GOODRICH PETROLEUM CORP
Form 10-Q
August 07, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended June 30, 2012

OR

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

Commission file number: 001-12719

GOODRICH PETROLEUM CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**76-0466193**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

801 Louisiana, Suite 700

Houston, Texas 77002

(Address of principal executive offices) (Zip Code)

(Registrant s telephone number, including area code): (713) 780-9494

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

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

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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	Smaller reporting company	¨

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

The number of shares outstanding of the Registrant s common stock as of August 1, 2012 was 36,391,165.

GOODRICH PETROLEUM CORPORATION AND SUBSIDIARY

TABLE OF CONTENTS

Table of Contents

PART 1 FINANCIAL INFORMATION

Item 1 Financial Statements

GOODRICH PETROLEUM CORPORATION AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

	June 30, 2012 (unaudited)	December 31, 2011
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 1,955	$ 3,347
Accounts receivable, trade and other, net of allowance	9,560	7,594
Income taxes receivable	147	340
Accrued oil and natural gas revenue	14,728	20,420
Fair value of oil and natural gas derivatives	40,070	56,486
Inventory	4,255	8,627
Prepaid expenses and other	1,418	4,315
Total current assets	72,133	101,129
PROPERTY AND EQUIPMENT:		
Oil and natural gas properties (successful efforts method)	1,678,180	1,542,406
Furniture, fixtures and equipment	5,977	5,654
	1,684,157	1,548,060
Less: Accumulated depletion, depreciation and amortization	(896,351)	(824,894)
Net property and equipment	787,806	723,166
Fair value of oil and natural gas derivatives	1,302	
Deferred tax assets	13,944	19,720
Deferred financing cost and other	17,673	18,088
TOTAL ASSETS	$ 892,858	$ 862,103
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 52,189	$ 46,095
Accrued liabilities	45,716	43,874
Accrued abandonment costs	474	5,176
Deferred tax liabilities current	13,944	19,720
Total current liabilities	112,323	114,865
LONG-TERM DEBT	626,510	566,126
Accrued abandonment costs	17,320	12,249
Fair value of oil and natural gas derivatives	6,059	17,420
Transportation obligation	7,213	7,743
Total liabilities	769,425	718,403

Commitments and contingencies (See Note 8)		
STOCKHOLDERS EQUITY:		
Preferred stock: 10,000,000 shares authorized: Series B convertible preferred stock, $1.00 par value, issued and outstanding 2,250,000 shares	2,250	2,250
Common stock: $0.20 par value, 100,000,000 shares authorized; issued and outstanding 36,388,801 and 36,378,508 shares, respectively	7,278	7,276
Treasury stock (530 and 44,826 shares, respectively)	(8)	(689)
Additional paid in capital	644,795	641,790
Retained earnings (accumulated deficit)	(530,882)	(506,927)
Total stockholders equity	123,433	143,700
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 892,858	$ 862,103

See accompanying notes to consolidated financial statements.

Table of Contents

GOODRICH PETROLEUM CORPORATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, Except Per Share Amounts)

(Unaudited)

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
REVENUES:				
Oil and natural gas revenues	$ 41,411	$ 52,434	$ 86,788	$ 93,352
Other	(65)	437	(134)	750
	41,346	52,871	86,654	94,102
OPERATING EXPENSES:				
Lease operating expense	6,695	5,215	15,049	10,118
Production and other taxes	2,087	1,645	4,080	2,595
Transportation and processing	3,522	2,301	7,650	4,687
Depreciation, depletion and amortization	34,562	30,927	66,840	55,886
Exploration	2,019	2,325	4,232	4,741
Impairment		1,050	2,662	1,050
General and administrative	6,690	7,328	14,611	15,578
Gain on sale of assets	(72)		(72)	(236)
	55,503	50,791	115,052	94,419
Operating income (loss)	(14,157)	2,080	(28,398)	(317)
OTHER INCOME (EXPENSE):				
Interest expense	(13,089)	(12,965)	(26,002)	(23,793)
Interest income and other	1	10	1	22
Gain on derivatives not designated as hedges	24,043	10,954	33,468	944
Gain on extinguishment of debt		3		58
	10,955	(1,998)	7,467	(22,769)
Income (loss) before income taxes	(3,202)	82	(20,931)	(23,086)
Income tax benefit				
Net income (loss)	(3,202)	82	(20,931)	(23,086)
Preferred stock dividends	1,512	1,512	3,024	3,024
Net loss applicable to common stock	$ (4,714)	$ (1,430)	$ (23,955)	$ (26,110)
PER COMMON SHARE				
Net loss applicable to common stock - basic	$ (0.13)	$ (0.04)	$ (0.66)	$ (0.72)
Net loss applicable to common stock - diluted	$ (0.13)	$ (0.04)	$ (0.66)	$ (0.72)
Weighted average common shares outstanding - basic	36,366	36,110	36,352	36,093
Weighted average common shares outstanding - diluted	36,366	36,110	36,352	36,093

See accompanying notes to consolidated financial statements.

4

Table of Contents

GOODRICH PETROLEUM CORPORATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six Months Ended June 30, 2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (20,931)	$ (23,086)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depletion, depreciation and amortization	66,840	55,886
Unrealized loss on derivatives not designated as hedges	3,753	12,168
Impairment	2,662	1,050
Amortization of leasehold costs	2,551	2,977
Share based compensation (non-cash)	3,035	3,177
Gain on sale of assets	(72)	(236)
Gain on extinguishment of debt		(58)
Amortization of finance cost and debt discount	6,272	8,203
Amortization of transportation obligation	589	
Change in assets and liabilities:		
Accounts receivable, trade and other, net of allowance	(1,964)	441
Income taxes receivable	193	3,882
Accrued oil and natural gas revenue	5,692	(8,040)
Inventory	4,371	1,088
Prepaid expenses and other	3,003	175
Accounts payable	6,095	2,259
Accrued liabilities	(4,159)	8,035
Net cash provided by operating activities	77,930	67,921
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(131,777)	(193,508)
Proceeds from sale of assets	39	172
Net cash used in investing activities	(131,738)	(193,336)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from bank borrowings	63,000	52,500
Principal payments of bank borrowings	(7,500)	(30,000)
Preferred stock dividends	(3,024)	(3,024)
Debt issuance costs	(56)	(9,094)
Other	(20)	(363)
Exercise of stock options and warrants	16	
Proceeds from high yield offering		275,000
Repurchase of convertible notes		(150,277)
Cash restricted for repurchase of convertible notes		(26,568)
Net cash provided by financing activities	52,416	108,174
DECREASE IN CASH AND CASH EQUIVALENTS	(1,392)	(17,241)

CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD		3,347		17,788
CASH AND CASH EQUIVALENTS, END OF PERIOD	$	1,955	$	547

See accompanying notes to consolidated financial statements.

Table of Contents

GOODRICH PETROLEUM CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 Description of Business and Significant Accounting Policies

Goodrich Petroleum Corporation (together with its subsidiary, we, our, or the Company) is an independent oil and natural gas company engaged in the exploration, development and production of oil and natural gas on properties primarily in (i) South Texas, which includes the Eagle Ford Shale, (ii) Northwest Louisiana and East Texas, which includes the Haynesville Shale and Cotton Valley Taylor Sand, and (iii) Southwest Mississippi and Southeast Louisiana, which includes the Tuscaloosa Marine Shale.

Principles of Consolidation The consolidated financial statements of the Company included in this Quarterly Report on Form 10-Q have been prepared, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC) and accordingly, certain information normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States (US GAAP) has been condensed or omitted. The consolidated financial statements include the financial statements of Goodrich Petroleum Corporation and its wholly-owned subsidiary. Intercompany balances and transactions have been eliminated in consolidation. The consolidated financial statements reflect all normal recurring adjustments that, in the opinion of management, are necessary for a fair presentation.

The accompanying consolidated financial statements of the Company should be read in conjunction with the consolidated financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2011. The results of operations for the three and six months ended June 30, 2012 are not necessarily indicative of the results to be expected for the full year.

Use of Estimates Our management has made a number of estimates and assumptions relating to the reporting of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities to prepare these consolidated financial statements in conformity with US GAAP.

Cash and Cash Equivalents Cash and cash equivalents include cash on hand, demand deposit accounts and temporary cash investments with maturities of ninety days or less at date of purchase.

Allowance for Doubtful Accounts We routinely assess the recoverability of all material trade and other receivables to determine their collectability. Many of our receivables are from a limited number of purchasers. Accordingly, accounts receivable from such purchases could be significant. Generally, our oil and natural gas receivables are collected within thirty to sixty days of production. We also have receivables from joint interest owners of properties we operate. We may have the ability to withhold future revenue disbursements to recover any non-payment of joint interest billings.

We accrue a reserve on a receivable when, based on the judgment of management, it is probable that a receivable will not be collected and the amount of the reserve may be reasonably estimated. As of each of June 30, 2012 and December 31, 2011, our allowance for doubtful accounts was immaterial.

Inventory Inventory consists of casing and tubulars that are expected to be used in our drilling program and oil in storage tanks. Inventory is carried on our Consolidated Balance Sheets at the lower of cost or market.

Property and Equipment We follow the successful efforts method of accounting for exploration and development expenditures. Under this method, costs of acquiring unproved and proved oil and natural gas leasehold acreage are capitalized. When proved reserves are found on an unproved property, the associated leasehold cost is transferred to proved properties. Significant unproved leases are reviewed periodically, and a valuation allowance is provided for any estimated decline in value. Costs of all other unproved leases are amortized over the estimated average holding period of the leases. Development costs are capitalized, including the costs of unsuccessful development wells.

Exploration Exploration expenditures, including geological and geophysical costs, delay rentals and exploratory dry hole costs are expensed as incurred. Costs of drilling exploratory wells are initially capitalized pending determination of whether proved reserves can be attributed to the discovery. If management determines that commercial quantities of hydrocarbons have not been discovered, capitalized costs associated with exploratory wells are expensed.

Fair Value Measurement Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of an asset should reflect its highest and best use by market participants, whether in-use or an in-exchange valuation premise. The fair value of a liability should reflect the risk of nonperformance, which includes, among other things, the Company s credit risk.

Table of Contents

GOODRICH PETROLEUM CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

We use various methods, including the income approach and market approach, to determine the fair values of our financial instruments that are measured at fair value on a recurring basis, which depend on a number of factors, including the availability of observable market data over the contractual term of the underlying instrument. For some of our instruments, the fair value is calculated based on directly observable market data or data available for similar instruments in similar markets. For other instruments, the fair value may be calculated based on these inputs as well as other assumptions related to estimates of future settlements of these instruments. We separate our financial instruments into three levels (levels 1, 2 and 3) based on our assessment of the availability of observable market data and the significance of non-observable data used to determine the fair value of our instruments. Our assessment of an instrument can change over time based on the maturity or liquidity of the instrument, which could result in a change in the classification of the instruments between levels.

Each of these levels and our corresponding instruments classified by level are further described below:

Level 1 Inputs unadjusted quoted market prices in active markets for identical assets or liabilities. Included in this level is our Senior Notes;

Level 2 Inputs quotes which are derived principally from or corroborated by observable market data. Included in this level are our Senior Credit Facility and commodity derivatives whose fair values are based on third-party quotes or available interest rate information and commodity pricing data obtained from third party pricing sources and our creditworthiness or that of our counterparties; and

Level 3 Inputs unobservable inputs for the asset or liability, such as discounted cash flow models or valuations, based on the Company s various assumptions and future commodity prices. Included in this level are our oil and natural gas properties which are deemed impaired.

At each of June 30, 2012 and December 31, 2011, the carrying amounts of our cash and cash equivalents, trade receivables and payables represented fair value because of the short-term nature of these instruments.

