NightHawk Radiology Holdings Inc
Form 10-K
February 19, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2007

OR

¨ **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 000-51786

NightHawk Radiology Holdings, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**87-0722777**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**
250 Northwest Boulevard, #202, Coeur d Alene, Idaho	**83814**
(Address of principal executive offices)	**(Zip code)**

(208) 676-8321

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	**Name of Each Exchange on Which Registered**
Common Stock, par value $0.001 per share	**NASDAQ GLOBAL SELECT MARKET**

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark whether the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b2 of the Exchange Act (Check one).

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

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

As of June 30, 2007 (the last business day of the registrant s most recently completed second fiscal quarter), the aggregate market value of the voting stock held by non-affiliates of the Registrant was $216 million. Shares of voting stock beneficially held by each officer and director and by each person who owns 5% or more of the outstanding voting stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of February 1, 2008, 30,312,322 shares of the registrant s Common Stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Listed hereunder are the documents, any portions of which are incorporated by reference and the Parts of this Form 10-K into which such portions are incorporated:

1. The Registrant s definitive proxy statement for use in connection with the Annual Meeting of Stockholders to be held on or about April 22, 2008 to be filed within 120 days after the Registrant s fiscal year ended December 31, 2007, portions of which are incorporated by reference into Part III of this Form 10-K.

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Cautionary Statement for Purposes of Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995

THIS ANNUAL REPORT CONTAINS FORWARD-LOOKING STATEMENTS THAT INVOLVE RISKS AND UNCERTAINTIES. THE STATEMENTS CONTAINED IN THIS ANNUAL REPORT THAT ARE NOT PURELY HISTORICAL ARE FORWARD-LOOKING STATEMENTS WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1933, AS AMENDED, AND SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED. THESE FORWARD-LOOKING STATEMENTS INCLUDE, WITHOUT LIMITATION, STATEMENTS RELATING TO FUTURE ECONOMIC CONDITIONS IN GENERAL AND STATEMENTS ABOUT OUR FUTURE:

STRATEGY AND BUSINESS PROSPECTS;

DEVELOPMENT AND EXPANSION OF SERVICES, AND THE SIZE, GROWTH, AND LEADERSHIP OF THE POTENTIAL MARKETS FOR THESE SERVICES;

DEVELOPMENT OF NEW CUSTOMER RELATIONSHIPS AND PRODUCTS;

SALES, EARNINGS, INCOME, EXPENSES, OPERATING RESULTS, TAX RATES, OPERATING AND GROSS PROFIT AND PROFIT MARGINS, VALUATIONS, RECEIVABLES, RESERVES, LIQUIDITY, INVESTMENT INCOME, CURRENCY RATES, EMPLOYEE STOCK OPTION EXERCISES, CAPITAL RESOURCE NEEDS, CUSTOMERS, AND COMPETITION;

ABILITY TO OBTAIN AND PROTECT OUR INTELLECTUAL PROPERTY AND PROPRIETARY RIGHTS; AND

ACQUISITIONS AND TRANSACTION COSTS AND ADJUSTMENTS.

ALL OF THESE FORWARD-LOOKING STATEMENTS ARE BASED ON INFORMATION AVAILABLE TO US ON THE DATE OF THIS ANNUAL REPORT. OUR ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THOSE DISCUSSED IN THIS ANNUAL REPORT. THE FORWARD-LOOKING STATEMENTS CONTAINED IN THIS ANNUAL REPORT, AND OTHER WRITTEN AND ORAL FORWARD-LOOKING STATEMENTS MADE BY US FROM TIME TO TIME, ARE SUBJECT TO CERTAIN RISKS AND UNCERTAINTIES THAT COULD CAUSE ACTUAL RESULTS TO DIFFER MATERIALLY FROM THOSE ANTICIPATED IN THE FORWARD-LOOKING STATEMENTS. FACTORS THAT MIGHT CAUSE SUCH A DIFFERENCE INCLUDE, BUT ARE NOT LIMITED TO, THOSE DISCUSSED IN ITEM 1A OF THIS REPORT ENTITLED RISK FACTORS.

ITEM 1. Business

Overview

NightHawk Radiology Holdings, Inc. (NightHawk), headquartered in Coeur d Alene, Idaho, is leading the transformation of the practice of radiology by providing high-quality, cost-effective solutions to radiology groups and hospitals throughout the United States. NightHawk provides the most complete suite of solutions, including professional services, business services, and its advanced, proprietary clinical workflow technology, all designed to increase efficiencies and improve the quality of patient care and the lives of physicians who provide it. NightHawk s team of U.S. board-certified, state-licensed and hospital-privileged physicians located in the United States and around the world provides services 24 hours a day, seven days a week, for more than 750 customers and the 26% of all U.S. hospitals they serve.

Our team of American Board of Radiology-certified, U.S. state-licensed and hospital-privileged radiologists uses our proprietary workflow technology to provide professional services (interpretations or reads) from locations around the world to our customers in the United States. The reads that we provide consist primarily of off-hours preliminary reads, but increasingly include final and sub-specialty interpretations and cardiac computed tomography (or CT) reads. In addition to these professional services, we also provide our customers with cardiac 3D

reconstructions, clinical workflow technology, and business services, all designed to enhance the care they provide to patients and improve the efficiency of their practices.

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In 2007, we expanded our solution suite and increased our operating leverage and scale through a series of acquisitions and investments.

- In February, we acquired Teleradiology Diagnostic Services, Inc., a leading provider of off-hours teleradiology services on the West Coast, providing services to hospitals throughout California, the largest market in the United States,
- In April, we acquired The Radlinx Group, Ltd., the third largest provider of teleradiology services in the country with affiliated radiologists located throughout the United States,
- In July, we acquired Midwest Physician Services, LLC, which provides a complete suite of business process services including revenue cycle management, administrative, information technology and other services critical to the operation of a radiology group,
- We opened new reading facilities in San Francisco, California and Austin, Texas,
- We dramatically increased the number of affiliated radiologists we have reading in the United States to more than one-half of our total affiliated radiologists, and
- We expanded our product lines from one core service offering in 2006 the preliminary reads to five by the end of 2007, including final and sub-specialty reads, 3D reconstructions and coronary CT angiographies (CCTA) services, clinical workflow technology, and business services.

We believe we have the most efficient and productive radiologists in the world. We are committed to enhancing the productivity of our affiliated radiologists by continuing to invest in developing our technology solutions and our internal information systems to support growing customer needs and our own growing business.

The U.S. healthcare market is experiencing a substantial increase in the development and use of diagnostic imaging technologies and procedures. This increase is driven by an aging population, advances in diagnostic imaging technologies, the growing availability and accessibility of imaging equipment in hospitals and clinics and more frequent physician referrals for diagnostic imaging procedures. According to Frost & Sullivan, digital diagnostic image procedure volume is expected to continue to grow 15% annually to over 500 million procedures per year by 2009. Additionally, advances in digital technology now allow for the transmission of radiological images in a high quality, standardized, cost-effective and encrypted format, which permits radiologists to provide their professional services from locations other than where the imaging services are performed.

While the volume of diagnostic imaging procedures is expected to grow 15% annually, the number of practicing radiologists is expected to increase by less than 2% annually, according to the American Journal of Roentgenology. Compounding this slow growth is the existing shortage of radiologists. The existing shortage and continued slow growth in radiologists are due, in part, to the retirement of existing radiologists and the limited number of positions in accredited radiology residency programs. The challenges associated with this shortage and the growing volume of imaging procedures are further compounded by the fact that radiology groups are required to provide their hospital customers with services 24 hours per day, seven days a week, in order to accommodate the growing number of off-hour procedures. Consequently, radiology practice groups and hospitals are increasingly seeking the assistance of outside providers to assist their own radiology staffs with both day and night coverage.

We help our customers manage these challenges by providing an attractive way to increase their productivity and efficiency and improve their quality of life, without sacrificing the quality of patient care. We assist our customers by providing them with business services designed to streamline the administration of their practices and with access to highly-qualified sub-specialty-trained radiologists to perform reads, day or night. Our professional services include both preliminary reads, which are performed for emergent care purposes, and final and sub-specialty reads, which are performed for both emergent and non-emergent care purposes. Our ability to provide coverage 24 hours per day supports our customers when their workloads during the day require

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further assistance and relieves the burden of performing reads overnight, and during holidays, weekends and other difficult-to-staff times. We believe this allows our customers to provide seamless patient care and to better attract and retain radiologists in their practices.

Nighthawk Radiology Services, LLC, which is a wholly-owned subsidiary of NightHawk, was formed in Coeur d Alene, Idaho in 2001 as an Idaho limited liability company and is currently the entity through which we conduct our principal operations. In March 2004, NightHawk Radiology Holdings, Inc. was formed to facilitate a recapitalization of Nighthawk Radiology Services, LLC.

Industry Background

Diagnostic Imaging

The practice of diagnostic radiology involves the interpretation of images of the human body to aid in the diagnosis and treatment of diseases, conditions and injuries. Diagnostic imaging procedures include computed tomography, or CT, magnetic resonance imaging, or MRI, ultrasound, nuclear medicine and X-ray technologies. Diagnostic radiologists correlate imaging findings with clinical information and other medical examinations, make diagnoses and may recommend further examinations or treatments.

Due to significant advances in imaging quality and technology, diagnostic imaging procedures are becoming increasingly essential components of the practice of medicine in most medical centers and hospitals. The non-invasive nature of most diagnostic imaging procedures, combined with faster digital processing capabilities and rapid broadband connectivity that allows for the transmission of images to radiology experts, has made the performance of these procedures in the emergency room and in other treatment venues more appealing and practical. As a result, physicians are relying more heavily on imaging procedures and radiological interpretations provided by radiologists as a standard of care to aid in patient care management decisions, resulting in continuing growth in the volume of radiological procedures performed.

The diagnostic imaging services industry is expected to continue to grow as a result of:

Positive market dynamics. Increasing physician awareness and utilization of imaging as a standard of care to aid in patient diagnosis, including its use as a preventive screening method, as well as an increased availability of diagnostic imaging equipment in medical centers and hospitals, has fueled the growth of the diagnostic imaging industry. Also, the use of diagnostic imaging procedures has risen with the increased provision of healthcare services generally due to an aging population in the United States. In addition, hospital emergency rooms are increasingly the first point of entry into the healthcare system for patients, resulting in a greater number of radiological procedures being ordered by emergency room physicians. Finally, diagnostic imaging procedures are being ordered more frequently than in the past as physicians seek to better manage medical liability risks by gathering as much data as possible to support their diagnoses and treatment protocols.

Advances in diagnostic imaging technologies. Advances in diagnostic imaging technologies and techniques have resulted in higher quality images, which facilitate the diagnosis of a wide variety of diseases, conditions and injuries quickly and accurately without exploratory surgery or other invasive procedures that are typically more expensive and result in higher risk and rehabilitation time to the patient. New imaging technologies and techniques have also permitted radiologists to make additional diagnoses not previously possible and have resulted in broader applications for diagnostic imaging technologies.

Advances in diagnostic-quality image transmission technologies. The advent of the Digital Imaging and Communications in Medicine, or DICOM, standard for transferring images and associated information, high-speed broadband Internet connections, digitization and picture archival and communication systems, or PACS, has contributed to increased utilization of diagnostic imaging technologies by permitting radiologists to practice remotely. As a result of these improvements in image transmission technologies, the time needed for an offsite radiologist to complete a read has generally decreased. Particularly in an emergency room setting, more rapid

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diagnosis of acute medical problems aids in the prompt identification of patients that need urgent surgery or hospital admission, decreases mortality and morbidity, and reduces healthcare costs by averting unnecessary hospital admissions and surgery.

Existing shortage of radiologists and continued slow growth in radiologists. In the practice of radiology today, there is an existing shortage of radiologists. This shortage is exacerbated by very slow growth in the number of practicing radiologists in the coming years. Industry experts estimate that the number of practicing radiologists will increase by less than 2% annually. The supply of radiologists to provide professional interpretations of images is very low, while the demand for imaging services is increasing significantly. This dynamic provides favorable market conditions for the teleradiology industry.

Our Solution Suite

We believe we are the leading provider of radiology solutions to radiology groups and hospitals across the United States. We believe we offer our customers a broad suite of solutions to meet a wide range of needs, including professional services, clinical workflow technology, and business services. Ninety percent of the professional services we currently provide are preliminary reads from images generated from hospital emergency departments. These reads are used by the treating physician to determine whether any immediate action is required in response to symptoms being presented by a patient. Typically, the preliminary diagnosis is followed the next morning by a more exhaustive final read performed by a local radiologist of our customer. Because third-party payors and patients pay only for the final reads performed by our radiology group customers and not the preliminary reads that we provide, our services related to these preliminary reads do not result in any incremental costs to third-party payors or patients nor are we currently dependent on payments by them for these reads. All of our customers are located in the United States and, as a result, all of our service revenue to date has been generated from customers in the United States.

In response to the needs of our radiology group customers in 2006, we began providing them with the ability to receive final and sub-specialty interpretations in addition to the preliminary reads we have historically provided. The growth in imaging, combined with the existing shortage of radiologists, continues to put increasing demands on radiologists, requiring radiology groups to work longer hours and/or try to recruit additional radiologists. Providing adequate staffing to hospitals, 24 hours per day, seven days a week, is an increasing challenge for radiology groups. Hiring additional radiologists to address all the variables that exist with staffing, together with the management challenges associated with the increasing complexity of imaging modalities, is making our solution suite a valuable and affordable alternative for radiology groups. By offering final and sub-specialty read capabilities we can reduce this burden as well as provide our customers with access to our highly-qualified sub-specialty-trained radiologists which helps improve the quality of care for our customers patients.

Also in 2006, we introduced TALON®, our advanced, proprietary workflow technology. TALON is an internally developed technology platform used by our affiliated radiologists that, along with ongoing IT, quality control and support services we provide, streamlines management of many of the administrative burdens associated with the practice of radiology which, in turn, permits radiologists to focus on growing their practice. By implementing this solution, we believe that our customers can realize some of the same benefits of improved efficiency and productivity that we have established in our operations.

In 2007, we began offering cardiac 3D reconstruction and CCTA professional services for our customers. CCTA services will primarily be used to rule out coronary artery disease in those presenting to an emergency room with chest pain. These services are also used for the triple rule out to rule out coronary artery disease, aortic dissection, and pulmonary embolism in a single exam. CCTA is the single exam that could replace all of those exams generally used when patients present with a low risk for coronary disease, e.g. physical exam, chest x-ray, EKG, blood tests, and finally a stress test and/or an invasive diagnostic cardiac catch by a cardiologist, which generally requires a 12-24 hour evaluation. CCTA can thus dramatically reduce the length of stay. CCTA

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services are used by radiology groups, acute-care hospitals, cardiac hospitals, and smaller hospitals that do not have the technicians or advanced workstations to provide these services. We expect demand for these services to significantly increase once the Centers for Medicare and Medicaid Services finalizes the CPT codes and reimbursement rates that will be used for CCTA reimbursement.

Also in 2007, we began offering business services to our customers. This was made possible through our acquisition of Midwest Physician Services in July of 2007. Our business services include revenue cycle management, facilities and human resources management, transcription, and other services required to effectively operate a radiology practice. These business services are extremely valuable to radiology groups seeking to reduce the administrative burdens of their practices, allowing them to focus on growing their operations and improving their efficiencies, all while enhancing the quality of patient care. We believe the combination of these business services with our professional services and clinical workflow technology provides a powerful competitive advantage by creating a one-stop shop with end-to-end solutions for small to large radiology groups.

As part of the acquisition of Midwest Physician Services, St. Paul Radiology P.A. signed a long-term agreement for business services which will also include the use of our TALON clinical workflow technology. St. Paul Radiology is one of the country s largest diagnostic imaging and interventional radiology providers, servicing more than 40 hospitals and imaging centers.

Our relationship with St. Paul Radiology and the acquisition of Midwest Physician Services is the first of its kind, again demonstrating the leadership role that NightHawk plays in transforming the practice of radiology. It allows us to expand our service offerings and is consistent with our mission to offer radiology group customers a complete range of solutions to fulfill all of their needs.

Key benefits of our solution suite to our radiology group customers and the hospitals and patients they serve include:

Improved efficiency and quality of life for our customers. By using our professional services, business services, and clinical workflow solutions, we believe that our radiology group customers can improve their efficiency. Additionally, by reducing a radiologist s off-hours coverage commitments, we believe that our customers can more effectively recruit and retain highly-qualified radiologists in a competitive job market where such commitments often result in lower job satisfaction. The existing shortage of radiologists makes recruiting exceptionally difficult for radiology groups; the use of NightHawk services improves a group s ability to recruit and retain the radiologists they seek to hire.

Enhanced patient care. Customers use our full suite of services to enhance patient care. By providing our customers with access 24 hours per day, seven days a week to highly-qualified sub-specialty-trained radiologists to perform reads, we believe that our solutions provide our customers an attractive and economical way to improve service levels, increase the effectiveness of their work environment and enhance the quality of patient care. Our services can improve the quality of patient care in underserved or rural communities due to improvements in image routing technology and to the increased availability of broadband connectivity. These communities are often the most challenged in recruiting radiologists to practice in their locales. In addition to using our professional services to meet their commitments to their hospital customers, our radiology group customers also rely on NightHawk for our business services and our clinical workflow technology which enable them to reduce the administrative burden of their practices and improve their efficiency so the radiologists can focus on delivering quality patient care.

Highly-qualified radiologists. Our affiliated radiologists are American Board of Radiology-certified in the United States and have received their medical training at some of the most respected medical schools in the United States. These radiologists include former chief residents and fellows from Cornell University, Harvard University, New York University, Northwestern University, the University of Pennsylvania, Stanford University and Vanderbilt University. In recognition of the expertise that our

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affiliated radiologists have developed in emergency radiology, Harvard s Brigham & Women s Hospital has established a program that places their emergency radiology fellows in our Sydney facility in order to train with our affiliated radiologists.

Efficient delivery of services. We have developed proprietary workflow technology that is designed to distribute radiological images and data to the appropriately licensed and privileged radiologist best able to provide the radiological interpretation, including a determination of applicable sub-specialty training, in the least amount of turnaround time. As a result of this technology, together with the support provided by our administrative professionals, our affiliated radiologists can better focus on the interpretation of radiological images without the burden of dedicating valuable time to administrative matters, resulting in more efficient delivery of our services to our customers and their patients.

Quality-control professionals. Our quality-control professionals relieve much of the administrative and technical burden typically associated with a radiology practice by coordinating the communication and transmission of images with the originating hospitals, remediating any technology failures, and finalizing and delivering the results of our affiliated radiologists reads. By reducing administrative burdens on our affiliated radiologists, our quality-control professionals enable our affiliated radiologists to better focus on the interpretation of radiological images, which we believe enhances the quality and efficiency of our solution.

Quality-assurance professionals. Our quality-assurance professionals serve as liaisons to our customers and evaluate and respond to any feedback that we may receive. We believe that these professionals enable us to quickly and effectively improve our services in order to respond to the changing needs of our customers.

Technology infrastructure and technical-support professionals. Our approach enables us to centrally deploy the computers and servers that comprise our technical infrastructure and to maintain a staff of on-site, technical-support personnel. As a result, we are able to monitor our computer systems and to take appropriate actions to prevent or respond to technical problems quickly and efficiently. We believe that this limits downtime and enhances the reliability of our services.

Business services one-stop shop for end-to-end solutions. By offering a full suite of solutions to meet a wide range of radiology group needs, we make it easy and efficient to contract with us to enhance our customer s ability to provide quality care, improve their ability to meet their hospital customers needs, and increase the efficiency of their practice. A key building block of our end-to-end solution is our business services. Our new NightHawk Business Services represent a significant growth opportunity for us; including cross-selling opportunities to the more than 750 customers we currently serve. We also offer these services beyond our current customer base to other radiology groups across the country. We believe this is a critical differentiating factor for NightHawk, further positioning ours as the industry s premium and most innovative brand. Anyone who has been in the radiology industry, or following it for any length of time, knows there are two critical issues for radiologists: quality of life and income. NightHawk has always helped radiology group customers address quality of life challenges through teleradiology. Our new business services offerings now enable us to help radiologists better manage their practices. By bundling these services together, we can help radiologists with their most significant challenges and develop customers for the long-term.

Key benefits of our business model include:

Premium brand drives market leadership. Our early entry into the emerging field of off-hours teleradiology services has permitted us to become well-established with our customers and to establish a brand that we believe has become synonymous with teleradiology. As a consequence of the relationships that we have developed with our customers, the current shortage of radiologists, and the burdens associated with licensing and privileging radiologists for a multi-state, multi-hospital practice, we believe that we can leverage our current market position to effectively compete with existing and future market entrants providing preliminary off-hour reads or final reads. In 2007, we believe we

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further strengthened this first-mover advantage and demonstrated again our leadership by being the first to offer cardiac CT and 3D reconstruction services. We remain the only provider offering clinical workflow technologies to help our customers achieve the productivity achieved by our affiliated radiologists. And we are the only provider that can now offer business services along with the professional services and clinical workflow technology.

Strong customer retention. Since our formation in 2001, we have secured more than 750 customers and the 26% of hospitals they serve as customers. Our customer contracts typically have one-year terms that automatically renew each successive year unless terminated by the customer or by us. We believe that our outstanding customer retention rate confirms the economic and other benefits that our solution provides to our customers and their patients.

