DIGIRAD CORP
Form 10-Q
April 29, 2010
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 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 MARCH 31, 2010

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

Commission file number: 000-50789

Digirad Corporation

(Exact name of registrant as specified in its charter)

Delaware	**33-0145723**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
13950 Stowe Drive, Poway, CA	**92064**
(Address of Principal Executive Offices)	**(Zip Code)**

(858) 726-1600

(Registrant s Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

Indicate by check mark whether registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer x (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

As of April 29, 2010, the registrant had 19,044,341 shares of Common Stock ($0.0001 par value) outstanding.

Table of Contents

DIGIRAD CORPORATION

TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Digirad Corporation

Consolidated Balance Sheets

(In thousands, except par value amounts)

	March 31, 2010 (Unaudited)	December 31, 2009*
Assets		
Current assets:		
Cash and cash equivalents	$ 13,497	$ 13,560
Securities available-for-sale	17,261	18,250
Accounts receivable, net	8,688	7,553
Inventories, net	6,541	6,402
Other current assets	1,307	1,234
Total current assets	47,294	46,999
Property and equipment, net	9,495	10,263
Intangible assets, net	1,111	1,243
Goodwill	184	184
Total assets	$ 58,084	$ 58,689
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 2,205	$ 1,797
Accrued compensation	2,313	2,344
Accrued warranty	329	332
Other accrued liabilities	2,213	2,106
Deferred revenue	2,417	2,594
Total current liabilities	9,477	9,173
Deferred rent	113	127
Commitments and contingencies		
Stockholders equity:		
Preferred stock, $0.0001 par value: 10,000 shares authorized; no shares issued or outstanding at March 31, 2010 and December 31, 2009		
Common stock, $0.0001 par value: 80,000 shares authorized; 18,471 and 18,477 shares issued and outstanding (net of treasury shares) March 31, 2010 and December 31, 2009, respectively	2	2
Treasury stock, at cost; 573 shares at March 31, 2010 and 547 shares at December 31, 2009	(1,039)	(991)
Additional paid-in capital	154,070	153,867
Accumulated other comprehensive income	334	149
Accumulated deficit	(104,873)	(103,638)
Total stockholders equity	48,494	49,389
Total liabilities and stockholders equity	$ 58,084	$ 58,689

* The consolidated balance sheet as of December 31, 2009, has been derived from the audited financial statements as of that date.

See accompanying notes.

Table of Contents

Digirad Corporation

Consolidated Statements of Operations

(In thousands, except per share amounts)

(Unaudited)

	Three months ended March 31, 2010	2009
Revenues:		
DIS	$ 10,723	$ 13,851
Product	4,346	3,859
Total revenues	15,069	17,710
Cost of revenues:		
DIS	8,803	10,194
Product	2,894	2,407
Total cost of revenues	11,697	12,601
Gross profit	3,372	5,109
Operating expenses:		
Research and development	725	772
Sales and marketing	1,630	1,708
General and administrative	2,262	2,409
Amortization of intangible assets	132	170
Restructuring loss		145
Total operating expenses	4,749	5,204
Loss from operations	(1,377)	(95)
Other income (expense):		
Interest income	122	103
Interest expense	(2)	(3)
Other income	22	39
Total other income	142	139
Net income (loss)	$ (1,235)	$ 44
Net income (loss) per common share basic and diluted	$ (0.06)	$ 0.00
Weighted average shares outstanding basic	19,229	19,017
Weighted average shares outstanding diluted	19,229	19,172

See accompanying notes.

Table of Contents

Digirad Corporation

Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Three months ended March 31, 2010	2009
Operating activities		
Net income (loss)	$ (1,235)	$ 44
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation	1,048	1,261
Amortization of intangible assets	132	170
Provision for bad debt	5	127
Stock-based compensation	176	165
Restructuring loss		145
(Gain) loss on disposal of assets	(2)	(40)
Amortization of premium on securities available-for-sale	89	111
Changes in operating assets and liabilities:		
Accounts receivable	(1,140)	(603)
Inventories	(113)	(1,377)
Other assets	(73)	280
Accounts payable	408	373
Accrued compensation	(31)	(687)
Other accrued liabilities	(73)	(546)
Net cash used in operating activities	(809)	(577)
Investing activities		
Purchases of property and equipment	(311)	(125)
Proceeds from sale of property and equipment	7	898
Purchases of securities available-for-sale	(1,596)	(3,871)
Maturities of securities available-for-sale	2,682	5,500
Net cash provided by investing activities	782	2,402
Financing activities		
Purchases of treasury stock		(11)
Issuances of common stock	28	5
Repurchases of common stock	(49)	
Repayment of obligations under capital leases	(15)	(17)
Net cash used in financing activities	(36)	(23)
Net (decrease) increase in cash and cash equivalents	(63)	1,802
Cash and cash equivalents at beginning of period	13,560	13,525
Cash and cash equivalents at end of period	$ 13,497	$ 15,327

See accompanying notes.

Table of Contents

DIGIRAD CORPORATION

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except per share amounts)

1. Interim Financial Information

Organization and Business

Digirad Corporation (Digirad), a Delaware corporation, is a leading provider of diagnostic imaging products and personnel and equipment leasing services that improve patient care while driving positive healthcare economics. Digirad has two reportable segments, Digirad Imaging Solutions (DIS) and Product. The accompanying consolidated financial statements include the operations of both segments. Intercompany accounts and transactions have been eliminated in consolidation. Substantially all of our revenue arises from sales activity in the United States. Through DIS, we provide in-office leasing services to physicians, offering certified personnel, required licensure, an imaging system and other support and supplies for the performance of nuclear and ultrasound imaging procedures under the supervision of our physician customers. DIS physician customers enter into annual lease contracts for imaging services generally delivered on a per-day basis. Our Product segment sells solid-state gamma cameras and provides camera service and maintenance contracts.

Basis of Presentation

We have prepared the accompanying unaudited consolidated financial statements in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and disclosures required by generally accepted accounting principles for complete financial statements. In the opinion of our management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2010 are not necessarily indicative of the results that may be expected for the entire year. For further information, see our financial statements and related disclosures thereto for the year ended December 31, 2009, from which our December 31, 2009 balance sheet information was derived in our most recent Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 12, 2010. We evaluated subsequent events through April 29, 2010, the date on which this Quarterly Report on Form 10-Q was filed with the Securities and Exchange Commission.

Net Income (Loss) Per Share

Basic EPS is calculated by dividing net income or loss by the weighted average number of common shares and vested restricted stock units outstanding. Diluted EPS is computed by dividing net income or loss by the weighted average number of common shares and vested restricted stock units outstanding and the weighted average number of dilutive common stock equivalents, including stock options and non-vested restricted stock units. Common stock equivalents are only included in the diluted earnings per share calculation when their effect is dilutive. Shares used to compute basic net income (loss) per share include 199,000 restrictive stock units as of March 31, 2010 compared to 68,000 in March 31, 2009.

