RADIOLOGIX INC
Form 10-Q
November 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 SEPTEMBER 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 November 12, 2002

COMMON STOCK, $0.0001 PAR VALUE 21,567,153 SHARES

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RADIOLOGIX, INC.

FORM 10-Q

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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

	SEPTEMBER 30, 2002 (UNAUDITED)	DECEMBER 31, 2001 (NOTE)
CURRENT ASSETS:		
Cash and cash equivalents	$ 16,133	$ 10,761
Accounts receivable, net of allowances	70,351	71,325
Due from affiliates	8,460	2,673
Income tax receivable	350	350
Other current assets	7,442	10,517
Total current assets	102,736	95,626
PROPERTY AND EQUIPMENT, net	61,796	60,339
INVESTMENTS IN JOINT VENTURES	9,900	7,095
GOODWILL	28,510	28,510
INTANGIBLE ASSETS, net	71,370	69,583
DEFERRED FINANCING COSTS, net	10,069	10,837
OTHER ASSETS		
Deferred income tax assets	3,867	3,867
Notes receivable	2,285	6,184
Other assets, net	5,973	2,684
Total assets	$ 296,506	$ 284,725
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable and accrued expenses	$ 19,162	$ 17,743
Accrued physician retention	9,247	8,832
Accrued salaries and benefits	6,379	8,318
Current portion of long term debt	266	398
Current portion of capital lease obligations	4,055	5,066
Other current liabilities	240	55
Total current liabilities	39,349	40,412
DEFERRED INCOME TAXES	6,619	6,619
LONG-TERM DEBT, net of current portion	172,458	184,905
CAPITAL LEASE OBLIGATIONS, net of current portion	2,769	6,783
DEFERRED REVENUE	3,165	--
OTHER LIABILITIES	159	348
Total liabilities	224,519	239,067
COMMITMENTS AND CONTINGENCIES		
MINORITY INTERESTS IN CONSOLIDATED SUBSIDIARIES	1,996	1,182
STOCKHOLDERS' EQUITY:		
Common stock	2	2
Additional paid-in capital	13,650	347
Treasury stock	(180)	--
Retained earnings	56,519	44,127
Total stockholders' equity	69,991	44,476
Total liabilities and stockholders' equity	$ 296,506	$ 284,725

See accompanying notes to unaudited consolidated financial statements.

Note: The balance at December 31, 2001 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

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RADIOLOGIX, INC. AND SUBSIDIARIES

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

	FOR THE THREE MONTHS ENDED SEPTEMBER 30,		FO E
	2002	2001	2
		(UNAUDITED)	
SERVICE FEE REVENUE	$ 71,275	$ 69,175	2
COSTS AND EXPENSES:			
Salaries and benefits	21,638	18,690	
Field supplies	4,294	4,175	
Field rent and lease expense	8,151	8,639	
Other field expenses	11,581	12,001	
Bad debt expense	6,188	6,342	
Corporate general and administrative	3,712	4,507	
Depreciation and amortization	6,728	5,829	
Interest expense, net	4,590	3,593	
Total costs and expenses	66,882	63,776	1
INCOME BEFORE TAXES, EQUITY IN EARNINGS OF INVESTMENTS AND MINORITY INTERESTS IN CONSOLIDATED SUBSIDIARIES	4,393	5,399	
Equity In Earnings Of Investments	1,212	1,181	
Minority Interests In Income Of Consolidated Subsidiaries	(286)	(275)	
INCOME BEFORE TAXES	5,319	6,305	
Income Tax Expense	2,128	2,523	
NET INCOME	$ 3,191	$ 3,782	$
NET INCOME PER COMMON SHARE			
Basic	$ 0.15	$ 0.19	$

Diluted	$ 0.14	$ 0.18	$
WEIGHTED AVERAGE SHARES OUTSTANDING			
Basic	21,489	19,578	
Diluted	24,234	22,817	

See accompanying notes to unaudited consolidated financial statements.