Impairment We periodically assess our long-lived assets recorded in oil and natural gas properties on the Consolidated Balance Sheets to ensure that they are not carried in excess of fair value, which is computed using Level 3 inputs such as discounted cash flow models or valuations, based on estimated future commodity prices and our various operational assumptions. An evaluation is performed on a field-by-field basis at least annually or whenever changes in facts and circumstances indicate that our oil and natural gas properties may be impaired.

As of June 30, 2012, we have interests in oil and natural gas properties totaling $786.2 million, net of accumulated depletion, which we account for under the successful efforts method. The expected future cash flows used for impairment reviews and related fair-value calculations are based on judgmental assessments of future production volumes, prices, and costs, considering all available information at the date of review. Due to the uncertainty inherent in these factors, we cannot predict when or if additional future impairment charges will be recorded. We estimated future net cash flows generated from our oil and natural gas properties by using oil and natural gas futures prices published by the New York Mercantile Exchange (NYMEX).

We determined during the first quarter of 2012 that the carrying amount of certain of our non-core oil and natural gas properties were not recoverable from future cash flows due to declining natural gas prices and, therefore, we recorded an impairment of $2.7 million for the three months ended March 31, 2012. These impairment charges reduced the fields carrying value to an estimated fair value of $0.9 million. No impairments were recorded for the three months ended June 30, 2012.

Depreciation Depreciation and depletion of producing oil and natural gas properties is calculated using the units-of-production method. Proved developed reserves are used to compute unit rates for unamortized tangible and intangible development costs, and proved reserves are used for unamortized leasehold costs.

Gains and losses on disposals or retirements that are significant or include an entire depreciable or depletable property unit are included in operating income. Depreciation of furniture, fixtures and equipment, consisting of office furniture, computer hardware and software and leasehold improvements is computed using the straight-line method over their estimated useful lives, which vary from three to five years.

GOODRICH PETROLEUM CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Transportation Obligation We entered into a gas gathering agreement with an independent service provider, effective July 27, 2010. The agreement is scheduled to remain in effect for a period of ten years and requires the service provider to construct pipelines and facilities to connect our wells to the service provider s gathering system in our Eagle Ford Shale area of South Texas. In compensation for the services, we agreed to pay the service provider 110% of the total capital cost incurred by the service provider to construct new pipelines and facilities. The service provider will bill us for 20 percent of the accumulated unpaid capital costs annually.

We account for the agreement by recording a long-term asset, included in Deferred financing cost and other on our Consolidated Balance Sheets. The asset is amortized using the units-of-production method and the amortization expense is included in Transportation and processing on our Consolidated Statements of Operations. The related current and long-term liabilities are presented on our Consolidated Balance Sheets in Accrued liabilities and Transportation obligation, respectively.

Asset Retirement Obligations We follow the accounting standard related to accounting for asset retirement obligations. These obligations are related to the abandonment and site restoration requirements that result from the acquisition, construction and development of our oil and natural gas properties. We record the fair value of a liability for an asset retirement obligation in the period in which it is incurred and a corresponding increase in the carrying amount of the related long-lived asset. Accretion expense is included in depreciation, depletion and amortization on our Consolidated Statements of Operations.

Revenue Recognition Oil and natural gas revenues are recognized when production is sold to a purchaser at a fixed or determinable price, when delivery has occurred and title has transferred, and if collectability of the revenue is probable. Revenues from the production of oil and natural gas properties in which we have an interest with other producers are recognized using the entitlements method. We record a liability or an asset for natural gas balancing when we have sold more or less than our working interest share of natural gas production, respectively. At each of June 30, 2012 and December 31, 2011, the net liability for natural gas balancing was immaterial. Differences between actual production and net working interest volumes are routinely adjusted.

Derivative Instruments We use derivative instruments such as futures, forwards, options, collars and swaps for purposes of hedging our exposure to fluctuations in the price of crude oil and natural gas and to hedge our exposure to changing interest rates. Accounting standards related to derivative instruments and hedging activities require that all derivative instruments subject to the requirements of those standards be measured at fair value and recognized as assets or liabilities in our Consolidated Balance Sheets. Changes in fair value are required to be recognized in earnings unless specific hedge accounting criteria are met. We have not designated any of our derivative contracts as hedges; accordingly, changes in fair value are reflected in earnings.

Income Taxes We account for income taxes, as required, under the liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

We recognize, as required, the financial statement benefit of an uncertain tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant tax authority.

Earnings Per Share Basic income per common share is computed by dividing net income available to common stockholders for each reporting period by the weighted-average number of common shares outstanding during the period. Diluted income per common share is computed by dividing net income available to common stockholders for each reporting period by the weighted average number of common shares outstanding during the period, plus the effects of potentially dilutive stock options and restricted stock calculated using the Treasury Stock method and the potential dilutive effect of the conversion of shares associated with our Series B Convertible Preferred Stock, 3.25% Convertible Senior Notes due 2026 and 5% Convertible Senior Notes due 2029.

Commitments and Contingencies Liabilities for loss contingencies, including environmental remediation costs, arising from claims, assessments, litigation, fines and penalties, and other sources are recorded when it is probable that a liability has been incurred and the amount of the assessment and/or remediation can be reasonably estimated. Recoveries from third parties, when probable of realization, are separately recorded and are not offset against the related environmental liability.

Share-Based Compensation We account for our share-based transactions using fair value and recognize compensation expense over the requisite service period. The fair value of each option award is estimated using a Black-Scholes option valuation model with various assumptions based on our estimates. Our assumptions include expected volatility, expected term of option, risk-free

GOODRICH PETROLEUM CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

interest rate and dividend yield. Expected volatility estimates are developed by us based on historical volatility of our stock. We use historical data to estimate the expected term of the options. The risk-free interest rate for periods within the expected life of the option is based on the U.S. Treasury yield in effect at the grant date. Our common stock does not pay dividends, so the dividend yield is zero. The fair value of restricted stock is measured using the close of the day stock price on the day of the award.

Guarantee On March 2, 2011, we issued and sold $275,000,000 aggregate principal amount of our 8.875% Senior Notes due 2019 (the 2019 Notes). The 2019 Notes are guaranteed on a senior unsecured basis by our wholly-owned subsidiary, Goodrich Petroleum Company, L.L.C.

Goodrich Petroleum Corporation, as the parent company (the Parent Company), has no independent assets or operations. The guarantee is full and unconditional, and the Parent Company has no other subsidiaries. In addition, there are no restrictions on the ability of the Parent Company to obtain funds from its subsidiary by dividend or loan. Finally, the Parent Company s wholly-owned subsidiary does not have restricted assets that exceed 25% of net assets as of the most recent fiscal year end that may not be transferred to the Parent Company in the form of loans, advances or cash dividends by the subsidiary without the consent of a third party.

New Accounting Pronouncements

ASU 2011-04 Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS. - In May 2011, the Financial Accounting Standards Board (the FASB) issued additional guidance intended to result in convergence between US GAAP and International Financial Reporting Standards (IFRS) requirements for measurement of and disclosures about fair value. The amendments are not expected to have a significant impact on companies applying US GAAP. Principal provisions of the amendments include: (i) application of the highest and best use is relevant only when measuring fair value for non-financial assets and liabilities; (ii) a prohibition on grouping financial instruments for purposes of determining fair value, except when an entity manages market and credit risks on the basis of the entity s net exposure to the group; (iii) an extension of the prohibition against the use of a blockage factor to all fair value measurements (that prohibition currently applies only to financial instruments with quoted prices in active markets); (iv) guidance that fair value measurement of equity instruments should be made from the perspective of a market participant that holds that instrument as an asset; and (v) a requirement that for recurring Level 3 fair value measurements, entities disclose quantitative information about unobservable inputs, a description of the valuation process used and qualitative details about the sensitivity of the measurements. In addition, for Balance Sheet items not carried at fair value but for which fair value is disclosed, entities will be required to disclose the Level within the fair value hierarchy that applies to the fair value measurement disclosed. This guidance is effective for interim and annual periods beginning after December 15, 2011. We have adopted this guidance effective January 1, 2012. The adoption of this guidance did not have an impact on the Company s fair value measurements, financial condition, results of operations or cash flows.

ASU 2011-05 Comprehensive Income: Presentation of Comprehensive Income - In June 2011, the FASB issued guidance intended to eliminate the option to report other comprehensive income and its components in the statement of changes in equity. ASU 2011-05 requires that all non-owner changes in stockholders equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. This new guidance is to be applied retrospectively for interim and annual periods beginning after December 15, 2011. The adoption of this guidance does not have an impact on the Company s financial condition, results of operations or cash flows.

ASU 2011-11 Balance Sheet: Disclosures about Offsetting Assets and Liabilities. - In December 2011, the FASB issued guidance intended to result in convergence between US GAAP and IFRS requirements for offsetting (netting) assets and liabilities presented in the statements of financial position. The guidance requires an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. The disclosure affects all entities with financial instruments and derivatives that are either offset on the balance sheet in accordance with ASC 210-20-45 or ASC 815-10-45, or subject to a master netting arrangement, irrespective of whether they are offset on the balance sheet. This information will enable users of an entity s financial statements to evaluate the effect or potential effect of netting arrangements on an entity s financial position, including the effect or potential effect of rights of setoff associated with certain financial instruments and derivative instruments. The guidance is effective for annual periods beginning on or after January 1, 2013 and interim periods within those annual periods. Entities should provide the disclosures required by this ASU retrospectively for all comparative periods presented. We will adopt this guidance effective January 1, 2013. The adoption of this guidance is not expected to have an impact on the Company s financial condition, results of operations or cash flows.

9

GOODRICH PETROLEUM CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 Asset Retirement Obligations

The reconciliation of the beginning and ending asset retirement obligation for the six months ended June 30, 2012, is as follows (in thousands):

Beginning balance	$ 17,425
Liabilities incurred	357
Revisions in estimated liabilities	
Liabilities settled	(551)
Accretion expense	567
Dispositions	(4)
Ending balance	17,794
Current liability	474
Long term liability	$ 17,320

NOTE 3 Debt

Debt consisted of the following balances as of the dates indicated (in thousands):

	June 30, 2012			December 31, 2011		
	Principal	Carrying Amount	Fair Value (1)	Principal	Carrying Amount	Fair Value (1)
Senior Credit Facility	$ 158,000	$ 158,000	$ 158,000	$ 102,500	$ 102,500	$ 102,500
3.25% Convertible Senior Notes due 2026	429	429	429	429	429	429
5.0% Convertible Senior Notes due 2029 (2)	218,500	193,081	203,751	218,500	188,197	201,785
8.875% Senior Notes due 2019	275,000	275,000	271,013	275,000	275,000	243,898
Total debt	$ 651,929	$ 626,510	$ 633,193	$ 596,429	$ 566,126	$ 548,612

(1) The carrying amount for the Senior Credit Facility represents fair value because the variable interest rates are reflective of current market conditions and the carrying amount of the 3.25% Convertible Senior Notes due 2026 represents fair value because the last transacted activity was at par; otherwise, fair value was obtained by direct market quotes within Level 1 of the fair value hierarchy.

(2) The debt discount is amortized using the effective interest rate method based upon an original five year term through October 1, 2014. The debt discount was $25.4 million and 30.3 million as of June 30, 2012 and December 31, 2011 respectively.

The following table summarizes the total interest expense (contractual interest expense, amortization of debt discount and financing costs) and the effective interest rate on the liability component of the debt (amounts in thousands, except effective interest rates):

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011

	Interest Expense	Effective Interest Rate	Interest Expense	Effective Interest Rate	Interest Expense	Effective Interest Rate	Interest Expense	Effective Interest Rate
Senior Credit Facility	1,336	3.7%	852		2,496	3.9%	1,711	
3.25% Convertible Senior Notes due 2026	3	3.3%	614	8.9%	7	3.3%	3,397	9.2%
5.0% Convertible Senior Notes due 2029	5,423	11.3%	5,175	11.4%	10,846	11.4%	10,350	11.5%
8.875% Senior Notes due 2019	6,327	9.2%	6,324	9.2%	12,653	9.2%	8,327	9.2%

* An Effective Interest Rate Calculation is not meaningful for the three and six months ended June 30, 2011 since there were only minimal to no amounts borrowed under the Senior Credit Facility during the period.