The following table sets forth the computation of basic and diluted net income (loss) per share for the periods indicated (in thousands, except per share amounts):

	Three months ended March 31,	
	2010	2009
Net income (loss)	$ (1,235)	$ 44
Shares used to compute basic net income (loss) per share	19,229	19,017
Dilutive potential common shares:		
Stock options		135
Restricted stock units		20
Shares used to compute diluted net income (loss) income per share	19,229	19,172

Basic and diluted net income (loss) per share	$ (0.06)	$ 0.00

Table of Contents

Comprehensive Income (Loss)

Comprehensive income (loss) consists of the following components (in thousands):

	Three months ended March 31,	
	2010	2009
Net income (loss), as reported	$ (1,235)	$ 44
Unrealized gains (losses) on marketable securities	185	(238)
Comprehensive loss	$ (1,050)	$ (194)

Fair-value of Financial Instruments

The carrying value of financial instruments, such as cash and cash equivalents, securities available-for-sale, accounts receivable, accounts payable and accrued liabilities approximate their fair value because of their short term nature. We do not hold or issue financial instruments for trading purposes.

Cash and Cash Equivalents. We consider all investments with a maturity of three months or less when acquired to be cash equivalents. Cash equivalents primarily represent funds invested in money market funds whose cost equals fair market value.

Securities, Available-for-Sale. Securities consist of money market funds, municipal bonds, as well as U.S. treasury, government and corporate debt securities. We classify all securities as available-for-sale, as the sale of such securities may be required prior to maturity to implement management strategies. These securities are carried at fair value, with the unrealized gains and losses reported as a component of other comprehensive income (loss) in stockholders equity until realized. Realized gains and losses from the sale of available-for-sale securities, if any, are determined on a specific identification basis. A decline in the market value of any available-for-sale security below cost that is determined to be other than temporary will result in a revaluation of its carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. No such impairment charges were recorded for any period presented. Premiums and discounts are amortized or accreted over the life of the related security as an adjustment to yield using the straight-line method. Interest income is recognized when earned. Realized gains and losses on investments in securities are based on the specific identification method and are included in other income within the Consolidated Statements of Operations. Realized gains and losses for the three months ended March 31, 2010 were not material. No realized gains or losses were incurred for the three months ended March 31, 2009. As of March 31, 2010, none of our investments has been in an unrealized loss position for more than 12 months. The amortization, accretion and interest income are included in interest income within the Consolidated Statements of Operations. The following table sets forth the composition of securities available for sale as of March 31, 2010 and December 31, 2009 (in thousands):

As of March 31, 2010	Maturity in Years	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. treasury securities	2 or less	$ 3,023	$ 8	$	$ 3,031
Municipal bonds	3 or less	102			102
Government sponsored entities	3 or less	4,296	4	(11)	4,289
Corporate debt securities	4 or less	9,499	343	(3)	9,839
		$ 16,920	$ 348	$ (14)	$ 17,261

As of December 31, 2009	Maturity in Years	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. treasury securities	2 or less	$ 4,050	$ 16	$	$ 4,066
Government sponsored entities	3 or less	3,912	6	(5)	3,913
Corporate debt securities	3 or less	10,037	155	(24)	10,168
Auction rate securities	3 or less	102			103

	$ 18,101	$ 178	$ (29)	$ 18,250

Table of Contents

2. Financial Statement Details

Inventories consisted of the following (in thousands):

	March 31, 2010	December 31, 2009
Raw materials	$ 2,191	$ 3,431
Work-in-progress	2,087	1,916
Finished goods	2,994	1,852
	7,272	7,199
Less reserves for excess and obsolete inventories	(731)	(797)
	$ 6,541	$ 6,402

Property and equipment consisted of the following (in thousands):

	March 31, 2010	December 31, 2009
Machinery and equipment	$ 22,171	$ 22,440
Computers and software	2,350	2,270
Leasehold improvements	803	764
	25,324	25,474
Less accumulated depreciation and amortization	(15,829)	(15,211)
	$ 9,495	$ 10,263

Other accrued liabilities consisted of the following (in thousands):

	March 31, 2010	December 31, 2009
Outside services and consulting	$ 379	$ 312
Radiopharmaceuticals and consumable medical supplies	347	323
Sales and property taxes payable	320	278
Professional fees	298	338
Facilities and related costs	228	218
Travel expenses	154	165
Other accrued liabilities	487	472
	$ 2,213	$ 2,106

3. Investments

We measure available-for-sale securities at fair value on a recurring basis. We measure fair value based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, the FASB Codification establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels. These levels, in order of highest priority to lowest priority, are described below:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities.

Level 2: Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.

Level 3: Unobservable inputs are used when little or no market data is available.

The fair values of our available-for-sale securities were determined using the following inputs (in thousands):

	Total	Fair Value Measurements at March 31, 2010 Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale securities:				
U.S. treasury securities	$ 3,031	$ 3,031	$	$
Municipal bonds	102		102	
Government sponsored entities	4,289		4,289	
Corporate debt securities	9,839		9,839	
Total available-for-sale securities:	$ 17,261	$ 3,031	$ 14,230	$

Our investments in U.S. treasury securities were valued based on publicly available quoted prices for identical securities as of March 31, 2010. Our investments in government sponsored entities and corporate debt securities were valued by a third party pricing vendor using proprietary valuation models and analytical tools. The inputs to these models related to similar instruments and were both objective and publicly available.

Table of Contents

4. Intangible Assets

Intangible assets consisted of the following (in thousands):

	March 31, 2010		
	Gross Amount	Accumulated Amortization	Net Book Value
Intangibles subject to amortization:			
Customer relationships	$ 2,600	$ 1,702	$ 898
Covenants not to compete	300	175	125
Patents	153	65	88
Total intangibles assets:	$ 3,053	$ 1,942	$ 1,111

	December 31, 2009		
	Gross Amount	Accumulated Amortization	Net Book Value
Intangibles subject to amortization:			
Customer relationships	$ 2,600	$ 1,588	$ 1,012
Covenants not to compete	300	160	140
Patents	153	62	91
Total intangible assets:	$ 3,053	$ 1,810	$ 1,243

All patents and their related amortization are recorded within the Product segment. All other intangible assets, including goodwill, and their related amortization expense are recorded within the DIS segment. The aggregate amortization expense related to intangible assets with finite lives for the three months ended March 31, 2010 was $0.1 million. Estimated future amortization expense related to intangible assets with finite lives at March 31, 2010 is as follows:

	In Thousands
2010 (remaining 9 months)	$ 295
2011	333
2012	234
2013	165
2014	57
Thereafter	27
Total	$ 1,111

5. Warranty

We provide a warranty on certain of our products and accrue the estimated cost at the time revenue is recorded. Warranty expense is charged to Product cost of revenues. Substantially all of the warranty periods are 12 months before customer-sponsored maintenance programs begin. Warranty reserves are established based on historical experience with failure rates and repair costs and the number of systems covered by warranty. Warranty reserves are depleted as our cardiac gamma cameras are repaired. The costs consist principally of materials, personnel, and overhead. We review warranty reserves quarterly and, if necessary, make adjustments.