RADIOLOGIX, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)

	FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2002	2001
	(UNAUDITED)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 12,392	$ 11,232
Adjustments to reconcile net income to net cash provided by operating activities:		
Minority interests	955	817
Depreciation and amortization	19,283	17,295
Equity in earnings of investments	(3,419)	(3,907)
Stock issued for termination of merger	--	600
Non-cash income from receipt of treasury stock	(180)	--
Changes in assets and liabilities		
Accounts receivable, net	(1,827)	(2,918)
Other receivables and current assets	489	4,467
Accounts payable and accrued expenses	3,058	2,503
Net cash provided by operating activities	30,751	30,089
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(17,917)	(4,586)
Distributions to joint ventures	(867)	(834)
Distributions from joint ventures	1,339	3,205
Other investments	(3,376)	(1,267)
Net cash used in investing activities	(20,821)	(3,482)

CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on long-term debt	(5,213)	(11,816)
Payments on senior credit facility	--	(11,416)
Financing costs	(422)	(2,961)
Proceeds from exercise of stock .... options	1,077	6
Net cash used in financing activities	(4,558)	(26,187)
NET INCREASE IN CASH AND CASH EQUIVALENTS	5,372	420
CASH AND CASH EQUIVALENTS, beginning of period	10,761	3,620
CASH AND CASH EQUIVALENTS, end of period	$ 16,133	$ 4,040

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 116 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 nine months periods ended September 30, 2002 and 2001, respectively, 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.

Recent Accounting Pronouncements

Radiologix adopted Statement of Financial Accounting Standards ("SFAS") No. 144, "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 SFAS No. 142, 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 SEPTEMBER 30,		FOR THE NINE MONTHS ENDED SEPTEMBER 30,	
	2002	2001	2002	2001
Net Income	$ 3,191	$ 3,782	$ 12,392	$ 11,232
Goodwill (net of tax benefit)	--	189	--	560
Adjusted Net Income	$ 3,191	$ 3,971	$ 12,392	$ 11,792
Basic Earnings Per Share:				
Net Income	$ 0.15	$ 0.19	$ 0.60	$ 0.58
Goodwill, net of tax	--	0.01	--	0.03
Adjusted Net Income	$ 0.15	$ 0.20	$ 0.60	$ 0.61
Diluted Earnings Per Share:				
Net Income	$ 0.14	$ 0.18	$ 0.54	$ 0.54
Goodwill, net of tax	--	0.01	--	0.03
Adjusted Net Income	$ 0.14	$ 0.19	$ 0.54	$ 0.57

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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 revenue of contracted radiology practices.

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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 SEPTEMBER 30,		FOR THE NINE MONT SEPTEMBER	
	2002	2001	2002	
Revenue for contracted radiology practices and diagnostic imaging centers, net of contractual adjustments	$ 98,092	$ 94,800	$ 298,021	$
Less: amounts retained by contracted radiology practices	(26,817)	(25,625)	(80,665)	
Service fee revenue, as reported	$ 71,275	$ 69,175	$ 217,356	$

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 adjustments. 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 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 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 (up to 30%) of the adjusted professional revenues as defined in the service agreements; and (2) 100% of the adjusted technical revenues as defined in the service agreements. In states where the law requires a flat fee structure, Radiologix has negotiated a base service fee, which is equal to the estimated fair market value of the services provided under the service agreements and which is renegotiated each year to equal the fair market value of the services provided under the service agreements. 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 (for example non-physician salaries and benefits, rent, depreciation, insurance, and interest) from the contracted radiology practices' revenue. Questar revenues are primarily derived from technical revenues generated from its diagnostic imaging centers.

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

	FOR THE THREE MONTHS ENDED SEPTEMBER 30,		FOR THE NINE MONT SEPTEMBER	
	2002	2001	2002	
Professional component	$ 12,804	$ 15,552	$ 42,371	$
Technical component	58,471	53,623	174,985	
Service fee, as reported	$ 71,275	$ 69,175	$ 217,356	$

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 payments 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 September 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 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

At September 30, 2002 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 8.0%. 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 8.5%. During the three months ended September 30, 2002, approximately $2.7 million of the convertible junior subordinated note was converted into 363,923 shares. For the nine months ended September 30, 2002, approximately $12.2 million of the convertible junior subordinated note was converted into 1,625,600 shares.