GOODRICH PETROLEUM CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Senior Credit Facility

On May 5, 2009, we entered into a Second Amended and Restated Credit Agreement (including all amendments, the Senior Credit Facility) that replaced our previous facility. Total lender commitments under the Senior Credit Facility are $600 million. The Senior Credit Facility matures on July 1, 2014 subject to automatic extension to February 25, 2016, if we prepay or escrow proceeds sufficient to prepay our $218.5 million 5% Convertible Senior Notes due 2029 (the 2029 Notes). Borrowings under the Senior Credit Facility are limited to, and subject to, periodic redeterminations of the borrowing base, which was $265 million as of June 30, 2012. Pursuant to the terms of the Senior Credit Facility, borrowing base redeterminations occur on each April 1 and October 1. Interest on borrowings under the Senior Credit Facility accrues at a rate calculated, at our option, at the bank base rate plus 1.00% to 1.75%, or LIBOR plus 2.00% to 2.75%, in each case depending on borrowing base utilization. As of June 30, 2012, we had $158 million outstanding under the Senior Credit Facility. Substantially all our assets are pledged as collateral to secure our obligations under the Senior Credit Facility.

The terms of the Senior Credit Facility require us to comply with certain covenants. Capitalized terms used here, but not defined, have the meanings assigned to them in the Senior Credit Facility. The primary financial covenants include:

Current Ratio of 1.0/1.0;

Ratio of EBITDAX to cash Interest Expense of not less than 2.5/1.0 for the trailing four quarters ; and

Total Debt no greater than 4.0 times EBITDAX for the trailing four quarters.

As used in connection with the Senior Credit Facility, EBITDAX is earnings before interest expense, income tax, depreciation, depletion and amortization, exploration expense, stock based compensation and impairment of oil and natural gas properties. In calculating EBITDAX for this purpose, earnings include realized gains (losses) from derivatives not designated as hedges but exclude unrealized gains (losses) from derivatives not designated as hedges.

We were in compliance with all the financial covenants of the Senior Credit Facility as of June 30, 2012.

8.875% Senior Notes due 2019

On March 2, 2011, we sold $275 million of our 2019 Notes. The 2019 Notes mature on March 15, 2019, unless earlier redeemed or repurchased. The 2019 Notes are our senior unsecured obligations and rank equally in right of payment to all of our other existing and future indebtedness. The 2019 Notes accrue interest at a rate of 8.875% annually, and interest is paid semi-annually in arrears on March 15 and September 15. The 2019 Notes are guaranteed by our subsidiary that also guarantees our Senior Credit Facility.

Before March 15, 2014, we may on one or more occasions redeem up to 35% of the aggregate principal amount of the 2019 Notes at a redemption price of 108.875% of the principal amount of the 2019 Notes, plus accrued and unpaid interest to the redemption date, with the net cash proceeds of certain equity offerings. On or after March 15, 2015, we may redeem all or a portion of the 2019 Notes at redemption prices (expressed as percentages of principal amount) equal to (i) 104.438% for the twelve-month period beginning on March 15, 2015; (ii) 102.219% for the twelve-month period beginning on March 15, 2016 and (iii) 100% on or after March 15, 2017, in each case plus accrued and unpaid interest to the redemption date. In addition, prior to March 15, 2015, we may redeem all or a part of the 2019 Notes at a redemption price equal to 100% of the principal amount of the 2019 Notes to be redeemed plus a make-whole premium, plus accrued and unpaid interest to the redemption date.

The indenture governing the 2019 Notes restricts our ability and the ability of certain of our subsidiaries to: (i) incur additional debt; (ii) make certain dividends or pay dividends or distributions on our capital stock or purchase, redeem or retire such capital stock; (iii) sell assets, including the capital stock of our restricted subsidiaries; (iv) pay dividends or other payments of our restricted subsidiaries; (v) create liens that secure debt; (vi) enter into transactions with affiliates and (vii) merge or consolidate with another company. These covenants are subject to a number of important exceptions and qualifications. At any time when the 2019 Notes are rated investment grade by both Moody s Investors Service, Inc. and Standard & Poor s Ratings Services and no Default (as defined in the indenture governing the 2019 Notes) has occurred and is continuing, many of these covenants will terminate.

5% Convertible Senior Notes due 2029

In September 2009, we sold $218.5 million of our 2029 Notes. The notes mature on October 1, 2029, unless earlier converted, redeemed or repurchased. The 2029 Notes are our senior unsecured obligations and rank equally in right of payment to all of our other existing and future indebtedness. The 2029 Notes accrue interest at a rate of 5% annually, and interest is paid semi-annually in arrears on April 1 and October 1 of each year.

GOODRICH PETROLEUM CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

We may not redeem the 2029 Notes before October 1, 2014. On or after October 1, 2014, we may redeem all or a portion of the 2029 Notes for cash, and the investors may require us to repurchase the 2029 Notes on each of October 1, 2014, 2019 and 2024. Upon conversion, we have the option to deliver shares at the applicable conversion rate, redeem in cash or in certain circumstances redeem in a combination of cash and shares.

Investors may convert their 2029 Notes at their option at any time prior to the close of business on the second business day immediately preceding the maturity date under the following circumstances: (1) during any fiscal quarter (and only during such fiscal quarter), if the last reported sale price of our common stock is greater than or equal to 135% of the conversion price of the 2029 Notes for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the preceding fiscal quarter; (2) prior to October 1, 2014, during the five business-day period after any ten consecutive trading-day period (the measurement period) in which the trading price of $1,000 principal amount of 2029 Notes for each trading day in the measurement period was less than 97% of the product of the last reported sale price of our common stock and the conversion rate on such trading day; (3) if the 2029 Notes have been called for redemption; or (4) upon the occurrence of one of specified corporate transactions. Investors may also convert their 2029 Notes at their option at any time beginning on September 1, 2029, and ending at the close of business on the second business day immediately preceding the maturity date.

The 2029 Notes are convertible into shares of our common stock at a rate equal to 28.8534 shares per $1,000 principal amount of 2029 Notes (equal to an initial conversion price of approximately $34.66 per share of common stock per share).

We separately account for the liability and equity components of our 2029 Notes in a manner that reflects our nonconvertible debt borrowing rate when interest is recognized in subsequent periods. Upon issuance of the notes in September 2009, in accordance with accounting standards related to convertible debt instruments that may be settled in cash upon conversion, we recorded a debt discount of $49.4 million, thereby reducing the carrying the value of $218.5 million notes on the December 31, 2009 balance sheet to $171.1 million and recorded an equity component net of tax of $32.1 million. The debt discount is amortized using the effective interest rate method based upon an original five year term through October 1, 2014.

3.25% Convertible Senior Notes Due 2026

During the year ended December 31, 2011, we repurchased $174.6 million of our 3.25% Convertible Senior Notes due 2026 (the 2026 Notes) using a portion of the net proceeds from the issuance of our 2019 Notes. At June 30, 2012, $0.4 million of the 2026 Notes remained outstanding. Holders may present to us for redemption the remaining outstanding 2026 Notes on December 1, 2016 and December 1, 2021. Upon conversion, we have the option to deliver shares at the applicable conversion rate, redeem in cash or in certain circumstances redeem in a combination of cash and shares.

The 2026 Notes are convertible into shares of our common stock at a rate equal to the sum of:

a) 15.1653 shares per $1,000 principal amount of 2026 Notes (equal to a base conversion price of approximately $65.94 per share) plus

b) an additional amount of shares per $1,000 of principal amount of 2026 Notes equal to the incremental share factor (2.6762), multiplied by a fraction, the numerator of which is the applicable stock price less the base conversion price and the denominator of which is the applicable stock price.

GOODRICH PETROLEUM CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4 Net Loss Per Common Share

Net loss applicable to common stock was used as the numerator in computing basic and diluted loss per common share for the three and six months ended June 30, 2012 and 2011. The following table sets forth information related to the computations of basic and diluted loss per share (amounts in thousands, except per share data):

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
	(Amounts in thousands, except per share data)			
Basic loss per share:				
Loss applicable to common stock	$ (4,714)	$ (1,430)	$ (23,955)	$ (26,110)
Weighted average shares of common stock outstanding	36,366	36,110	36,352	36,093
Basic loss per share	$ (0.13)	$ (0.04)	$ (0.66)	$ (0.72)
Diluted loss per share:				
Loss applicable to common stock	$ (4,714)	$ (1,430)	$ (23,955)	$ (26,110)
Dividends on convertible preferred stock (1)				
Interest and amortization of loan cost on senior convertible notes, net of tax (2)				
	$ (4,714)	$ (1,430)	$ (23,955)	$ (26,110)
Weighted average shares of common stock outstanding	36,366	36,110	36,352	36,093
Assumed conversion of convertible preferred stock (1)				
Assumed conversion of convertible senior notes (2)				
Stock options and restricted stock (3)				
Weighted average diluted shares outstanding	36,366	36,110	36,352	36,093
Diluted loss per share	$ (0.13)	$ (0.04)	$ (0.66)	$ (0.72)
(1) Common shares issuable upon assumed conversion of convertible preferred stock were not presented as they would have been anti-dilutive.	3,587,850	3,587,850	3,587,850	3,587,850
(2) Common shares issuable upon assumed conversion of the 2026 Notes and the 2029 Notes were not presented as they would have been anti-dilutive.	6,310,974	7,511,157	6,310,974	7,511,157
(3) Common shares issuable on assumed conversion of restricted stock and employee stock option were not included in the computation of diluted loss per common share since their inclusion would have been anti-dilutive.	216,846	196,536	199,001	178,093

NOTE 5 Income Taxes

We recorded no income tax expense or benefit for the three and six months ended June 30, 2012. We increased our valuation allowance and reduced our net deferred tax assets to zero during 2009 after considering all available positive and negative evidence related to the realization of our deferred tax assets. Our assessment of the realization of our deferred tax assets has not changed, and, as a result, we continue to maintain a full valuation allowance for our net deferred assets as of June 30, 2012.

As of June 30, 2012, we have no unrecognized tax benefits. There were no significant changes to the calculation since December 31, 2011.

Table of Contents

GOODRICH PETROLEUM CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 Stockholders Equity

Restricted Stock

	Three Months Ended June 30, 2012	Six Months Ended June 30, 2012
Restricted shares vested	2,550	4,639
Weighted average grant date value per share	$ 18.44	$ 22.16

Stock Options

	Three Months Ended June 30, 2012	Six Months Ended June 30, 2012
Options exercised		4,000
Weighted average exercise price		$ 4.11

NOTE 7 Derivative Activities

We use commodity and financial derivative contracts to manage fluctuations in commodity prices and interest rates. We are currently not designating our derivative contracts for hedge accounting. All gains and losses both realized and unrealized from our derivative contracts have been recognized in other income (expense) on our Consolidated Statements of Operations.

The following table summarizes the realized and unrealized gains and losses we recognized on our oil and natural gas derivatives for the three and six month periods ended June 30, 2012 and 2011.