The activities in our warranty reserve consisted of the following (in thousands):

	Three months ended March 31,	
	2010	2009
Balance at beginning of period	$ 332	$ 906
Charges to cost of revenues	182	143
Applied to liability	(185)	(240)
Balance at end of period	$ 329	$ 809

Table of Contents

6. Segments

Our reporting segments have been determined based on the nature of the products and/or services offered to customers or the nature of their function in the organization. We evaluate performance based on the operating income contributed by each segment. The accounting policies of the reporting segments are the same as those described in the summary of significant accounting policies in our Annual Report on Form 10-K. Segment results are as follows (in thousands):

	Three months ended March 31,	
	2010	2009
Gross profit by segment:		
DIS	$ 1,920	$ 3,657
Product	1,452	1,452
Consolidated gross profit	$ 3,372	$ 5,109
Income (loss) from operations by segment:		
DIS	$ (954)	$ 287
Product	(423)	(382)
Consolidated income (loss) from operations	$ (1,377)	$ (95)
Depreciation and amortization of tangible and intangible assets by segment:		
DIS	$ 1,038	$ 1,281
Product	142	150
Consolidated depreciation and amortization	$ 1,180	1,431

	As of March 31,	
	2010	2009
Identifiable assets by segment:		
DIS	$ 17,138	$ 23,470
Product	40,946	36,951
Consolidated assets	$ 58,084	$ 60,421

7. Income Taxes

As of December 31, 2009, we had unrecognized tax benefits of approximately $1.6 million. There has been no significant change in unrecognized tax benefits through March 31, 2010. Included in the unrecognized tax benefits of $1.6 million at December 31, 2009 was $1.3 million of tax benefits that, if recognized, would reduce our annual effective tax rate, subject to the valuation allowance. We do not expect our unrecognized tax benefits to change significantly over the next 12 months.

We file income tax returns in the U.S. and in various state jurisdictions with varying statutes of limitations. We are no longer subject to income tax examination by tax authorities for years prior to 2005; however, our net operating loss and research credit carry-forwards arising prior to that year are subject to adjustment. Our policy is to recognize interest expense and penalties related to income tax matters as a component of income tax expense. There was approximately $7,000 accrued interest and penalties associated with uncertain tax positions as of March 31, 2010.

8. Commitments and Contingencies

Acquisition

On May 1, 2007, we completed the acquisition of substantially all of the assets and liabilities of Ultrascan, Inc. (Ultrascan), a provider of ultrasound imaging systems and services to physicians offices and hospitals. Additional consideration, payable in cash and common stock, of up to $3.9 million may be payable to the seller, or its designees, in the event that certain financial milestones are achieved over a four year period commencing on the date of the acquisition. The additional consideration will be added to goodwill if and when it is earned, because the nature of the financial milestones do not give rise to the existence of additional intangible assets.

Stock Repurchase Program

On February 4, 2009, our board of directors authorized a stock buyback program to repurchase up to an aggregate of $2.0 million of our issued and outstanding common shares. The timing and extent of the repurchase depends upon market conditions, applicable legal requirements, and other factors. During the three months ended March 31, 2010, we repurchased 25,800 shares of our common stock at a cost of $49,000, at a weighted average price of $1.91 per share for the three months ended March 31, 2010. Since the inception of the program, we repurchased 573,218 shares of our common stock at a cost of $1,039,000, at a weighted average price of $1.79 per share.

Legal Matters

In the normal course of business, we have been, and will likely continue to be, subject to litigation or administrative proceedings incidental to our business, such as claims related to customer disputes, employment practices, wage and hour disputes, product liability, professional liability, commercial disputes, licensure restrictions or denials, and warranty or patent infringement. Responding to litigation or administrative proceedings, regardless of whether they have merit, can be expensive

Table of Contents

and disruptive to normal business operations. As litigation and the administrative proceedings are inherently uncertain, we cannot predict the outcome of such matters. While the ultimate outcome of litigation is always uncertain, we do not believe that it will have a material adverse effect on our business or financial results.

Table of Contents

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

The following discussion and analysis should be read in conjunction with our financial statements and notes thereto included in this report on Form 10-Q, and the audited financial statements and notes as of and for the year ended December 31, 2009 included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 12, 2010. Operating results are not necessarily indicative of results that may occur in future periods.

This report contains various forward-looking statements regarding our business, financial condition, results of operations and future plans and projects. Forward-looking statements discuss matters that are not historical facts and can be identified by the use of words such as believes, expects, anticipates, intends, estimates, projects, can, could, may, will, would or similar expressions. In this report, for examp forward-looking statements regarding, among other things, the efficacy of our centers of influence model, our expectations about the rate of revenue growth in specific business segments and the reasons for that growth and our profitability, our expectations regarding an increase in sales, strategic traction and marketing and sales spending, uncertainties relating to our ability to compete, uncertainties relating to our ability to increase our market share, changes in coverage and reimbursement policies of third-party payors and the effect on our ability to sell our products and services, our ability to timely develop new products or services that will be accepted by the market, competition from alternative imaging modalities, declining average selling prices for our Product offerings, reduced supplies of radiopharmaceuticals, and the profitability of our DIS core footprint.

Although these forward-looking statements reflect the good faith judgment of our management, such statements can only be based upon facts and factors currently known to us. Forward-looking statements are inherently subject to risks and uncertainties, many of which are beyond our control. As a result, our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth below under the caption Risk Factors. For these statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. You should not unduly rely on these forward-looking statements, which speak only as of the date on which they were made. They give our expectations regarding the future, but are not guarantees. We undertake no obligation to update publicly or revise any forward-looking statements, whether as a result of new information, future events or otherwise, unless required by law.

Overview

We are a leading provider of diagnostic imaging products and personnel and equipment leasing services that improve patient care while driving positive healthcare economics. We designed and commercialized the first solid-state nuclear gamma camera for the detection of cardiovascular disease and other medical conditions. Our imaging systems are sold in a portable or a fixed configuration, and provide enhanced operability, improved patient comfort and, in the case of our triple-headed Cardius® 3 XPO system, shorter image acquisition time when compared to traditional vacuum tube cameras. Our nuclear cameras fit easily into floor spaces as small as seven feet by eight feet and facilitate the delivery of nuclear medicine procedures in a physician s office, an outpatient hospital setting or within multiple departments of a hospital.

We generate revenues within two primary operating segments: our personnel and equipment leasing service business (Digirad Imaging Solutions, or DIS) and our Product segment. Through DIS, we offer a comprehensive personnel and equipment leasing services program as an alternative to purchasing a gamma camera or ultrasound equipment for physicians who wish to perform nuclear imaging, echocardiography, vascular ultrasound, or any combination of these procedures in their offices by leasing the imaging system, certified personnel and other support required to perform imaging in the physician s office. The flexibility of our products and our DIS leasing service allows physicians more control over the diagnosis and treatment of their patients in their offices and to retain revenue from procedures they would otherwise refer elsewhere. DIS leasing services are primarily provided to cardiologists and internists who enter into annual contracts for personnel and equipment services delivered on a per-day basis. Our typical lease contracts provide service coverage ranging from once per month to five times per week. We experience some seasonality in our DIS business related to summer vacations, holidays and inclement weather, which historically has most negatively affected our third quarter. We are experiencing a significant market change due to the decline in reimbursements to our physicians and the uncertainty with healthcare legislation. This market change may require further changes to our business model in order for our physician customers and us to maintain a viable economic model. Our product revenue results primarily from selling solid-state gamma cameras and camera maintenance contracts. We sell our imaging systems to physician offices, hospitals, and imaging centers primarily in the United States, although we have sold a small number of imaging systems internationally. As a result of the healthcare environment trends, we introduced a new product in 2009 called our Cardius® X-ACT camera, which is a rapid cardiac SPECT/VCT imager. The Cardius® X-ACT camera is positioned more toward the hospital and larger cardiology practices.