Recruitment and retention of radiologists by us. We have been able in the past, and believe that we will continue to be able in the future, to recruit and retain radiologists as necessary to meet increasing demand for our services and the growth of our business. We believe that our success in recruiting and retaining radiologists in a competitive labor market is largely a result of our ability to provide our affiliated radiologists with flexible schedules that permit them to avoid nighttime work, together with our competitive compensation packages. In addition, we have strategically located our reading facilities throughout the United States and overseas in an effort to provide opportunities for radiologists to work in attractive, cosmopolitan cities. We also support individual affiliated radiologists working from locations of their choosing around the world.

Licensing and privileging expertise. All of our affiliated radiologists have the necessary licenses and privileges to read the images that are delivered to them, and we have developed a staff of approximately 50 full-time professionals dedicated to obtaining and renewing the necessary licenses and privileges. We are accredited by the Joint Commission on the Accreditation of Healthcare Organizations, or JCAHO, which permits our customers hospitals, to the extent that they are also JCAHO-accredited, to rely on our internal privileging processes for our affiliated radiologists. This enables us to streamline a privileging process that otherwise can vary significantly among hospitals and to reduce the time required to launch services to a new customer. Our affiliated radiologists are licensed to practice medicine in an average of 29 states and have been granted privileges at an average of 426 hospitals.

Our Strategy

Our objective is to expand on our position as the leading provider of radiology solutions to radiology groups across the United States. We believe that we have a strong brand and that we have established a position as a leading innovator in the radiology services industry. We intend to capitalize on our brand and reputation to facilitate greater acceptance and expansion of teleradiology services and other radiology solutions while at the same time improving the overall quality of patient care.

Key elements of our strategy include:

Target new customers with expanded sales and marketing efforts. We intend to increase our customer base through a combination of sales and marketing initiatives, continued focus on customer service and the provision of services and technologies that meet our customers needs. We have 23 direct sales professionals that we employ in order to continue to aggressively target radiology groups of all sizes as well as governmental and military establishments.

Continue to enhance our service offerings. Beginning in 2006, we began expanding our service offerings beyond off-hours preliminary read services. This service expansion includes the provision of final and sub-specialty interpretations, cardiac imaging solutions, clinical workflow technology, and business services. Our expanded service offerings provide an opportunity to cross-sell new solutions to existing customers as well as target new prospective customers with a broader suite of solutions.

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Further, by bundling our services together, we can help radiologists with their most significant challenges quality of life and income and in that way, develop customers for the long-term.

Expand our customers utilization of our current service hours for our off-hours services. Customers who use our preliminary read services have the flexibility to contract with us for off-hours coverage commitments between the hours of 5:00 p.m. and 8:00 a.m., local time, Monday through Friday, and up to 24 hours per day on weekends and holidays. Most of our customers do not currently contract for all of the hours of off-hour coverage that we are able to provide. For example, some may rely on NightHawk to provide services from 11:00 p.m. to 8:00 a.m. Through our sales and marketing efforts, we intend to sell these customers additional hours of preliminary reads coverage during these time periods.

Pursue strategic and fold-in acquisitions. We regularly consider, and intend to continue to pursue, strategic and fold-in acquisitions that are complementary to our business or offer us other benefits, such as growing individual product lines, broadening our suite of service offerings, expanding our technology platform or strengthening our position in existing markets. For example, since our inception we have acquired five teleradiology companies, including DayHawk Radiology Services, LLC, American Teleradiology Nighthawks, Inc., Teleradiology Diagnostic Service, Inc., Radlinx Group, Ltd. and Emergency Radiology Services, LLC. We also acquired a business services company, Midwest Physician Services, LLC.

Develop markets for our data and technology solutions. In 2006, we introduced and closed our first sale of the use of TALON, our customer workflow solution. TALON is an internally developed technology platform used by our affiliated radiologists which, along with ongoing IT, quality control and support services we provide, streamlines many of the administrative burdens associated with the practice of radiology which, in turn, permits radiologists to focus more on the productivity of their practice. In addition, we are exploring the development and commercialization of data solutions that may be of value to our customers.

Operations

Service offerings. We currently offer a comprehensive suite of radiology solutions, including our off-hours preliminary reads, final and sub-specialty reads, cardiac 3D reconstructions and cardiac CT professional services, workflow technology and business services to our customers.

Affiliated radiologists. As of December 31, 2007, we had 113 affiliated radiologists who were providing services for us. We structure our relationships with our affiliated radiologists in a manner that we believe results in an independent contractor relationship, and we have no control over the radiological services or interpretations rendered by the radiologists or their independent judgment concerning the practice of medicine. We typically enter three-year professional services contracts with our affiliated radiologists. The contracts typically provide that we will make available a minimum number of hours that the radiologists can work per year. In each case, the contract is structured so that the radiologist has significant flexibility in determining, and control of, the radiologist s work schedule. We believe that our affiliated radiologists consider this flexibility an attractive and unique aspect of their relationship with us.

Our goal is to recruit the best radiologists in the United States. Our current affiliated radiologists include former chief residents and fellows from Cornell University, Harvard University, New York University, Northwestern University, the University of Pennsylvania, Stanford University and Vanderbilt University. For those who wish to work in one of our centralized reading facilities, we offer them the opportunity to work together and collaborate in a professional atmosphere which enhances their job satisfaction.

Our affiliated radiologists are required to hold a current license in good standing to practice medicine in each of the states from which they receive radiological images. In addition, our affiliated radiologists are required to have been granted privileges at each hospital from which those images originate. Due to these requirements,

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and because our customers serve nearly 1,500 hospitals as of December, 31, 2007, our affiliated radiologists are licensed to practice medicine in an average of 29 states and have been granted privileges at an average of 426 hospitals.

Network and workflow. We deliver our professional services through a workflow process that utilizes public network infrastructures, virtual private networks, on-site servers, and proprietary workflow technologies. Our network has been designed to be secure, scalable, efficient and redundant. The following is a description of our workflow process:

Requisition of interpretations. When a radiological procedure is performed on a patient, the radiology technologist at the hospital will order an interpretation by either faxing a requisition to our toll-free telephone number, sending the requisition electronically utilizing our software, or calling in the requisition to our quality-control professionals. The information faxed or sent electronically contains basic patient and procedural information and relevant clinical data. Upon completion of the procedure, the technologist transfers the images to us via an established virtual private network, or VPN. Upon receipt of the requisition order and images, one of our designated quality-control professionals sends a digital confirmation of the receipt of the images and order to the technologist at the hospital.

Image transmission. We process all incoming images and patient data at one of our centralized facilities located in Sydney, Australia, Zurich, Switzerland, Austin, Texas, or Coeur d Alene, Idaho, depending on the time of day. These facilities are connected to hospitals through VPNs, which encrypt the patient and clinical data for secure delivery. Typically, the radiological images are initially transferred to the Internet via the hospital s Internet service provider. The images and data then traverse the Internet through standard networking infrastructure and are automatically directed to one of our reading facilities.

We have designed our networks, server infrastructure, and workflow technologies to be efficient and redundant. In the event of a network or server failure, the originating hospital delivers the images and data set to an assigned radiologist from our radiology group customer. As a result, our processes are intended to ensure that a radiologist is always available to perform the necessary services for the hospital and the patient.

Order acceptance and assignment. After the images and data sets are received at our reading facilities, they are packaged by our teleradiology assistants using proprietary workflow technology prior to delivery to affiliated radiologists. We employ quality-control professionals who perform many of the administrative functions associated with performing radiological interpretations. These administrative tasks include ensuring the accuracy of patient information, coordinating and communicating with the emergency room and radiology department staff, ensuring the full receipt of the radiological-image data set, using our proprietary workflow solutions to distribute the images to one of our affiliated radiologists, and delivering the results back to the requesting physician.

Interpretation and delivery of report. After the images and data sets have been received by our quality-control professionals, the assigned radiologist interprets the images, dictates his or her findings, reviews the transcription and submits a report back to the designated quality-control professional. The quality-control professional then proofreads the radiologist s report and transmits it back to the requesting physician. After the report has been transmitted, the quality-control professional contacts the originating hospital to confirm that the report has been received. In certain cases, the quality-control professional will verbally communicate the findings to the healthcare professional at the originating hospital.

Quality-assurance processes. We employ quality-assurance professionals whose primary responsibility is to manage our quality assurance program as it relates to the interpretations completed by our affiliated radiologists. They process any feedback from our customers on any discrepancies between the preliminary reads by our affiliated radiologists and the final reads by our customers radiologists.

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Customer service. Our customer service staff works with customers to research any questions or concerns they have regarding our service overall. Such questions might relate to study turn around time, challenges with image transmission, etc. Customer service inquiries and resolution help determine where we should commit resources. Our customer service staff handles all inquiries other than those related to specific report quality which are directed to our quality assurance team.

Business services. Our business services unit, NightHawk Business Services, is located in, and managed from, St. Paul, Minnesota. It includes approximately 100 employees. These services are sold by our existing field sales representatives and delivered from St. Paul.

Licensing and Privileging

For each hospital from which an affiliated radiologist receives radiological images, the affiliated radiologist must hold a current license in good standing to practice medicine in the state in which the hospital is located and must have been granted privileges to practice at that particular hospital. As a result, and because we were providing services to nearly 1,500 hospitals as of December 31, 2007, we have licensed each of our affiliated radiologists in an average of 29 states and have privileged each of our affiliated radiologists at an average of 426 hospitals. By ensuring that our affiliated radiologists are licensed and privileged at many of our hospital sites, we design redundancy into our solution in order to minimize or eliminate the periods of time during which we do not have an affiliated radiologist available to provide services to a particular hospital.

The licensing procedures and requirements vary according to each state s laws and regulations governing the issuance of medical licenses. These procedures typically include an extensive application process that covers significant aspects of the applicant s professional and personal life. In addition, to maintain a license to practice medicine in a given state, the state will often require the physician to undergo continuing education and training and maintain minimum thresholds of medical liability insurance.

To facilitate compliance with the licensing requirements of the various states in which we provide services, we employ licensing specialists to manage the state medical license application processes for our affiliated radiologists. These state-licensing specialists perform a number of functions, including tracking expiration dates, implementing procedures to renew licenses, and tracking continuing medical education, medical liability insurance coverage and other ongoing licensing-related obligations.

As with state licensing procedures, the privileging requirements of each hospital can vary significantly. However, hospitals that are accredited under the Joint Commission on Accreditation of Healthcare Organizations, or JCAHO, are permitted to rely upon the privileging information and procedures from other JCAHO-accredited institutions. We have been a JCAHO-accredited entity since October 2003. As a result, JCAHO hospitals can accept our privileging information and procedures, which reduces the period of time before we can begin providing reads for those hospitals.

Technology Development and Innovation

Site implementation. After we enter into a contract with a new customer, our site-implementation professionals work with the technology personnel of the hospital that will provide images to us to configure a virtual private network, or VPN, connection and DICOM routing information to transfer images. Upon successful testing of the encryption and transfer of images via the VPN connection, we provide the hospital with written operating procedures that prescribe how to order a radiological interpretation through our proprietary online ordering system. Typically, we also conduct a workflow training session by web conference to educate the appropriate hospital personnel about this process.

Systems and network administration. We employ information technology professionals to maintain our systems and network and to provide technical support to our customers. Our customers may contact us for technical support 24 hours, 7 days a week.

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Software development. We focus our research and development efforts on improving and enhancing our existing workflow solutions, as well as on developing new solutions to enable us to more efficiently and effectively deliver our services to our customers. For instance, in 2006, we introduced and closed our first sale of the use of TALON, our customer workflow solution. These proprietary workflow solutions were developed by software engineers located in our Sydney, Australia and Milwaukee, Wisconsin offices.

Customers

We provide services to more than 750 customers and the nearly 1,500 of U.S. hospitals they serve. In 2007, we partnered with a nationally recognized market research firm to launch a customer satisfaction study. The study results revealed what drives radiology groups satisfaction with teleradiology providers and identified key improvement opportunities we are leveraging to further enhance customer loyalty and our ability to meet customer needs. As a result of our partnership with our customers and our intimate understanding of their current needs and where the radiology industry is headed, we have retained a substantial percentage of our contracts that have been up for renewal since our inception. Despite increased competition, we believe that our customer retention rate remains strong and confirms the value provided by our solutions and demonstrates the value of our brand in the industry.

Sales and Marketing

Sales. We sell our services primarily through our direct sales force comprised of 23 telesales and field sales personnel who are organized by geographic regions in the United States. Our sales professionals focus their efforts on radiology groups of all sizes and, in some cases, cardiology groups and hospitals. In addition, we have experienced in the past, and expect to experience in the future, the acquisition of new customers as a result of communications among radiology groups. We do not pay any fees or discounts associated with customers who generate new customer leads for us.

We continue to monitor the effectiveness of our sales personnel and processes and have identified areas of improvement that we intend to focus on in 2008.

Marketing. Our marketing objectives are to generate qualified sales leads, build our brand and raise awareness of NightHawk as the leading provider of radiology solutions to radiology groups across the United States.

Our principal marketing initiatives include:

- direct mail campaigns,
- participation in, and sponsorship of, radiology conferences and trade shows, and
- using our website to provide service and company information.

Competition

The market for radiology services is highly competitive, rapidly evolving and fragmented, and subject to changing technology and market dynamics. Our primary competitors include both large and small scale service providers, some of which have only a local or regional presence. In 2007, NightHawk partnered with a nationally recognized market research firm to launch the industry s first-ever customer satisfaction study. The study results revealed what drives radiology groups satisfaction with teleradiology providers and identified key improvement opportunities we are leveraging to further enhance customer loyalty and our ability to meet customer needs. Study results reveal that four factors drive overall satisfaction with teleradiology providers:

- report accuracy/content,

clinical interactions with the teleradiology staff,

technical support, and

turnaround time required to complete and return interpretations.

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We believe other competitive factors in our market include:

- reputation of service provider,
- quality of the service provided,
- price of services,
- number of states in which radiologists are licensed,
- market acceptance by radiology groups and hospitals,
- quality and reliability of service-provider technology and workflow infrastructure,
- quality of customer support,
- sales and marketing capabilities of the service provider, and
- financial stability of the service provider.

Government Regulation and Supervision

General. The healthcare industry is highly regulated. Our ability to operate profitably will depend in part upon the ability of us, our affiliated radiologists, and our customers and their radiologists to obtain and maintain all necessary licenses and other approvals and operate in compliance with applicable healthcare regulations. We believe that healthcare regulations will continue to change. Therefore, we monitor developments in healthcare law and are likely to be required to modify our operations from time to time as the business and regulatory environment changes. Although we believe that we are operating in compliance with applicable federal and state laws, neither our current nor anticipated business operations has been the subject of judicial or regulatory interpretation. We cannot provide assurance that a review of our business by courts or regulatory authorities will not result in a determination that could adversely affect our operations or that the healthcare regulatory environment will not change in a way that restricts our operations.

Physician licensure laws. The practice of medicine, including the practice of radiology and teleradiology, is subject to state licensure laws, regulations and approvals. Physicians who provide professional medical services to a patient via a telemedicine system must, in most instances, hold a valid license to practice medicine in the state in which the patient is located. We have established a system for ensuring that our affiliated radiologists are appropriately licensed under applicable state law.

Corporate practice of medicine; fee splitting. The laws of many states, including states in which our customers are located, prohibit us from exercising control over the medical judgments or decisions of our affiliated radiologists and from engaging in certain financial arrangements, such as splitting professional fees with physicians. These laws and their interpretations vary from state to state and are enforced by state courts and regulatory authorities, each with broad discretion. We structure our relationships with our affiliated radiologists and our customers in a manner that we believe is in compliance with prohibitions against the corporate practice of medicine and fee splitting, and in a manner that requires that our affiliated radiologists exercise complete control over their own medical judgments and decisions.

Medicare and Medicaid reimbursement programs affecting professional services. Professional radiology interpretation services performed from a location outside of the United States are generally not reimbursable by the Medicare program and certain state Medicaid programs. Accordingly, we do not bill Medicare or Medicaid programs for professional services performed by our affiliated radiologists located outside of the United States. Instead, our revenue is primarily derived from service fees paid to us by our customer radiology groups and hospitals. As a result, our service fees do not fluctuate or change based solely on changes in Medicare or Medicaid reimbursement levels. Professional radiology interpretation services performed from within the United States are reimbursable by Medicare. NightHawk provides final read services for its customers for a fixed fee and our customers invoice their clients directly.

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Federal and state anti-kickback prohibitions. Various federal and state laws govern financial arrangements among healthcare providers. The federal anti-kickback law prohibits the knowing and willful offer, payment, solicitation or receipt of any form of remuneration in return for, or with the purpose to induce, the referral of Medicare, Medicaid, or other federal healthcare program patients, or in return for, or with the purpose to induce, the purchase, lease or order of items or services that are covered by Medicare, Medicaid, or other federal healthcare programs. Similarly, many state laws prohibit the solicitation, payment or receipt of remuneration in return for, or to induce the referral of patients in private as well as government programs. Violation of these anti-kickback laws may result in substantial civil or criminal penalties for individuals or entities and/or exclusion from participating in federal or state healthcare programs. We believe that we are operating in compliance with applicable federal and state anti-kickback laws and that our contractual arrangements with our customers are structured in a manner that is compliant with such laws.

Health Insurance Portability and Accountability Act of 1996. HIPAA authorizes the imposition of civil money penalties against entities that employ or enter into contracts with individuals or entities that have been excluded from participation in the Medicare or Medicaid programs. We perform background checks on our affiliated radiologists, and do not believe that we employ or contract with any excluded individuals or entities. However, a finding that we have violated this provision of HIPAA could have a material adverse effect on our business and financial condition.

HIPAA also established several separate criminal penalties for making false or fraudulent claims to insurance companies and other non-governmental payors of healthcare services. These provisions are intended to punish some of the same conduct in the submission of claims to private payors as the Federal False Claims Act covers in connection with governmental health programs. We believe that our services have not historically been provided in a way that would place either our clients or ourselves at risk of violating the HIPAA anti-fraud statutes. We could be vulnerable to prosecution under these statutes if any of our customers deliberately or recklessly submits claims that contain false, misleading or incomplete information.

In addition, the Administrative Simplification provisions of HIPAA require the promulgation of regulations establishing national standards for, among other things, certain electronic healthcare transactions, the use and disclosure of certain individually identifiable patient health information, and the security of the electronic systems maintaining this information. These are commonly known as the HIPAA transaction and code set standards, privacy standards, and security standards, respectively.

The administrative provisions of HIPAA direct the federal government to adopt national electronic standards for automated transfer of certain healthcare data among healthcare payors, plans and providers. HIPAA is designed to enable the entire healthcare industry to communicate electronic data using a single set of standards. We are a covered entity under HIPAA and, as such, we must operate in compliance with the electronic transaction code standards, privacy standards and security standards. Further, because we only provide treatment services to patients of our contracted radiology groups and hospitals that are either independent or jointly provided with services rendered by those entities, we do not fall within the definition of a business associate. A business associate is an entity that performs services for or on behalf of a covered entity and is required to enter into an agreement with that covered entity to comply with certain components of the HIPAA administrative simplification provisions. We have developed policies, procedures and systems for handling patient health information and data that we believe are in compliance with the requirements of HIPAA.

In addition to HIPAA, Australia and many U.S. states have adopted statutes and regulations that are similar to or, in some cases, more stringent than HIPAA. We believe that our operations are consistent with these statutes and regulations.

Federal Deficit Reduction Act of 2005. The Federal Deficit Reduction Act of 2005, or the DRA, requires that medical providers receiving more than $5,000,000 in annual Medicaid payments from a specific state must establish certain written policies to be disseminated to that provider s employees, contractors and agents. The

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written policies required by the DRA include information about the Federal False Claims Act, administrative remedies under the Program Fraud Civil Remedies Act, state and local laws regarding false claims for those localities in which the practice operates, and the protections given to whistleblowers under such laws. We believe that we are not currently subject to the informational and educational mandates of the DRA because we do not now receive more than the requisite amount of Medicaid payments from any state.

Intellectual Property

Our principal intellectual property assets include our brand and our proprietary software technology. We rely primarily on trade secret and unfair competition laws in the United States and other jurisdictions as well as confidentiality procedures and contractual provisions to protect these assets. We believe that the name NightHawk cannot be afforded trademark protection as it is a generic term used to describe the provision of off-hours radiology services. However, we intend to pursue all protections available, including common law claims for unfair competition practices, for improper use of the NightHawk name. We also hold the registered trademark DayHawk, which is used internally to represent our hours of coverage during weekends and holidays.

In addition to our trade names, we have filed one patent application covering certain aspects of our proprietary workflow technology.

We enter into confidentiality and proprietary rights agreements with our employees, affiliated radiologists, consultants and other third parties and control access to software, documentation and other proprietary information.

If a claim is asserted that we have infringed the intellectual property of a third party, we may be required to seek licenses to that technology. In addition, we license third-party technologies that are incorporated into some elements of our services. Licenses from third-party technologies may not continue to be available to us at a reasonable cost, or at all. Additionally, the steps we have taken to protect our intellectual property rights may not be adequate. Third parties may infringe or misappropriate our proprietary rights. Competitors may also independently develop technologies that are substantially equivalent or superior to the technologies we employ in our services. If we fail to protect our proprietary rights adequately, our competitors could offer similar services, potentially significantly harming our competitive position and decreasing our revenue.