4. DEFERRED REVENUE

In connection with the amendment of the service agreement with one of the contracted radiology practices in July 2002, we have recorded deferred revenue of $3.3 million in consideration recognized for the amended agreement. The deferred revenue will be amortized over a 20 year period. In addition, a receivable of $3.3 million was recorded to reflect the consideration due from the contracted radiology practice, as a result of this amendment. The receivable is classified as due from affiliates and will be funded by the contracted radiology practice by a reduction of the payment retained by the contracted radiology practice through December 31, 2002.

5. 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 September 30, 2001 and 2002, 373,671 and 1,131,534 shares, respectively, related to stock options were included in diluted EPS. In addition, diluted EPS includes the effect of the convertible junior subordinated note (see Note 3) using the "if converted" method to the extent the securities are not anti-dilutive. For the three months ended September 30, 2001, and 2002, under the "if converted" method, $286,000 and $144,000, respectively, of tax effected interest savings and 2,866,094 and 1,613,898, 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 nine months ended September 30, 2001 and 2002, 303,498 and 1,227,184 shares, respectively, related to stock options were included in diluted EPS. In addition, diluted EPS includes the effect of the convertible junior subordinated note (see Note 3) using the "if converted" method to the extent the securities are not anti-dilutive. For the nine months ended September 30, 2001, and 2002, under the "if converted" method, approximately $832,000 and $614,000, respectively, of tax effected interest savings and 2,501,258 and 2,183,777, respectively, weighted average shares were included in the calculation of diluted EPS as an addition to net income and weighted average shares outstanding, respectively.

6. 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 table summarizes the operating results and assets by the five reportable segments (in thousands):

	FOR THE NINE MONTHS ENDED SEPTEMBER 30, 200				
	Mid-Atlantic Region(1)	Northeastern Region(2)	Central Region(3)	Western Region(4)	Que

Service fee revenue	$	92,967	48,136	26,444	24,835
Operating expenses	$	63,280	34,535	17,838	19,355
Operating income	$	29,687	13,601	8,606	5,480
Operating margin		32%	28%	33%	22%
Equity in earnings of investments	$	2,683	--	736	--
Minority interests	$	(631)	--	(319)	--
Depreciation and amortization expense	$	6,134	2,653	1,514	2,783
Interest expense	$	1,544	591	384	665
Income before taxes	$	24,061	10,357	7,125	2,032
Assets	$	77,847	39,129	27,012	21,476
Purchases of property and equipment	$	9,286	2,878	1,991	3,107

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FOR THE NINE MONTHS ENDED SEPTEMBER 30, 200

		Mid-Atlantic Region(1)	Northeastern Region(2)	Central Region(3)	Western Region(4)	Que
Service fee revenue	$	81,735	45,384	25,658	25,302	
Operating expenses	$	56,669	33,503	16,834	19,362	
Contribution	$	25,066	11,881	8,824	5,940	
Contribution margin		31%	26%	34%	24%	
Equity in earnings of investments	$	2,822	--	1,085	--	
Minority interests	$	(500)	--	(334)	--	
Depreciation and amortization expense	$	4,939	2,214	1,071	2,008	
Interest expense	$	1,247	523	286	405	
Income before taxes	$	21,202	9,144	8,218	3,527	
Assets	$	53,766	44,312	24,027	18,581	
Purchases of property and equipment	$	3,008	959	401	192	

(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.

Corporate assets, including intangible assets, as of September 30, 2001 and 2002 were $96,118 and $111,038 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 nine months ended September 30, 2001 and 2002 (in thousands):

	FOR THE NINE MONTHS ENDED SEPTEMBER 30,	
	2002	2001
Segment profit	$ 46,831	$ 43,606
Unallocated amounts:		
Corporate general and administrative	(11,577)	(11,017)
Corporate other income	180	--
Corporate depreciation and amortization	(4,267)	(5,093)
Corporate interest expense	(10,513)	(8,775)
Income before taxes	$ 20,654	$ 18,721

	FOR THE NINE MONTHS ENDED SEPTEMBER 30,	
	2002	2001
Expenditures:		
Segment purchases of property and equipment	$ 17,674	$ 4,482
Corporate purchases of property and equipment	243	104
Total purchases of property and equipment expenditures	$ 17,917	$ 4,586