Table of Contents

Our Market

The target market for our products and services is comprised of approximately 26,000 cardiologists, 130,000 internal medicine physicians, as well as family practice physicians, and hospitals in the United States that perform or could perform nuclear cardiac and ultrasound procedures. As of March 31, 2010, we have provided imaging services through DIS to more than 1,100 physicians and physician groups. We have sold 648 cameras through our Product segment. More than half of our DIS nuclear and ultrasound imaging customers are internal medicine physicians or other primary care practitioners, and the remainder are primarily cardiologists. Our market has been negatively affected by declining reimbursements, pricing pressures, decreases in radiopharmaceutical supplies and continuing efforts by some third party payors to reduce health care expenditures by requiring physicians to obtain specific accreditations or certifications. We are addressing these market pressures by introducing new products, such as our Cardius® X-ACT camera, and modifying our DIS business model to allow physicians to scan more patients per day. We anticipate introducing other new products and services in 2010 and beyond.

Trends and Drivers

The medical device industry, including the market for nuclear and ultrasound imaging systems and services, is highly competitive. Our business continues to be negatively affected by many factors, including declining healthcare reimbursement rates for cardiac imaging procedures, competition from alternative imaging modalities such as CT Angiography, competition from other small owner-operated mobile nuclear imaging providers, declining average selling prices for our Product offerings, general uncertainty in the healthcare marketplace and reduced availability of radiopharmaceuticals due to world-wide shortages. We expect each of these trends to continue in the foreseeable future. In 2009, we began to experience a decline in demand for our cameras, partially due to very limited hospital and physician group capital budgets, in addition to uncertainties related to upcoming changes in healthcare regulations and economic conditions. This trend has continued into the first quarter of 2010.

Our primary focus in 2009 was to improve both our profitability and our cash flow results. In 2008 and 2009, we initiated a restructuring plan designed to create greater efficiency in our DIS business segment by selling or closing underperforming locations. This, combined with a more efficient management structure, a reduced workforce and a focus on attaining this goal, contributed to the achievement of operating income and positive cash flow in 2009. Our physicians incurred a significant reimbursement reduction on January 1, 2010, which has impacted their businesses (i.e., reduced the profitability of our services) and, in return, our business (i.e., reduced the number of days that we scanned in the quarter). Furthermore, the severe winter weather in the east and midwest reduced the number of scan days in the first quarter of 2010. Also, the uncertainty over the enactment of the sustainable growth rate (SGR) continues to linger. Congress deferred the implementation of an additional 21.2% reduction in reimbursement by way of the sustainable growth rate from January 1, 2010 to March 1, 2010 to April 1, 2010 and now to June 1, 2010. The uncertainty around the impact and affect of the sustainable growth rate continues to cause concern with our physician customers. We are building and modifying our business model to adapt to environmental and regulatory changes in the healthcare marketplace.

In our Product segment, we continue to build on past Product segment achievements by introducing new products targeted specifically at the larger physician practices and hospital market segments. In 2009, we received U.S. Food and Drug Administration (FDA) 510(k) clearance for our new Cardius® X-ACT imaging system. Cardius® X-ACT is a rapid cardiac SPECT/VCT imaging system that features a low-dose volume computed tomography (VCT) attenuation correction system that significantly reduces artifacts in the images caused by overlying tissues increasing interpretive ease and accuracy. In late 2009, we introduced a new product called c*pax, a complete on-line fee-per-study cardiovascular information system, as a potential add-on companion for any of our nuclear cameras or ultrasound equipment. Our new c*pax product is a fully-integrated approach that reduces physicians capital costs, information technology support and maintenance costs.

First Three Months of 2010 Financial Highlights

Our consolidated revenues were $15.1 million during the three months ended March 31, 2010 (2010), which represented a decrease of $2.6 million, or 14.9%, over the comparable prior year period (2009) due to a decrease in revenue from our DIS segment, slightly offset by an increase from our Product segment. DIS revenue decreased $3.1 million, or 22.6%, due to a reduction in the number of scan days. Our physician customers reduced their scan days in part due to the reduction in reimbursements that went into effect on January 1, 2010 and in part due to the inclement weather experienced in January and February 2010. Product revenues increased $0.5 million, or 12.6%, over the same period in 2009, primarily due to an increase in the average selling price of our cameras and accessories, mainly our new Cardius® X-ACT camera, which were sold to larger cardiology practices and hospitals. The number of cameras sold in the three months ended March 31, 2010 was the same as the number of cameras sold in the same period in 2009.

We realized a loss from operations and a net loss for the three months ended March 31, 2010 as a result of decreased DIS segment gross profits, despite reduction in our operating expenses. Our consolidated net loss for the three months ended

13

Table of Contents

March 31, 2010 was $1.2 million, compared to net income of $44,000 during the same period in 2009. The decline in profitability in our DIS segment, was primarily attributable to the significant reimbursement reduction on January 1, 2010, experienced by our physician customers, along with the severe winter weather in the east and Midwest, which reduced the number of scan days in the first quarter of 2010.

Our DIS business currently operates in 20 states. In 2010, DIS operated 73 nuclear gamma cameras and 62 ultrasound imaging systems, compared to 75 nuclear gamma cameras and 62 ultrasound imaging systems in 2009. We are seeking to improve our overall profitability through more efficient utilization of our fleet of gamma cameras and ultrasound equipment. We measure efficiency by tracking system utilization, which is measured based on the percentage of days that our nuclear gamma cameras and ultrasound equipment are used to deliver services to customers out of the total number of days that they are available to deliver such services. System utilization decreased to 62% in 2010, compared to 64% for 2009, primarily due to fewer scan days.

Results of Operations

The following table sets forth our results from operations expressed as percentages of revenues for the three months ended March 31, 2010 and 2009:

	Three months ended March 31,	
	2010	**2009**
Revenues:		
DIS	71.2%	78.2%
Product	28.8	21.8
Total revenues	100.0	100.0
Total cost of revenues	77.6	71.2
Gross profit	22.4	28.8
Operating expenses:		
Research and development	4.8	4.4
Marketing and sales	10.8	9.6
General and administrative	15.0	13.5
Amortization of intangible assets	0.9	1.0
Restructuring loss		0.8
Total operating expenses	31.5	29.3
Loss from operations	(9.1)	(0.5)
Other income	0.9	0.7
Net income (loss)	(8.2)%	0.2%

Comparison of Three Months Ended March 31, 2010 and 2009

Revenues

Consolidated. Consolidated revenue was $15.1 million for 2010, which represents a decrease of $2.6 million, or 14.9%, compared to the prior year quarter, as a result of lower DIS revenues. DIS revenue accounted for 71.2% of total revenues for 2010, compared to 78.2% for 2009. We expect DIS revenue to continue to represent the larger percentage of our consolidated revenue in future periods.

