Facility, and its convertible notes.

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

Radiologix's 2002 annual stockholders meeting was held on June 11, 2002. 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	18,151,316	367,680
Paul D. Farrell	18,096,316	422,680
Joseph C. Mello	18,092,316	426,680
Derace L. Schaffer, M.D.	18,073,616	445,380
Michael L. Sherman, M.D.	17,818,157	700,839
Mark L. Wagar	17,121,397	1,397,599

Appointment of Ernst & Young LLP For: 18,332,953 Against: 185,901 Abstain: 142

PART II: OTHER INFORMATION

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 no Current Reports on Form 8-K during the quarter for which this report is filed.

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, 2002	/s/ MARK L. WAGAR Mark L. Wagar Chairman of the Board and Chief Executive Officer (Principal Executive Officer)
Date: August 14, 2002	/s/ SAMI S. ABBASI Sami S. Abbasi Chief Financial Officer and Executive Vice President (Principal Accounting Officer)

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INDEX TO EXHIBITS

EXHIBIT NUMBER	DESCRIPTION
3.1	Restated Certificate of Incorporation of American Physician Partners, Inc. ***
3.2	Amended and Restated Bylaws of American Physician Partners, Inc. ***
3.3	Amendment to Restated Certificate of Incorporation of American Physician Partners, Inc. (Incorporated by reference to Exhibit 3.3 to the registrant's Form 10-Q for the quarter ended June 30, 1999)
3.4	Amendment to Restated Bylaws of American Physician Partners, Inc. (Incorporated by reference to Exhibit 3.4 to the registrant's Form 10-Q for the quarter ended June 30, 1999)
4.1	Form of certificate evidencing ownership of Common Stock of American Physician Partners, Inc. **
4.2	Securities Purchase Agreement dated as of August 3, 1999 by and between American Physician Partners, Inc. and BT Capital Partners SBIC, L.P. @ (see Exhibit 4.1 thereof)
4.3	Convertible Junior Subordinated Promissory Note dated August 1, 1999 issued to BT Capital Partners SBIC, L.P. @ (see Exhibit 4.2 thereof).
4.4	Indenture dated as of December 12, 2001, among Radiologix,

Inc., as Issuer, its subsidiaries identified in the Indenture, as Guarantors, and U.S. Bank, N.A., as Trustee, with respect to $160 Million 10 1/2% Senior Notes due December 15, 2008. (Incorporated by reference to Exhibit 4.4 to the registrant's annual report on Form 10-K for 2001).

4.5	Registration Rights Agreement dated December 12, 2001, among Radiologix, Inc., as Issuer, its subsidiaries identified in the Registration Rights Agreement, as Guarantors, and Jefferies & Company, Inc. and Deutsche Banc Alex. Brown Inc., as Initial Purchasers, with respect to $160 Million 10 1/2% Senior Notes due December 15, 2008 (Incorporated by reference to Exhibit 4.5 to the registrant's annual report on Form 10-K for 2001).
10.36	Amendment Number 3 to Employment Agreement between Radiologix, Inc. and Mark L. Wagar dated as of February 11, 2002. (Incorporated by reference to the same numbered exhibit to the registrant's report on Form 10-Q for the quarter ended March 31, 2002.)
10.37	Amendment Number 4 to Employment Agreement between Radiologix, Inc. and Mark S. Martin dated as of February 11, 2002. (Incorporated by reference to the same numbered exhibit to the registrant's report on Form 10-Q for the quarter ended March 31, 2002.)
10.38	Amendment Number 1 to Employment Agreement between Radiologix, Inc. and Sami S. Abbasi dated as of February 11, 2002. (Incorporated by reference to the same numbered exhibit to the registrant's report on Form 10-Q for the quarter ended March 31, 2002.)
10.39	Amendment Number 4 to Employment Agreement between Radiologix, Inc. and Paul M. Jolas dated as of February 11, 2002. (Incorporated by reference to the same numbered exhibit to the registrant's report on Form 10-Q for the quarter ended March 31, 2002.)
99.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002 of Mark L. Wagar, dated August 14, 2002.*
99.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002 of Sami S. Abbasi, dated August 14, 2002.*

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* Filed herewith.

** Incorporated by reference to Exhibits 4.1, 10.1, 10.3 and 10.5 through 10.19, respectively, to the registrant's Registration Statement No. 333-31611 on Form S-4.

*** Incorporated by reference to the corresponding Exhibit number to the registrant's Registration Statement No. 333-30205 on Form S-1.

@ Incorporated by reference to Exhibits 2.1, 4.1 and 4.2, respectively, to the Registrant's Form 8-K filed on August 3, 1999.