7. 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, 2001 and September 30, 2002, and the statements of income and cash flows for the nine months ended September 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)

SEPTEMBER 30, 2002
(IN THOUSANDS)

	PARENT	SUBSIDIARY GUARANTORS	NON-GUARANTOR SUBSIDIARIES	ELIMINATIO
ASSETS:				
Cash and cash equivalents	$ 11,642	$ (1,337)	$ 5,828	$
Accounts receivable, net	--	67,180	3,171	
Other current assets	964	15,510	(222)	
Total current assets	12,606	81,353	8,777	
Property and equipment, net	2,309	56,207	3,280	
Investment in subsidiaries	137,420	--	--	(137,4
Goodwill	--	28,510	--	
Intangible assets, net	--	69,746	1,624	
Other assets, net	19,363	12,698	33	
	$ 171,698	$ 248,514	$ 13,714	$ (137,4
LIABILITIES AND STOCKHOLDERS' EQUITY:				
Accounts payable and accrued expenses ..	$ 8,707	$ 23,630	$ 2,451	$
Current portion of long-term obligations	76	3,702	543	
Other current liabilities	(2)	242	--	
Total current liabilities	8,781	27,574	2,994	
Long-term obligations, net of current portion	171,524	2,234	1,469	
Other noncurrent liabilities	(78,598)	89,609	(1,068)	
Minority interests	--	--	1,996	
Stockholders' equity	69,991	129,097	8,323	(137,4
	$ 171,698	$ 248,514	$ 13,714	$ (137,4

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RADIOLOGIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING BALANCE SHEET (AUDITED)

DECEMBER 31, 2001
(IN THOUSANDS)

	PARENT	SUBSIDIARY GUARANTORS	NON-GUARANTOR SUBSIDIARIES	ELIMINATIO
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	--	--	(110,6
Goodwill	--	28,510	--	
Intangible assets, net	--	67,800	1,783	
Other assets, net	17,379	13,201	87	
	$ 139,351	$ 245,186	$ 10,823	$ (110,6
LIABILITIES AND STOCKHOLDERS' EQUITY:				
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	44,476	104,728	5,907	(110,6
	$ 139,351	$ 245,186	$ 10,823	$ (110,6

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RADIOLOGIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF INCOME (UNAUDITED)

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

	PARENT	SUBSIDIARY GUARANTORS	NON-GUARANTOR SUBSIDIARIES	ELIMINATION
Service fee revenue	$ --	$ 200,592	$ 16,764	$ -
Costs and expenses:				
Salaries and benefits	--	60,431	2,266	-
Field supplies	--	12,327	877	-
Field rent and lease expense	--	22,938	1,484	-
Other field expenses	(180)	30,411	4,936	-
Bad debt expense	--	17,383	1,166	-
Corporate general and administrative	11,577	--	--	-
Depreciation and amortization	2,076	16,456	751	-
Interest expense, net	10,513	3,452	302	-
Total costs and expenses	23,986	163,398	11,782	-
Income (loss) before taxes, minority interest in consolidated subsidiaries and equity in earnings of investments	(23,986)	37,194	4,982	-
Equity in earnings of investments	--	3,419	--	-
Minority interests in consolidated subsidiaries	--	--	(955)	-
Income (loss) before taxes	(23,986)	40,613	4,027	-
Income tax expense (benefit)	(9,594)	16,245	1,611	-
Net income (loss)	$ (14,392)	$ 24,368	$ 2,416	$ -

RADIOLOGIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF INCOME (UNAUDITED)

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2001
(IN THOUSANDS)