Employees and Independent Contractors

As of December 31, 2007, we had 503 employees. None of our employees are represented by a labor union. We consider our relationships with our employees to be good.

Also as of December 31, 2007, we had 113 affiliated radiologists who provide services to our customers. Our affiliated radiologists are independent contractors of NightHawk. We consider our relationships with our independent contractors to be good.

Website

Our website address is www.nighthawkrad.net and can be used to access, free of charge, through the investor relations category, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports, as soon as reasonably practicable after we electronically file such material with or furnish it to the SEC. The information on our website is not incorporated as a part of this annual report. The public can also obtain copies of these reports by visiting the SEC s Public Reference Room at 100 F Street, NE, Washington DC 20549, or by calling the SEC at 1-800-SEC-0330, or by accessing the SEC s website at http://www.sec.gov.

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ITEM 1A. Risk Factors

YOU SHOULD CAREFULLY CONSIDER THE RISKS DESCRIBED BELOW BEFORE MAKING AN INVESTMENT DECISION. OUR BUSINESS, PROSPECTS, FINANCIAL CONDITION OR OPERATING RESULTS COULD BE MATERIALLY ADVERSELY AFFECTED BY ANY OF THESE RISKS. THE TRADING PRICE OF OUR COMMON STOCK COULD DECLINE DUE TO ANY OF THESE RISKS AND YOU MAY LOSE ALL OR PART OF YOUR INVESTMENT. IN ASSESSING THE RISKS DESCRIBED BELOW, YOU SHOULD ALSO REFER TO THE OTHER INFORMATION CONTAINED IN THIS REPORT, INCLUDING OUR CONSOLIDATED FINANCIAL STATEMENTS AND THE RELATED NOTES, BEFORE DECIDING TO PURCHASE ANY SHARES OF OUR COMMON STOCK.

We have a short operating history in an emerging market, which makes it difficult to evaluate our business and prospects.

We have a short operating history in an emerging market. As a result, our current business and future prospects are difficult to evaluate. You must consider our business and prospects in light of the risks and difficulties we encounter as an early-stage company in a rapidly evolving market. Some of these risks relate to our potential inability to:

effectively manage our business and technology,

effectively manage the integration of companies that we have acquired, or in the future may acquire,

develop new services that complement our existing business,

market our services to our customers due to regulatory rules governing reassignment of payments, which could affect our customers ability to collect fees for services provided by our affiliated radiologists,

acquire additional customers,

successfully provide high levels of service quality as we expand the scale of our business,

manage rapid growth in personnel and operations,

effectively manage our medical liability risk, and

recruit and retain radiologists and other key personnel.

We may not be able to successfully address these and the other risks described in this report. Failure to adequately do so would harm our business and cause our operating results to suffer. Furthermore, our limited operating history has resulted in revenue growth rates that we may not be able to sustain, and therefore may not be indicative of our future results of operations. As a result, the price of our common stock could decline.

The market in which we participate is competitive and we expect competition to increase in the future, which will make it more difficult for us to sell our services and may result in pricing pressure, reduced revenue and reduced market share.

The market for professional radiology services and business process services is competitive and rapidly changing, barriers to entry are relatively low, and with the introduction of new technologies and market entrants, we expect competition to intensify in the future. If we fail to compete effectively, our operating results will be harmed. Some of our principal competitors, including our largest competitor, Virtual Radiologic

Corporation, offer their services at a lower price, which has resulted and may continue to result in pricing pressure and, perhaps, lost customers. If we are unable to maintain our current pricing, our operating results could be negatively impacted. In addition, pricing pressures and increased competition could result in reduced revenue, reduced profits or the failure of our services to achieve or maintain more widespread market acceptance, any of which could harm our business.

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In addition, if companies larger than we are enter the market through internal expansion or acquisition of one of our competitors, the change in the competitive landscape could adversely affect our ability to compete effectively. These competitors could have established customer relationships and greater financial, technical, sales, marketing and other resources than we do, and could be able to respond more quickly to new or emerging technologies or devote greater resources to the development, promotion and sale of their services. This competition could harm our ability to sell our services, which may lead to lower prices, reduced revenue and, ultimately, reduced market share.

If we acquire any companies or technologies in the future, they could prove difficult to integrate, disrupt our business, dilute stockholder value and adversely affect our operating results.

A key element of our strategy is to pursue strategic acquisitions that are complementary to our business or offer us other strategic benefits. Acquisitions in which we may engage involve numerous risks, including:

- difficulties in integrating operations, technologies, services and personnel,
- diversion of financial and management resources from existing operations,
- risk of entering new markets,
- potential write-offs of acquired assets,
- potential loss of key employees, and
- inability to generate sufficient revenue to offset acquisition costs.

We may experience these difficulties as we integrate the operations of future companies we acquire with our operations.

In addition, if we finance acquisitions by issuing convertible debt or equity securities, our existing stockholders may be diluted which could affect the market price of our stock. Including the acquisitions of Midwest Physicians Services, LLC, Emergency Radiology Services, LLC, Teleradiology Diagnostic Service, Inc. and The Radlinx Group, Ltd., we have made six acquisitions to date, and our management has limited experience in completing acquisitions and integrating acquired businesses with our operations. If we fail to properly evaluate and execute acquisitions, our business and prospects may be harmed.

If our arrangements with our affiliated radiologists or our customers are found to violate state laws prohibiting the corporate practice of medicine or fee splitting, our business, financial condition and our ability to operate in those states could be adversely impacted.

The laws of many states, including states in which our customers are located, prohibit us from exercising control over the medical judgments or decisions of physicians and from engaging in certain financial arrangements, such as splitting professional fees with physicians. These laws and their interpretations vary from state to state and are enforced by state courts and regulatory authorities, each with broad discretion. We enter into agreements with our affiliated radiologists pursuant to which the radiologists render professional medical services. In addition, we enter into agreements with our customers to deliver professional radiology interpretation services in exchange for a service fee. We structure our relationships with our affiliated radiologists and our customers in a manner that we believe is in compliance with prohibitions against the corporate practice of medicine and fee splitting. While we have not received notification from any state regulatory or similar authorities asserting that we are engaged in the corporate practice of medicine or that the payment of service fees to us by our customers constitutes fee splitting, if such a claim were successful, we could be subject to civil and criminal penalties and could be required to restructure or terminate the applicable contractual arrangements. A determination that these arrangements violate state statutes, or our inability to successfully restructure our relationships with our affiliated radiologists to comply with these statutes, could eliminate customers located in certain states from the market for our services, which would have a materially adverse effect on our business, financial condition and operations.

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We may be unable to successfully expand our services beyond the off-hours emergency radiology market.

We have historically focused our business on providing emergency radiology services during the hours of 5:00 p.m. to 8:00 a.m. and 24 hours per day on weekends and holidays. In 2006, we expanded our hours of service to 24 hours, 7 days a week and began offering final reads and sub-specialty services, including cardiac imaging services, to enhance our service offerings to our customers. In addition, our acquisitions of MPS and ERS will permit us to provide a more complete suite of radiology solutions. However, our efforts to provide these final reads and sub-specialty services, or any other services beyond our current services offerings and radiology solutions, may not result in significant revenue growth for us. In addition, efforts to expand our services into these new markets may divert management resources from existing operations and require us to commit significant financial resources to an unproven business. To support these service offerings, we have recently opened two additional centralized reading centers in San Francisco, California and Austin, Texas, similar to our facilities in Sydney, Australia and Zurich, Switzerland. If we are unable to effectively and profitably expand our offerings in these areas, our business, financial condition and results of operations could be adversely affected.

If our affiliated radiologists are characterized as employees, we would be subject to employment and withholding liabilities and may be subject to prohibitions against the corporate practice of medicine.

We structure our relationships with our affiliated radiologists in a manner that we believe results in an independent contractor relationship, not an employee relationship. An independent contractor is generally distinguished from an employee by his or her degree of autonomy and independence in providing services. A high degree of autonomy and independence is generally indicative of a contractor relationship, while a high degree of control is generally indicative of an employment relationship. Although we believe that our affiliated radiologists are properly characterized as independent contractors, tax or other regulatory authorities may in the future challenge our characterization of these relationships. If such regulatory authorities or state, federal or foreign courts were to determine that our affiliated radiologists are employees, and not independent contractors, we would be required to withhold income taxes, to withhold and pay social security, Medicare and similar taxes and to pay unemployment and other related payroll taxes. We would also be liable for unpaid past taxes and subject to penalties. In addition, such a determination may also result in a finding that we are engaged in the corporate practice of medicine in violation of the laws of many states. As a result, any determination that our affiliated radiologists are our employees would materially harm our business and operating results.

Our growth strategy depends on our ability to recruit and retain qualified radiologists and other skilled personnel. If we are unable to do so, our future growth would be limited and our business and operating results would be harmed.

Our success is dependent upon our continuing ability to recruit and retain qualified radiologists. An inability to recruit and retain radiologists would have a material adverse effect on our ability to grow and would adversely affect our results of operations. We face competition for radiologists from other healthcare providers, including radiology groups, research and academic institutions, government entities and other organizations. In addition, our affiliated radiologists are typically U.S. citizens who must obtain visas to work in Australia or Switzerland. We have worked with the government of Australia to establish a visa program and have assisted our affiliated radiologists in the visa application process with the government of Switzerland, and to date all of our professionals have successfully obtained work visas in a timely manner. However, any future inability to obtain or difficulty in obtaining work visas for our affiliated radiologists, due to changing immigration regulations or otherwise, would jeopardize our business and harm our results.

In addition to recruiting radiologists, we must identify, recruit and retain skilled executive, technical, administrative, sales, marketing and operations personnel for our headquarters in Coeur d Alene, Idaho. Competition for highly qualified and experienced personnel is intense due to the limited number of people available with the necessary skills. In addition, Coeur d Alene has a relatively small pool of potential employees

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with the skills that we require, and is a small city in a relatively rural part of the country, making it difficult for us to recruit employees from larger metropolitan areas of the country. Failure to attract and retain the necessary personnel would inhibit our growth and harm our business.

We have been subject to medical liability claims and may become subject to additional claims, which could cause us to incur significant expenses and may require us to pay significant damages if not covered by insurance.

Our business entails the risk of medical liability claims against our affiliated radiologists and us. We or our affiliated radiologists are subject to ongoing medical liability claims in the ordinary course of business. Although we maintain medical liability insurance for ourselves and our affiliated radiologists with coverage that we believe is appropriate in light of the risks attendant to our business, successful medical liability claims could result in substantial damage awards which exceed the limits of our insurance coverage. In addition, medical liability insurance is expensive and insurance premiums may increase significantly in the future, particularly as we expand our services to include final and sub-specialty reads and cardiac imaging services. As a result, adequate medical liability insurance may not be available to our affiliated radiologists or us in the future at acceptable costs or at all.

Any claims made against us that are not fully covered by insurance could be costly to defend against, result in substantial damage awards against us and divert the attention of our management and our affiliated radiologists from our operations, which could adversely affect our operations and financial performance. In addition, any claims might adversely affect our business or reputation.

We indemnify our radiology group and hospital customers against damages or liabilities that they may incur as a result of the actions of our affiliated radiologists or us. We also indemnify some of our affiliated radiologists against medical liability claims. Our indemnification obligations are typically payable only to the extent that damages incurred are not covered by insurance.

We have also assumed and succeeded to substantially all of the obligations of the businesses that we have acquired. Medical liability claims may be asserted against us for events that occurred prior to these acquisitions. In connection with our acquisitions, the sellers of the businesses that we have acquired have agreed to indemnify us for certain claims. However, we may not be able to collect payment under these indemnity agreements, which could affect us adversely.

Our customers may terminate their agreements with us, or their agreements with the hospitals that they serve may be terminated, either of which could adversely affect our financial condition and operating results.

Our revenue is derived primarily from fee-for-service billings to our radiology group customers. Our agreements with our customers generally provide for one-year terms and automatically renew for successive one-year terms unless terminated by our customers or us upon 30 days prior notice. Following the first anniversary of the agreements, the agreements typically may be terminated at any time by our customers or us upon 60 days prior notice. Our customers may elect not to renew their contracts with us, they may seek to renegotiate the terms of their contracts or they may choose to reduce or eliminate our services in the future. If our arrangements with our customers are canceled, or are not renewed or replaced with other arrangements having at least as favorable terms, our business, financial condition and results of operations could be adversely affected. In addition, to the extent that our radiology group customers agreements with the hospitals that they serve are terminated, our business, financial condition and results of operations could be adversely affected.

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If our security measures are breached and unauthorized access is obtained to patient or customer data, we may face liabilities and our system may be perceived as not being secure, causing customers to curtail or stop using our services, which could lead to a decline in revenues.

We are required to implement administrative, physical and technological safeguards to ensure the security of the patient data that we create, process or store. These safeguards may fail to ensure the security of patient or customer data, thereby subjecting us to liability, including civil monetary penalties and possible criminal penalties. If our security measures are breached, whether as a result of third party action, employee error, malfeasance or otherwise, and, as a result, someone obtains unauthorized access to patient or customer data, our reputation will be damaged, our business may suffer and we could incur significant liability. Because techniques used to obtain unauthorized access to systems change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventive measures.

Enforcement of federal and state laws regarding privacy and security of patient information may adversely affect our business, financial condition or operations.

The use and disclosure of certain healthcare information by healthcare providers and their business associates have come under increasing public scrutiny. Federal standards under the Health Insurance Portability and Accountability Act of 1996, or HIPAA, establish rules concerning how individually-identifiable health information may be used, disclosed and protected. Historically, state law has governed confidentiality issues and HIPAA preserves these laws to the extent they are more protective of a patient s privacy or provide the patient with more access to his or her health information. As a result of the implementation of the HIPAA regulations, many states are considering revisions to their existing laws and regulations that may or may not be more stringent or burdensome than the federal HIPAA provisions. We must operate our business in a manner that complies with all applicable laws, both federal and state and that does not jeopardize the ability of our customers to comply with all applicable laws to which they are subject. We believe that our operations are consistent with these legal standards. Nevertheless, these laws and regulations present risks for healthcare providers and their business associates that provide services to patients in multiple states. Because few of these laws and regulations have been interpreted by government regulators or courts, our interpretations and activities may be challenged. If a challenge to our activities is successful, it could have an adverse effect on our operations, may require us to forgo relationships with customers in certain states, and may restrict the territory available to us to expand our business. In addition, even if our interpretations of HIPAA and other federal and state laws and regulations are correct, we could be held liable for unauthorized uses or disclosures of patient information as a result of inadequate systems and controls to protect this information or due to the theft of information by unauthorized computer programmers who penetrate our network security.

Future changes in healthcare regulation are difficult to predict and may constrain or require us to restructure our operations, which could negatively impact our business and operating results.

The healthcare industry is heavily regulated and subject to frequent changes in governing laws and regulations as well as to evolving administrative interpretations. Our business could be adversely affected by regulatory changes at the federal or state level that impose new requirements for licensing, new restrictions on reimbursement for medical services by government programs, new pretreatment certification requirements for patients seeking radiology procedures, or new limitations on services that can be performed by us. In addition, federal, state and local legislative bodies have adopted and continue to consider medical cost containment legislation and regulations that have restricted or may restrict reimbursement to entities providing services in the healthcare industry and referrals by physicians to entities in which the physicians have a direct or indirect financial interest or other relationship. For example, Medicare recently adopted a regulation that limits the technical component of the reimbursement for multiple diagnostic tests performed during a single session at medical facilities other than hospitals. Any of these or future reimbursement regulations or policies could limit the number of diagnostic tests our customers order and could have a material adverse effect on our business.

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Although we monitor legal and regulatory developments and modify our operations from time to time as the regulatory environment changes, we may not be able to adapt our operations to address every new regulation, and such regulations may adversely affect our business. In addition, although we believe that we are operating in compliance with applicable federal and state laws, our business operations have not been scrutinized or assessed by judicial or regulatory agencies. We cannot assure you that a review of our business by courts or regulatory authorities would not result in a determination that adversely affects our operations or that the healthcare regulatory environment will not change in a way that will restrict our operations.

Our growth and our continued operations as a publicly-traded company could strain our personnel, management and infrastructure resources, which may harm our business.

We are currently experiencing a period of rapid growth in our headcount and operations, which has placed, and will continue to place, a significant strain on our management, administrative, operational and financial infrastructure. We also anticipate that further growth will be required to address increases in the scope of our operations and size of our customer base. Our success will depend in part upon the ability of our current senior management team to manage this growth, as well as to manage our operations as a publicly-traded company effectively.

To effectively manage our anticipated growth, we will need to continue to improve our operational, financial and management processes and controls and our reporting systems and procedures. In addition, the additional headcount we are adding and capital investments we are making will increase our costs, which will make it more difficult for us to offset any future revenue shortfalls by offsetting expense reductions in the short term. If we fail to successfully manage our growth and our operations as a publicly-traded company, our business and operating results will be harmed.

Our operating results are subject to seasonal fluctuation, which makes our results difficult to predict and could cause our performance to fall short of quarterly expectations.

We have experienced increased demand for and revenues from our services during the second and third fiscal quarters of each year. We believe that these increases are a result of increased outdoor and transportation activities during summer months. During the first and fourth quarters of each fiscal year, when weather conditions are colder for a large portion of the United States, we have historically experienced relatively lower revenues than those experienced during the second and third quarters. We may continue to experience this or other seasonality in the future. These seasonal factors may lead to unpredictable variations in our quarterly operating results and cause the trading price of our common stock to decline. Additionally, our ability to schedule adequate radiologist coverage during the seasonal period of increased demand for our services may affect our ability to provide appropriate turnaround times in our services to clients.

Interruptions or delays in our information systems or in network or related services provided by third-party suppliers could impair the delivery of our services and harm our business.

Our operations depend on the uninterrupted performance of our information systems, which are substantially dependent on systems provided by third parties over which we have little control. Failure to maintain reliable information systems, or disruptions in our information systems could cause disruptions and delays in our business operations which could have a material adverse effect on our business, financial condition and results of operations.

We rely on broadband connections provided by third party suppliers to route digital images from hospitals in the United States to our facilities in Australia, Switzerland and the United States. Any interruption in the availability of the network connections between the hospitals and our reading facilities would reduce our revenue and profits. Frequent or persistent interruptions in our services could cause permanent harm to our reputation and

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brand and could cause current or potential customers to believe that our systems are unreliable, leading them to switch to our competitors. Because our customers may use our services for critical healthcare services, any system failures could result in damage to our customers businesses and reputation. These customers could seek significant compensation from us for their losses, and our agreements with our customers do not limit the amount of compensation that they may receive. Any claim for compensation, even if unsuccessful, would likely be time consuming and costly for us to resolve.

Although our systems have been designed around industry-standard architectures to reduce downtime in the event of outages or catastrophic occurrences, they remain vulnerable to damage or interruption from earthquakes, floods, fires, power loss, telecommunication failures, terrorist attacks, computer viruses, break-ins, sabotage, and acts of vandalism. In addition, the connections from hospitals to our reading facility in Australia rely on two cables that link the west coast of the United States with Australia. Despite any precautions that we may take, the occurrence of a natural disaster or other unanticipated problems at our reading facilities or in the networks that connect our reading facilities with our hospitals could result in lengthy interruptions in our services. We do not carry business interruption insurance to protect us against losses that may result from interruptions in our service as a result of system failures.

Hospital privileging requirements or physician licensure laws may limit our market, and the loss of hospital privileges or state medical licenses held by our affiliated radiologists could have a material adverse affect on our business, financial condition and results of operations.

Each of our affiliated radiologists must be granted privileges to practice at each hospital from which the radiologist receives radiological images and must hold a license in good standing to practice medicine in the state in which the hospital is located. The requirements for obtaining and maintaining hospital privileges and state medical licenses vary significantly among hospitals and states. If a hospital or state restricts or impedes the ability of physicians located outside of the United States to obtain privileges or a license to practice medicine at that hospital or in that state, the market for our services could be reduced. In addition, any loss of existing privileges or medical licenses held by our affiliated radiologists could impair our ability to serve our existing customers and have a material adverse affect on our business, financial condition and results of operations.

Medicare and Medicaid rules governing reassignment of payments could affect our customers ability to collect fees for services provided by our affiliated radiologists and our ability to market our services to our customers.

The majority of our customers are radiology practices. These customers, and not us, bill and receive payments from Medicare and/or Medicaid for the professional services provided by our affiliated radiologists. Medicare and Medicaid generally prohibit a physician who performs a covered medical service from reassigning to anyone else (including to other physicians) the performing physician s right to receive payment directly from Medicare or Medicaid, except in certain circumstances. We believe that the services provided by our affiliated radiologists satisfy one or more of the exceptions to this prohibition, but the various Medicare carriers and state Medicaid authorities may interpret these exceptions differently than we do. Because Medicare and Medicaid payments may comprise a significant portion of the total payments received by our customers for the services of our affiliated radiologists, if it were determined that we do not qualify for an exception, our customers could be prohibited from billing Medicare and/or Medicaid for the services of our affiliated radiologists and this would cause a material adverse effect on our ability to market our services and on our business and results of operations. Future laws or regulations, moreover, may require that we bill Medicare or Medicaid directly for new services we provide to our customers. Should this occur, we would either be required to forgo business with such customers or be required to design, develop and implement an appropriate recordkeeping and billing system to bill Medicare and Medicaid.