	Three Months Ended June 30,		Six Months Ended June 30,	
Oil and Natural Gas Derivatives (in thousands)	**2012**	**2011**	**2012**	**2011**
Realized gain on oil and natural gas derivatives	$ 21,328	$ 5,964	$ 37,221	$ 13,112
Unrealized gain (loss) on oil and natural gas derivatives	2,715	4,990	(3,753)	(12,168)
Total gain on oil and natural gas derivatives	$ 24,043	$ 10,954	$ 33,468	$ 944

Commodity Derivative Activity

We enter into swap contracts, costless collars or other derivative agreements from time to time to manage commodity price risk for a portion of our production. Our strategy, which is administered by the Hedging Committee of our Board of Directors, and reviewed periodically by the entire Board of Directors, has been to generally hedge between 30% and 70% of our estimated total production for the period the derivatives are in effect. As of June 30, 2012, the commodity derivatives we used were in the form of:

(a) collars, where we receive the excess, if any, of the floor price over the reference price, based on NYMEX quoted prices, and pay the excess, if any, of the reference price over the ceiling price,

(b) swaps, where we receive a fixed price and pay a floating price, based on NYMEX or specific transfer point quoted prices, and

(c) swaptions, where we grant the counter party the right but not the obligation to enter into an underlying swap by a specific date at a specific strike price.

Table of Contents

GOODRICH PETROLEUM CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Despite the measures taken by us to attempt to control price risk, we remain subject to price fluctuations for natural gas and crude oil sold in the spot market. Prices received for natural gas sold on the spot market are volatile due to seasonality of demand and other factors beyond our control. Domestic crude oil and natural gas prices could have a material adverse effect on our financial position, results of operations and quantities of reserves recoverable on an economic basis. We routinely exercise our contractual right to net realized gains against realized losses when settling with our financial counterparties. As of June 30, 2012, our open forward positions on our outstanding commodity derivative contracts, all of which were with BNP Paribas, Bank of Montreal, Royal Bank of Canada and JPMorgan Chase Bank, N.A., were as follows:

Contract Type	Daily Volume	Total Volume	Average Floor/Cap	Fair Value at June 30, 2012 (in thousands)
Natural gas collars (MMBtu)				
2012	40,000	14,640,000	$ 6.00-$7.09	$ 22,335
			Fixed Price	
Natural gas swaps (MMBtu)				
2012	20,000	7,320,000	$5.35	8,762
Natural gas swaptions (MMBtu)				
2013	20,000	7,300,000	$5.35	
2014	20,000	7,300,000	$5.35	(1,350)
Oil swaps (BBL)				
2012	3,000	1,037,500	$97.30-$104.25	
2013	500	182,500	$103.15	
2013 (1)	500	15,500	$101.50	11,662
Oil swaptions (BBL)				
2013	2,500	912,500	$97.30-$112.00	
2014	1,500	547,500	$97.30-$101.00	(6,096)
			Total	$ 35,313

(1) Swap is only for the month of January.

During the second quarter of 2012, we entered into the following new derivative contracts.

Contract Type	Daily Volume	Strike Price	Contract Start Date	Contract Termination
Oil swap (BBL)	500	$ 104.25	May 1, 2012	December 31, 2012
Oil swap (BBL)	500	$ 103.15	January 1, 2013	December 31, 2013

Subsequent to June 30, 2012, we entered into the following new derivative contract.

Contract Type	Daily Volume	Strike Price	Contract Start Date	Contract Termination
Oil swap (BBL)	500	$ 92.50	August 1, 2012	December 31, 2013

The following table summarizes the fair values of our derivative financial instruments that are recorded at fair value classified in each level as of June 30, 2012 (in thousands). We measure the fair value of our commodity derivative contracts by applying the income approach. See Note 1 Description of Business and Significant Accounting Policies - Fair Value Measurement for our discussion for inputs used and valuation techniques for determining fair values.

	June 30, 2012 Fair Value Measurements Using			
Description	**Level 1**	**Level 2**	**Level 3**	**Total**
Current Assets Commodity Derivatives	$	$ 40,070	$	$ 40,070
Non-current Assets Commodity Derivatives		1,302		1,302
Non-current Liabilities Commodity Derivatives		(6,059)		(6,059)
Total	$	$ 35,313	$	$ 35,313

Table of Contents

GOODRICH PETROLEUM CORPORATION AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8 Commitments and Contingencies

As of June 30, 2012, we do not have any changes in material commitments and contingencies, including outstanding and pending litigation.

NOTE 9 Acquisitions

In the six months ended June 30, 2012, we acquired rights to an additional 55,000 gross (52,000 net) acres in undeveloped leases in the Tuscaloosa Marine Shale for a total of $16.7 million.

Table of Contents

Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

We have made in this report, and may from time to time otherwise make in other public filings, press releases and discussions with Company management, forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 concerning our operations, economic performance and financial condition. These forward-looking statements include information concerning future production and reserves, schedules, plans, timing of development, contributions from oil and natural gas properties, marketing and midstream activities, and also include those statements accompanied by or that otherwise include the words may, could, believes, expects, anticipates, intends, estimates, projects, predicts, target, goal, plans, objective, potential, s or variations on such expressions that convey the uncertainty of future events or outcomes. We have based these forward-looking statements on our current expectations and assumptions about future events. These statements are based on certain assumptions and analyses made by us in light of our experience and our perception of historical trends, current conditions and expected future developments as well as other factors we believe are appropriate under the circumstances. Although we believe that the expectations reflected in such forward-looking statements are reasonable, we can give no assurance that such expectations will prove to be correct. These forward-looking statements speak only as of the date of this report, or if earlier, as of the date they were made; we undertake no obligation to publicly update or revise any forward-looking statements whether as a result of new information, future events or otherwise.

These forward-looking statements involve risk and uncertainties. Important factors that could cause actual results to differ materially from our expectations include, but are not limited to, the following risk and uncertainties:

- planned capital expenditures;
- future drilling activity;
- our financial condition;
- business strategy, including our ability to successfully transition to more liquids-focused operations;
- the market prices of oil and natural gas;
- uncertainties about our estimated quantities of oil and natural gas reserves;
- financial market conditions and availability of capital;
- production;
- hedging arrangements;
- future cash flows and borrowings;

litigation matters;

pursuit of potential future acquisition opportunities;

sources of funding for exploration and development;

general economic conditions, either nationally or in the jurisdictions in which we do business;

legislative or regulatory changes, including retroactive royalty or production tax regimes**,** hydraulic-fracturing regulation, drilling and permitting regulations, derivatives reform, changes in state and federal corporate taxes, environmental regulation, environmental risks and liability under federal, state and foreign and local environmental laws and regulations;

the creditworthiness of our financial counterparties and operation partners;

the securities, capital or credit markets; and

our ability to repay our debt.

For additional information regarding known material factors that could cause our actual results to differ from projected results, please read the rest of this report and Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2011.

Overview

We are an independent oil and natural gas company engaged in the exploration, development and production of properties primarily in (i) South Texas, which includes the Eagle Ford Shale Trend, (ii) Northwest Louisiana and East Texas, which includes the Haynesville Shale and Cotton Valley Taylor Sand and (iii) Southwest Mississippi and Southeast Louisiana which includes the Tuscaloosa Marine Shale.

We seek to increase shareholder value by growing our oil and natural gas reserves, production revenues and operating cash flow. In our opinion, on a long term basis, growth in oil and natural gas reserves and cash flow on a cost-effective basis are the most important indicators of performance success for an independent oil and natural gas company.

Management strives to increase our oil and natural gas reserves, production and cash flow through exploration and development activities. We develop an annual capital expenditure budget which is reviewed and approved by our board of directors on a quarterly basis and revised throughout the year as circumstances warrant. We take into consideration our projected operating cash flow and externally available sources of financing, such as bank debt, when establishing our capital expenditure budget.

We place primary emphasis on our cash flow from operating activities (operating cash flow) in managing our business. Management considers operating cash flow a more important indicator of our financial success than other traditional performance measures such as net income because operating cash flow considers only the cash expenses incurred during the period and excludes the non-cash impact of unrealized hedging gains (losses) and impairments.

Our revenues and operating cash flow depend on the successful development of our inventory of capital projects with available capital, the volume and timing of our production, as well as commodity prices for oil and natural gas. Such pricing factors are largely beyond our control, but we employ commodity hedging techniques in an attempt to minimize the volatility of short term commodity price fluctuations on our earnings and operating cash flow.

Business Strategy

Our business strategy is to provide long-term growth in reserves on a cost-effective basis. We focus on adding reserve value through the development of our Haynesville Shale, Cotton Valley Taylor Sand, Eagle Ford Shale Trend and Tuscaloosa Marine Shale acreage and the timely development of our large, relatively low-risk development program in the Southeast and Northwest Louisiana, East and South Texas and Southwest Mississippi area. We regularly evaluate possible acquisitions of prospective acreage and oil and natural gas drilling opportunities.

Several of the key elements of our business strategy are the following:

Develop existing property base. We seek to maximize the value of our existing assets by developing and exploiting our properties with the lowest risk and the highest rate of return potential. We intend to develop our multi-year inventory of drilling locations on our acreage in the Eagle Ford Shale Trend, Haynesville Shale, Cotton Valley Taylor Sand and Tuscaloosa Marine Shale in order to develop our oil and natural gas reserves.

Increase our oil production. During the past year, we have concentrated on increasing our crude oil production and reserves by investing and drilling in the Eagle Ford Shale Trend and Tuscaloosa Marine Shale. We intend to take advantage of the current favorable sales price of oil compared to the relative sales price of natural gas. We increased our oil production as a percentage of total production from 8% and 7% for the three and six months ended June 30, 2011, respectively to 18% and 17% for the three and six months June 30, 2012, respectively.

Expand acreage position in shale plays. As of June 30, 2012, we have acquired approximately 132,300 net acres in the Tuscaloosa Marine Shale in Southeastern Louisiana and Southwestern Mississippi. We continue to concentrate our efforts in areas where we can apply our technical expertise and where we have significant operational control or experience. To leverage our extensive regional knowledge base, we seek to acquire leasehold acreage with significant drilling potential in areas that exhibit characteristics similar to our existing properties. We continually strive to rationalize our portfolio of properties by selling marginal non-core properties in an effort to redeploy capital to exploitation, development and exploration projects that offer a potentially higher overall return.

Focus on maximizing cash flow margins. We intend to maximize operating cash flow by focusing on higher-margin oil development in the Eagle Ford Shale Trend and the Tuscaloosa Marine Shale. In the current commodity price environment, our Eagle Ford Shale Trend and Tuscaloosa Marine Shale assets offer more attractive cash flow margins than our natural gas assets.

Table of Contents

Maintain financial flexibility. As of June 30, 2012, we have a borrowing base of $265 million under our $600 million Senior Credit Facility, of which $158 million was outstanding. Pursuant to the terms of the Senior Credit Facility, borrowing base redeterminations occur on a semi-annual basis on April 1 and October 1. We have historically funded growth through cash flow from operations, debt, equity and equity-linked security issuances, divestments of non-core assets and entering into strategic joint ventures. We actively manage our exposure to commodity price fluctuations by hedging meaningful portions of our expected production through the use of derivatives, including fixed price swaps, swaptions and costless collars. The level of our hedging activity and the duration of the instruments employed depend upon our view of market conditions, available hedge prices and our operating strategy.

Primary Operating Areas

Eagle Ford Shale Trend

During the first half of 2012, we continued drilling operations on our acreage in the Eagle Ford Shale Trend. We entered the Eagle Ford Shale Trend in April 2010. Our leasehold position is located in both La Salle and Frio Counties, Texas. We hold approximately 53,500 gross (38,200 net) acres as of June 30, 2012, all of which are either producing from or prospective for the Eagle Ford Shale. During the first half of 2012, we conducted drilling operations on approximately 20 gross (13 net) Eagle Ford Shale Trend wells. In 2012, we plan to spend approximately $175 million representing 70% of our capital budget, on 32 gross (22 net) wells in the Eagle Ford Shale Trend. During the first half of 2012, we spent approximately $91.6 million on drilling and completion, leasehold and infrastructure capital expenditures in the Eagle Ford Shale Trend.