	PARENT	SUBSIDIARY GUARANTORS	NON-GUARANTOR SUBSIDIARIES	ELIMINATI

Service fee revenue	$ --	$ 189,443	$ 13,879	$
Costs and expenses:				
Salaries and benefits	--	53,916	1,882	
Field supplies	--	11,170	912	
Field rent and lease expense	--	23,683	1,722	
Other field expenses	--	30,405	4,520	
Bad debt expense	--	19,074	--	
Corporate general and administrative	11,017	--	--	
Depreciation and amortization	2,087	14,651	557	
Interest expense, net	8,775	3,210	110	
Total costs and expenses	21,879	156,109	9,703	
Income (loss) before taxes, minority interest in consolidated subsidiaries and equity in earnings of investments	(21,879)	33,334	4,176	
Equity in earnings of investments	--	3,907	--	
Minority interests in consolidated subsidiaries	--	--	(817)	
Income (loss) before taxes	(21,879)	37,241	3,359	
Income tax expense (benefit)	(8,751)	14,896	1,344	
Net income (loss)	$ (13,128)	$ 22,345	$ 2,015	$

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RADIOLOGIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS (UNAUDITED)

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

	PARENT	SUBSIDIARY GUARANTORS	NON-GUARANTOR SUBSIDIARIES	ELIM
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	$ (7,630)	$ 37,165	$ 1,216	$
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchases of property and equipment, net	(2,431)	(15,269)	(217)	
Joint ventures	--	472	--	
Other items	(2,751)	(697)	72	
Net cash used in investing activities	(5,182)	(15,494)	(145)	
CASH FLOWS FROM FINANCING ACTIVITIES:				

Proceeds (payments) on long-term debt	(4,049)	(1,784)	620	
Due to/from parent/subsidiaries	17,586	(17,663)	77	
Other items	3,247	(2,608)	16	
Net cash provided by (used in) financing activities............	16,784	(22,055)	713	
NET INCREASE (DECREASE) IN CASH .... AND CASH EQUIVALENTS	3,972	(384)	1,784	
CASH AND CASH EQUIVALENTS, beginning of period	7,670	(953)	4,044	
CASH AND CASH EQUIVALENTS, end of period	$ 11,642	$ (1,337)	$ 5,828	$

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RADIOLOGIX, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS (UNAUDITED)

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2001
(IN THOUSANDS)

	PARENT	SUBSIDIARY GUARANTORS	NON-GUARANTOR SUBSIDIARIES	ELIMINATI
NET CASH PROVIDED BY (USED IN) .... OPERATING ACTIVITIES	$ (6,563)	$ 32,517	$ 4,135	$
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchases of property and equipment, net	(997)	(3,132)	(457)	
Joint ventures	--	2,371	--	
Other items	2,499	(3,081)	(685)	
Net cash provided by (used in) investing activities	1,502	(3,842)	(1,142)	
CASH FLOWS FROM FINANCING ACTIVITIES:				
Payments on long-term debt	(15,774)	(6,894)	(564)	
Senior credit facility	24,307	(21,650)	(2,657)	
Due to/from parent/subsidiaries	(2,961)	--	--	
Other items	1,415	(1,540)	131	
Net cash provided by (used in) financing activities........	6,987	(30,084)	(3,090)	
NET DECREASE IN CASH AND CASH EQUIVALENTS.......................	1,926	(1,409)	(97)	
CASH AND CASH EQUIVALENTS,				

beginning of period	941	191	2,488	
CASH AND CASH EQUIVALENTS, end of period	$ 2,867	$ (1,218)	$ 2,391	$

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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, 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 nine months ended September 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 September 30, 2002, we owned, operated or maintained an ownership interest in imaging equipment at 116 locations and provided management services to ten radiology practices. As of September 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 nine months ended September 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 nine months ended September 30, 2002, 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 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.

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. 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 (for example, 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 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 increased from 31% to 32% for the nine months ended September 30, 2001 and 2002. The operating margin for the Northeastern region increased from 26% for the nine months ended September 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 34% for the nine months ended September 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. The decrease was partially offset by decreased purchased billing services and by increased technical revenues in the Central region overall. The operating margin for the Western region decreased from 24% for the nine months ended September 30, 2001 to 22% in 2002. The decrease is primarily attributable to a decrease in the number of hospitals in which we provide management services and the impact of increased salaries and benefits. The decrease was partially offset by a decrease in rent expense, attributable to the purchase in December 2001 of equipment previously held under operating leases. The operating margin for Questar increased from 17% for the nine months ended September 30, 2001 to 23% for the nine months ended September 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.