DIS. Our DIS revenue was $10.7 million for 2010, which represents a decrease of $3.1 million, or 22.6%, compared to the prior year quarter. The decrease resulted from our physician s initial reaction to the decline in nuclear reimbursements along with their uncertainty over the potential changes in healthcare reform, combined with severe winter weather in January and February 2010, which reduced the number of revenue-able service days. We also experienced decreases in radiopharmaceutical supplies in the first quarter, which negatively affected our revenues. With the passage of the recent healthcare reform legislation, the deferment of the sustainable growth rate and the expected increase in

radiopharmaceutical supplies by summer, we are working with our current and new physician customers to engage or re-engage our services and we expect revenues to increase for the remainder of the year.

Product. Our Product revenue was $4.4 million for 2010, which represents an increase of $0.5 million, or 12.6%, compared to the prior year quarter. The increase in revenue resulted from the same number of gamma camera sales this year as last year; however, we experienced an increase in the average sales prices as our product sales mix was represented by a larger percentage of our new Cardius® X-ACT imaging cameras. We believe that the increase in our new gamma camera is a result of our new technology and the beginning of our efforts to penetrate the hospital marketplace.

Table of Contents

Gross Profit

Consolidated. Consolidated gross profit was $3.4 million for 2010, representing a decrease of $1.7 million, or 34%, compared to the prior year quarter. The decrease in consolidated gross profit is principally the result of the decline in DIS revenue. Consolidated gross profit as a percentage of revenue decreased to 22.4% for 2010 from 28.8% for 2009.

DIS. Cost of DIS revenue consists primarily of labor, radiopharmaceuticals, equipment depreciation, and other costs associated with the provision of services. Cost of DIS revenue was $8.8 million for 2010, representing a decrease of $1.4 million, or 13.6%, compared to the prior year quarter. The decrease in cost of DIS revenue is primarily a result of decreased radiopharmaceutical expenses and some labor costs. DIS gross profit was $1.9 million for 2010, which represents a decrease of $1.7 million, or 47.5%, from a gross profit of $3.7 million in 2009. DIS gross profit as a percentage of revenue decreased to 17.9% for 2010 from 26.4% for 2009. The decline in operational performance is primarily associated with the sudden reduction in scan days without a corresponding and timely reduction in labor and overhead expenses.

Product. Cost of Product revenue primarily consists of materials, labor and overhead costs associated with the manufacturing and warranty of our products. Cost of goods sold for the Product segment was $2.9 million for 2010, representing an increase of $0.5 million, or 20.2%, compared to the prior year quarter as our product sales mix shifted and we incurred certain manufacturing variances due to lower production volumes. Product gross profit was $1.5 million for 2010 and 2009. Product gross profit as a percentage of revenue decreased to 33.4% for 2010 from 37.6% for 2009, primarily due to an increase in personnel and manufacturing overhead as a percentage of revenue.

Operating Expenses

Research and Development. Research and development expenses are the costs associated with the design, development and enhancement of our products, and consist of salaries, development material costs, facility and overhead costs, consulting fees, and non-recurring engineering costs. We continue to invest in research and development with a focus on innovation as we seek to improve our existing technology. In 2009, we received U.S. Food and Drug Administration 510(k) clearance for our new Cardius® X-ACT imaging system. Research and development expenses were $0.7 million for 2010, which represents a decrease of $0.05 million, or 6.1%, compared to the prior year quarter. Research and development expenses were 16.7% of Product revenue for 2010 compared to 20% in 2009, a decrease of 3.3% over the prior year period. We plan to continue investing in our technology platform to penetrate new and existing market segments and attract new customers.

Marketing and Sales. Marketing and sales expenses consist primarily of salaries, commissions, bonuses, recruiting costs, travel, marketing and collateral materials and trade show costs. Marketing and sales expenses were $1.6 million for 2010, representing a decrease of $0.08 million, or 4.6%, compared to the prior year quarter, principally as a result of lower personnel costs. Marketing and sales expenses were 10.8% of total revenue for 2010 compared to 9.6% for 2009, as we invest in penetrating the hospital and larger cardiology practice marketplace.

General and Administrative. General and administrative expenses consist primarily of salaries and other related costs for accounting, human resources, information technology and executive personnel, legal related costs, professional fees, outside services, insurance, and costs related to our board of directors. General and administrative expenses were $2.3 million for 2010, representing a decrease of $0.1 million, or 6.1% compared to the prior year quarter, principally as a result of lower personnel costs. General and administrative expenses were 15% of total revenue for 2010 compared to 13.5% for 2009, mainly due to lower DIS revenue.

Other Income

Other income consists primarily of interest income, net of interest and other expenses. Other income was unchanged from the prior year period.

Net Income (Loss)

Our net loss was $1.2 million for 2010 compared to a net gain of $0.04 million for 2009. The decline in profitability was primarily as a result of decreased DIS segment gross profits partially offset by a reduction in our operating expenses. The reduction in our operating expenses was primarily achieved through cost saving measures begun in 2009 and continued into the first quarter of 2010.

Table of Contents

Liquidity and Capital Resources

We require working capital principally to finance accounts receivable and inventory and for capital expenditures. Our working capital requirements vary from period to period depending on several factors, including our manufacturing volumes, the timing of our deliveries and the payment cycles of our customers. Our capital expenditures consist primarily of DIS nuclear cameras, ultrasound equipment, and vans to transport our people and equipment to customer locations.

As of March 31, 2010, we had cash, cash equivalents and securities available-for-sale of $31 million. We currently invest our cash reserves in money market funds, municipal bonds, as well as U.S. treasury, government and corporate debt securities. Based upon our current level of expenditures, we believe our current working capital, together with cash flows from operating activities, will be more than adequate to meet our anticipated cash requirements for working capital, debt service and capital expenditures for at least the next 12 months.

Net cash used in operations totaled $0.8 million in 2010, primarily due to our net loss and the increase of accounts receivable and inventory. Net cash provided by investing activities amounted to $0.8 million in 2010 and is primarily due to maturities of securities available-for-sale, partially offset by net purchases of securities available-for-sale and property and equipment. Net cash used in financing activities amounted to approximately $0.04 million in 2010, which primarily represents the repurchase of our common stock under a Rule 10b-18 plan. On February 4, 2009, our board of directors authorized a stock buyback program to repurchase up to an aggregate of $2.0 million of our issued and outstanding common shares. The timing of stock repurchases and the number of shares of common stock to be repurchased has been, and will be made, in compliance with Rule 10b-18 under the Securities Exchange Act of 1934 and will depend upon market conditions, applicable legal and contractual requirements, and other factors. Purchases under this program to date totaled $1.05 million, including purchases of $1.0 million in 2009 and $0.05 million in the three months ended March 31, 2010.

The acquisition of assets and liabilities of Ultrascan may require additional consideration of cash and common stock of up to $3.9 million to be paid to the seller or its designees in the event that certain financial milestones are achieved through May 2011. The additional consideration will be added to goodwill if and when it is earned, because the nature of the financial milestones do not give rise to the existence of additional intangible assets.