Tuscaloosa Marine Shale

We hold approximately 156,900 gross (132,300 net) acres in the Tuscaloosa Marine Shale as of June 30, 2012, an emerging oil shale play. Our acreage is located in East Feliciana, West Feliciana, St. Helena, Concordia and Washington Parishes in Southeastern Louisiana and Wilkinson, Pike and Amite Counties in Southwestern Mississippi. During the year we added approximately 55,000 gross (52,000 net) acres in the Trend. During the first half of 2012, we conducted drilling operations on approximately three gross (one net) Tuscaloosa Marine Shale wells. In 2012, we plan to spend approximately $20 million to drill and complete four gross (two net) Tuscaloosa Marine Shale wells. During the first half of 2012, we spent approximately $21.6 million in the Tuscaloosa Marine Shale Trend, which included $16.7 million for leasehold costs.

Haynesville Shale Trend

Our relatively low risk development drilling program in this trend is primarily centered in Rusk, Panola, Angelina and Nacogdoches counties, Texas and DeSoto and Caddo Parishes, Louisiana. We hold approximately 126,500 gross (81,700 net) acres as of June 30, 2012 producing from and prospective for the Haynesville Shale. Our net production volumes from our Haynesville Shale wells aggregated approximately 45,400 Mcfe per day in the second quarter of 2012, or approximately 50% of our total production for the quarter. In early 2012, we reduced our capital spending budget in the Haynesville Shale Trend to approximately $27.5 million due to low natural gas prices and we currently have minimal to no capital dollars budgeted for the second half of 2012. During the first half of 2012, we conducted drilling operations on approximately six gross (three net) Haynesville Shale Trend wells, which included five gross (two net) non-operated wells that were drilled in 2011 but were cased in early 2012. As of June 30, 2012, we have approximately 14 gross (six net) Haynesville Shale Trend wells drilled and waiting on completion.

Core Haynesville Shale

Our core Haynesville Shale drilling program is primarily concentrated in the Bethany-Longstreet and Greenwood-Waskom fields in Caddo and DeSoto Parishes in Northwest Louisiana. Our core Haynesville Shale drilling activity includes both operated and non-operated drilling in and around our core acreage positions in Northwest Louisiana. We currently hold approximately 32,000 gross (15,600 net) acres as of June 30, 2012. Our net production volumes from our core Haynesville Shale wells totaled approximately 36,200 Mcfe per day in the second quarter of 2012, or approximately 40% of our total production for the quarter. For the remainder of 2012, we have minimal to no capital dollars budgeted for Core Haynesville Shale drilling and completion activity.

Shelby Trough / Angelina River Trend

We operate all of our drilling activities in this area, which is primarily located in Nacogdoches, Angelina and Shelby counties, Texas. The Company currently holds approximately 41,200 gross (29,700 net) acres as of June 30, 2012. Our net production volumes from the Shelby Trough wells totaled approximately 5,500 Mcfe per day in the second quarter of 2012, or approximately 6% of our total production for the quarter. During the first half of 2012, we conducted drilling operations on one 100% owned Angelina River Trend well, and we have currently deferred completion activity on that well until 2013. For the remainder of 2012, we have minimal to no capital dollars budgeted for Angelina River Trend drilling and completion activity.

Table of Contents

Overview of Second Quarter 2012 Results

Second Quarter 2012 financial and operating results included:

Our oil and condensate production for the second quarter of 2012 increased to 18% of our total production compared to 8% of our total production in the second quarter of 2011.

Our oil revenue for the second quarter of 2012 increased to 61% of our total oil and natural gas revenue compared to 25% of our oil and natural gas revenue in the second quarter of 2011.

We conducted drilling operations on 15 gross (10 net) wells in the second quarter of 2012, including 13 gross (nine net) Eagle Ford Shale Trend wells in South Texas and two gross (one net) in the Tuscaloosa Marine Shale Trend. We added 10 gross (five net) wells to production in the second quarter of 2012, of which seven gross (4.5 net) were in the Eagle Ford Shale Trend. As of June 30, 2012, we had 18 gross (nine net) wells drilled and waiting on completion mostly comprised of 14 gross (six net) Haynesville Shale Trend wells.

We completed our first non-operated well and began drilling operations on our first operated well in the Tuscaloosa Marine Shale.

We purchased an additional 47,500 net acres in the Tuscaloosa Marine Shale resulting in a net acreage position of 132,300 net acres.

Results of Operations

For the three months ended June 30, 2012, we reported a net loss applicable to common stock of $4.7 million, or $0.13 per basic and diluted share, on total revenue of $41.3 million as compared to a net loss applicable to common stock of $1.4 million, or $0.04 per basic and diluted share, on total revenue of $52.9 million for the three months ended June 30, 2011. The decrease in average realized sales price contributed approximately $0.9 million to the decrease in oil and natural gas revenue, while the decrease in production volumes contributed approximately $10.1 million to the decrease in oil and natural gas revenue as compared to the three months ended June 30, 2011. We recorded a $24.0 million gain on derivatives not designated as hedges in the three months ended June 30, 2012, compared to an $11.0 million gain on derivatives not designated as hedges for the three months ended June 30, 2011.

For the six months ended June 30, 2012, we reported a net loss applicable to common stock of $24.0 million, or $0.66 per basic and diluted share, on total revenue of $86.7 million as compared to a net loss applicable to common stock of $26.1 million, or $0.72 per basic and diluted share, on total revenue of $94.1 million for the six months ended June 30, 2011. The decrease in production volumes in the six months ended June 30, 2012 compared to the same period in 2011 reduced oil and natural gas revenue by $11.9 million, while the increase in average realized sales price benefited oil and natural gas revenues in the six months ended June 30, 2012 by approximately $5.3 million. We recorded a $33.5 million gain on derivatives not designated as hedges in the six months ended June 30, 2012, compared to a $0.9 million gain on derivatives not designated as hedges for the six months ended June 30, 2011.

Table of Contents

The following table reflects our summary operating information for the periods presented (in thousands except for price and volume data).

(In thousands, except for price data)	**Three Months Ended June 30,**		**Six Months Ended June 30,**
	10,877		
Distributions to counterparties of cash flow hedges	(3,151)	-	
Distributions to noncontrolling interests	(88)	(205)	
Proceeds from issuance of common stock	-	383	
Net cash (used in) provided by financing activities	(22,665)	27,802	
NET INCREASE (DECREASE) IN CASH	1,198	(18)	
CASH AND CAH EQUIVALENTS, beginning of period	-	18	
CASH AND CASH EQUIVALENTS, end of period	$1,198	$-	
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION			
Cash paid during the period for interest	$32,046	$36,529	

The accompanying notes are an integral part of these financial statements.

6

RADNET, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
(unaudited)

Supplemental Schedule of Non-Cash Investing and Financing Activities

We entered into capital leases and equipment notes for approximately $10.4 million and $21.4 million, excluding capital leases assumed in acquisitions, during the nine months ended September 30, 2009 and 2008, respectively. We also acquired equipment for approximately $8.2 million and $19.1 million during the nine months ended September 30, 2009 and 2008 that we had not paid for as of September 30, 2009 and 2008, respectively. The offsetting amount due was recorded in our consolidated balance sheet under accounts payable and accrued expenses.

We record the change in fair value of the effective portion of our interest rate swaps that are designated as cash flow hedges to accumulated other comprehensive loss. As such, we recorded unrealized gains (losses) as a component of other comprehensive loss of ($2.3 million) and of $813,000, for the nine months ended September 30, 2009 and 2008, respectively.

As discussed in Note 5, we entered into interest rate swap modifications in the first quarter of 2009. These modifications include a significant financing element and, as such, all cash inflows and outflows subsequent to the date of modification are presented as financing activities.

Detail of investing activity related to acquisitions can be found in Note 3.

RADNET, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

NOTE 1 - NATURE OF BUSINESS AND BASIS OF PRESENTATION

We operate a group of regional networks comprised of 175 diagnostic imaging facilities located in seven states with operations primarily in California, Maryland, the Treasure Coast area of Florida, Kansas, Delaware, New Jersey and the Finger Lakes (Rochester) and Hudson Valley areas of New York. We provide diagnostic imaging services including magnetic resonance imaging (MRI), computed tomography (CT), positron emission tomography (PET), nuclear medicine, mammography, ultrasound, diagnostic radiology, or X-ray, and fluoroscopy. The Company's operations comprise a single segment for financial reporting purposes.

The consolidated financial statements include the accounts of RadNet Management, Inc. ("or RadNet Management") and Beverly Radiology Medical Group III, a professional partnership ("BRMG"). The consolidated financial statements also include RadNet Management I, Inc., RadNet Management II, Inc., Radiologix, Inc., RadNet Management Imaging Services, Inc., Delaware Imaging Partners, Inc., New Jersey Imaging Partners, Inc. and Diagnostic Imaging Services, Inc. (DIS), all wholly owned subsidiaries of RadNet Management. All of these affililiated entities are referred to collectively in this report as "Radnet", "we", "us" or the "Company" in this report.

Howard G. Berger, M.D. is our President and Chief Executive Officer, a member of our Board of Directors and owns approximately 18% of our outstanding common stock. Dr. Berger also owns, indirectly, 99% of the equity interests in BRMG. BRMG provides all of the professional medical services at the majority of our facilities located in California under a management agreement with us, and contracts with various other independent physicians and physician groups to provide the professional medical services at most of our other California facilities. We generally obtain professional medical services from BRMG in California, rather than provide such services directly or through subsidiaries, in order to comply with California's prohibition against the corporate practice of medicine. However, as a result of our close relationship with Dr. Berger and BRMG, we believe that we are able to better ensure that medical service is provided at our California facilities in a manner consistent with our needs and expectations and those of our referring physicians, patients and payors than if we obtained these services from unaffiliated physician groups. BRMG is a partnership of Pronet Imaging Medical Group, Inc. (99%), Breastlink Medical Group, Inc. (100%) and Beverly Radiology Medical Group, Inc. (99%), each of which are 99% or 100% owned by Dr. Berger. RadNet provides non-medical, technical and administrative services to BRMG for which it receives a management fee, per the management agreement. Through the management agreement and our relationship with Dr. Berger, we have exclusive authority over all non-medical decision making related to the ongoing business operations of BRMG. Based on the provisions of the agreement, we have determined that BRMG is a variable interest entity, and that we are the primary beneficiary as defined in Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 810 (ASC Topic 810, originally issued as Financial Accounting Standards Board (FASB) Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51 (FIN 46(R)), and consequently, we consolidate the revenue and expenses of BRMG. All intercompany balances and transactions have been eliminated in consolidation.

At a portion of our centers in California and at all of the centers which are located outside of California, we have entered into long-term contracts with independent radiology groups in the area to provide physician services at those facilities. These third party radiology practices provide professional services, including supervision and interpretation of diagnostic imaging procedures, in our diagnostic imaging centers. The radiology practices maintain full control over the provision of professional services. The contracted radiology practices generally have outstanding physician and practice credentials and reputations; strong competitive market positions; a broad sub-specialty mix of physicians; a history of growth and potential for continued growth. In these facilities we enter into long-term agreements with radiology practice groups (typically 40 years). Under these arrangements, in addition to obtaining technical fees for the use of our diagnostic imaging equipment and the provision of technical services, we provide management services and receive a fee based on the practice group's professional revenue, including revenue derived outside of our diagnostic imaging centers. We own the diagnostic imaging equipment and, therefore, receive 100% of the technical reimbursements associated with imaging procedures. The radiology practice groups retain the professional reimbursements associated with imaging procedures after deducting management service fees. Our management service fees are included in net revenue in the consolidated statement of operations and totaled $7.6 million and $8.7 million for the three months ended September 30, 2009 and 2008, respectively, and $22.6 million and $24.9 million for the nine months ended September 30, 2009 and 2008, respectively. We have no financial controlling interest in the independent radiology practices, as defined in ASC Topic 810 (originally defined in EITF 97-2); accordingly, we do not consolidate the financial statements of those practices in our consolidated financial statements.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X and, therefore, do not include all information and footnotes necessary for a fair presentation of financial position, results of operations and cash flows in conformity with U.S. generally accepted accounting principles complete financial statements; however, in the opinion of our management, all adjustments consisting of normal recurring adjustments necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods ended September 30, 2009 and 2008 have been made. The results of operations for any interim period are not necessarily indicative of the results for a full year. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2008.