Medicare reimbursement rules currently provide that the proper Medicare carrier to pay physician claims is the Medicare carrier for the region in which the physician or practice providing the service is located, rather than the Medicare carrier for the region in which the patient receiving the services is located. Many of our affiliated

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radiologists are located in a Medicare region that is different from the Medicare region in which the patient and treating hospital are located. Since it is incumbent on our customers to file with the proper Medicare carrier in order to receive payment, it may be necessary for our customers to enroll with additional Medicare carriers in order to properly submit claims for reimbursement. To the extent that our customers are unwilling or unable to do so, they may be unwilling to use our services unless we were to submit the claims. Should this occur, we would either be required to forgo business with such customers or be required to design, develop and implement an appropriate recordkeeping and billing system to bill Medicare and Medicaid. The Center for Medicare and Medicaid Services, or CMS, recently proposed amending the reimbursement rules to provide for reimbursement by the Medicare carrier for the region in which the patient and hospital are located regardless of the location of the physician. If adopted, the amended reimbursement rules would eliminate the need for our customers to enroll with additional Medicare carriers.

Changes in the rules and regulations governing Medicare s and Medicaid s payment for medical services could affect our revenues, particularly with respect to final reads.

Although most reads we provide are preliminary reads rather than final reads, we are providing an increasing number of final and sub-specialty reads and cardiac imaging services. Cost containment pressures on Medicare and Medicaid could result in a reduction in the amount that the government will pay for these reads, which could cause pricing pressure on our services. Should that occur, we could be required to lower our prices, or our customers could elect to provide the reads themselves or obtain such services from one of our competitors, and not utilize the services of our affiliated radiologists, which would have a material adverse effect on our business, results of operations and financial condition.

We may be subject to less favorable levels of payment based upon third party payor fee schedules.

Many patients are covered by some form of private or government health insurance or other third party payment program. Third party payors generally establish fee schedules or other payment authorization methods for various procedures that govern which procedures will be reimbursed by the third party payors and the amount of reimbursement. To the extent that such schedules impact the rates at which third party payors are willing to pay the healthcare providers with whom we contract to provide imaging services, we are indirectly impacted by such fee schedules. However, if we were to negotiate direct payment arrangements with third party payors in the future, we would be directly impacted by such schedules. In addition, there is no guarantee that Medicare, state Medicaid programs, or commercial third party payors will continue to cover professional radiology services. Any reduction or elimination in coverage for our services could adversely impact our business.

Our business could be materially affected if a U.S. Department of Health & Human Services Office of Inspector General study results in a recommendation that Medicare only pay for reads performed contemporaneously in an emergency room setting.

In its Fiscal Year 2008 Work Plan, the U.S. Department of Health & Human Services Office of Inspector General, or HHS-OIG, indicated that it would conduct a study and issue a report assessing the appropriateness of Medicare billings for diagnostic tests performed in hospital emergency rooms. Part of the assessment will include a determination as to whether the tests were read contemporaneously with the patient s treatment. It is possible that, in the final report, the HHS-OIG could recommend to CMS that it change its reimbursement rules to clearly indicate that CMS will only pay for reads performed contemporaneously with a patient s treatment by a physician located within the United States. If CMS were to adopt this recommendation, final reads would no longer be eligible for reimbursement if performed by a physician other than the one who performed the preliminary read. In turn, if our customers were no longer able to be reimbursed for certain final reads, our customers may seek alternative arrangements for the performance of their preliminary reads, which could adversely impact our business.

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Changes in the healthcare industry or litigation reform could reduce the number of diagnostic radiology procedures ordered by physicians, which could result in a decline in the demand for our services, pricing pressure and decreased revenue.

Changes in the healthcare industry directed at controlling healthcare costs and perceived over-utilization of diagnostic radiology procedures could reduce the volume of radiological procedures performed. For example, in an effort to contain increasing imaging costs, some managed care organizations and private insurers are instituting pre-authorization policies which require physicians to pre-clear orders for diagnostic radiology procedures before those procedures can be performed. If pre-clearance protocols are broadly instituted throughout the healthcare industry, the volume of radiological procedures could decrease, resulting in pricing pressure and declining demand for our services. In addition, it is often alleged that many physicians order diagnostic procedures even when the procedures may have limited clinical utility in large part to establish a record for defense in the event of a medical liability claim. Changes in tort law could reduce the number of radiological procedures ordered for this purpose and therefore reduce the total number of radiological procedures performed each year, which could harm our operating results.

We may not have adequate intellectual property rights in our brand, which could limit our ability to enforce such rights.

Our success depends in part upon our ability to market our services under the NightHawk brand. However, we believe that the term NightHawk cannot be afforded trademark protection as it is a generic term used to describe the provision of off-hours radiology services. Other than DayHawk, we have not secured registrations of our other marks. Other businesses may have prior rights in the brand names that we market under or in similar names, which could limit or prevent our ability to use these marks, or to prevent others from using similar marks. If we are unable to prevent others from using our brand names, or if others prohibit us from using them, our revenue could be adversely affected. Even if we are able to protect our intellectual property rights in such brands, we could incur significant costs in doing so.

Any failure to protect our intellectual property rights in our workflow technology could impair its value and our competitive advantage.

We rely heavily on our proprietary workflow technology to distribute radiological images to the appropriately licensed and privileged radiologist best able to provide the necessary clinical insight in the least amount of turnaround time. If we fail to protect our intellectual property rights adequately, our competitors may gain access to our technology, and our business may be harmed. We currently do not hold any patents with respect to our technology. Although we have filed an application for a patent covering our workflow technology, we may be unable to obtain patent protection for this technology. In addition, any patents we may obtain may be challenged by third parties. Accordingly, despite our efforts, we may be unable to prevent third parties from using or misappropriating our intellectual property.

We may in the future become subject to intellectual property rights claims, which could harm our business and operating results.

The information technology industry is characterized by the existence of a large number of patents, trademarks and copyrights and by frequent litigation based on allegations of infringement or other violations of intellectual property rights. As an example, we are aware that on July 31, 2007, Merge eMed, Inc., or Merge, filed a complaint against another teleradiology provider, Virtual Radiologic Corporation, or VRC, alleging that VRC has infringed on certain of Merge s patents relating to teleradiology. In connection with that litigation, VRC has filed a Request for Reexamination with the U.S. Patent and Trademark Office, or US PTO, which asks the US PTO to re-examine the validity of the patents at issue. While we are not currently a party to any litigation, if Merge or another third party asserts that our technology violates that third-party s proprietary rights, or if a court holds that our technology violates such rights, we may be required to re-engineer our technology, obtain licenses from third parties to continue using our technology without substantial re-engineering or remove the

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infringing functionality or feature. In addition, we may incur substantial costs defending any such claim. We may also become subject to damage awards, which could cause us to incur additional losses and harm our financial position.

Monitoring potential infringement of and defending or asserting our intellectual property rights may entail significant expense. We may initiate claims or litigation against third parties for infringement of our proprietary rights or to establish the validity of our proprietary rights. Any litigation, whether or not it is resolved in our favor, could result in significant expense to us and divert the efforts of our technical and management personnel.

We are dependent on our management team, and the loss of any key member of this team may prevent us from implementing our business plan in a timely manner.

Our success depends largely upon the continued services of our executive officers, particularly Dr. Paul Berger, our Chief Executive Officer and Chairman of the Board. The loss of Dr. Berger or Jon D. Berger, our Senior Vice President of Strategy and Business Development could have a material adverse effect on our business, financial condition, results of operations and the trading price of our common stock.

For example, in February 2008, we announced the resignations of our president and chief operating officer and our chief financial officer. We may not be able to effectively recruit executives to fill these positions and, even if we are successful, integrating these new executives may prove difficult and time-consuming. Each of our executives is employed on an at-will basis. The search for replacements for any of our executives could be time consuming and could distract our management team from the day-to-day operations of our business.

If we fail to implement and maintain an effective system of internal controls, we may not be able to report our financial results in an accurate or timely manner, prevent fraud or comply with Section 404 of the Sarbanes-Oxley Act of 2002, which may harm our business and affect the trading price of our stock.

Effective internal controls are necessary for us to provide reliable financial reports in a timely manner and to prevent fraud. Historically, we have had limited accounting personnel and other resources with which to design and implement our internal controls and procedures. As a result, in their audit of our fiscal 2004 financial statements, our auditors identified in their report to our audit committee material weaknesses relating to the adequacy and competency of our financial reporting personnel. Following receipt of our auditor s report, we consulted with our audit committee and undertook remedial steps to address these deficiencies, including hiring additional staff and training our new and existing staff. Although our auditors did not identify material weaknesses in our internal controls in connection with their audit of our financial statements as of and for the years ended December 31, 2007, 2006 or 2005, we cannot assure you that we will maintain an effective system of internal controls in the future. Beginning with our annual report on Form 10-K for our fiscal year ended December 31, 2007, we are required to comply with the requirement of Section 404 of the Sarbanes-Oxley Act of 2002 to include in each of our annual reports an assessment by our management of the effectiveness of our internal controls over financial reporting and a report of our independent registered public accounting firm addressing these assessments. If we fail to adequately staff and train our accounting and finance personnel to meet the demands of operating as a public company, including the requirements of the Sarbanes-Oxley Act of 2002, or fail to maintain adequate internal controls, any resulting material weakness in internal controls could prevent our management from concluding the internal controls are effective and impair our ability to prevent material misstatements in our financial statements, which could cause our business to suffer. In addition, investors perceptions that our internal controls are inadequate or that we are unable to produce accurate financial statements in a timely manner or prevent fraud may negatively affect the trading price of our stock or result in stockholder litigation.

We may be unable to enforce non-compete agreements with our affiliated radiologists.

Our independent contractor agreements with our affiliated radiologists typically provide that the radiologists may not compete with us for a period of time, typically one year, after the agreements terminate. These covenants not to compete are enforceable to varying degrees from jurisdiction to jurisdiction. In most jurisdictions, a covenant not to compete will be enforced only to the extent that it is necessary to protect the

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legitimate business interest of the party seeking enforcement, that it does not unreasonably restrain the party against whom enforcement is sought and that it is not contrary to the public interest. This determination is made based upon all the facts and circumstances of the specific case at the time enforcement is sought. It is unclear whether our interests will be viewed by courts as the type of protected business interest that would permit us to enforce a non-competition covenant against the radiologists. A determination that these provisions are not enforceable could have a material adverse effect on us.

Enforcement of state and federal anti-kickback laws may adversely affect our business, financial condition or operations.

Various federal and state laws govern financial arrangements among healthcare providers. The federal anti-kickback law prohibits the knowing and willful offer, payment, solicitation or receipt of any form of remuneration in return for, or with the purpose to induce, the referral of Medicare, Medicaid, or other federal healthcare program patients, or in return for, or with the purpose to induce, the purchase, lease or order of items or services that are covered by Medicare, Medicaid, or other federal healthcare programs. Similarly, many state laws prohibit the solicitation, payment or receipt of remuneration in return for, or to induce the referral of patients in private as well as government programs. Violation of these anti-kickback laws may result in substantial civil or criminal penalties for individuals or entities and/or exclusion from participating in federal or state healthcare programs. If we are excluded from federal or state healthcare programs, our customers who participate in those programs would not be permitted to continue doing business with us. We believe that we are operating in compliance with applicable law and believe that our arrangements with providers would not be found to violate the anti-kickback laws. However, these laws could be interpreted in a manner inconsistent with our operations.

Because our customers submit claims to the Medicare program based on the services we provide, it is possible that a lawsuit could be brought against us or our customers under the federal False Claims Act, and the outcome of any such lawsuit could have a material adverse effect on our business, financial condition and operations.

The Federal False Claims Act provides, in part, that the federal government may bring a lawsuit against any person whom it believes has knowingly presented, or caused to be presented, a false or fraudulent request for payment from the federal government, or who has made a false statement or used a false record to get a claim approved. The government has taken the position that claims presented in violation of the federal anti-kickback law may be considered a violation of the Federal False Claims Act. The Federal False Claims Act further provides that a lawsuit brought under that act may be initiated in the name of the United States by an individual who was the original source of the allegations, known as the relator. Actions brought under the Federal False Claims Act are sealed by the court at the time of filing. The only parties privy to the information contained in the complaint are the relator, the federal government and the court. Therefore, it is possible that lawsuits have been filed against us that we are unaware of or which we have been ordered by the court not to discuss until the court lifts the seal from the case. Penalties include fines ranging from $5,500 to $11,000 for each false claim, plus three times the amount of damages that the federal government sustained because of the act of that person. We believe that we are operating in compliance with the Medicare rules and regulations, and thus, the Federal False Claims Act. However, if we were found to have violated certain rules and regulations and, as a result, submitted or caused our customers to submit allegedly false claims, any sanctions imposed under the Federal False Claims Act could result in substantial fines and penalties or exclusion from participation in federal and state healthcare programs which could have a material adverse effect on our business and financial condition.

Federal regulatory and law enforcement authorities have recently increased enforcement activities with respect to Medicare and Medicaid fraud and abuse regulations and other reimbursement laws and regulations, including laws and regulations that govern our activities and the activities of teleradiologists. These increased enforcement activities may have a direct or indirect adverse affect on our business, financial condition and results of operations.

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Additionally, some state statutes contain prohibitions similar to and possibly even more restrictive than the Federal False Claims Act. These state laws may also empower state administrators to adopt regulations restricting financial relationships or payment arrangements involving healthcare providers under which a person benefits financially by referring a patient to another person. We believe that we are operating in compliance with these laws. However, if we are found to have violated such laws, our business, results of operations and financial condition would be harmed.

Changes in the governmental interpretation or enforcement of the federal prohibition on physician self-referral may adversely affect our business, financial conditions or operations.

The federal Stark Law prohibits a physician from referring Medicare or Medicaid patients for the provision of designated health services by an entity in which the physician has an investment interest or with which the physician has entered into a compensation arrangement. Designated health services include both the professional and technical components of diagnostic tests using X-rays, ultrasound or other imaging services, CT, MRI, radiation therapy and diagnostic mammography services. Violation of the Stark Law may result in substantial civil penalties and/or exclusion from participation in federal health care programs for both the referring physicians and any entities that submit technical and/or professional component claims for any diagnostic tests ordered by those referring physicians. We believe that we have structured our arrangements between our affiliated radiologists and our customers in a manner that complies with applicable law. However, this law could be interpreted in a manner inconsistent with our arrangements.

We Currently Hold a Large Amount of Indebtedness

In July 2007, we entered into a credit facility with Morgan Stanley pursuant to which we borrowed $100.0 million. We used a portion of this loan to fund our acquisitions of The Radlinx Group and of Midwest Physician Services and Emergency Radiology Services. At December 31, 2007, we had debt outstanding of $99.5 million. Such a large amount of indebtedness could have negative consequences for us including, without limitation:

- limitations on our ability to obtain financing in the future,
- much of our cash flow will be dedicated to interest obligations and unavailable for other purposes,
- limiting our liquidity and operational flexibility in changing economic, business and competitive conditions which could require us to consider restructuring existing debt or deferring acquisitions or other strategic opportunities, and
- making us more susceptible to changes in credit ratings which could, particularly in the case of a downgrade below investment grade, impact our ability to obtain financing in the future and increase the cost of such financing.

The failure to comply with the covenants in the agreements governing the terms of our or our indebtedness could be an event of default and could accelerate the payment obligations and, in some cases, could affect other obligations.

The trading price of our common stock has been volatile and will likely remain volatile.

The trading prices of many newly publicly-traded companies are highly volatile, particularly companies such as ours that have limited operating histories. Since our initial public offering in February 2006, the trading price of our common stock has been subject to wide fluctuations. Factors that will continue to affect the trading price of our common stock include:

- variations in our operating results,
- announcements of new services, strategic alliances or significant agreements by us or by our competitors,

recruitment or departure of key personnel,

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changes in the estimates of our operating results or changes in recommendations by any securities analysts that follow our common stock, and

market conditions in our industry, the industries of our customers and the economy as a whole.

In addition, if the market for healthcare stocks or healthcare services or the stock market in general experiences loss of investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, operating results or financial condition. The trading price of our common stock might also decline in reaction to events that affect other companies in our industry even if these events do not directly affect us.

If securities analysts do not publish research or reports about our business, or if they downgrade our stock, the price of our stock could decline.

The trading market for our common stock will rely in part on the availability of research and reports that third-party industry or financial analysts publish about us. There are many large, publicly-traded companies active in the healthcare services industry, which may mean it will be less likely that we receive widespread analyst coverage. Furthermore, if one or more of the analysts who do cover us downgrade our stock, our stock price would likely decline. If one or more of these analysts cease coverage of our company, we could lose visibility in the market, which in turn could cause our stock price to decline.

The concentration of our capital stock ownership with insiders will likely limit your ability to influence corporate matters.

Our executive officers, directors, current five percent or greater stockholders and affiliated entities collectively own a relatively large percentage of the outstanding shares of our common stock. As a result, these stockholders, acting together, will have control over most matters that require approval by our stockholders, including the election of directors and approval of significant corporate transactions. Corporate action might be taken even if other stockholders oppose them. This concentration of ownership might also have the effect of delaying or preventing a change of control of our company that other stockholders may view as beneficial.

We are exposed to foreign currency exchange risks, which could harm our business and operating results.

We maintain significant operations in Australia and Switzerland, and are exposed to adverse changes in exchange rates associated with the expenses of our operations in these countries. However, we do not currently engage in any hedging transactions to mitigate these risks. Although from time to time we review our foreign currency exposure and evaluate whether we should enter into hedging transactions, we may not adequately hedge against any future volatility in currency exchange rates and, if we engage in hedging transactions, the transactions will be based on forecasts which later may prove to be inaccurate. Any failure to hedge successfully or anticipate currency risks properly could adversely affect our operating results.

In addition, half of our affiliated radiologists live in Australia and Switzerland, but receive compensation from us in U.S. dollars. Any relative weakness in the U.S. dollar compared to the Australian dollar or Swiss franc may increase the cost of living for our affiliated radiologists and make it less attractive for our affiliated radiologists to sign or renew their service contracts with us.

Provisions in our certificate of incorporation and bylaws and Delaware law might discourage, delay or prevent a change of control of our company or changes in our management and, therefore, depress the trading price of our common stock.

Our certificate of incorporation and bylaws contain provisions that could depress the trading price of our common stock by acting to discourage, delay or prevent a change in control of our company or changes in our management that the stockholders of our company may deem advantageous. These provisions:

establish a classified board of directors so that not all members of our board are elected at one time,

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provide that directors may only be removed for cause,

authorize the issuance of blank check preferred stock that our board could issue to increase the number of outstanding shares and to discourage a takeover attempt,

eliminate the ability of our stockholders to call special meetings of stockholders,

prohibit stockholder action by written consent, which has the effect of requiring all stockholder actions to be taken at a meeting of stockholders,

provide that the board of directors is expressly authorized to make, alter or repeal our bylaws, and

establish advance notice requirements for nominations for election to our board or for proposing matters that can be acted upon by stockholders at stockholder meetings.

In addition, Section 203 of the Delaware General Corporation Law may discourage, delay or prevent a change in control of our company.

ITEM 1B. Unresolved Staff Comments

None.

ITEM 2. Properties

The table below provides a summary of our principal facilities as of December 31, 2007:

Location	Total Square Feet (1)	Leased or Owned	Principal Function
St Paul, Minnesota	55,000	Leased	Staff operations
Coeur d Alene, Idaho	15,000	Leased	Corporate offices
Sydney, Australia	9,000	Leased	Reading facility and support staff operations
Milwaukee, Wisconsin	9,000	Leased	Information Technology center
Zurich, Switzerland	8,000	Leased	Reading facility and support staff operations
Coppel, Texas	8,000	Leased	Staff operations
Austin, Texas	5,000	Leased	Reading facility
Ann Arbor, Michigan	5,000	Leased	Staff operations
San Francisco, California	3,000	Leased	Reading facility

(1) Rounded to the nearest thousand square feet.

ITEM 3. Legal Proceedings

We are involved in various legal proceedings arising in the ordinary course of our business activities. We maintain insurance policies with coverages that we believe are appropriate in light of the risks attendant to our business, and believe that the resolution of the current claims will not have a material adverse impact on our consolidated results of operations, cash flows or our financial position. However, depending on the amount of damages resulting from a current or future claim, an unfavorable resolution of a claim could materially affect our future results of operations, cash flows or financial position.

ITEM 4. Submission of Matters to a Vote of Security Holders

None.

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PART II

ITEM 5. Market for Registrant s Common Stock, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market for Our Common Stock

Our common stock is traded on the NASDAQ Global Select Market under the symbol NHWK since February 9, 2006, the date of our initial public offering. Prior to that time, there was no public market for our common stock. The following table sets forth, for the period indicated, the high and low sales prices of our common stock for our two most recent fiscal years.

	Common Stock Price	
	High	Low
Fiscal Year Ended December 31, 2007		
First Quarter	$ 26.98	$ 17.50
Second Quarter	$ 21.18	$ 16.96
Third Quarter	$ 24.51	$ 18.16
Fourth Quarter	$ 24.25	$ 19.09
Fiscal Year Ended December 31, 2006		
First Quarter (from February 9)	$ 27.50	$ 18.01
Second Quarter	$ 24.95	$ 15.75
Third Quarter	$ 20.75	$ 15.60
Fourth Quarter	$ 28.00	$ 16.85

Holders

On February 1, 2008, the last reported sale price for our common stock on the Nasdaq Global Market was $16.30 per share. As of February 1, 2008, there were approximately 41 holders of record of our common stock, although there are a much larger number of beneficial owners.