Critical Accounting Policies

Management s discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements which are prepared in accordance with accounting principles that are generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities, related disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. We continually evaluate our estimates and judgments, the most critical of which are those related to revenue recognition and inventory valuation. We base our estimates and judgments on historical experience and other factors that we believe to be reasonable under the circumstances. Materially different results can occur as circumstances change and additional information becomes known. The accounting policies are the same as those described in the summary of significant accounting policies in our Annual Report on Form 10-K.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to market risk due to changes in interest rates relates primarily to the increase or decrease in the amount of interest income we can earn on our investment portfolio. Our risk associated with fluctuating interest rates is limited to our investments in interest rate sensitive financial instruments. Under our current policies, we do not use interest rate derivative instruments to manage exposure to interest rate changes. We attempt to increase the safety and preservation of our invested principal funds by limiting default risk, market risk and reinvestment risk. We mitigate default risk by investing in investment grade securities. A 100 basis point adverse move in interest rates along the entire interest rate yield curve would not materially affect the fair value of our interest sensitive financial instruments. Changes in interest rates over time will increase or decrease our interest income.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

We maintain disclosure controls and procedures and internal controls that are designed to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission s rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures and internal controls, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable, and not absolute, assurance of achieving the desired control objectives. In reaching a

Table of Contents

reasonable level of assurance, management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures and internal controls.

As required by the Securities and Exchange Commission Rule 13a-15(e) and Rule 15d-15(e), we carried out an evaluation, under the supervision of and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting during the first quarter of fiscal 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In the normal course of business, we have been, and will likely continue to be, subject to litigation or administrative proceedings incidental to our business, such as claims related to customer disputes, employment practices, wage and hour disputes, product liability, professional liability, commercial disputes, licensure restrictions or denials, and warranty or patent infringement. Responding to litigation or administrative proceedings, regardless of whether they have merit, can be expensive and disruptive to normal business operations. As litigation and the administrative proceedings are inherently uncertain, we cannot predict the outcome of such matters. While the ultimate outcome of litigation is always uncertain, we do not believe that it will have a material adverse effect on our business or financial results.

ITEM 1A. RISK FACTORS

We may incur additional losses due to the downturn in the U.S. economy.

Our revenues have been impacted, and may be significantly further impacted, by the downturn in the U.S. economy which may drive greater pricing pressures from our competition, further decrease the number of cameras that we are able to sell, or lead to disruptions in our supply chain, any or all of which could result in operating losses or negative cash flows. Further, we cannot assure that an improvement in economic conditions would result in an immediate improvement in our operating results or cash flows.

Recently enacted federal health care reform and follow-on regulations could adversely impact our business

Laws were passed in early 2010 by the federal government that could fundamentally change how insurance companies and governmental programs reimburse our physician and healthcare entity customers for the provision of medical services, including the diagnostic imaging tests they perform using the products and services we sell or lease to them, which could negatively impact the demand for our services and/or require us to implement significant changes in how, where and whether we deliver our products and services. The expansion of the use of radiology benefit managers (RBMs) to pre-authorize and prevent diagnostic imaging, the requirement that physicians who provide advanced imaging in their offices provide patients with notices of alternative providers and the change in the mix of payers are among the factors that could negatively impact our volume of business or challenge our existing business models. Also, the creation of over 100 additional healthcare bureaucracies could make it more difficult for our customers to make quick purchase decisions. There remains great uncertainty in the healthcare industry as a whole while we all wait for regulations to be enacted and regulatory bodies to be formed.

Our revenues may decline further due to reductions in Medicare reimbursement rates and/or increased third party payor certification requirements.

The success of our business is largely dependent on our customers ability to build a financially viable imaging business either through the purchase of our imaging systems and/or utilizing leased DIS personnel and equipment and radiopharmaceuticals. Our customers have been faced with the downward trend in Medicare reimbursement rates, as well as the continuing efforts by some insurance companies to reduce health care expenditures by hiring RBM who are compensated by insurance companies based on denying physicians authorization to perform imaging

services in their office, most often by requiring physicians to obtain accreditations, additional certifications and refusing entry into geographic imaging panels, and their continued efforts to restrict the use of mobile or leased cameras. The RBMs are unregulated entities who often own or use imaging centers that compete with independent physicians to authorize/deny panel admission for independent physicians and refuse to provide written approvals/denials and the reasons for them. The federal government set aside monies in the 2009 recession recovery acts to hire these RBMs to provide image management services to Medicare/Medicaid.

Table of Contents

Medicare/Medicaid reimbursement for imaging significantly declined in 2009 (ultrasound) and in 2010 (nuclear) and there remains uncertainty with respect to additional cuts that may be imposed by the implementation of the Sustainable Growth Factor (SGR) to nuclear imaging. While nuclear imaging was cut 36% in 2010, the application of the SGR would result in a further cut of 21.2% in reimbursements. These cuts have and would significantly impact the viability of in-office imaging performed by independent physicians. The reimbursement rates for hospitals and hospital related entities remains higher. It is likely that private insurers would similarly adjust reimbursements downward. The implementation of the SGR has been pushed back by Congressional action to take effect in June 1, 2010. It is unknown if this will be delayed again or if a permanent fix will be enacted. These cuts and pending cuts have resulted in cancellations of business, the delay of purchase and lease decisions by our existing and prospective customers. We have adjusted the fair market value of our lease services in light of this industry trend and there is potential further degradation in our pricing and customer volume.

We are subject to changing health care regulatory rules which could adversely affect us.

Various potential changes to health care regulatory rules could require us to change our operations significantly and could harm us financially. Nuclear medicine is a designated health service under the federal physician self-referral prohibition law known as the Stark Law, which states that a physician may not refer designated health services to an entity with which the physician or an immediate family member has a financial relationship, unless an exception applies. DIS physician customers may be able to meet the in-office ancillary services (IOAS) exception to the Stark Law, appropriately supervise the individuals performing the nuclear imaging services and bill for them, and if the services are performed in the same building in which the physicians regularly practice medicine. From time to time, the Centers for Medicare & Medicaid Services (CMS) and Congress have proposed to modify the Stark regulations in a manner that may restrict physicians in some business arrangements from utilizing the in-office ancillary services exception to the Stark Law. Recent health care reform legislation now requires physicians who take advantage of the IOAS exception to provide a list of alternative imaging providers to their patients. Increased enforcement efforts could also cause physician customers to opt out of using the IOAS exception to provide imaging in their office, but could also put us at a competitive advantage over our competitors who have not historically structured their lease arrangements taking into account these applicable regulations.

Our business is not widely diversified.

We sell products and lease our imaging systems and personnel primarily in the cardiac nuclear and ultrasound imaging markets. We may not be able to leverage our assets to diversify our products and services in order to generate revenue beyond the cardiac nuclear and ultrasound imaging markets in a timely manner. If we are unable to diversify our product and service offerings, our financial condition may suffer.

We compete against businesses that have different competitive strengths.

The market for cardiac nuclear imaging cameras continues to decrease, thereby making competition a greater challenge. Our competition has negatively impacted our sales prices and volume. Some of our competitors enjoy significant advantages over us, including greater name recognition, greater financial and technical resources, established relationships with healthcare professionals, larger distribution networks, and greater resources for product development as well as marketing and sales. Additionally, certain medical device companies have developed alternative portable cameras that directly compete with our product offerings. If we are unable to expand our current market share, our revenues could decline.