Certain prior period amounts have been reclassified to conform with the current period presentation. These changes have no effect on net income (loss).

We have evaluated subsequent events through November 9, 2009, which represents the filing date of this Form 10-Q with the Securities and Exchange Commission.

Liquidity and Capital Resources

We had a working capital balance of $11.1 million and $1.4 million at September 30, 2009 and December 31, 2008, respectively. We had a net loss attributable to Radnet, Inc.'s common shareholders of $1.7 million, and net income attributable to Radnet, Inc.'s common shareholders of $138,000 for the three months ended September 30, 2009 and 2008, respectively. We had losses attributable to Radnet, Inc.'s common shareholders of $2.9 million and $7.5 million for the nine months ended September 30, 2009 and 2008, respectively. We also had a Radnet, Inc. shareholder equity deficit of $78.5 million and $81.0 million at September 30, 2009 and December 31, 2008, respectively.

We operate in a capital intensive, high fixed-cost industry that requires significant amounts of capital to fund operations. In addition to operations, we require a significant amount of capital for the initial start-up and development expense of new diagnostic imaging facilities, the acquisition of additional facilities and new diagnostic imaging equipment, and to service our existing debt and contractual obligations. Because our cash flows from operations have been insufficient to fund all of these capital requirements, we have depended on the availability of financing under credit arrangements with third parties.

Our business strategy with regard to operations focuses on the following:

§ Maximizing performance at our existing facilities;
§ Focusing on profitable contracting;
§ Expanding MRI, CT and PET applications;
§ Optimizing operating efficiencies; and
§ Expanding our networks.

Our ability to generate sufficient cash flow from operations to make payments on our debt and other contractual obligations will depend on our future financial performance. A range of economic, competitive, regulatory, legislative and business factors, many of which are outside of our control, will affect our financial performance. Although no assurance can be given, taking these factors into account, including our historical experience, we believe that through implementing our strategic plans and continuing to restructure our financial obligations, we will obtain sufficient cash to satisfy our obligations as they become due in the next twelve months.

NOTE 2 - RECENT AND PENDING ACCOUNTING STANDARDS AND PRONOUNCEMENTS

In June 2009, the FASB issued SFAS No. 167, Amendment to FASB Interpretation No. 46(R) (SFAS No. 167). SFAS No. 167 amends FIN 46(R), and changes the consolidation guidance applicable to a Variable Interest Entity (VIE). SFAS No. 167 requires the use of a qualitative analysis rather than a quantitative analysis to determine whether an enterprise is the primary beneficiary of a VIE, and is, therefore, required to consolidate the VIE. SFAS No. 167 also requires continuous reassessments of whether an enterprise is the primary beneficiary of a VIE, while FIN 46(R) only requires reconsideration of the primary beneficiary of a VIE when specific events occur. This new pronouncement also requires enhanced disclosures about an enterprise's involvement with a VIE. SFAS No. 167 will be effective for interim and annual reporting periods beginning after November 15, 2009. Although we have not completed our assessment, we believe the adoption of SFAS No. 167 will not have a material impact on our financial position, results of operations or cash flows.

FASB Accounting Standards Codification

During the three months ended September 30, 2009, the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC" or "Codification") became the authoritative source of accounting principles accepted in the United States ("GAAP") recognized by the FASB. All existing FASB accounting standards and guidance were superseded by the ASC. Instead of issuing new accounting standards in the form of statements, FASB staff positions and Emerging Issues Task Force abstracts, the FASB now issues Accounting Standards Updates that update the Codification. Rules and interpretive releases of the Securities and Exchange Commission ("SEC") under authority of federal securities laws continue to be additional sources of authoritative GAAP for SEC registrants.

Other recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the AICPA, and the SEC did not, or are not believed by management to, have a material impact on our present or future consolidated financial statements.

NOTE 3 - FACILITY ACQUISITIONS

Medical Resources, Inc.

On June 12, 2009, we acquired the assets and business of nine imaging centers located in New Jersey from Medical Resources, Inc. for approximately $2.1 million. At the time of the acquisition, we immediately sold the assets and business of one of those nine centers to an unrelated third party for approximately $650,000. We have made a preliminary purchase price allocation of the acquired assets and liabilities associated with the remaining eight centers at their respective fair values in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 805 (ASC Topic 805, originally issued as Statement of Financial Accounting Standards No. 141 (R), Business Combinations.

In accordance with ASC Topic 805, any excess of fair value of acquired net assets over the acquisition consideration results in a gain on bargain purchase. Prior to recording a gain, the acquiring entity must reassess whether all acquired assets and assumed liabilities have been identified and recognized and perform re-measurements to verify that the consideration paid, assets acquired, and liabilities assumed have been properly valued. The Company underwent such a reassessment, and as a result, has recorded a gain on bargain purchase of approximately $1.4 million. If new information is obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement of the amounts recognized for assets acquired and liabilities assumed, the Company will retrospectively adjust the amounts recognized as of the acquisition date. The final acquisition consideration and allocation thereof may change significantly from these estimates.

We believe that the gain on bargain purchase resulted from various factors that impacted the sale of those New Jersey assets. The seller was performing a full liquidation of its assets for the benefit of its creditors. Upon liquidation of all of its assets, the seller intended to close its business. The New Jersey assets were the only remaining assets to be sold before a full wind-down of the seller's business could be completed. We believe that the seller was willing to accept a bargain purchase price from us in return for our ability to act more quickly and with greater certainty than any other prospective acquirer. The decline in the credit markets made it difficult for other acquirers who relied upon third party financing to complete the transaction. The relatively small size of the transaction for us, the lack of required third-party financing and our expertise in completing similar transactions in the past gave the seller confidence that we could complete the transaction expeditiously and without difficulty.

In our preliminary purchase price allocation we recorded approximately $3.1 million of land and fixed assets, $250,000 of intangible assets and $121,000 of other current assets.

Inter-County Imaging.

On March 31, 2009, we acquired the assets and business of Inter-County Imaging in Yonkers, NY for approximately $553,000. We have made a preliminary purchase price allocation of the acquired assets and liabilities, and approximately $500,000 of fixed assets and no goodwill was recorded with respect to this transaction.

Elite Diagnostic Imaging LLC.

On March 27, 2009, we acquired the assets and business of Elite Diagnostic Imaging, LLC in Victorville, CA for approximately $1.3 million. We have made a preliminary purchase price allocation of the acquired assets and liabilities, and approximately $1.2 million of fixed assets and $100,000 of goodwill was recorded with respect to this transaction.

NOTE 4 - INCOME (LOSS) PER SHARE ATTRIBUTABLE TO RADNET, INC.'S COMMON SHAREHOLDERS

We utilize Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 260 (ASC Topic 260, originally issued as Statement of Financial Accounting Standards SFAS No. 128, "Earnings per Share." Basic earnings (loss) per share is computed by dividing earnings (loss) available to common stockholders by the weighted-average number of common shares outstanding. Diluted earnings (loss) per share is computed similar to basic earnings (loss) per share except that the denominator is increased to include additional common shares available upon exercise of stock options and warrants using the treasury stock method, except for periods of operating loss for which no common share equivalents are included because their effect would be anti-dilutive Loss per share attributable to Radnet, Inc.'s common shareholders for the three and nine month periods ended September 30, 2009 and 2008 was calculated as follows (in thousands except share and per share data):

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Net income (loss) attributable to Radnet, Inc.'s common shareholders	$ (1,726)	$ 138	$ (2,904)	$ (7,486)
BASIC LOSS PER SHARE ATTRIBUTABLE TO RADNET, INC.'S COMMON SHAREHOLDERS				
Weighted average number of common shares outstanding during the year	36,105,149	35,759,779	35,982,558	35,669,400
Basic loss per share attributable to Radnet, Inc.'s common shareholders	$ (0.05)	$ 0.00	$ (0.08)	$ (0.21)
DILUTED LOSS PER SHARE ATTRIBUTABLE TO RADNET, INC.'S COMMON SHAREHOLDERS				
Weighted average number of common shares outstanding during the year	36,105,149	35,759,779	35,982,558	35,669,400
Add additional shares issuable upon exercise of stock options and warrants	-	1,255,005	-	-
Weighted average number of common shares used in calculating diluted loss per share	36,105,149	37,014,784	35,982,558	35,669,400
Diluted loss per share attributable to Radnet, Inc.'s common shareholders	$ (0.05)	$ 0.00	$ (0.08)	$ (0.21)

For the three months ended September 30, 2009 and the nine months ended September 30, 2009 and 2008, we excluded all options and warrants in the calculation of diluted loss per share because their effect is antidilutive.

NOTE 5 - DERIVITIVE INSTRUMENTS

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 815 (ASC Topic 815, originally issued as Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities), requires companies to recognize all of their derivative instruments as either assets or liabilities in the statement of financial position at fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge, or a hedge of a net investment in a foreign operation.

We are exposed to certain risks relating to our ongoing business operations. The primary risk managed by using derivative instruments is interest rate risk. We have entered into interest rate swap agreements to manage interest rate risk exposure. The interest rate swap agreements utilized by us effectively modifies our exposure to interest rate risk by converting our floating-rate debt to a fixed rate basis during the period of the interest rate swap, thus reducing the impact of interest-rate changes on future interest expense.

In accordance with ASC Topic 815, we designate our interest rate swaps as cash flow hedges of floating-rate borrowings. For interest rate swaps that are designated and qualify as a cash flow hedge (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is initially reported as a component of other comprehensive income, then reclassified into earnings in the same line item associated with the forecasted transaction and in the same period or periods during which the hedged transaction affects earnings (e.g., in “interest expense” when the hedged transactions are interest cash flows associated with floating-rate debt). The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item, if any (i.e., the ineffectiveness portion), or hedge components excluded from the assessment of effectiveness, are recognized in the statement of operations during the current period.

As part of our senior secured credit facility financing, we swapped 50% of the aggregate principal amount of the facilities to a floating rate within 90 days of the closing. On April 11, 2006, effective April 28, 2006, we entered into an interest rate swap on $73.0 million fixing the LIBOR rate of interest at 5.47% for a period of three years. This swap was made in conjunction with the $161.0 million credit facility that closed on March 9, 2006. In addition, on November 15, 2006, we entered into an interest rate swap, designated as a cash flow hedge, on $107.0 million fixing the LIBOR rate of interest at 5.02% for a period of three years, and on November 28, 2006, we entered into an interest rate swap, also designated as a cash flow hedge, on $90.0 million fixing the LIBOR rate of interest at 5.03% for a period of three years. Previously, the interest rate on the above $270.0 million portion of the credit facility was based upon a spread over LIBOR which floats with market conditions.

During the first quarter of 2009 we modified the two interest rate swaps designated as cash flow hedges mentioned above. The modifications, commonly referred to as “blend and extends”, extended the maturity of, and re-priced these two interest rate swaps originally executed in 2006, for an additional 36 months, resulting in an estimated annualized cash interest expense savings of $2.9 million.