Dividends

In September 2005, we distributed $13.0 million as a special distribution to the holders of our common stock and redeemable preferred stock. Immediately prior to our initial public offering in February 2006, we distributed an additional $7.0 million as another special distribution to the holders of our common stock and redeemable preferred stock.

Except for the special distributions noted above, we have never declared or paid any cash dividend on our capital stock. We currently intend to retain future earnings and do not expect to pay any dividends in the foreseeable future and certain covenants in our Credit Facility restrict our ability to pay dividends or make other distributions with respect to our equity securities. See Note 6 to our consolidated financial statements included in Item 8 of this Annual Report on Form 10-K.

Securities Authorized for Issuance Under Equity Compensation Plans

Please see Part III, Item 12 of this report for disclosure relating to our equity compensation plans.

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Performance Graph

The performance graph below illustrates a comparison of cumulative total stockholder return data based on an initial investment of $100 in NightHawk Radiology Holdings, Inc. common stock, as compared with the Russell 2000 Index and the Dow Jones US Healthcare Index from February 9, 2006 through December 31, 2007.

Dates	NightHawk Radiology	Russell 2000	Dow Jones US Healthcare
February 6, 2006	$ 100.00	$ 100.00	$ 100.00
March 31, 2006	$ 115.69	$ 106.75	$ 100.30
June 30, 2006	$ 86.88	$ 100.95	$ 95.35
September 30, 2006	$ 92.64	$ 101.65	$ 103.34
December 31, 2006	$ 123.49	$ 110.17	$ 104.61
March 31, 2007	$ 88.09	$ 111.69	$ 104.95
June 30, 2007	$ 87.41	$ 116.76	$ 109.40
September 30, 2007	$ 118.69	$ 113.00	$ 111.66
December 31, 2007	$ 101.94	$ 107.19	$ 104.61

Recent Sales of Unregistered Securities

There were no unregistered sales of equity securities during fiscal years 2007 and 2006.

Issuer Purchases of Equity Securities

There were no issuer purchases of equity securities during fiscal 2007 and 2006.

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ITEM 6. Selected Consolidated Financial Data

The following selected consolidated financial data should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements included elsewhere in this report. All references to number of shares outstanding and per share amounts have been restated to reflect the 1 for 1.25 reverse stock split that occurred January 23, 2006. Company results include the results from Midwest Physicians Services, LLC (MPS), Emergency radiology Services, LLC (ERS), The Radlinx Group, Ltd. (Radlinx) and Teleradiology Diagnostic Service, Inc. (TDS) from their respective acquisition dates in 2007, American Teleradiology Nighthawks, Inc. (ATN) purchased on September 30, 2005, and DayHawk Radiology Services, LLC (DayHawk) purchased in November, 2004. The historical results presented below are not necessarily indicative of financial results to be achieved in future periods.

	For the Years Ended December 31,				
	2007	**2006**	**2005**	**2004**	**2003**
Service Revenue	$ 151,662,042	$ 92,168,246	$ 64,061,528	$ 39,283,002	$ 16,216,322
Operating Income	26,127,290	23,398,928	17,321,781	11,714,091	4,760,287
Net Income (Loss)	14,693,846	(28,401,117)	(29,960,392)	3,325,239	4,785,565
Net Income (Loss) Applicable to Common Stockholders	$ 14,693,846	$ (28,518,651)	$ (36,509,398)	$ 2,560,497	$ 4,785,565
Earnings (Loss) Per Common Share:					
Basic	$ 0.49	$ (1.00)	$ (2.11)	$ .11	$ .10
Diluted	$ 0.47	$ (1.00)	$ (2.11)	$ .11	$ .10
Cash Flow Data					
Net cash provided by operating activities	23,636,708	19,130,678	11,528,548	10,244,913	4,327,584
Net cash used in investing activities	(123,424,530)	(40,048,534)	(3,305,069)	(2,843,841)	(1,028,578)
Net cash provided by (used in) financing activities	85,243,472	54,808,187	(1,426,853)	(3,771,381)	(1,168,155)
Total Assets	263,465,687	116,066,366	35,535,762	17,262,330	6,551,429
Total Long-Term Debt (including current portion)	99,500,000		24,003,429	12,000,000	
Total Liabilities	128,776,973	13,436,632	85,183,990	23,468,422	917,300
Common Stock Data					
Market price at year end	$ 21.05	$ 25.50	N/A	N/A	N/A
Average number of common shares outstanding (1)	30,083,080	28,528,079	17,273,970	24,196,437	49,732,156
Dividends declared per common share			$ 0.844		
Preferred Stock Data					
Redeemable convertible preferred shares outstanding			6,500,003	6,500,003	
Dividends declared per convertible preferred share		$ 0.844	$ 0.295		

(1) The weighted average shares of common stock outstanding for the years ended December 31, 2004 and 2003 are based on the assumed conversion of LLC units into common stock at the beginning of 2001 based on the conversion ratio from the recapitalization transaction.

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ITEM 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read in conjunction with our audited consolidated financial statements and notes thereto that appear elsewhere in this report. This discussion contains forward-looking statements reflecting our current expectations that involve risks and uncertainties. Actual results may differ materially from those discussed in these forward-looking statements due to a number of factors, including those set forth in the section entitled Risk Factors and elsewhere in this report.

Overview

NightHawk Radiology Holdings, Inc. is leading the transformation of the practice of radiology by providing high-quality, cost-effective services to radiology groups and hospitals throughout the United States. We provide the most complete suite of solutions, including professional services, business services, and our advanced, proprietary clinical workflow technology, all designed to increase efficiencies and improve the quality of patient care and the lives of physicians who provide it. Our team of U.S. board-certified, state-licensed, and hospital-privileged physicians located in the United States, Australia, and Switzerland, provides services 24 hours a day, seven days a week, for more than 750 customers covering approximately 26% of all U.S. hospitals. For more information, visit www.nighthawkrad.net.

Nighthawk Radiology Services, LLC, an Idaho limited liability company, is our wholly-owned subsidiary and was formed in Coeur d Alene, Idaho in 2001 to serve as the entity through which we conduct our primary operations. In March 2004, NightHawk Radiology Holdings, Inc. was formed to facilitate a recapitalization of Nighthawk Radiology Services, LLC.

On February 8, 2006, a registration statement relating to our initial public offering of our common stock was declared effective by the Securities and Exchange Commission. Under this registration statement, we registered the issuance of 5,800,000 shares of our common stock, and another 1,445,000 shares of our common stock sold by certain selling stockholders. All 7,245,000 shares of common stock issued pursuant to the registration statement, including the 1,445,000 shares sold by the selling stockholders, were sold at a price to the public of $16.00 per share.

Recent Acquisitions

On July 16, 2007, we acquired all of the outstanding equity interests of Midwest Physicians Services, LLC (MPS) and Emergency Radiology Services (ERS) from SPR Holdings II, LLC. MPS was formed by St. Paul Radiology, P.A. (St. Paul Radiology) to provide a complete suite of business process services to support its radiology practice. This suite of business process services includes revenue cycle management, administrative, information technology and other services critical to the operation of a radiology group. With this acquisition, we now provide a more complete suite of radiology solutions, including professional services, our proprietary workflow technology, and business process solutions.

We acquired all of the outstanding equity interests of MPS and ERS for an aggregate consideration of (i) $62.9 million in cash including certain costs associated with the acquisition and (ii) a warrant that was issued to St. Paul Radiology. This warrant entitles St. Paul Radiology to purchase 300,000 shares of our common stock at any time after July 16, 2010 and before July 16, 2017 at a price equal to the market price of a share of our common stock at closing on July 16, 2007, which was $18.75 at close. The fair value of the warrant of $3.3 million was calculated using a Black-Scholes model. $57.5 million of the cash portion of the purchase price was paid to SPR Holdings at closing and the remaining $5.0 million was placed into an escrow account to serve as a source of funds to satisfy the indemnification obligations of SPR Holdings under the purchase agreement.

On April 5, 2007, we completed the acquisition of The Radlinx Group, Ltd. (Radlinx), a privately held radiology services company. The acquisition expands our core off-hours business and helps grow our final

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interpretation and sub-specialty business, while increasing our domestic presence and capabilities. We acquired Radlinx for total consideration consisting of $53.0 million in cash at closing plus additional cash consideration to be paid as an earnout within 45 days of the one-year anniversary of the closing, which amount will be calculated as 25% of the revenues generated by certain Radlinx customers during that period. As of December 31, 2007, we have recorded an additional liability of $4.9 million for this contingent consideration.

On February 9, 2007, we acquired Teleradiology Diagnostic Service, Inc. (TDS). We regard the acquisition of TDS as a strategic acquisition of an off-hours professional radiology services business that is supplemental to our current business and that expands our presence in California. We purchased TDS for an aggregate price of $23.8 million dollars, of which $21.8 million was paid in cash at the closing of the acquisition and $1.2 million to be paid out at the conclusion of the eighteen month escrow period.

On September 30, 2005, we acquired American Teleradiology Nighthawks, Inc. (ATN). The acquisition of ATN was thought of as an acquisition of two distinct businesses (i) an off-hours teleradiology business that was supplemental to our off-hours business, and (ii) nascent hospital business that focused on partnering with radiologists in order to supplement the services they provide to their hospitals. The consideration that was possibly to be paid to the ATN stockholders in connection with the acquisition was based exclusively upon the future financial performance of these two businesses. Specifically, the consideration to the stockholders of ATN was to be calculated as follows:

Up-Front Payment: 315,279 shares of our common stock issued on September 30, 2005,

Off-Hours Earnout: $3,511,025 was recorded as additional consideration in September 2006, to be issued as an estimated 183,000 shares of our stock to stockholders of ATN as of the acquisition date. The additional consideration was calculated in accordance with the provisions of the purchase agreement as the amount equal to (a) the quotient obtained by dividing (i) revenue generated by the off-hours teleradiology business from ATN customers during the twelve month period ended September 30, 2006 by (ii) $12.69 (which was the value per share of our common stock on the date of completion of the acquisition (as agreed by the parties)) minus (b) 315,279 (which was the number of shares of our common stock issued to the stockholders of ATN at the completion of the acquisition).

Hospital Earnout: If the hospital business proved to be profitable in the 18 months following the acquisition, additional shares of our common stock were to be issued in an amount equal to the sum of (a) the quotient obtained by dividing (i) earnings before interest, taxes, depreciation and amortization, or EBITDA, generated by the hospital business during the twelve month period ending March 31, 2007 by (ii) $12.69, which was the value per share of our common stock on the date of completion of the acquisition (as agreed by the parties), plus (b) the quotient obtained by dividing (A) three times (3x) the EBITDA amount described in clause (i) by (B) the fair market value of our common stock, determined on a per share basis, on March 31, 2007. During the quarter ended March 31, 2007, we determined that the hospital business did not generate any EBITDA and, thus, that no amount was earned for the second component of the contingent consideration.

Both components of the contingent consideration amount are currently subject to dispute and are being negotiated between the former stockholders of ATN and our management. Although the company does not believe that additional shares will be issued as part of the hospital business earnout described above, the contingent consideration components ultimately due is subject to resolution of this dispute and agreement by the parties.

The 315,279 shares of common stock that were issued at the completion of the acquisition were recorded at par value as common stock with additional amounts up to fair value recorded as Additional Paid-In Capital. The shares, if any, that may be issued as a result of negotiation between the parties will be recorded in a similar manner upon resolution.

Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America, or U.S. GAAP. The preparation of these financial statements in accordance with U.S. GAAP requires us to utilize accounting policies and make certain estimates and

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assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingencies as of the date of the financial statements and the reported amounts of revenue and expenses during a fiscal period. The SEC considers an accounting policy to be critical if it is important to a company s financial condition and results of operations, and if it requires the exercise of significant judgment and the use of estimates on the part of management in its application. We have discussed the selection and development of the critical accounting policies with the audit committee of our board of directors, and the audit committee has reviewed our related disclosures in this report. Although we believe that our judgments and estimates are appropriate, actual results may differ from those estimates.

We believe the following to be our critical accounting policies because they are both important to the portrayal of our financial condition and results of operations and they require critical management judgment and estimates about matters that are uncertain:

- revenue recognition and allowance for doubtful accounts,
- stock-based compensation,
- use of estimates,
- purchase accounting and long-lived assets including goodwill and other acquired intangible assets,
- income taxes,
- derivative accounting, and
- accounting for redeemable preferred stock.

If actual results or events differ materially from those contemplated by us in making these estimates, our reported financial condition and results of operations for future periods could be materially affected. See Risk Factors for certain matters that may affect our future results of operations or financial condition.

Revenue Recognition and Allowance for Doubtful Accounts

We enter into services contracts with our customers that typically have a one year term, and automatically renew for each successive year unless terminated by the customer or by us. The amount we charge for our radiology services varies by customer based on a number of factors, including the hours of coverage we provide for the customer, the number of interpretations we provide to the customer and the technical and administrative services we provide to the customer. We recognize revenue when we have satisfied all of our significant contractual obligations to our customers and we determine that the collection of the resulting receivable is reasonably assured. Revenue from services is recognized in the fiscal month in which the radiological interpretation is complete and forwarded to the customer. We review our historical collection experience on a quarterly basis to determine the necessity of a provision for doubtful accounts. As of December 31, 2007 and 2006, we had reserved $0.6 million and $0.4 million, respectively, for doubtful accounts based on our estimate of the collectibility of outstanding receivables as of that date.

Stock-Based Compensation

Physician Stock-Based Compensation. We record share-based compensation expense in connection with any grant of stock options, restricted stock units, or other issuance of shares of common stock to our affiliated radiologists. We calculate the share-based compensation expense associated with the issuance of stock options to our affiliated radiologists in accordance with Statement of Financial Accounting Standard (SFAS) No. 123 (revised 2004), *Share-Based Payment* (SFAS 123 (R)) and Emerging Issues Task Force Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Service*s (EITF 96-18), by

determining the fair value using a Black-Scholes model. In accordance with EITF 96-18, because our radiologists are independent contractors, we calculate the fair value of the share-based compensation expense in each period. The expense amount is determined by calculating the fair

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value of the shares earned in each period and recording that amount as expense during such period. If the price of our common stock increases over a given period, this accounting treatment results in compensation expense that exceeds the expense we would have recorded if these individuals were employees. Stock-based compensation to our affiliated radiologists is included in professional services expense.

Non-Physician Stock-Based Compensation. We also record stock-based compensation expense in connection with any grant of stock options, restricted stock units, warrants or other issuance of shares of common stock to employees, directors and non-physician contractors. We calculate the stock-based compensation expense associated with the issuance of stock options and warrants to our employees, directors and non-physician contractors in accordance with SFAS No. 123 (R) by determining the fair value using a Black-Scholes model. We calculate the stock-based compensation expense related to the issuance of restricted stock units or shares of our common stock to our employees, directors and non-physician contractors based on the fair value of our common stock on the date the restricted stock units or shares are issued. Stock-based compensation to employees and non-physician contractors is included in sales, general and administrative expense.

Determination of Fair Value of our Stock Options. As indicated above, we record stock-based compensation expense associated with our stock options in accordance with SFAS 123 (R) and EITF 96-18, as applicable, which require us to calculate the expense associated with our stock options by determining the fair value of the options. To determine the fair value of our stock options, we use a Black-Scholes model which takes into account the exercise price of the stock option, the fair value of the common stock underlying the stock option, as measured on the date of grant (or at each reporting date for grants to non-employees that require future service), and an estimation of the volatility of the common stock underlying the stock option.

Use of Estimates

On an ongoing basis, we evaluate our estimates relating to the items described below. We generally base our estimates on our historical experience (which is limited) and on various other assumptions that we believe to be reasonable along with the guidance provided by SFAS No. 5, *Accounting for Contingencies*, the results of which form the basis for making judgments about the carrying values of assets and liabilities.

Accounts receivable allowance. We monitor customer payments and maintain a reserve for estimated losses resulting from our customers inability to make required payments. In estimating the reserve, we evaluate the collectibility of our accounts receivable from a specific customer when we become aware of circumstances that may impair the customer s ability to meet its financial obligations and record an allowance against amounts due. To date, we have not experienced any material difficulties in collecting payments from our customers and only began maintaining a reserve for potential customer nonpayment during 2005. We believe that the potential aggregate amount of nonpayment by our customers is limited in part by the frequency of our billing cycle and the ease with which we may discontinue service to customers during periods of nonpayment. However, actual future losses from uncollectible accounts may differ from our estimates due to our limited experience in establishing reserves for nonpayment, our limited history of non-collection, and the difficulty in predicting the future payment practices of a large number of customers.

Fair value of redeemable preferred stock conversion feature. Prior to the date of our initial public offering, our estimates of the fair value of our redeemable preferred stock conversion feature were determined by management. However, because our outstanding redeemable preferred stock converted into common stock at the closing of our initial public offering, we will not record any additional charges associated with the change in fair value of the conversion feature after such date. As a result, since the closing of our initial public offering, we are no longer required to make these estimates.

Loss contingency for medical liability claims. We record a loss contingency for a medical liability claim in the month in which we deem such liability to be probable. Our determination of the probability of the liability is based upon a review of the claim by our executive staff, legal counsel and insurance carrier. Upon the

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determination that the liability is probable, we record a loss contingency for the claim up to the amount of the deductible specified in our medical liability insurance policy. To date, we have not experienced any liabilities for claims that were in excess of our prior loss contingency estimates for such claims. However, actual future losses from medical liability claims may differ from our estimates to the extent that we suffer an adverse determination for a claim that we did not deem the liability probable, did not record a loss contingency up to the maximum amount of our insurance deductible, or do not have insurance coverage or indemnification rights.

Incurred But Not Reported Claims. Starting in 2006, we started using actuarial assumptions to estimate and record a liability for incurred but not reported (IBNR) professional liability claims. Our estimated IBNR liability is based on long-term industry trends and averages, and considers a number of factors, including changes in claim reporting patterns, claim settlement patterns, judicial and legislative decisions, and economic conditions. Our estimated IBNR liability will fluctuate if claims experience changes over time.

Purchase Accounting and Long-Lived Assets Including Goodwill and Other Acquired Intangible Assets

The acquisitions of the MPS, ERS, Radlinx, TDS and ATN businesses were accounted for using the purchase method of accounting as prescribed in SFAS 141. Accordingly, purchase accounting adjustments have been reflected in our financial statements for all periods subsequent to the respective purchase dates. The purchase accounting entries are reflected on our financial statements as of the purchase date. In accordance with SFAS No. 141, as amended, Business Combinations (SFAS 141), we have revalued the assets and liabilities acquired as part of the acquisitions of MPS, ERS, Radlinx, TDS, and ATN at their respective fair values.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (SFAS 141(R)) which establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any controlling interest; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effect of the business combination. SFAS 141(R) will be effective for us on January 1, 2009. We are currently evaluating the impact of adopting SFAS 141(R).

Under the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets*, (SFAS 142), we do not amortize goodwill. Certain intangible assets are amortized over their estimated useful lives. Goodwill and unamortized intangible assets are evaluated for impairment at least annually or more frequently if events and circumstances indicate that the goodwill and intangible assets might be impaired. Amortized other intangible assets are evaluated for impairment in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, (SFAS 144) when events and circumstances indicate that the assets might be impaired.

SFAS 144 requires impairment losses to be recognized for long-lived assets through operations when indicators of impairment exist and the underlying cash flows are not sufficient to support the asset s carrying value. In addition, SFAS 144 requires that a long-lived asset (disposal group) to be sold that meets certain recognition criteria be classified as held for sale and measured at the lower of carrying amount or fair value less cost to sell. SFAS 144 also requires that a long-lived asset subject to closure (abandonment) before the end of its previously estimated useful life continue to be classified as held and used until disposal, with depreciation estimates revised to reflect the use of the asset over its shortened useful life.

We regularly evaluate the carrying value of intangible and long-lived assets for events or changes in circumstances that indicate that the carrying amount may not be recoverable or that the remaining estimated useful life should be changed. Potential indicators of impairment can include, but are not limited to (1) history of operating losses or expected future losses, (2) significant adverse change in legal factors, (3) changes in the extent or manner in which the assets are used, (4) current expectations to dispose of the assets by sale or other means, and (5) reductions or expected reductions of cash flow. If we determine there is an indication of

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impairment, we compare undiscounted net cash flows to the carrying value of the respective asset. If the carrying value exceeds the undiscounted net cash flows, we perform an impairment calculation using discounted cash flows, valuation analyses or comparisons to recent sales or purchase transactions to determine estimated fair value.

Income Taxes

We account for income taxes in accordance with SFAS No. 109 (FAS 109), *Accounting for Income Taxes.* This standard requires, among other things, the separate recognition of deferred tax assets and deferred tax liabilities. Such deferred tax assets and deferred tax liabilities represent the tax effect of temporary differences between financial reporting and tax reporting measured at enacted tax rates in effect for the year in which the differences are expected to reverse. In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48), which requires that we recognize only the impact of tax positions that, based on their technical merits, are more likely than not to be sustained upon an audit by the taxing authority. FIN 48 also specifies standards for estimating and recognizing interest income and expense associated with the tax positions.