In addition, our DIS customers may switch to other service providers. Our DIS segment competes against small local, owner operated or regional businesses, some of whom have the advantage of a lower cost structure, and against imaging centers that install nuclear gamma cameras and make them available to physicians in their geographic vicinity. If these competitors are able to win significant portions of our business, our sales could decline significantly. Our financial condition could be adversely affected under such circumstances.

Our operations are highly dependent upon the availability of certain radiopharmaceuticals and third-party suppliers, thereby making us vulnerable to supply problems and price fluctuations, which could harm our business.

Our personnel and equipment leasing service involves the use of radiopharmaceuticals. We have experienced disruptions in the supply of these radiopharmaceuticals which have caused us to cancel services that would have otherwise been provided. If we are unable to obtain an adequate supply of the necessary radiopharmaceuticals, we may be unable to lease our personnel and equipment through our DIS operations and our business may be harmed. Shortages can also cause price increases that may not be accounted for in third party reimbursement rates, thereby causing us to lose margin or require us to pass increases on to customers.

Table of Contents

During 2009, there was a significant reduction in the availability of radioactive medical isotopes worldwide. For example, a nuclear reactor in Chalk River, Ontario, which supplies 50% of certain medical isotopes to the United States market, is currently off-line for repairs and will not return to service before late 2009 or early 2010. In 2010, the High Flux Reactor in Petten, the Netherlands is scheduled to go offline for six months for repairs. The volcano eruption in Iceland has negatively impacted the availability of generators for the United States market and similar European air traffic events can have similar impacts. The lack of production of radiopharmaceuticals in Canada and the lack of United States facilities has exacerbated an already short supply of medical isotopes worldwide and caused price increases. Continued shortages could affect our DIS business by reducing the number of days of service or moving physicians toward alternate imaging modalities. Our financial condition could be adversely affected under such circumstances.

In addition, we rely on a limited number of third parties to manufacture and supply certain key components of our products. Alternative sources of production and supply may not be readily available. For example, key components of the detector heads and the processing and control software utilized in our gamma cameras are manufactured or supplied by a single source. We have also outsourced production of significant portions of our end product to a single contract manufacturer. If a disruption in the availability of parts or in the operations of these suppliers were to occur, our ability to build gamma cameras could be materially affected. For this reason, we have backup plans in place that are designed to prevent delays in production. If these plans are unsuccessful, delays in the production of our gamma cameras for an extended period of time could cause a loss of revenue, which could significantly harm our business and results of operations.

Failure to retain qualified technologists could limit our growth and adversely affect our business.

Our future growth and ability to generate profits depends, in part, upon our ability to identify, hire, and retain nuclear medicine technologists, certified cardiographic technicians, and certified ultrasound technologists, particularly those with multiple certifications in the ultrasound modality as these are individuals in high demand. The inability to retain such employees would diminish the knowledge and experience that we, as an organization, possess and might delay or prevent the achievement of our objectives. Hiring qualified technical personnel may be difficult due to the limited number of qualified candidates and the intense competition for these types of employees. Furthermore, we have historically suffered high employee turnover in regards to imaging technologists. If we are unable to reduce employee turnover, our business and financial condition may be adversely affected.

Our quarterly and annual financial results are difficult to predict and are likely to fluctuate from period to period.

We have historically experienced seasonality in the leasing services offered by our DIS operations. While our physicians are obligated to pay us for all lease days to which they have committed, our contracts permit some flexibility in scheduling when services are to be performed. We cannot predict with certainty the degree to which seasonal circumstances such as the summer slowdown, winter holiday vacations and weather conditions may affect the results of our operations. We have also experienced fluctuations in demand of our cardiac nuclear gamma cameras due to economic conditions, capital budget availability or other financial or business reasons. In addition, due to the way that customers in our target markets acquire our products, a large percentage of our camera orders are booked during the last month of each quarterly accounting period. As such, a delivery delay of only a few days may significantly impact our quarter-to-quarter comparisons. Moreover, the sales cycle in our Product segment for our cameras is typically lengthy, which may cause us to experience significant revenue fluctuations. For these reasons, quarterly and annual sales and operating results may vary in the future. Therefore, period-to-period comparisons of our results of operations are not necessarily meaningful and should not be relied upon as indicators of future performance. Because of these and other factors, our operating results in one or more future reporting periods may fail to meet the expectations of securities analysts or investors, which could cause our stock price to decline significantly.

Our common stock is thinly traded and our options plan could affect the trading price of our common stock.

Our common stock is thinly traded and any significant sales of our common stock may cause volatility in our common stock price. We also have registered shares of common stock that we may issue under our employee benefit plans or from our treasury stock. Accordingly, these shares can be freely sold in the public market upon issuance, subject to restrictions under the securities laws. If any of these stockholders cause a large number of securities to be sold in the public market, the sales could reduce the trading price of our common stock. Stockholders holding a significant amount of our common stock will be able to significantly influence matters requiring approval by our stockholders, possibly including the election of directors and the approval of mergers or other business combination transactions.

Table of Contents

We spend considerable time and money complying with federal and state laws, regulations and other rules, and if we are unable to comply with such laws, regulations and other rules, we could face substantial penalties.

We are directly, or indirectly through our clients, subject to extensive regulation by both the federal government and the states in which we conduct our business, including: the federal Medicare and Medicaid anti-kickback laws and other Medicare laws, regulations, rules, manual provisions, and policies that prescribe the requirements for coverage and payment for services performed by us and our DIS customers; the federal False Claims statutes; the federal Health Insurance Portability and Accountability Act of 1996, or HIPAA, as amended in 2009 under the HITECH Act that places direct legal obligations and higher liability on us with respect to the security and handling of personal health information; the Stark Law; the federal Food, Drug and Cosmetic Act; federal and state radioactive materials laws; state food and drug and pharmacy laws and regulations; state laws that prohibit the practice of medicine by non-physicians and fee-splitting arrangements between physicians and non-physicians; state scope-of-practice laws; and federal rules prohibiting the mark-up of diagnostic tests to Medicare under certain circumstances. If our DIS customers are unable or unwilling to comply with these statutes, regulations, rules and policies, utilization rates of our services and products could decline and our business could be harmed.

We maintain a compliance program to identify and correct any compliance issues and remain in compliance with all applicable laws, to train employees, to audit and monitor our operations, and to achieve other compliance goals. Like most companies with compliance programs, we occasionally discover compliance concerns. In such cases, we take responsive action including corrective measures when necessary. There can be no assurance that our responsive actions will insulate us from liability associated with any detected compliance concerns.

If our past or present operations are found to be in violation of any of the laws, regulations, rules or policies described above or the other laws or regulations to which we or our customers are subject, we may be subject to civil and criminal penalties, damages, fines, exclusion from federal or state health care programs, or the curtailment or restructuring of our operations. Similarly, if our customers are found to be non-compliant with applicable laws, they may be subject to sanctions which could have a negative impact on us. If we are excluded from federal or state health care programs, our customers who participate in those programs could not do business with us. Any penalties, damages, fines, curtailment or restructuring of our operations could adversely affect our ability to operate our business and our financial results. Any action against us for violation of these laws, even if we successfully defend against it, could cause us to incur significant legal expenses, divert our management s attention from the operation of our business, and damage our reputation.