On the LIBOR hedge modification for a notional amount of $107 million of LIBOR exposure, the Company on January 29, 2009 replaced the existing fixed LIBOR rate of 5.02% with a new rate of 3.47% maturing on November 15, 2012. On the second LIBOR hedge modification for a notional amount of $90 million of LIBOR exposure, the Company on February 5, 2009 replaced the existing fixed LIBOR rate of 5.03% with a new rate of 3.61% also maturing on November 15, 2012. Both modified interest swaps have been designated as cash flow hedges.

As part of these modifications, the negative fair values of the original interest rate swaps, as well as a certain amount of accrued interest, associated with the original cash flow hedges were incorporated into the fair values of the new modified cash flow hedges. The related Accumulated Other Comprehensive Loss (AOCL) associated with the negative fair values of the original cash flow hedges on their dates of modification, which totaled $6.1 million, is being amortized on a straight-line basis to interest expense through November 15, 2009, the maturity date of the original cash flow hedges. As of September 30, 2009, after amortization of $4.9 recorded in the first three quarters of 2009, the remaining unamortized AOCL associated with the original cash flow hedges was $1.2 million.

We document our risk management strategy and hedge effectiveness at the inception of the hedge, and, unless the instrument qualifies for the short-cut method of hedge accounting, over the term of each hedging relationship. Our use of derivative financial instruments is limited to interest rate swaps, the purpose of which is to hedge the cash flows of variable-rate indebtedness. We do not hold or issue derivative financial instruments for speculative purposes. In accordance with ASC Topic 815, derivatives that have been designated and qualify as cash flow hedging instruments are reported at fair value. The gain or loss on the effective portion of the hedge (i.e., change in fair value) is initially reported as a component of accumulated other comprehensive loss in the Company's Consolidated Statement of Stockholders' Equity Deficit. The remaining gain or loss, if any, is recognized currently in earnings.

A tabular presentation of the fair value of derivative instruments as of September 30, 2009 is as follows (amounts in thousands):

	Balance Sheet Location	Fair Value – Asset (Liability) Derivatives
Derivatives designated as hedging instruments under ASC Topic 815		
Interest rate contracts	Other non-current liabilities	$(9,929)

A tabular presentation of the effect of derivative instruments on our statement of operations is as follows (amounts in thousands):

For the Three Months Ended September 30, 2009

Derivatives in ASC Topic 815 – Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain (Loss) Recognized in OCI During the Term of the Hedge Relationship Reclassified into Income (Effective Portion)	Location of Gain (Loss) Recognized in OCI During the Term of the Hedge Relationship Reclassified into Income (Effective Portion)
Interest rate contracts	($ 1,856)	Interest income/ (expense)	* ($1,836)	Interest income/(expense)

For the Nine Months Ended September 30, 2009

Derivatives in ASC Topic 815 – Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Loss Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain (Loss) Recognized in OCI During the Term of the Hedge Relationship Reclassified into Income (Effective Portion)	Location of Gain (Loss) Recognized in OCI During the Term of the Hedge Relationship Reclassified into Income (Effective Portion)
Interest rate contracts	($ 2,341)	Interest income/ (expense)	* ($4,895)	Interest income/(expense)

* Amortization of OCI associated with the original cash flow hedges prior to modification (see discussion above).

NOTE 6 - INVESTMENT IN JOINT VENTURES

We have eight unconsolidated joint ventures with ownership interests ranging from 18% to 50%. These joint ventures represent partnerships with hospitals, health systems or radiology practices and were formed for the purpose of owning and operating diagnostic imaging centers. Professional services at the joint venture diagnostic imaging centers are performed by contracted radiology practices or a radiology practice that participates in the joint venture. Our investment in these joint ventures is accounted for under the equity method. Investment in joint ventures increased $302,000 to $17.9 million at September 30, 2009 compared to $17.6 million at December 31, 2008. This increase is primarily related to our purchase of an additional $315,000 of share holdings in joint ventures that were existing as of December 31, 2008 as well as our equity earnings, net of eliminating all inter company profits, of $6.8 million for the nine months ended September 30, 2009, offset by $6.8 million of distributions received during the period.

We received management service fees from the centers underlying these joint ventures of approximately $1.6 million and $1.8 million for the three months ended September 30, 2009 and 2008, respectively, and $5.4 million and $5.5 million for the nine months ended September 30, 2009 and 2008, respectively.

The following table is a summary of key financial data for these joint ventures as of and for the nine months ended September 30, 2009 (in thousands):

Balance Sheet Data:		September 30, 2009
Current assets	$	19,669
Noncurrent assets		28,471
Current liabilities		(6,767)
Noncurrent liabilities		(8,383)
Total net assets	$	32,990
Book value of Radnet joint venture interests	$	14,348
Cost in excess of book value of acquired joint venture interests		3,383
Elimination of intercompany profit remaining on Radnet's consolidated balance sheet		208
Total value of Radnet joint venture interests	$	17,939
Total book value of other joint venture partner interests	$	18,642
Net revenue	$	56,826
Net income	$	10,334

NOTE 7 - SHARE BASED COMPENSATION

We have two long-term incentive plans that currently have outstanding stock options which we refer to as the 2000 Plan and the 2006 Plan. The 2000 Plan was terminated as to future grants when the 2006 Plan was approved by the shareholders in 2006. We have reserved for issuance under the 2006 Plan 6,500,000 shares of common stock. Certain options granted under the 2006 Plan to employees are intended to qualify as incentive stock options under existing tax regulations. In addition, we issue non-qualified stock options and warrants under the 2006 Plan from time to time to non-employees, in connection with acquisitions and for other purposes and we may also issue stock under the Plan. Stock options and warrants generally vest over two to five years and expire five to ten years from date of grant.

As of September 30, 2009, 1,855,583, or approximately 46.6%, of all the outstanding stock options and warrants under our option plans are fully vested. During the nine months ended September 30, 2009, we granted options and warrants to acquire 1,733,750 shares of common stock.

We have issued warrants outside the Plan under various types of arrangements to employees, in conjunction with debt financing and in exchange for outside services. All warrants issued after our February 2007 listing on the NASDAQ Global Market have been characterized as awards under the 2006 Plan. All warrants outside the Plan have been issued with an exercise price equal to the fair market value of the underlying common stock on the date of grant. The warrants expire from five to seven years from the date of grant. Vesting terms are determined by the board of directors or the compensation committee of the board of directors at the date of grant.

As of September 30, 2009, 2,486,232, or approximately 80.6%, of all the outstanding warrants outside the 2006 Plan are fully vested. During the nine months ended September 30, 2009, we did not grant any warrants outside the 2006 Plan.

The compensation expense recognized for all equity-based awards is net of estimated forfeitures and is recognized over the awards' service period. In accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 718 (ASC Topic 718, originally issued as Staff Accounting Bulletin ("SAB") No. 110, Valuation of Share Based Payment arraignments for Public Companies), we classified equity-based compensation in operating expenses with the same line item as the majority of the cash compensation paid to employees.

The following tables illustrate the impact of equity-based compensation on reported amounts (in thousands except per share data):

	For the Three Months Ended September 30,			
	2009		2008	
	Impact of Equity-Based Compensation			
	As Reported	Comp.	As Reported	Comp.
Income from operations	$9,143	$(712)	$9,540	$(831)
Income (loss) attributable to Radnet, Inc.'s common shareholders before income taxes	$(1,495)	$(712)	$152	$(831)
Net Income (loss) attributable to Radnet, Inc.'s common shareholders	$(1,726)	$(712)	$138	$(831)
Net basic earnings per share attributable to Radnet, Inc.'s common shareholders	$(0.05)	$(0.02)	$0.00	$(0.02)
Net diluted earnings per share attributable to Radnet, Inc.'s common shareholders	$(0.05)	$(0.02)	$0.00	$(0.02)

	For the Nine Months Ended September 30,			
	2009		2008	
	Impact of Equity-Based Compensation			
	As Reported	Comp.	As Reported	Comp.
Income from operations	$28,174	$(2,937)	$23,024	$(1,887)
Loss attributable to Radnet, Inc.'s common shareholders before income taxes	$(2,623)	$(2,937)	$(7,335)	$(1,887)
Net loss attributable to Radnet, Inc.'s common shareholders	$(2,904)	$(2,937)	$(7,486)	$(1,887)
Net basic earnings per share attributable to Radnet, Inc.'s common shareholders	$(0.08)	$(0.08)	$(0.21)	$(0.05)
Net diluted earnings per share attributable to Radnet, Inc.'s common shareholders	$(0.08)	$(0.08)	$(0.21)	$(0.05)

The following summarizes all of our option and warrant activity for the nine months ended September 30, 2009:

Outstanding Options and Warrants Under the 2006 Plan	Shares	Weighted Average Exercise price Per Common Share	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value
Balance, December 31, 2008	2,451,000	$5.44		
Granted	1,733,750	2.41		
Exercised	-	-		
Canceled or expired	(200,000)	5.01		
Balance, September 30, 2009	3,984,750	4.14	4.36	$646,733
Exercisable at September 30, 2009	1,855,583	4.11	4.11	473,991

15

Non-Plan Outstanding Warrants	Shares	Weighted Average Exercise price Per Common Share	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value
Balance, December 31, 2008	3,432,898	$2.07		
Granted	-	-		
Exercised	(350,000)	0.64		
Canceled or expired	-	-		
Balance, September 30, 2009	3,082,898	2.23	2.55	$ 2,902,360
Exercisable at September 30, 2009	2,486,232	1.75	2.56	2,830,760

The aggregate intrinsic value in the table above represents the difference between our closing stock price on September 30, 2009 and the exercise price, multiplied by the number of in-the-money options and warrants on September 30, 2009. Total intrinsic value of options and warrants exercised during the nine months ended September 30, 2009 was approximately $811,500. As of September 30, 2009, total unrecognized share-based compensation expense related to non-vested employee awards was approximately $5.5 million, which is expected to be recognized over a weighted-average period of approximately 2.2 years.

The fair value of each option/warrant granted is estimated on the grant date using the Black-Scholes option pricing model which takes into account as of the grant date the exercise price and expected life of the option/warrant, the current price of the underlying stock and its expected volatility, expected dividends on the stock and the risk-free interest rate for the term of the option/warrant.

The following is the weighted average data used to calculate the fair value:

	Risk-free Interest Rate	Expected Life	Expected Volatility	Expected Dividends
September 30, 2009	2.65%	3.1 years	91.45%	-
September 30, 2008	2.75%	3.7 years	74.68%	-

We have determined the expected term assumption under the "Simplified Method" as defined in ASC Topic 718, originally issued as SAB No. 110. The expected stock price volatility is based on the historical volatility of our stock. The risk-free interest rate is based on the U.S. Treasury yield in effect at the time of grant with an equivalent remaining term. We have not paid dividends in the past and do not currently plan to pay any dividends in the near future.

The weighted-average grant date fair value of stock options and warrants granted during the nine months ended September 30, 2009 and 2008 was $1.43 and $4.20, respectively.

NOTE 8 - FAIR VALUE MEASUREMENTS

ASC Topic 820 (originally issued as SFAS 157, Fair Value Measurements), defines fair value, establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the United States, and expands disclosures about fair value measurements. We adopted the provisions of ASC Topic 820 as of January 1, 2008 for financial instruments. Although the adoption of ASC Topic 820 did not materially impact our financial position, results of operations, or cash flow, we are now required to provide additional disclosures as part of our financial statements.

ASC Topic 820 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers are: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

Our consolidated balance sheets include the following financial instruments: cash and cash equivalents, receivables, trade accounts payable, capital leases, long-term debt and other liabilities. We consider the carrying amounts of cash and cash equivalents, receivables, other current assets and current liabilities to approximate their fair value because of the relatively short period of time between the origination of these instruments and their expected realization or payment. Additionally, we consider the carrying amount of our capital lease obligations to approximate their fair value because the weighted average interest rate used to formulate the carrying amounts approximates current market rates.