Developing our provision for income taxes, including our effective tax rate and analysis of potential tax exposure items, if any, requires significant judgment and expertise in federal and state income tax laws, regulations and strategies, including the determination of deferred tax assets and liabilities and any estimated valuation allowances we deem necessary to value deferred tax assets. Our judgments and tax strategies are subject to audit by various taxing authorities. While we believe we have provided adequately for our income tax liabilities in our consolidated financial statements, adverse determinations by these taxing authorities could have a material adverse effect on our consolidated financial condition, results of operations or cash flows.

Derivative Accounting

In accordance with U.S. GAAP, we recognize all derivatives on the consolidated balance sheet at fair value. We designate at inception whether the derivative contract is considered hedging or non-hedging in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133). If the derivative qualifies and is designated as a hedge, depending on the nature of the hedge, changes in its fair value will either be offset against the change in fair value of the hedged item through earnings or recognized in other comprehensive income (loss) until the hedged item is recognized in earnings. The ineffective portion of a derivative s change in fair value will be immediately recognized in earnings. During 2007, we entered into two interest rate swap contracts with a combined notional amount of $100,000,000 in connection with our outstanding debt. The contracts expire on September 30, 2009 and 2010, respectively. The contracts were initiated to maintain compliance with debt requirements and to protect us against changes in the interest payments associated with its variable-rate long-term debt, and therefore are considered cash flow hedges. As a result, as long as the swap is deemed highly effective, changes in the fair value of the swaps are recorded as either an asset (a gain position), or a liability (a loss position) on the balance sheet, with the offset recorded in accumulated other comprehensive income, a separate component of shareholders equity.

Accounting for Redeemable Preferred Stock

We account for derivative financial instruments in accordance with SFAS 133. We record derivative financial instruments as assets or liabilities in our consolidated balance sheets, measured at fair value. We record the change in fair value of such instruments as non-cash gains or losses in our consolidated statements of operations. We do not enter into derivative contracts for trading purposes.

On March 31, 2004, in connection with the organization and capitalization of NightHawk Radiology Holdings, Inc., we issued 6,500,003 shares of redeemable preferred stock for a total consideration of $13.0 million. Each share of redeemable preferred stock was convertible, at the option of the holder, into one share of

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common stock. The conversion feature of the redeemable preferred stock was considered an embedded derivative under the provisions of SFAS 133, and accordingly was accounted for separately from the redeemable preferred stock. We determined the fair value of the redeemable preferred stock conversion feature based upon the fair value of the underlying common stock. On the date of issuance, the estimated fair value of the conversion feature was $1.7 million which was recorded as a liability on the date of issuance, thus reducing the recorded value of the redeemable preferred stock to $11.3 million. At each balance sheet date, we adjusted the carrying value of the embedded derivative to estimated fair value and recognized the change in such estimated value in our consolidated statements of operations.

We also classified the redeemable preferred stock as mezzanine equity. As such, we accreted the carrying value of such stock to its redemption value using the effective interest method through the redemption period. In addition, the redeemable preferred stock accrued dividends since the date of issuance. We recognized these two types of accretion of redeemable preferred stock in our consolidated statement of operations as a decrease in net income available to common stockholders.

At the closing of our initial public offering, all outstanding shares of redeemable preferred stock converted into common stock. As a result, beginning at the closing of the initial public offering we have not recorded any additional charge associated with the change in fair value of the conversion feature. Effective February 9, 2006, the amount reported as fair value of the redeemable preferred stock conversion feature was reclassified to additional paid-in capital in the equity section of the balance sheet. Also, the rights of the holders of redeemable preferred stock to receive accrued dividends or to exercise redemption rights terminated. As a result, the accretion of redeemable preferred stock also terminated. These amounts were reclassified to stockholders equity.

How We Generate Revenue

Historically, we have generated substantially all of our revenue from the professional radiology services that we provide our customers. We typically provide these services pursuant to one-year services contracts that automatically renew for each successive year unless terminated by the customer or by us. The amount we charge for our radiology services varies by customer based upon a number of factors, including the hours of coverage we provide for the customer, the number of interpretations we perform for the customer and the technical and administrative services we provide to the customer.

More recently, through our acquisition of Midwest Physician Services announced on July 16, 2007, we have expanded our service offerings for radiology groups to include business services such as revenue cycle management, human resources services, facilities management, accounting and financial services, transcription services, records management, operational support, and quality assurance program support.

We also license the use of our proprietary clinical workflow technology to customers which includes both hosted applications and related services such as implementation setup, training, report customization and monitoring.

We recognize revenue generated by our professional and business services during the month in which services are provided and we bill our customers at the beginning of the following month. Because the invoices are typically paid directly by our customers, we do not currently depend upon any material payments by third-party payors or patients.

Since our first full year of operations, we have experienced significant revenue growth, from $4.7 million in 2002 to $151.7 million in 2007. This growth in revenue resulted primarily from:

- an increase in our customer base,
- an increase in utilization of our services by our customers,
- acquisitions,

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an expansion of services offered,

an expansion of our service hours,

a high customer retention rate, and

growth in the use of diagnostic imaging technologies and procedures in the healthcare industry.

For the full-year 2007, our exam volumes reached more than 2.7 million and our affiliated radiologists were providing services to more than 750 customers serving nearly 1,500 hospitals. The total number of hospitals we cover represents approximately 26% of all hospitals in the United States.

Most of our current customers contract with us for a limited set of professional services. There is significant opportunity among our customer base to cross-sell our services to expand the types of professional services we provide to customers and also to begin providing clinical workflow technology and business services to those customers.

Our Operating Expenses

Our operating expenses consist primarily of professional services expense, sales, general and administrative expense, interest expense and income tax expense. We record stock compensation expense in connection with equity issuances to our affiliated radiologists (which we refer to as physician stock-based compensation) and in connection with equity issuances to our employees, directors and non-physician contractors (which we refer to as non-physician stock-based compensation). In our consolidated statements of operations, we present our physician stock-based compensation expense as part of our professional services expenses and our non-physician stock-based compensation as part of our sales, general and administrative expense.

Professional Services Expense. Professional service expenses consist primarily of the fees we pay to affiliated radiologists, any physician stock-based compensation, the premiums for medical liability insurance, and any medical liability claims loss expenses. Affiliated radiologists are independent contractors compensated using a formula that is generally based upon the number of hours worked, with additional incentives for the workload completed as well as year-end discretionary bonuses. Professional services expenses are recognized in the month in which the services are performed.

Malpractice Expense. We recognize expenses associated with medical liability premiums in the month in which the expense is incurred. We record reserves for both reported and incurred but not reported (IBNR) amounts. Reported amounts are reserved based upon our best estimate of future probable costs. IBNR claims are estimated by a third party using historical claims lag information received by our third party claims administrator and industry indices. This reserve is intended to cover potential medical claims that might arise related to all of the radiological interpretations performed by our affiliated radiologists since inception.

Physician Stock-Based Compensation Expense. As described previously, we record physician stock-based compensation expense in connection with any stock options, restricted stock units or other issuance of shares of our common stock to our affiliated radiologists and present this expense in our consolidated statements of operations as part of our professional services expense. We calculate the stock-based compensation expense associated with the issuance of stock options and warrants to affiliated radiologists in accordance with SFAS No. 123(R) and EITF No. 96-18.

Sales, General and Administrative Expense. Sales, general and administrative expense consists primarily of salaries and related expenses for all employees and non-physician contractors, non-physician stock-based compensation, information technology and telecommunications expenses, costs associated with licensing and privileging our affiliated radiologists, facilities and office-related expenses, sales and marketing expenses and other general and administrative expenses.

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Non-Physician Stock-Based Compensation Expense. As described previously, we record non-physician stock-based compensation expense in connection with any grant of stock options, restricted stock units, warrants or other issuance of shares of our common stock to our employees, directors and non-physician contractors and present this expense in our consolidated statement of income as part of our sales, general and administrative expense. We calculate the stock-based compensation expense associated with the issuance of stock options and warrants to our employees, directors and non-physician contractors in accordance with SFAS No. 123(R).

Our Non-Operating Expenses

In addition to our operating expenses, we record the following non-operating expenses.

Interest Expense. The interest expense we incur in a given period is directly attributable to the principal amount of debt we have outstanding during such period.

Change in Fair Value of Redeemable Preferred Stock Conversion Feature. We entered into a stockholders agreement with the holders of our Series A preferred stock pursuant to which we agreed to repurchase all or any portion of the shares of redeemable preferred stock then held by such holders at any time after seven years from the date of issuance. The redemption provision in the stockholders agreement, which terminated upon the closing of our initial public offering, provided that the repurchase price for such shares of redeemable preferred stock would be the greater of (i) the market value of the common stock issuable upon conversion of the redeemable preferred stock or (ii) the liquidation value of such shares of redeemable preferred stock (including all accrued and unpaid dividends). The conversion feature of the redeemable preferred stock was considered an embedded derivative under the provisions of SFAS No. 133, and accordingly was accounted for separately from the redeemable preferred stock. On the date of issuance, the estimated fair value of the conversion feature was $1.7 million which was recorded as a liability on the balance sheet date on the date of issue thus reducing the recorded value of the redeemable preferred stock to $11.3 million. While these shares remained outstanding, on each balance sheet date subsequent to the execution of that agreement, we adjusted the carrying value of the embedded derivative to estimated fair value and recognized the change in such estimated value in our consolidated statements of operations.

At the closing of our initial public offering, all outstanding shares of redeemable preferred stock converted into shares of common stock, and, as a result, we do not record any additional expenses associated with the change in fair value of the conversion feature of our redeemable preferred stock after such date.

Income Tax Expense. We recognize income taxes under the asset and liability method in accordance with FAS 109. This approach requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities.

Redeemable Preferred Stock Accretion. Shares of our redeemable preferred stock accrued dividends from the date of issuance until their conversion into shares of common stock at the closing of our initial public offering. The redeemable preferred stock dividends were cumulative and accrued at a rate of 6% per annum based on the sum of the liquidation value of each share of redeemable preferred stock, $2.00, plus all accumulated and unpaid dividends. Dividends accumulated at the end of each calendar quarter. In addition to accruing dividends, we also accrued the carrying amount of the redeemable preferred stock to its redemption value using the effective interest method through the redemption period. We recognized these two types of accretion of redeemable preferred stock in our consolidated statements of operations as a decrease in net income available to common stockholders.

At the closing of our initial public offering, all outstanding shares of redeemable preferred stock converted into shares of common stock and the rights of the holders of redeemable preferred stock to receive accrued dividends or to exercise redemption rights terminated. As a result, the accretion relating to our redeemable preferred stock also terminated. These amounts are now reported within stockholders equity.

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Trends in our Business and Results of Operations

Revenue Trends. Our business has grown rapidly since inception. This growth has been driven by an increase in our customer base, an increase in utilization of our service by our customers, acquisitions, an expansion of services offered, an expansion of our service hours, a high customer retention rate and the growth in the use of diagnostic imaging technologies and procedures in the healthcare industry. Our strategy is to expand on our position as the leading provider of radiology services by:

- continuing to expand our service offerings in final and sub-specialty interpretations, cardiac imaging services and business process services,
- expanding our radiology group customers utilization of our services as they implement coverage of additional hospitals,
- targeting new customers,
- pursuing both strategic and tactical acquisitions, and
- developing markets for our data and technology solutions.

Our revenue has increased in absolute dollars each year since inception and our revenue growth rate has been strong year over year. Our 2007 fourth quarter and full year revenues grew 77% and 65% respectively, compared to the same periods in 2006. We expect that a number of our customers will implement our new service offerings, continue to implement coverage for additional hospitals as well as continue to use additional hours of our service, resulting in an overall increase in the utilization of our service by those customers.

Volume and revenue trends are driven by continuing growth in imaging demand, strong customer retention and recurring revenue streams, and expanded service offerings. Historically, we have seen an increase in exam volumes during the second and third quarters of each fiscal year, when weather conditions tend to be warmer in much of the United States and our customers take greater advantage of our coverage. During the first and fourth quarters of each fiscal year, when weather conditions are colder for a large portion of the United States, we have historically experienced relatively lower exam volumes than those experienced during the second and third quarters. We expect this seasonality to continue. A summary of our historical volumes is as follows:

			Growth Rates		Acquisition Contribution First 12 months			
Quarter	**Year**	**Total Volumes**	**Sequential**	**Year over Year**	**DayHawk**	**ATN**	**TDS**	**Radlinx**
Q1	2004	120,554	36%	210%				
Q2	2004	152,640	27%	178%				
Q3	2004	182,737	20%	133%				
Q4	2004	193,883	6%	119%	8,316			
FY	**2004**	**649,814**	**149%**	**149%**				
Q1	2005	222,341	15%	84%	15,850			
Q2	2005	266,023	20%	74%	17,355			
Q3	2005	298,759	12%	63%	18,905			
Q4	2005	328,815	10%	70%	8,480	29,640		
FY	**2005**	**1,115,938**	**72%**	**72%**				
Q1	2006	364,155	11%	64%		32,130		
Q2	2006	417,269	15%	57%		32,622		
Q3	2006	463,028	11%	55%		32,086		

Q4	2006	448,084	(3)%	36%		
FY	**2006**	**1,692,536**	**52%**	**52%**		
Q1	2007	484,477	8%	33%	27,089	
Q2	2007	731,418	51%	75%	51,095	137,611
Q3	2007	787,673	8%	70%	52,708	143,339
Q4	2007	730,992	(7)%	63%	51,644	124,394
FY	**2007**	**2,734,560**	**62%**	**62%**		

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Trends in Professional Service Fees. Since inception, our professional service fees have increased in absolute dollars each year, primarily due to the addition of new radiologists to perform an increased workload as our business has grown. We expect that our professional service fees will continue to increase in absolute dollars as we contract with additional radiologists to meet the increasing demand for our services, as we begin to offer additional services, and as a result of scheduled increases in hourly fees under our existing agreements with our affiliated radiologists. We expect our margins to improve and professional services expense to decline as a percentage of revenue compared to current levels as we integrate our recent acquisitions and as our new affiliated radiologists productivity improves.

Trends in Medical Liability Expense. Our medical liability expense has also increased in absolute dollars each year since inception, primarily due to increases in our medical liability premiums as our business has grown and our reporting of IBNR. We expect our medical liability premiums and our IBNR expense to continue to increase in absolute dollars in future periods as our business continues to grow. In addition, if we have claims in future periods for which we deem a liability to be probable, our medical liability expense may increase.

Trends in Physician Stock-Based Compensation Expense. The amount of physician stock-based compensation expense we record in a given period depends primarily on the number of shares subject to outstanding options held by our affiliated radiologists, the number of hours worked, and the change in the value of our common stock in that period. Because of the accounting treatment required by EITF 96-18, if the value of our common stock increases over a given period, we will record a compensation expense that generally exceeds the expense we would have recorded if these individuals were employees because EITF 96-18 requires us to record the increase in the value of the option during such period as an expense. Our expense in future periods for physician stock-based compensation will be driven primarily by new equity-based grants we make to our affiliated radiologists, the rate at which those equity awards and the currently outstanding options are earned over such periods, as well as changes, if any, in our stock price during such periods.

Trends in Sales, General and Administrative Expense. Our sales, general and administrative expense has increased in absolute dollars each year since inception primarily as a result of increased payroll expenses in connection with the addition of key management personnel and general headcount necessary to support our growth. Our employee headcount increased from 223 at December 31, 2006 to 503 at December 31, 2007. We expect that payroll expenses will continue to rise as we increase headcount at all levels of our business as we continue to grow. In addition to rising payroll expense, we expect that our general and administrative expenses will increase in absolute dollars due to increases in telecommunications and information technology costs, licensing and privileging costs and increased accounting, legal and consulting costs. Also, we expect that our general and administrative expense will increase in absolute dollars with the additions of our offices in San Francisco, California, Austin, Texas, Dallas, Texas, St. Paul, Minnesota and Ann Arbor, Michigan, as well as the anticipated expansion of our Coeur d Alene office in 2008. Accordingly, we expect sales, general and administrative expense to increase in absolute dollars in future periods.

Trends in Non-Physician Stock-Based Compensation Expense. The amount of non-physician stock-based compensation expense we record in a given period depends primarily on the number of shares subject to outstanding options. As we continue to grant options and restricted stock units to our employees and directors, we expect our non-physician stock-based compensation expense to continue to increase in future periods.

Trends in Interest Expense. On April 5, 2007, we entered into a Credit Agreement relating to a term loan in an amount of $53.0 million to acquire The Radlinx Group, Ltd. On July 10, 2007, we entered into an Amended and Restated Credit Agreement and increased our borrowings to $100.0 million to assist in funding the MPS and ERS acquisitions and associated fees. During the third quarter, we entered into two interest rate swap contracts to cover the full $100.0 million in borrowing and to provide a hedge for us against changes in the interest payments associated with this variable-rate long-term debt. While these swaps are in place, our effective interest rate should be approximately 7.4%. We expect our interest expense to remain consistent in future periods unless we change our debt or hedge positions.

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Trends in Interest Income. In February 2006, we completed an initial public offering of our common stock from which we received net proceeds of $84.2 million after deducting underwriter discounts and commissions and $2.1 million in offering costs. Of this amount, we invested $63.0 million in a mix of highly-liquid, investment-grade securities and cash, primarily consisting of securities issued by U.S. government and federal agencies along with money market accounts and municipal securities. We utilized a portion of these securities in our acquisitions of TDS, Radlinx, MPS and ERS. We expect this amount to change based on our future needs.

Trends and Treatment of Redeemable Preferred Stock. Upon the closing of our initial public offering, all outstanding shares of redeemable preferred stock converted into shares of common stock and the rights of the holders of redeemable preferred stock to receive accrued dividends or to exercise redemption rights terminated. As a result, since the date of the closing of our initial public offering, we have not recorded any additional expenses associated with the change in fair value of the conversion feature of our redeemable preferred stock, and the accretion relating to our redeemable preferred stock has terminated.

Results of Operations

The following table sets forth selected consolidated statements of operations data for each of the periods indicated as a percentage of service revenue.

	Fiscal Year Ended December 31,		
	2007	**2006**	**2005**
Service revenue	100%	100%	100%
Operating costs and expenses:			
Professional services (1)	42	42	35
Sales, general and administrative (2)	36	30	36
Depreciation and amortization	5	2	2
Total operating costs and expenses	83	74	73
Operating income	17	26	27
Other income (expense):			
Interest expense	(4)	(1)	(2)
Interest income	2	3	
Other, net			
Change in fair value of redeemable preferred stock conversion feature		(48)	(62)
Total other income (expense)	(2)	(46)	(64)
Income (loss) before income taxes	15	(20)	(37)
Income tax expense	6	11	10
Net income (loss)	9	(31)	(47)
Redeemable preferred stock accretion			(2)
Preferred dividends			(8)
Net income (loss) applicable to common stockholders	9%	(31)%	(57)%

(1) Includes non-cash stock-based compensation expense of $4,429,358 for 2007, $4,886,678 for 2006 and $916,170 for 2005.
(2) Includes non-cash stock-based compensation expense of $10,601,004 for 2007, $1,073,455 for 2006 and $3,273,018 (which amount includes a non-recurring, non-cash sales, general and administrative expense of $2.9 million associated with the full acceleration of shares of common stock held by a member of our board of directors) for 2005.

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Comparison of Fiscal Years Ended December 31, 2007 and December 31, 2006

Service Revenue

	Fiscal Year Ended December 31,		Change	
	2007	2006	In Dollars	Percentage
Service revenue	$ 151,662,042	$ 92,168,246	$ 59,493,796	65%

The increase in service revenue from 2006 to 2007 resulted primarily from a 23% or $21.4 million increase in organic revenue and $38.1 million in additional revenue from the TDS, Radlinx, MPS and ERS acquisitions. The organic growth is driven by a 27% increase in read volumes due to an increase in utilization by our customers of our hours of service, an increase in the number of our customers and their affiliated sites, new services and the growth in the use of diagnostic imaging technologies and procedures in the healthcare industry.

Operating Costs and Expenses

Professional Services

	Fiscal Year Ended December 31,		Change	
	2007	2006	In Dollars	Percentage
Professional services (1)	$ 63,617,406	$ 38,963,287	$ 24,654,119	63%
Percentage of service revenue	*42%*	*42%*		

(1) Includes non-cash stock-based compensation expense of $4,429,358 for 2007, $4,886,678 for 2006.

The increase in professional services expense from 2006 to 2007 resulted primarily from an increase in the number of our affiliated radiologists. From 2006 to 2007, we increased the number of our affiliated radiologists from 62 to 113. This increase was driven primarily by the addition of radiologists in connection with our acquisition of TDS and Radlinx as well as the increased demand for our services and our ability to effectively recruit additional radiologists to meet such demand. The following expenses comprise our professional services expense:

Professional Service Fees. Our professional service fees increased from $30.2 million for 2006 to $56.3 million for 2007, an 86% increase. The increase in total expense was largely due to the increased volume of radiological interpretations performed by our affiliated radiologists due to our continued growth. As a percentage of revenue, professional service fees increased from 33% for 2006 to 37% for 2007. This increase is driven by the acquisitions of TDS and Radlinx and the absorption of their professional service fee structures. We expect margins to improve and professional services expense to decline as a percentage of revenue as the integrations progress and our new affiliated radiologists productivity improves.

Physician Stock-Based Compensation Expense. The physician stock-based compensation expense decreased from $4.9 million in 2006 to $4.4 million in 2007. The decrease was driven primarily by the vesting of certain equity instruments in the fourth quarter. As a percentage of service revenue, physician stock-based compensation expense decreased from 5% for 2006 to 3% for 2007.