Recent Developments

During the three months ended September 30, 2002, we experienced lower volume than management's expectations as a result of greater than expected seasonality and increased payor pre-authorization activity. Recently, an increasing number of payors in which we do business with have instituted more comprehensive pre-authorization programs on certain procedures. Under pre-authorization programs, the referring physician must justify medical necessity based on payor's specific guidelines prior to the services being rendered. As pre-authorization programs mature with referring physicians and payors, we cannot give any assurance that it will not continue to have an adverse effect on our business, results of operations or financial condition.

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

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 THREE MONTHS ENDED SEPTEMBER 30, 2002	FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2001
Revenue from contracted radiology practices and diagnostic imaging centers, net of contractual allowances	$ 98,092	$ 94,800
Less: amounts retained by contracted radiology practices	(26,817)	(25,625)
Service fee revenue, as reported	$ 71,275	$ 69,175

Revenue from contracted radiology practices and diagnostic imaging centers, net of contractual allowances, increased $3.3 million, from $94.8 million in 2001 to $98.1 million in 2002. This increase was primarily due to increased revenues derived from increased volume at the diagnostic imaging centers which increased our revenue from contracted radiology practices and diagnostic imaging centers. Amounts retained by contracted radiology practices increased from $25.6 million in 2001 to $26.8 million in 2002. As a percentage of revenue from contracted radiology practices and diagnostic imaging centers, net of contractual adjustments, the costs remained constant at 27.0% and 27.3% for 2001 and 2002, respectively. The increase in revenue from contracted radiology practices and diagnostic imaging centers, net of contractual adjustments, and the increase in amounts retained by contracted radiology practices, resulted in service fee revenue increasing $2.1 million, from $69.2 million in 2001 to $71.3 million, in 2002.

Salaries and Benefits

Salaries and benefits increased $2.9 million, from $18.7 million in 2001 to

$21.6 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 27.0% in 2001 to 30.4% in 2002.

Field Supplies

Field supplies increased $100,000, from $4.2 million in 2001 to $4.3 million in 2002. As a percentage of service fee revenue, these costs remained constant at 6.0% for 2001 and 2002.

Field Rent and Lease Expense

Field rent and lease expense decreased $400,000, from $8.6 million in 2001 to $8.2 million in 2002. As a percentage of service fee revenue, these costs were 12.5% and 11.4% in 2001 and 2002, respectively. The decrease in the rent and lease expense was primarily attributable to the purchase in December 2001 of equipment previously held under operating leases.

Other Field Expenses

Other field expenses decreased $400,000 from $12.0 million in 2001 to $11.6 million in 2002. Generally, these costs do not increase in proportion with increases in volume and revenue. However, as a percentage of service fee revenue, these costs

decreased from 17.3% in 2001 to 16.2% in 2002. Purchased billing services decreased approximately $700,000 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 certain hospitals. In addition, malpractice liability insurance expense decreased approximately $200,000 from $900,000 in 2001 to $700,000 in 2002. In connection with the amendment of the service agreement with certain of our contracted radiology practices, we no longer incur malpractice liability insurance premiums for physicians of those contracted radiology practices. Prior to July 1, 2002, malpractice liability insurance premiums for these contracted radiology practices was included in certain contractually agreed upon expenses in which we reimbursed those practices for a portion of their expense.

Bad Debt Expense

Bad debt expense decreased $100,000 from $6.3 million in 2001 to $6.2 million in 2002. As a percentage of service fee revenue, these costs were 9.2% and 8.7% 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 inherently result in a higher stated value than if it were calculated as a percentage of revenue of the contracted radiology practices and diagnostic imaging centers. 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 6.3% in 2001 and 2002, respectively.

Corporate General and Administrative

Corporate general and administrative expenses decreased $800,000, from $4.5 million in 2001 to $3.7 million in 2002. As a percentage of service fee revenue, these costs were 6.5% and 5.2% in 2001 and 2002, respectively. During the three months ended September 30, 2001 we recorded a $1.0 million one-time charge for transaction costs related to the termination of a merger. Adjusting for the one-time charge, corporate general and administrative expenses increased 5.7% 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, offset by lower incentive compensation.