Our manufacturing operations and executive offices are located at a single facility that may be at risk from fire, earthquakes or other disasters.

Our manufacturing operations and executive offices are located in a single facility in Poway, California, near known fire areas and earthquake fault zones. Any future natural disaster could cause substantial delays in our operations, damage to our manufacturing equipment and inventory, and cause us to incur additional expenses. Although we have taken precautions to insure our facilities and continuing operations, this may not be adequate to cover our losses in any particular case. A disaster could significantly harm our business and results of operations.

The medical device industry is litigious, which could result in the diversion of our management s time and efforts, and require us to pay damages which may not be covered by our insurance.

Our operations entail risks of claims or litigation relating to product liability, radioactive contamination, patent infringement, trade secret disclosure, warranty claims, product recalls, property damage, misdiagnosis, personal injury and death. Any litigation or claims against us, or claims we bring against others, may cause us to incur substantial costs, could place a significant strain on our financial resources, divert the attention of our management from our core business and harm our reputation. We may incur significant liability in the event of any such litigation, regardless of the merit of the action. If we are unable to obtain insurance, or if our insurance is inadequate to cover claims, our cash reserves and other assets could be negatively impacted. Additionally, costs associated with maintaining our insurance could become prohibitively expensive, and our ability to become profitable could be diminished.

Our ability to protect our intellectual property and proprietary technology through patents and other means is uncertain.

Our success depends significantly on our ability to protect our proprietary rights to the technologies used in our products. Our pending U.S. and foreign patent applications, which include claims to material aspects of our products and procedures that are not currently protected by issued patents, may not issue as patents in a form that will be advantageous to us. Any patents we have obtained or do obtain may be challenged by re-examination or otherwise invalidated or eventually found unenforceable. Both the patent application process and the process of managing patent disputes can be time consuming and expensive. Competitors may attempt to challenge or invalidate our patents, or may be able to design alternative techniques or devices that avoid infringement of our patents, or develop products with functionalities that are comparable to ours. In the event a competitor infringes upon our patent or other intellectual property rights, litigation to enforce our intellectual property rights or to

defend our patents against challenge, even if successful, could be expensive and time

Table of Contents

consuming and could require significant time and attention from our management. We may not have sufficient resources to enforce our intellectual property rights or to defend our patents against challenges from others.

Anti-takeover provisions in our organizational documents, our Stockholders Rights Plan and Delaware law may prevent or delay removal of current management or a change in control.

Our restated certificate of incorporation and restated bylaws contain provisions that may delay or prevent a change in control, discourage bids at a premium over the market price of our common stock, and adversely affect the market price of our common stock and the voting and other rights of the holders of our common stock. The rights issued pursuant to our Stockholder Rights Plan will become exercisable, subject to certain exceptions, the tenth day after a person or group announces acquisition of 15% or more of our common stock or announces commencement of a tender or exchange offer, the consummation of which would result in ownership by the person or group of 15% or more of our common stock. In addition, as a Delaware corporation, we are subject to Delaware law, including Section 203 of the Delaware General Corporation Law. In general, Section 203 prohibits a Delaware corporation from engaging in any business combination with any interested stockholder for a period of three years following the date that the stockholder became an interested stockholder unless certain specific requirements are met as set forth in Section 203. These provisions, alone or together, could have the effect of deterring or delaying changes in incumbent management, proxy contests or changes in control.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On February 4, 2009, our Board of Directors approved a stock repurchase program whereby we may, from time to time, purchase up to $2.0 million worth of our common stock in the open market, in privately negotiated transactions or otherwise, at prices that we deem appropriate. The plan has no expiration date. Details of purchases made during 2009 and the three months ended March 31, 2010 are as follows:

	Total Number of Shares Purchased During the Period	Average Price Paid Per Share for Period Presented	Total Cumulative Number of Shares Purchased as Part of Publicly Announced Plan	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plan
Period:				
February 4, 2009 February 28, 2009	8,700	$ 0.98	8,700	$1,991,474
March 1, 2009 March 31, 2009	2,600	0.99	11,300	1,988,900
May 1, 2009 May 31, 2009	183,500	1.26	194,800	1,758,352
June 1, 2009 June 30, 2009	14,300	1.25	209,100	1,740,438
July 1, 2009 July 310, 2009	33,200	2.14	242,300	1,669,307
August 1, 2009 August 31, 2009	192,918	2.02	435,218	1,279,640
September 1, 2009 September 30, 2009	14,000	2.11	449,218	1,250,085
November 1, 2009 November 30, 2009	93,200	2.28	542,418	1,037,627
December 1, 2009 December 31, 2009	5,000	2.38	547,418	1,025,739
February 1, 2010 February 28, 2010	25,800	1.91	573,218	976,571
As of March 31, 2010:	573,218	$ 1.79	573,218	$ 976,571

In addition to the above purchases, John Sayward, a member of our board of directors and an affiliated purchaser as defined in Rule 10b-18(a)(3), purchased 20,000 shares of common stock in the open market at an average price of $1.02 per share in February 2009.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. (REMOVED AND RESERVED)
None.

ITEM 5. OTHER INFORMATION
None.

Table of Contents

ITEM 6. EXHIBITS

Exhibit Number	Description
3.1(1)	Restated Certificate of Incorporation
3.2(2)	Restated Bylaws
4.1(3)	Form of Specimen Stock Certificate
4.2(4)	Amended and Restated Investors Rights Agreement by and among Digirad Corporation and the investors listed on the schedule attached thereto, dated April 23, 2002, as amended
31.1	Certification of Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) promulgated pursuant to the Securities Exchange Act of 1934, as amended
31.2	Certification of Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) promulgated pursuant to the Securities Exchange Act of 1934, as amended
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(1) This exhibit was previously filed as an exhibit to the Company s quarterly report on Form 10-Q originally filed with the Securities and Exchange Commission on August 11, 2004, as amended thereafter, and is incorporated herein by reference.

(2) The exhibit was previously filed as an exhibit to the Company s quarterly report on Form 8-K filed with the Securities and Exchange Commission on May 9, 2007, and is incorporated herein by reference.

(3) This exhibit was previously filed as an exhibit to the Registration Statement on Form S-1 (File No. 333-113760) originally filed with the Securities and Exchange Commission on March 19, 2004, as amended thereafter, and is incorporated herein by reference.

(4) This exhibit was previously filed as an exhibit to the Company s quarterly report on Form 10-Q filed with the Securities and Exchange Commission on November 2, 2004, and is incorporated herein by reference.

Table of Contents

SIGNATURES

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

DIGIRAD CORPORATION

Date: April 29, 2010

By: /s/ TODD P. CLYDE
Todd P. Clyde

President and Chief Executive Officer

(Principal Executive Officer)

Date: April 29, 2010

By: /s/ RICHARD B. SLANSKY
Richard B. Slansky

Chief Financial Officer

(Principal Financial and Accounting Officer)

Table of Contents

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