Medical Liability Expense. Our medical liability expense decreased from $3.9 million for 2006 to $2.9 million for 2007. Medical liability premiums remained consistent in 2006 and 2007 at $1.9 million. The 2007 expense also includes $1.0 million attributable to the increase in our estimated IBNR reserve for exposure related to potential medical liability claims that have not yet been reported. The additional IBNR costs were driven by the acquisitions of TDS and Radlinx and increasing volumes. In 2006, we recorded a $2.0 million reserve that was intended to cover potential medical claims that might arise related to all of the radiological interpretations

performed by our affiliated radiologists since inception. As a percentage of service revenue, medical liability expense decreased from 4% for 2006 to 2% for 2007.

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Sales, General and Administrative

	Fiscal Year Ended December 31,		Change	
	2007	2006	In Dollars	Percentage
Sales, general and administrative (1)	$ 54,018,090	$ 27,607,317	$ 26,410,773	96%
Percentage of service revenue	*36%*	*30%*		

(1) Includes non-cash stock-based compensation expense of $10,601,004 for 2007, $1,073,455 for 2006.

The increase in our sales, general and administrative expense from 2006 to 2007 resulted primarily from increases in payroll expense due to additional hiring and acquisitions and our increased non-physician stock-based compensation. As a percentage of service revenue, sales, general and administrative expense increased from 30% to 36% from 2006 to 2007. Higher absolute spending was driven primarily by investments in new service offerings and infrastructure, as well as the expansion of our management team along with temporary duplicative costs related to the recent acquisitions that have not yet been eliminated.

The following expenses comprise our sales, general and administrative expense:

Payroll and Related Expense. Our sales, general and administrative headcount increased from 223 at December 31, 2006 to 503 at December 31, 2007, a 127% increase, and resulted in an increase in non-stock-based payroll expense from $16.4 million to $27.5 million from 2006 to 2007, a 68% increase. This increase in payroll expense resulted from acquisitions, additions due to new business offerings, new management and personnel additions in our quality control and information technology departments.

Information Technology and Telecommunications Expense. Our non-payroll information technology and telecommunications expense increased from $2.0 million in 2006 to $3.1 million for 2007, a 50% increase. The increase in expense resulted from our acquisitions and organic growth as we have expanded our operations to include centralized facilities in locations in the United States to support our service offerings.

Facilities Expense. Our facilities and office-based expense increased from $2.0 million in 2006 to $3.4 million for 2007, a 70% increase. The increase in facilities and office-based expense was driven primarily by the increase in number of facilities and occupancy expenses associated with the acquisitions.

Other General and Administrative Expense. Our other general and administrative expense consists primarily of professional accounting, legal and consulting services, general liability insurance and employee-related expenses such as recruiting, travel and entertainment. Other general and administrative expense increased from $4.3 million in 2006 to $6.6 million in 2007, a 54% increase. The increase in other general and administrative expense was driven primarily by higher accounting and consulting costs related mostly to Sarbanes-Oxley compliance, legal costs as well as higher travel costs.

Non-Physician Stock-Based Compensation Expense. Our non-physician stock-based compensation expense increased from $1.1 million in 2006 to $10.6 million in 2007. This increase was primarily due to increased equity grants made during 2007, including a decision by the Compensation Committee to pay 2007 executive bonuses in restricted stock units in lieu of cash. The restricted stock units were granted with a 1-year vesting period to further align interest of management with those of our stockholders.

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Other Income (Expense)

Interest Expense

	Fiscal Year Ended December 31,		Change	
	2007	2006	In Dollars	Percentage
Interest expense	$ 5,885,511	$ 562,221	$ 5,323,290	947%
Percentage of service revenue	*(4)%*	*(1)%*		

Our interest expense for the 2007 consists of the interest expense incurred on term loans under our current Credit Facility. On April 5, 2007 we borrowed $53.0 million in connection with the Radlinx acquisition and an additional $47.0 million on July 10, 2007 in connection with the MPS and ERS acquisitions. Also included in interest expense is $0.4 million of amortized deferred loan fees. Our interest expense for 2006 consisted primarily of interest payable under our credit facility with Comerica Bank. Additionally, in the first quarter of 2006 we incurred an expense of $0.3 million related to unamortized deferred loan fees as a result of terminating our credit facilities with Comerica Bank. Upon the initial public offering in first quarter of 2006, we repaid the balance of the term loan with Comerica Bank and terminated the loan facility.

Interest Income

	Fiscal Year Ended December 31,		Change	
	2007	2006	In Dollars	Percentage
Interest income	$ 3,130,335	$ 3,027,917	$ 102,418	3%
Percentage of service revenue	*2%*	*3%*		

Interest income for the years ended December 31, 2007 and 2006 consisted primarily of interest income on cash balances and marketable securities purchased from the cash we received in connection with our initial public offering and our ongoing operations. In 2006, we received cash proceeds of $86.3 million, of which $30.1 million was used to repay all outstanding indebtedness to Comerica Bank. We invested the remaining balance in a mix of highly-liquid, investment-grade securities and cash, primarily consisting of securities issued by U.S. government and federal agencies along with money market accounts and municipal securities. The increase in 2007 is primarily due to a full twelve months of interest and better market returns, partially offset by the use of cash for acquisitions.

Change in Fair Value of Redeemable Preferred Stock Conversion Feature

	Fiscal Year Ended December 31,		Change	
	2007	2006	In Dollars	Percentage
Change in fair value of redeemable preferred stock conversion feature	$	$ 44,183,770	$ 44,183,770	(100)%
Percentage of service revenue	*%*	*(48)%*		

In 2006 through the closing of our initial public offering, the fair value of the redeemable preferred stock conversion feature increased by a total of $44.2 million, resulting in a non-cash expense of $44.2 million in the first quarter of 2006. At the time of the closing of our initial public offering in the first quarter of 2006, all outstanding shares of redeemable preferred stock converted into common stock, and, as a result, after such date we do not record any additional expenses associated with the change in fair value of the conversion feature of our redeemable preferred stock. We will no longer record this expense in future periods.

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Income Tax Expense

	Fiscal Year Ended December 31,		Change	
	2007	2006	In Dollars	Percentage
Income tax expense	$ 8,615,352	$ 10,047,713	$ (1,432,361)	(14)%
Percentage of service revenue	*6%*	*11%*		

We recorded income tax expense of $8.6 million for 2007 and $10.0 million for 2006. The change in income tax expense is due primarily to a corresponding change in pre-tax income, exclusive of the change in fair value of redeemable preferred stock conversion feature referred to above.

Preferred Stock Accretion

	Fiscal Year Ended December 31,		Change	
	2007	2006	In Dollars	Percentage
Preferred stock accretion	$	$ 117,534	$ 117,534	(100)%
Percentage of service revenue	*%*	*%*		

The preferred stock accretion is comprised of two types of accretion based on the underlying redeemable convertible preferred stock. For the year ended December 31, 2006, the preferred stock accretion consisted of $93,000 as a result of the accretion of dividends at a daily rate of 6% per annum, and $25,000 as a result of the amortization of the carrying amount of the redeemable convertible preferred to its redemption value using the effective interest method through the redemption period. At the time of the closing of our initial public offering in the first quarter of 2006, all outstanding shares of redeemable preferred stock converted into common stock and, as a result, after such date we did not record any additional accretion and amortization associated with the preferred stock. We will no longer record this expense in future periods.

Comparison of Fiscal Years Ended December 31, 2006 and December 31, 2005

Service Revenue

	Fiscal Year Ended December 31,		Change	
	2006	2005	In Dollars	Percentage
Service revenue	$ 92,168,246	$ 64,061,528	$ 28,106,718	44%

The increase in service revenue from the year ended December 31, 2005 to the year ended December 31, 2006 resulted primarily from a 52% increase in volumes primarily due to an increase in the number of our radiology group customers and their affiliated hospitals, an increase in utilization by our customers of our hours of service and the growth in the use of diagnostic imaging technologies and procedures in the healthcare market during this period. The number of radiology group and hospital customers to which we provided service increased from 463 as of December 31, 2005 to 551 as of December 31, 2006, a 19% increase in customers, and the number of hospital sites to which we provided service increased from 860 as of December 31, 2005 to 1,008 as of December 31, 2006, a 17% increase. The increase in the number of our customers and hospitals served resulted primarily from increased market acceptance of teleradiology as a solution, an increase in the recognition by the marketplace of the quality of our service offerings, the success by our sales professionals in generating new customers, and an improvement in our ability to meet the increased demand for our service, primarily through the addition of affiliated radiologists and the expansion of our hours of service.

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Operating Costs and Expenses

Professional Services

	Fiscal Year Ended December 31,		Change	
	2006	2005	In Dollars	Percentage
Professional services (1)	$ 38,963,287	$ 22,401,184	$ 16,562,103	74%
Percentage of service revenue	*43%*	*35%*		

(1) Includes non-cash stock-based compensation expense of $4,886,678 for 2006 and $916,170 for 2005.

The increase in professional services expense for the year ended December 31, 2006 compared to the year ended December 31, 2005 resulted primarily from an increase in the number of our affiliated radiologists providing service, an increase in our 2006 medical liability expense due to our IBNR reserve, an increase in our physician stock-based compensation expense, as well as an increase in the professional service fees we paid to our affiliated radiologists as a result of increased volumes and scheduled increases in hourly rates under the terms of the professional services agreements with our affiliated radiologists. From December 31, 2005 to December 31, 2006, we increased the number of our affiliated radiologists from 47 to 62. This increase was driven primarily by the increased demand for our services and was attributable to our ability to effectively recruit additional radiologists to meet such demand. While our professional services expense increased by 74% for the period, our professional services expense as a percentage of service revenue increased from 35% for the year ended December 31, 2005, to 43% for the year ended December 31, 2006 due to the expenses described below:

Physician Professional Service Fee Expense. Our physician professional service fee expense increased from $20.5 million for the year ended December 31, 2005 to $30.2 million for the same period in 2006, a 48% increase, and, as a percentage of service revenue, from 32% to 33% during that same period. The increase in expense was largely due to the increased volumes created by our continued growth. The slight increase as a percentage of revenue is driven by modest price declines in the current year.

Physician Stock-Based Compensation Expense. We experienced a significant increase in non-cash physician stock-based compensation expense from $0.9 million for the year ended December 31, 2005 to $4.9 million for 2006. As a percentage of service revenue, physician stock-based compensation expense increased from 1% for the year ended December 31, 2005 to 5% for the same period in 2006. This increase was driven primarily by a significant increase in our stock price which was primarily due to the completion of our initial public offering, an increased number of physicians, and increased vesting in options held by our physicians.

Medical Liability Expense. Our medical liability expense increased from $1.0 million for 2005 to $3.9 million for 2006. Of the expense recorded in 2006, $0.7 million was attributable to a claims loss contingency expense on reported medical liability claims and $2.0 million was attributable to a reserve for exposure related to potential medical liability claims that have not yet been reported. This charge represents a transition to an actuarial analysis that we were first able to complete in late 2006 due to its limited operating and claims experience. The charge is intended to cover potential medical claims that might arise related to all of the radiological interpretations performed by our affiliated radiologists since inception.

Sales, General and Administrative

	Fiscal Year Ended December 31,		Change	
	2006	2005	In Dollars	Percentage
Sales, general and administrative (1)	$ 27,607,317	$ 22,988,027	$ 4,619,290	20%
Percentage of service revenue	*30%*	*36%*		

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(1) Includes non-cash stock-based compensation expense of $1,073,455 for 2006 and $3,273,018 (which amount includes a non-recurring, non-cash sales, general and administrative expense of $2.9 million associated with the full acceleration of shares of common stock held by a member of our board of directors) for 2005.

Total sales, general and administrative expenses are up 20% over 2005. The increase in sales, general and administrative expense was primarily due to increases in payroll expense due to additional hiring and costs associated with the continued growth in our business and increased costs associated with operating as a public company. Of the $23.0 million of expense in the year ended December 31, 2005, $2.9 million was due to a non-cash stock compensation expense associated with a restricted stock grant to one of our board members. Including non-cash stock compensation expense, expressed as a percentage of service revenue, sales, general and administrative expense is down from 36% for the year ended December 31, 2005 to 30% for the year ended December 31, 2006.

The following expenses comprise our sales, general and administrative expense:

Payroll and Related Expense. Our sales, general and administrative headcount increased from 172 at December 31, 2005 to 223 at December 31, 2006, a 30% increase, and resulted in an increase in payroll expense from $11.8 million for 2005 to $16.4 million for 2006, a 39% increase. This increase in payroll expense resulted primarily from personnel additions as a result of our continued growth. Expressed as a percentage of service revenue, our sales, general and administrative payroll and related expenses remained consistent at 18% of service revenue for both periods.

Information Technology and Telecommunications Expense. Our non-payroll information technology and telecommunications expense increased from $1.7 million for the year ended December 31, 2005 to $2.0 million for year ended December 31, 2006, an 18% increase. As a percentage of service revenue, IT and telecommunications expense decreased from 3% for 2005 to 2% for 2006. This decrease resulted primarily from lower telephone service costs as we implemented cost reduction initiatives.

Facilities Expense. Our facilities and office-based expense increased from $1.5 million for the year ended December 31, 2005 to $2.0 million for the year ended December 31, 2006, a 31% increase. The increase in facilities and office-based expense was driven primarily by increased facilities and occupancy expenses associated with our facilities in Sydney, Australia, Zurich, Switzerland, Milwaukee, Wisconsin and Coeur d Alene, Idaho.

Other General and Administrative Expense. Our other general and administrative expense consists primarily of professional accounting, legal and consulting services, general liability insurance and employee related expenses such as recruiting, travel and entertainment. Other general and administrative expense increased from $3.1 million for the year ended December 31, 2005 to $4.3 million for the year ended December 31, 2006, a 39% increase. The increase in other general and administrative expense was driven primarily by increased costs associated with operating as a public company such as investor relations and increased directors and officer s insurance policy premiums as well as increase costs associated with our secondary offering in October 2006, offset by lower accounting, recruiting and legal costs. In addition, we incurred higher travel and entertainment expenses as well as increased training and costs associated with the additional headcount.

Non-Physician Stock-Based Compensation Expense. Our non-physician stock-based compensation expense decreased from $3.3 million for 2005 to $1.1 million for 2006. As a percentage of revenue, these costs were approximately 5% and 1% of revenue for the year ended December 31, 2005 and 2006, respectively. During 2005, $2.9 million of our non-physician stock-based compensation expense was related to the vesting of a restricted stock grant to one of our board members.

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Other Income (Expense)

Interest Expense

	Fiscal Year Ended December 31,		Change	
	2006	2005	In Dollars	Percentage
Interest expense	$ 562,221	$ 1,178,323	$ (616,102)	(52)%
Percentage of service revenue	*1%*	*2%*		

The interest expense for the year ended December 31, 2005 consisted primarily of interest payable under outstanding promissory notes issued to certain affiliates of Summit Partners and interest payable under a $3.0 million revolving line of credit with Silicon Valley Bank. The aggregate principal balance of the outstanding promissory notes was $9.0 million through March 31, 2005. The aggregate principal balance of our revolving credit facility with Silicon Valley Bank was $3.0 million through March 31, 2005. On April 20, 2005, we entered into a loan agreement with Comerica Bank that provided us a $12.0 million term loan facility and a $3.0 million revolving line of credit. We used the proceeds from the term loan facility to repay in full all outstanding indebtedness under the promissory notes held by the entities affiliated with Summit Partners and the revolving credit facility with Silicon Valley Bank. In September 2005, we borrowed an additional $13.0 million under our term loan facility with Comerica Bank and distributed the full amount as a special distribution to the holders of our common stock and redeemable preferred stock. Prior to the initial public offering in February 2006, we borrowed an additional $7.0 million under our term loan facility with Comerica Bank and distributed the full amount as a special distribution to the holders of our common stock and redeemable preferred stock. Thus, our interest expense for 2005 consisted primarily of interest payable under our credit facility with Comerica Bank up until the termination of that agreement in February 2006. Upon the initial public offering in first quarter of 2006, we repaid the balance of the term loan with Comerica Bank and terminated the loan facility. Additionally, in the year ended December 31, 2006 we incurred an expense of $0.3 million related to unamortized deferred loan fees as a result of terminating our credit facilities with Comerica Bank.

Interest Income

	Fiscal Year Ended December 31,		Change	
	2006	2005	In Dollars	Percentage
Interest income	$ 3,027,917	$ 67,072	$ 2,960,843	4414%
Percentage of service revenue	*4%*	*%*		

Interest income for the year ended December 31, 2006 consisted primarily of interest income on cash balances and marketable securities purchased from the cash we received in connection with our initial public offering and operations. We received cash proceeds of $86.3 million, of which $30.1 million was used to repay all outstanding indebtedness to Comerica Bank. We invested the remaining balance in a mix of highly-liquid, investment-grade securities and cash, primarily consisting of securities issued by U.S. government and federal agencies along with money market accounts and municipal securities.

Change in Fair Value of Redeemable Preferred Stock Conversion Feature

	Fiscal Year Ended December 31,		Change	
	2006	2005	In Dollars	Percentage
Change in fair value of redeemable preferred stock conversion feature	$ 44,183,770	$ 39,728,473	$ 4,455,297	11%
Percentage of service revenue	*48%*	*62%*		

During the year ended December 31, 2005, the fair value of the redeemable preferred stock conversion feature increased by a total of $39.7 million. In 2006 through the closing of our initial public offering, the fair

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value of the redeemable preferred stock conversion feature increased by a total of $44.2 million, resulting in a non-cash expense of $44.2 million in the first quarter of 2006. At the time of the closing of our initial public offering in the first quarter of 2006, all outstanding shares of redeemable preferred stock converted into common stock, and, as a result, after such date we do not record any additional expenses associated with the change in fair value of the conversion feature of our redeemable preferred stock.

Income Tax Expense

	Fiscal Year Ended December 31,		Change	
	2006	2005	In Dollars	Percentage
Income tax expense	$ 10,047,713	$ 6,391,302	$ 3,656,411	57%
Percentage of service revenue	*11%*	*10%*		

We recorded income tax expense of $10.0 million for 2006 and $6.4 million for 2005. The change in income tax expense is due to a corresponding change in pre-tax income, as compared to the same period for 2005.

Preferred Stock Accretion

	Fiscal Year Ended December 31,		Change	
	2006	2005	In Dollars	Percentage
Preferred stock accretion	$ 117,534	$ 1,062,451	$ (944,917)	(89)%
Percentage of service revenue	*%*	*2%*		

The preferred stock accretion is comprised of two types of accretion based on the underlying redeemable convertible preferred stock. For the year ended December 31, 2006, the preferred stock accretion consisted of approximately $93,000 as a result of the accretion of dividends at a daily rate of 6% per annum, and approximately $25,000 as a result of the amortization of the carrying amount of the redeemable convertible preferred to its redemption value using the effective interest method through the redemption period. For 2005, the preferred stock accretion consisted of $0.8 million as a result of the accretion of dividends and $0.2 million as a result of the amortization. At the time of the closing of our initial public offering in the first quarter of 2006, all outstanding shares of redeemable preferred stock converted into common stock and, as a result, after such date we did not record any additional accretion and amortization associated with the preferred stock. Thus, because we recorded an expense due to the accretion of our preferred stock for only a portion of the first quarter of 2006, we experienced lower expense than that recorded in 2005. We will no longer record this expense in future periods.

Preferred Dividends

	Fiscal Year Ended December 31,		Change	
	2006	2005	In Dollars	Percentage
Preferred dividends	$	$ 5,486,555	$ (5,486,555)	(100)%
Percentage of service revenue	*%*	*9%*		

In September 2005, we borrowed $13.0 million under our term loan facility with Comerica Bank and distributed the full amount as a special distribution to the holders of our common stock and redeemable preferred stock. A second dividend in the amount of $7.0 million or $0.295 per share for each share of common stock and preferred stock outstanding as of September 9, 2005 was also declared in September 2005. $5.5 million of these combined amounts was attributable to the holders of our redeemable preferred stock.

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Seasonality in Operating Results

Historically, we have seen an increase in same-site volumes during the second and third quarters of each fiscal year, when weather conditions tend to be warmer in much of the United States. We believe these increases are a result of increased outdoor and transportation activities during summer months and our customers taking greater advantage of our coverage. During the first and fourth quarters of each fiscal year, when weather conditions are colder for a large portion of the United States, we have historically experienced relatively lower same-site volumes than those experienced during the second and third quarters. We expect this seasonality to continue.

Liquidity and Capital Resources

Cash, Cash Equivalents and Marketable Securities

Our financial position includes cash, cash equivalents and marketable securities of $62.5 million at December 31, 2007 and $84.3 million at December 31, 2006.

The discussion below highlights significant aspects of our capital resources and cash flow activities (in millions).

	December 31, 2007	December 31, 2006
Capital resources		
Cash and cash equivalents	$ 31.9	$ 46.5
Marketable securities	30.6	37.8
Total	$ 62.5	$ 84.3

	December 31, 2007	December 31, 2006
Cash flow activities		
Net cash provided (used) by:		
Operating activities	$ 23.6	$ 19.1
Investing activities	(123.4)	(40.0)
Financing activities	85.2	54.8
Increase (decrease) in cash and cash equivalents	$ (14.6)	$ 33.9

The discussion below highlights significant aspects of our cash flows.