Depreciation and Amortization

Depreciation and amortization expense increased $900,000, from $5.8 million in 2001 to $6.7 million in 2002. As a percentage of service fee revenue, these costs were 8.4% and 9.4% in 2001 and 2002, respectively. The increase in depreciation expense is primarily attributable to the purchase of $7.8 million of property and equipment for replacement, maintenance, and expansion during the three months ended September 2002 compared to $1.0 million during the three months ended September 2001. In addition, the increase in depreciation expense is due 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 of 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 $1.0 million from $3.6 million in 2001 to $4.6 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 $2.5 million in 2001 and $2.1 million in 2002 was based on a 40% effective tax rate.

Net Income

Net income decreased from $3.8 million in 2001 to $3.2 million in 2002. Net income as a percentage of service fee revenue was 4.5% in 2002, which decreased from 5.5% in 2001.

NINE MONTHS ENDED SEPTEMBER 30, 2001 COMPARED TO NINE MONTHS ENDED SEPTEMBER 30, 2002

Service Fee Revenue

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

	FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2002	2001
Revenue from contracted radiology practices and diagnostic imaging centers, net of contractual allowances	$ 298,021	$ 284,238
Less: amounts retained by contracted radiology practices	(80,665)	(80,916)
Service fee revenue, as reported	$ 217,356	$ 203,322

Revenue from contracted radiology practices and diagnostic imaging centers, net of contractual adjustments, increased $13.8 million, from $284.2 million in 2001 to $298.0 million in 2002. This increase was primarily due to increased revenues derived from increased volume at the diagnostic imaging centers, which increased our revenue from contracted radiology practices and diagnostic imaging centers. Amounts retained by contracted radiology practices decreased from $80.9 million in 2001 to $80.7 million in 2002. The increase in revenue from contracted radiology practices and diagnostic imaging centers, net of contractual adjustments, and the decrease in amounts retained by contracted radiology practices, resulted in service fee revenue increasing $14.1 million, from $203.3 million in 2001 to $217.4 million, in 2002.

Salaries and Benefits

Salaries and benefits increased $6.9 million, from $55.8 million in 2001 to $62.7 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 27.4% and 28.8% in 2001 and 2002, respectively.

Field Supplies

Field supplies increased $1.1 million, from $12.1 million in 2001 to $13.2 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 $1.0 million, from $25.4 million in 2001 to $24.4 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 was primarily attributable to the purchase in December 2001 of equipment previously held under operating leases.

Other Field Expenses

Other field expenses remained relatively constant at $34.9 million in 2001 and $35.2 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 17.3% in 2001 to 16.2% in 2002. Purchased billing services decreased approximately $1.8 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 certain hospitals.

Bad Debt Expense

Bad debt expense decreased $500,000, from $19.1 million in 2001 to $18.6 million in 2002. As a percentage of service fee revenue, these costs were 9.4% 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 inherently result in a higher stated value than if it were calculated as a percentage of revenue of the contracted radiology practice and diagnostic imaging centers. 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 $600,000, from $11.0 million in 2001 to $11.6 million in 2002. As a percentage of service fee revenue, these costs were 5.4% and 5.3% 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. This increase is offset by a $1.0 million one-time charge related to the termination of a merger recorded during the nine months ended September 30, 2001, and lower year to date incentive compensation.

Depreciation and Amortization

Depreciation and amortization expense increased $2.0 million, from $17.3 million in 2001 to $19.3 million in 2002. As a percentage of service fee revenue, these costs were 8.5% and 8.9% in 2001 and 2002, respectively. The increase in depreciation expense is primarily attributable to the purchase of $17.9 million of property and equipment for replacement, maintenance, and expansion during the nine months ended September 30, 2002. In addition, the increase in depreciation expense is 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 $2.2 million, from $12.1 million in 2001 to $14.3 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 $7.5 million in 2001 and $8.3 million in 2002 was based on a 40% effective tax rate.

Net Income

Net income increased from $11.2 million in 2001 to $12.4 million in 2002. Net income as a percentage of service fee revenue was 5.7% in 2002, which increased from 5.5% in 2001.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity for the nine months ended September 30, 2002, was derived principally from net cash proceeds from operating activities. As of September 30, 2002, we had net working capital of $63.4 million, including cash and cash equivalents of $16.1 million. We had current assets of $102.7 million and current liabilities of $39.3 million, including current maturities of long-term debt and capital lease obligations of $4.3 million. For the nine months ended September 30, 2002, we generated $30.8 million in net operating cash flow, invested $20.8 million and used cash of $4.6 million in financing activities.

Net cash from operating activities for the nine months ended September 30, 2002 of $30.8 million increased from the $30.1 million for the same period in 2001 due to increased net income. This was partially offset by 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 73 days at September 30, 2001 to 70 days at September 30, 2002.

Net cash used in investing activities for the nine months ended September 30, 2001 and 2002 was $3.5 million and $20.8 million, respectively. Purchases of property and equipment during the nine months ended September 30, 2001 and 2002 were $4.6 million and $17.9 million, respectively. For the nine months ended September 30, 2002, we have invested $9.9 million in the replacement and maintenance of property and equipment and $8.0 million in the expansion of property and equipment.

Net cash flows used in financing activities for the nine months ended September 30, 2001 and 2002 were $26.2 million and $4.6 million, respectively. At September 30, 2002, we had outstanding borrowings of $160 million under our senior notes, $12.0 million outstanding under our convertible subordinated junior note and an additional $7.6 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. 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 September 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 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 health care data between health care payors, plans and providers. HIPAA is designed to enable the entire health care 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. We are in the process of determining the readiness status of our software vendors, payors and claim clearinghouses to assess exposure with regard to this legislation. We are at risk for both our own HIPAA compliance and the compliance of those with whom we do business , particularly third party payors and hospitals. There can be no assurance that HIPAA compliance issues will not have an adverse effect on our business, results of operations or financial condition.

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.

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. CONTROLS AND PROCEDURES

Within 90 days prior to the date of filing this Quarterly Report on Form 10-Q, we carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 15d-14 under the Securities Exchange Act of 1934. The evaluation was carried out under the supervision of our Chief Executive Officer and Chief Financial Officer. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that our disclosure controls and procedures are effective in alerting them on a timely basis to material information that is required to be included in our periodic filings with the Securities and Exchange Commission. After the date of that evaluation, no significant changes were made in our internal controls or in other factors that could significantly affect internal controls, nor were any corrective actions required with regard to significant deficiencies and material weaknesses.

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

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PART II: OTHER INFORMATION

ITEM 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 September 24, 2002, announcing the modification of its financial guidance for fiscal year 2002 following the impact on third quarter procedure volume and service fee revenue of greater than expected seasonality in July and August.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

RADIOLOGIX, INC.

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

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CERTIFICATION OF
CHIEF EXECUTIVE OFFICER

I, Mark L. Wagar, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Radiologix, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

    a) Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

    b) Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

    c) Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

    a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

    b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

By: /s/ Mark L. Wagar

Mark L. Wagar
Chairman and Chief Executive Officer

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CERTIFICATION OF
CHIEF FINANCIAL OFFICER

I, Sami S. Abbasi, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Radiologix, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a) Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b) Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

   c) Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

   a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this

quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

By: /s/ Sami S. Abbasi

Sami S. Abbasi
Executive Vice President and Chief Financial Officer

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).
10.6	Amended and Restated Service Agreement among Radiologix, Inc., Advanced Imaging Partners, Inc., and Advanced Radiology, P.A., dated as of July 1, 2002.*
10.7	Amended and Restated Service Agreement among Radiologix, Inc., Ide Imaging Partners, Inc., and The Ide Group, P.C., dated as of July 1, 2002.*
10.9	Amended and Restated Service Agreement among Radiologix, Inc., Mid Rockland Imaging Partners, Inc., and Hudson Valley Radiology Associates, P.L.L.C., dated as of July 1, 2002.*
10.15	Amended and Restated Service Agreement among Radiologix, Inc., Radiology and Nuclear Medicine Partners, Inc., and Radiology and Nuclear Medicine, L.L.C., dated as of July 1, 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.*
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.*

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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.