Operating Activities

Since our inception in August 2001, we have funded our operations primarily from cash flows generated by our operating activities. Net cash from operations in 2007, 2006 and 2005 was $23.6 million, $19.1 million and $11.5 million, respectively.

For the year ended December 31, 2007, we generated net cash from operations of $23.6 million from net income of $14.7 million. Significant non-cash charges included in net income that did not impact our net cash from operations during this period include depreciation and amortization of $7.9 million and stock compensation expense of $15.0 million.

For the year ended December 31, 2006, we generated net cash from operations of $19.1 million from a net loss of $28.4 million. Significant non-cash charges included in the net loss that did not impact our net cash from operations during this period include depreciation and amortization of $2.2 million, $0.3 million for the write-off of financing fees, stock compensation expense of $6.0 million and $44.2 million from the change in fair value of our redeemable preferred stock conversion feature.

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The changes in our operating assets and liabilities, net of acquired balances, and the associated impacts on our net cash from operations during the fiscal year ended December 31, 2007 as compared to the changes during the fiscal year ended December 31, 2006 are primarily due to the following factors:

Accounts Receivable. Accounts receivable increased by $8.2 million during the twelve months ended December 31, 2007 compared to a $2.5 million increase during the twelve months ended December 31, 2006. Increases in accounts receivable decrease cash from operations. The increase in receivables is due to an absolute increase in our total revenue driven growth both organically and from our acquisitions. Monthly billings at year end have increased by approximately 82% in 2007 compared to 2006.

Deferred Income Tax. Exclusive of deferred income taxes recorded in purchase accounting in connection with the business acquisitions, the deferred income tax assets increased by $6.1 million during the year ended December 31, 2007 compared to an increase of $3.4 million during the year ended December 31, 2006. The increase is primarily due to an increase in non-deductible stock compensation expense in 2007 in comparison to 2006.

Investing Activities

Net cash used in investing activities was $123.4 million for the year ended December 31, 2007. Net cash used by investing activities was primarily attributable to the use of $22.7 million for the acquisition of TDS, $41.2 million for the acquisition of Radlinx and $62.9 million for the acquisitions of MPS and ERS.

Investments in marketable securities with maturities greater than ninety days are classified as investing activities on the Consolidated Statement of Cash Flows. Investment activity during 2007 included the purchase of $34.2 million in marketable securities, offset by cash receipts of $41.8 million as a result of certain investments reaching maturity during the period. We also invested $4.6 million in property and equipment during 2007. The majority of these capital expenditures were associated with computer equipment and the continued investment in our information technology infrastructure.

Net cash used in investing activities was $40.0 million for the year ended December 31, 2006. This increase in net cash used in investing activities over this period resulted primarily from the purchase of $84.8 million in marketable securities from a portion of the net cash proceeds received from our initial public offering. We also received $47.6 million as a result of certain of our investments reaching maturity during the year ended December 31, 2006. We also invested $2.9 million in property and equipment during 2006. The majority of these capital expenditures were associated with purchases of equipment and the continued investment in our information technology infrastructure.

Financing Activities

Net cash provided by financing activities was $85.2 million for the year ended December 31, 2007. On April 5, 2007, we entered into a term loan in the amount of $53.0 million to acquire Radlinx. Immediately following the acquisition of Radlinx, we paid in full $12.6 million in assumed notes payable and lines of credit. In July 2007, we amended the credit facility and increased the loan to $100.0 million as part of the financing for the MPS and ERS acquisitions. We also incurred $4.5 million in deferred financing costs. The remaining financing activities represent the cash proceeds to us from the exercise of stock options.

Net cash provided by financing activities was $54.8 million for the year ended December 31, 2006. During the first quarter of 2006 we completed our initial public offering from which we received net proceeds of $84.7

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million after deducting discounts and commissions paid to our underwriters and $1.6 million in stock issuance costs paid during the year.

On January 2, 2006, we paid a regularly scheduled debt payment to Comerica Bank in the amount of $1.1 million. On February 8, 2006, we borrowed an additional $7.0 million under our term loan facility and distributed the full amount as a special dividend to the holders of our common stock and our then-outstanding redeemable convertible preferred stock. On February 14, 2006, we repaid in full the outstanding principal with Comerica Bank in the amount of $29.9 million with proceeds from our initial public offering. After repaying this outstanding debt, we terminated our term and revolving loan facilities with Comerica Bank.

Financial condition and liquidity

We expect our long-term liquidity needs to consist primarily of working capital, capital expenditure requirements and future acquisitions. We intend to fund these liquidity needs from cash generated from operations and through credit agreements. We entered in to a credit agreement on April 5, 2007 and amended it July 10, 2007. We borrowed $100.0 million under the Amended Credit Facility. Interest under the credit agreement is based on a floating per annum rate (based upon one, two, three or six-month interest periods) based on LIBOR plus a margin of 2.50% (7.33% at December 31, 2007). During 2007, we entered into two interest rate swap contracts to cover the full $100.0 million in borrowings and to provide a hedge for us against changes in the interest payments in the next three years associated with this variable-rate long-term debt. While these swaps are in place, our effective rate should be approximately 7.4%. The Amended Credit Facility is guaranteed by substantially all of our assets as collateral. As discussed above, we used the proceeds to purchase Radlinx, MPS and ERS. For more information on our financing activities, see Note 6 Long-Term Debt, of the Notes to Consolidated Financial Statements in Item 8. Our outstanding balance on this agreement at December 31, 2007 was $99.5 million. We believe our capital resources will be sufficient to meet our anticipated cash needs, including interest and principal payments on our outstanding debt, for at least the next twelve months.

Off-Balance Sheet Arrangements and Contractual Obligations

Off-Balance Sheet Arrangements

Our Sydney and San Francisco office leases and our medical liability insurance policy are collateralized by separate letters of credit totaling $0.7 million and $0.6 million as of December 31, 2007 and 2006, respectively.

Contractual Obligations

The following table presents a summary of our contractual obligations as of December 31, 2007:

	Payments Due Within				
(in millions)	**Less than 1 Year**	**1-3 Years**	**3-5 Years**	**More than 5 Years**	**Total**
Long-term debt obligations (a)	$ 1.0	$ 2.0	$ 2.0	$ 94.5	$ 99.5
Interest on long-term borrowings (b)	7.4	14.4	14.0	10.5	46.3
Operating lease commitments	2.5	3.9	3.1	4.4	13.9
Total contractual obligations	$ 10.9	$ 20.3	$ 19.1	$ 109.4	$ 159.7

(a) See above information on Credit Agreement.

(b) Interest paid in all years may differ due to future refinancing of debt. Interest on our floating rate debt was calculated for all years using the effective rate as of December 31, 2007 including the impact of current interest rate swap contracts.

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As a result of the adoption of FIN 48 during 2007, we have recorded a $0.3 million liability for uncertain tax positions as of December 31, 2007, of which the entire amount may result in cash payment. We are not including these amounts in the above contractual obligations table because of the difficulty in making reasonably reliable estimates of the timing of cash settlements with the respective taxing authorities.

New Accounting Pronouncements

See Note 1 for a discussion of SFAS 157, *Fair Value Measurements*, issued by the FASB in September 2006, SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, issued by the FASB in February 2007, SAFS 141(R), *Business Combinations*, issued by the FASB in December 2007, and SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment to ARB No. 51*, issued by the FASB in February 2007. We are currently evaluating the impact of these accounting pronouncements, if any, on our financial statements.

We have evaluated FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48), which was issued by the FASB in July 2006. We adopted the provisions of FIN 48 on January 1, 2007. As a result, we recorded $660,800 of unrecognized tax benefits. Final recognition of those benefits would result in corresponding unrecognized tax obligations of $601,100. Accordingly, the net impact on retained earnings for the cumulative effect of adopting FIN 48 was $59,700. All of the unrecognized tax benefits would affect our effective tax rate if recognized. See Notes 1 and 10 of the Notes to Consolidated Financial Statements in Item 8 for further discussion of the impact of FIN 48 to the financial statements.

ITEM 7A. Quantitative and Qualitative Disclosures about Market Risk

Foreign Currency Exchange Risk

Although a large number of our affiliated radiologists work from our centralized reading facilities in Australia and Switzerland, the professional service fees we pay to our affiliated radiologists are denominated primarily in U.S. dollars. As a result, only our operating leases in those countries present foreign currency exchange risks. Because we are not currently subject to material foreign currency exchange risk, we have not, to date, entered into any hedging contracts. If a weakening U.S. dollar requires us to increase the amounts we pay to our affiliated radiologists in the future in order to maintain a constant level of compensation denominated in U.S. dollars, our results of operations and cash flows could be affected. Any foreign exchange risks are related to the foreign currency exchange rates between the U.S. dollar and the Australian dollar and between the U.S. dollar and the Swiss franc.

Interest Rate Sensitivity

We had cash and cash equivalents totaling $31.9 million at December 31, 2007. These amounts were invested primarily in interest-bearing money market accounts. Additionally, we had marketable securities totaling $30.6 million at December 31, 2007 invested primarily in U.S. government agency securities and municipal securities. The cash and cash equivalents are held for working capital purposes. We do not enter into investments for trading or speculative purposes. We believe that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates. However, any declines in interest rates will reduce future investment income.

As of December 31, 2007, we had $99.5 million in variable rate debt. Because of the two interest rate swap contracts entered in to during 2007, these debt amounts are not subject to interest rate risk during the terms of such contracts. For more information on our hedging activities, see Note 12 Derivative Financial Instruments, of the Notes to Consolidated Financial Statements in Item 8.

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ITEM 8. Financial Statements and Supplementary Data

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

NightHawk Radiology Holdings, Inc.

Coeur d Alene, Idaho

We have audited the accompanying consolidated balance sheets of NightHawk Radiology Holdings, Inc. and subsidiaries (the Company) as of December 31, 2007 and 2006, and the related consolidated statements of operations, comprehensive income, stockholders equity (deficit), and cash flows for each of the three years in the period ended December 31, 2007. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of NightHawk Radiology Holdings, Inc. and subsidiaries as of December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, in 2007 the Company adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109*, which changed its method of accounting for income taxes as of January 1, 2007.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company s internal control over financial reporting as of December 31, 2007, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 14, 2008 expressed an unqualified opinion on the Company s internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP

Boise, Idaho

February 14, 2008

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NIGHTHAWK RADIOLOGY HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31, 2007	2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 31,956,468	$ 46,500,818
Marketable securities	30,624,642	37,810,963
Trade accounts receivable, net	25,665,009	12,706,146
Deferred income taxes	655,124	365,930
Prepaid expenses and other current assets	2,812,231	2,076,037
Total current assets	91,713,474	99,459,894
Property and equipment, net	10,554,913	6,192,541
Goodwill	68,601,360	4,913,844
Intangible assets, net	87,132,789	2,922,543
Deferred income taxes	1,251,113	2,480,972
Other assets, net	4,212,038	96,572
Total	$ 263,465,687	$ 116,066,366
LIABILITIES		
Current liabilities:		
Accounts payable	$ 6,071,513	$ 3,437,458
Accrued expenses	12,880,852	5,615,176
Accrued performance bonuses	2,106,610	1,024,891
Accrued payroll and related benefits	2,462,813	1,359,107
Long-term debt, due within one year	1,000,000	
Total current liabilities	24,521,788	11,436,632
Insurance reserve	3,038,000	2,000,000
Long-term debt	98,500,000	
Other liabilities	2,717,185	
Total liabilities	128,776,973	13,436,632
Commitments and contingencies (Note 7)		
STOCKHOLDERS EQUITY:		
Common stock 150,000,000 shares authorized; $.001 par value; 30,312,322 and 29,944,069 shares issued and outstanding at December 31, 2007 and 2006, respectively	30,312	29,944
Additional paid-in capital	249,273,581	230,116,635
Retained earnings (deficit)	(112,957,598)	(127,516,845)
Accumulated other comprehensive income (deficit)	(1,657,581)	
Total stockholders equity	134,688,714	102,629,734
Total	$ 263,465,687	$ 116,066,366

The accompanying notes are an integral part of the consolidated financial statements.

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NIGHTHAWK RADIOLOGY HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Years Ended December 31,		
	2007	**2006**	**2005**
Service revenue	$ 151,662,042	$ 92,168,246	$ 64,061,528
Operating costs and expenses:			
Professional services (includes non-cash compensation expense of $4,429,358, $4,886,678 and $916,170)	63,617,406	38,963,287	22,401,184
Sales, general, and administrative (includes non-cash compensation expense of $10,601,004, $1,073,455 and $3,273,018)	54,018,090	27,607,317	22,988,027
Depreciation and amortization	7,899,256	2,198,714	1,350,536
Total operating costs and expenses	125,534,752	68,769,318	46,739,747
Operating income	26,127,290	23,398,928	17,321,781
Other income (expense):			
Interest expense	(5,885,511)	(562,221)	(1,178,323)
Interest income	3,130,335	3,027,917	67,072
Other, net	(62,916)	(34,258)	(51,147)
Change in fair value of redeemable preferred stock conversion feature		(44,183,770)	(39,728,473)
Total other income (expense)	(2,818,092)	(41,752,332)	(40,890,871)
Income (loss) before income taxes	23,309,198	(18,353,404)	(23,569,090)
Income tax expense	8,615,352	10,047,713	6,391,302
Net income (loss)	14,693,846	(28,401,117)	(29,960,392)
Redeemable preferred stock accretion		(117,534)	(1,062,451)
Preferred dividends			(5,486,555)
Net income (loss) applicable to common stockholders	$ 14,693,846	$ (28,518,651)	$ (36,509,398)
Earnings (loss) per common share:			
Basic	$ 0.49	$ (1.00)	$ (2.11)
Diluted	$ 0.47	$ (1.00)	$ (2.11)
Weighted average of common shares outstanding:			
Basic	30,083,080	28,528,079	17,273,970
Diluted	31,083,971	28,528,079	17,273,970

The accompanying notes are an integral part of the consolidated financial statements.

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NIGHTHAWK RADIOLOGY HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY (DEFICIT)

	Common Stock		Additional Paid-in Capital	Other Comprehensive Income (Loss)	Retained Earnings (Deficit)	Total
	Shares	Amount				
Balance December 31, 2004	15,522,860	$ 15,523	$ 2,916,406	$	$ (25,640,879)	$ (22,708,950)
Net loss					(29,960,392)	(29,960,392)
Issuance of restricted stock to non-employees			2,926,255			2,926,255
Issuance of stock options employees			346,763			346,763
Issuance of stock options non-employees			916,170			916,170
Stock issued in acquisition	315,279	315	2,328,757			2,329,072
Accretion of redeemable common stock					(10,947,864)	(10,947,864)
Accretion of redeemable preferred stock					(1,062,451)	(1,062,451)
Dividends paid ($.549 per common and preferred share)					(13,000,000)	(13,000,000)
Dividends declared ($.295 per common and preferred share)					(7,000,000)	(7,000,000)
Balance December 31, 2005	15,838,139	$ 15,838	$ 9,434,351	$	$ (87,611,586)	$ (78,161,397)
Net loss					(28,401,117)	(28,401,117)
Shares issued upon exercise of stock options	134,498	134	403,469			403,603
Issuance of stock options employees			879,875			879,875
Issuance of stock options non-employees			5,080,258			5,080,258
Issuance of stock initial public offering	5,800,000	5,800	86,298,200			86,304,000
Stock issuance costs			(2,112,365)			(2,112,365)
Conversion of redeemable preferred stock	6,500,003	6,500	13,267,950			13,274,450
Reclassification of redeemable common stock	1,671,429	1,672	26,741,189			26,742,861
Termination of redeemable preferred stock conversion feature			89,440,020			89,440,020
Accretion of redeemable common stock					(11,386,608)	(11,386,608)
Accretion of redeemable preferred stock					(117,534)	(117,534)
Excess tax benefit from stock options exercised			683,688			683,688
Balance December 31, 2006	29,944,069	$ 29,944	$ 230,116,635	$	$ (127,516,845)	$ 102,629,734
Cumulative impact of change in accounting for in income taxes					(134,599)	(134,599)
Net income					14,693,846	14,693,846
Shares issued upon exercise of stock options and vesting of restricted stock units	368,253	368	1,162,707			1,163,075
Issuance of stock options employees			8,330,075			8,330,075
Issuance of stock options non-employees			4,705,065			4,705,065
Excess tax benefit from stock options exercised			1,624,889			1,624,889
Issuance of warrants in acquisitions			3,334,210			3,334,210
Change in fair value of derivatives, net of tax				(1,657,581)		(1,657,581)
Balance December 31, 2007	30,312,322	$ 30,312	$ 249,273,581	$ (1,657,581)	$ (112,957,598)	$ 134,688,714

The accompanying notes are an integral part of the consolidated financial statements.

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NIGHTHAWK RADIOLOGY HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended December 31,		
	2007	2006	2005
Cash flows from operating activities:			
Net income (loss)	$ 14,693,846	$ (28,401,117)	$ (29,960,392)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	7,899,256	2,198,714	1,350,536
Accretion of discounts on marketable securities	(355,644)	(634,848)	
Amortization of debt issuance costs	395,324		
Other losses	198,463	365,024	22,748
Deferred income taxes (excluding effects of acquisitions)	(6,097,929)	(3,418,406)	(771,922)
Change in fair value of redeemable preferred stock conversion feature		44,183,770	39,728,473
Non-cash stock compensation expense	15,030,362	5,960,133	4,189,188
Excess tax benefit from exercise of stock options	(1,624,889)	(683,688)	
Provision for doubtful accounts and sales credits	403,687	256,503	310,178
Changes in operating assets and liabilities (excluding effects of acquisitions):			
Trade accounts receivable	(8,244,818)	(2,477,078)	(3,717,638)
Prepaid expenses and other assets	(273,997)	(1,355,059)	(1,941,686)
Accounts payable	2,701,286	4,664,348	1,944,654
Accrued expenses	(641,042)	(1,545,186)	(115,888)
Accrued bonus	(913,503)	(306,459)	12,501
Accrued payroll and related benefits	466,306	324,027	477,796
Net cash provided by operating activities	23,636,708	19,130,678	11,528,548
Cash flows from investing activities:			
Purchase of marketable securities	(34,221,035)	(84,823,115)	
Proceeds from maturities of marketable securities	41,763,000	47,647,000	
Purchase of property and equipment	(4,546,200)	(2,872,419)	(2,841,764)
Cash and cash equivalents received from acquisitions	339,085		36,695
Cash paid for acquisitions	(126,759,380)		(500,000)
Net cash used in investing activities	(123,424,530)	(40,048,534)	(3,305,069)
Cash flows from financing activities:			
Repayments of lines of credit	(1,678,953)		(3,000,000)
Proceeds from notes payable and debt	100,000,000	7,000,000	25,780,900
Repayment of notes payable and debt	(11,366,093)	(31,003,429)	(11,207,753)
Debt issuance costs	(4,499,446)		
Proceeds from issuance of common stock, net of issuance costs		84,724,323	
Proceeds from exercise of stock options	1,163,075	403,605	
Excess tax benefit from exercise of stock options	1,624,889	683,688	
Dividends paid		(7,000,000)	(13,000,000)
Net cash provided by (used in) financing activities	85,243,472	54,808,187	(1,426,853)
Net (decrease) increase in cash and cash equivalents	(14,544,350)	33,890,331	6,796,626
Cash and cash equivalents beginning of year	46,500,818	12,610,487	5,813,861
Cash and cash equivalents end of year	$ 31,956,468	$ 46,500,818	$ 12,610,487

Supplemental disclosures of cash flow information:			
Cash paid for interest	$ 5,460,431	$ 648,236	$ 963,794
Cash paid for income taxes	13,210,019	14,119,091	6,689,743

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NIGHTHAWK RADIOLOGY HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

	For the Years Ended December 31,		
	2007	**2006**	**2005**
Non-cash investing and financing activities:			
Purchases of equipment included in accounts payable	$ 176,218	$ 78,441	$ 22,114
Acquisition costs included in accrued expenses and accounts payable	104,749		
Accretion of redeemable preferred stock		117,534	1,062,451
Accretion of redeemable common stock		11,386,608	10,947,864
Conversion of redeemable convertible preferred stock		13,274,450	
Conversion of redeemable common stock		26,742,861	
Termination of preferred stock conversion feature		89,440,020	
Stock issuance costs paid in 2005 reclassified to additional paid-in capital		532,686	
Prepayment of expenses with notes payable			780,900
Details of American Teleradiology Nighthawks, Inc. Acquisition:			
Receivables		$	$ (1,005,609)
Other assets			(257,435)
Property and equipment		105,991	(293,183)
Deferred income tax assets			(71,592)
Goodwill		(3,578,056)	(381,000)
Intangible assets			(2,680,000)
Accounts payable and other liabilities			666,215
Deferred income tax liabilities		(38,960)	1,299,945
Notes payable assumed			430,282
Issuance of common stock			2,329,072
Contingently issuable common stock		3,511,025	
Net cash received in acquisition		$	$ 36,695
Details of Teleradiology Diagnostic Service, Inc. Acquisition:			
Cash	$ 78,892		
Receivables	1,315,679		
Other assets	85,363		
Property and equipment	197,062		
Deferred income tax assets	25,808		
Goodwill	16,078,354		
Intangible assets	12,250,000		
Accounts payable and other liabilities	(1,393,825)		