At September 30, 2009, based on Level 2 inputs, we determined the fair values of our first and second lien term loans issued on November 15, 2006 and extended on August 23, 2007 to be $231.1 million and $163.2 million, respectively. The carrying amount of the first and second lien term loans at September 30, 2009 was $243.3 million and $170.0 million, respectively.

The Company maintains interest rate swaps which are required to be recorded at fair value on a recurring basis. At September 30, 2009 the fair value of these swaps of a liability of $9.9 million was determined using Level 2 inputs. More specifically, the fair value was determined by calculating the value of the difference between the fixed interest rate of the interest rate swaps and the counterparty’s forward LIBOR curve, which would be the input used in the valuations. The forward LIBOR curve is readily available in the public markets or can be derived from information available in the public markets.

On January 1, 2009, the Company adopted without material impact on its condensed consolidated financial statements the provisions of ASC Topic 820 related to nonfinancial assets and nonfinancial liabilities that are not required or permitted to be measured at fair value on a recurring basis, which include those measured at fair value including goodwill impairment testing, indefinite-lived intangible assets measured at fair value for impairment assessment, nonfinancial long-lived assets measured at fair value for impairment assessment, asset retirement obligations initially measured at fair value, and those initially measured at fair value in a business combination.

NOTE 9 - RELATED PARTY TRANSACTIONS

On June 1, 2009 we entered into a 10 year operating lease for a building at one of our imaging centers located in Wilmington, Delaware in which our Senior Vice President of Materials Management is a 50% owner. The monthly rent under this operating lease is approximately $25,000. We believe that the monthly lease amount is in line with similar 10 year lease contracts available for comparable buildings in the area.

NOTE 10 - SUBSEQUENT EVENTS

On October 1, 2009, we completed the acquisition of the imaging assets of Chesapeake Urology Associates in Baltimore, Maryland for approximately $900,000. Chesapeake Urology operated CT scanners in three locations in the greater Baltimore area.

On October 1, 2009, we completed the acquisition of the women’s imaging business of Ridgewood Diagnostics, a multi-modality women’s imaging practice located near Rochester, New York’s Unity Hospital for $1.1 million and 50,000 shares of RadNet common stock. In conjunction with the Ridgewood Diagnostics transaction, on October 16, 2009, we completed the acquisition of the women’s imaging business of Unity Hospital for $100,000. We plan to consolidate the Ridgewood Diagnostics and Unity Hospital operations into one facility during 2010.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements reflect, among other things, management's current expectations and anticipated results of operations, all of which are subject to known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements, or industry results, to differ materially from those expressed or implied by such forward-looking statements. Therefore, any statements contained herein that are not statements of historical fact may be forward-looking statements and should be evaluated as such. Without limiting the foregoing, the words "believes," "anticipates," "plans," "intends," "will," "expects," "should" and similar words and expressions are intended to identify forward-looking statements. Except as required under the federal securities laws or by the rules and regulations of the SEC, we assume no obligation to update any such forward-looking information to reflect actual results or changes in the factors affecting such forward-looking information. The factors included in "Risks Relating to Our Business," in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008, as amended or supplemented by the information if any, in Part II – Item 1A below, among others, could cause our actual results to differ materially from those expressed in, or implied by, the forward-looking statements.

The Company intends that all forward-looking statements made will be subject to the safe harbor protection of the federal securities laws pursuant to Section 27A of the Securities Act and Section 21E of the Exchange Act. Forward-looking statements are based upon, among other things, the Company's assumptions with respect to:

- future revenues;
- expected performance and cash flows;
- changes in regulations affecting the Company;
- changes in third-party reimbursement rates;
- the outcome of litigation;
- the availability of radiologists at BRMG and our other contracted radiology practices;
- competition;
- acquisitions and divestitures of businesses;
- joint ventures and other business arrangements;
- access to capital and the terms relating thereto;
- technological changes in our industry;
- successful execution of internal plans;
- compliance with our debt covenants; and
- anticipated costs of capital investments.

You should consider the limitations on, and risks associated with, forward-looking statements and not unduly rely on the accuracy of predictions contained in such forward-looking statements. As noted above, these forward-looking statements speak only as of the date when they are made. The Company does not undertake any obligation to update forward-looking statements to reflect events, circumstances, changes in expectations, or the occurrence of unanticipated events after the date of those statements. Moreover, in the future, the Company, through senior management, may make forward-looking statements that involve the risk factors and other matters described in this Form 10-Q as well as other risk factors subsequently identified, including, among others, those identified in the Company's filings with the SEC on Form 10-K, Form 10-Q and Form 8-K.

Overview

The following discussion should be read along with the unaudited condensed consolidated financial statements included in this Form 10-Q, as well as the Company's 2008 Annual Report on Form 10-K filed with the Securities and Exchange Commission, which provides a more thorough discussion of the Company's services, industry outlook, and business trends.

We operate a group of regional networks comprised of 175 diagnostic imaging facilities located in seven states with operations primarily in California, Maryland, the Treasure Coast area of Florida, Kansas, Delaware, New Jersey and the Finger Lakes (Rochester) and Hudson Valley areas of New York. Diagnostic imaging uses non-invasive procedures to generate representations of internal anatomy and function that can facilitate the early diagnosis and treatment of diseases and disorders and may reduce unnecessary invasive procedures often minimizing the cost and amount of care for patients. Services at our facilities include magnetic resonance imaging ("MRI"), computed tomography ("CT"), positron emission tomography ("PET"), nuclear medicine, mammography, ultrasound, diagnostic radiology, or X-ray, and fluoroscopy. The Company's operations comprise a single segment for financial reporting purposes.

Our business strategy with regard to operations focuses on the following:

§ Maximizing performance at our existing facilities;
§ Focusing on profitable contracting;
§ Expanding MRI, CT and PET applications;
§ Optimizing operating efficiencies; and
§ Expanding our networks

During the nine months ended September 30, 2009 we continued to improve on a number of these operating objectives. Revenue increased at our existing facilities over the prior year period, primarily as a result of an increase in the number of procedures. We have maintained tight control on major expenses including salaries and professional reading fees. In addition, on June 12, 2009 we continued the expansion of our networks with the acquisition of the assets and business of nine imaging centers located in New Jersey from Medical Resources, Inc.

The following discussion should be read along with the unaudited consolidated condensed financial statements included in this Form 10-Q, as well as the Company's 2008 Annual Report on Form 10-K filed with the Securities and Exchange Commission, which provides a more thorough discussion of the Company's services, industry outlook, and business trends.

We operate a group of regional networks comprised of 175 diagnostic imaging facilities located in seven states with operations primarily in California, Maryland, the Treasure Coast area of Florida, Kansas, Delaware, New Jersey and the Finger Lakes (Rochester) and Hudson Valley areas of New York, providing diagnostic imaging services including magnetic resonance imaging (MRI), computed tomography (CT), positron emission tomography (PET), nuclear medicine, mammography, ultrasound, diagnostic radiology, or X-ray, and fluoroscopy. The Company's operations comprise a single segment for financial reporting purposes.

The consolidated financial statements include the accounts of RadNet Management, Inc. ("or RadNet Management") and Beverly Radiology Medical Group III, a professional partnership ("BRMG"). The consolidated financial statements also include RadNet Management I, Inc., RadNet Management II, Inc., Radiologix, Inc., RadNet Management Imaging Services, Inc., Delaware Imaging Partners, Inc., New Jersey Imaging Partners, Inc. and Diagnostic Imaging Services, Inc. (DIS), all wholly owned subsidiaries of RadNet Management. All of these affililiated entities are referred to collectively in this report as "Radnet", "we", "us" or the "Company".

Howard G. Berger, M.D. is our President and Chief Executive Officer, a member of our Board of Directors and owns approximately 18% of our outstanding common stock. Dr. Berger also owns, indirectly, 99% of the equity interests in BRMG. BRMG provides all of the professional medical services at the majority of our facilities located in California under a management agreement with us, and contracts with various other independent physicians and physician groups to provide the professional medical services at most of our other California facilities. We generally obtain professional medical services from BRMG in California, rather than provide such services directly or through subsidiaries, in order to comply with California's prohibition against the corporate practice of medicine. However, as a result of our close relationship with Dr. Berger and BRMG, we believe that we are able to better ensure that medical service is provided at our California facilities in a manner consistent with our needs and expectations and those of our referring physicians, patients and payors than if we obtained these services from unaffiliated physician groups. BRMG is a partnership of Pronet Imaging Medical Group, Inc. (99%), Breastlink Medical Group, Inc. (100%) and Beverly Radiology Medical Group, Inc. (99%), each of which are 99% or 100% owned by Dr. Berger. RadNet provides non-medical, technical and administrative services to BRMG for which it receives a management fee, per the management agreement. Through the management agreement and our relationship with Dr. Berger, we have exclusive authority over all non-medical decision making related to the ongoing business operations of BRMG. Based on the provisions of the agreement, we have determined that BRMG is a variable interest entity, and that we are the primary beneficiary as defined in Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 810 (ASC Topic 810, originally issued as Financial Accounting Standards Board (FASB) Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51 (FIN 46(R)), and consequently, we consolidate the revenue and expenses of BRMG. All intercompany balances and transactions have been eliminated in consolidation.

At a portion of our centers in California and at all of the centers which are located outside of California, we have entered into long-term contracts with independent radiology groups in the area to provide physician services at those facilities. These third party radiology practices provide professional services, including supervision and interpretation of diagnostic imaging procedures, in our diagnostic imaging centers. The radiology practices maintain full control over the provision of professional services. The contracted radiology practices generally have outstanding physician and practice credentials and reputations; strong competitive market positions; a broad sub-specialty mix of physicians; a history of growth and potential for continued growth. In these facilities we enter into long-term agreements with radiology practice groups (typically 40 years). Under these arrangements, in addition to obtaining technical fees for the use of our diagnostic imaging equipment and the provision of technical services, we provide management services and receive a fee based on the practice group’s professional revenue, including revenue derived outside of our diagnostic imaging centers. We own the diagnostic imaging equipment and, therefore, receive 100% of the technical reimbursements associated with imaging procedures. The radiology practice groups retain the professional reimbursements associated with imaging procedures after deducting management service fees. Our management service fees are included in net revenue in the consolidated statement of operations and totaled $7.6 million and $8.7 million for the three months ended September 30, 2009 and 2008, respectively, and $22.6 million and $24.9 million for the nine months ended September 30, 2009 and 2008, respectively. We have no financial controlling interest in the independent radiology practices, as defined in ASC Topic 810 (originally defined in EITF 97-2); accordingly, we do not consolidate the financial statements of those practices in our consolidated financial statements.

Critical Accounting Estimates

Our discussion and analysis of financial condition and results of operations are based on our consolidated financial statements that were prepared in accordance with U.S. generally accepted accounting principles, or GAAP. Management makes estimates and assumptions when preparing financial statements. These estimates and assumptions affect various matters, including:

- Our reported amounts of assets and liabilities in our consolidated balance sheets at the dates of the financial statements;
- Our disclosure of contingent assets and liabilities at the dates of the financial statements; and
- Our reported amounts of net revenue and expenses in our consolidated statements of operations during the reporting periods.

These estimates involve judgments with respect to numerous factors that are difficult to predict and are beyond management’s control. As a result, actual amounts could materially differ from these estimates.

The SEC, defines critical accounting estimates as those that are both most important to the portrayal of a company’s financial condition and results of operations and require management’s most difficult, subjective or complex judgment, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods.

As of the period covered in this report, there have been no material changes to the critical accounting estimates we use, and have explained, in our annual report on Form 10-K for the fiscal year ended December 31, 2008.

Results of Operations

The following table sets forth, for the periods indicated, the percentage that certain items in the statement of operations bears to net revenue.

20

RADNET, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS EXCEPT SHARE DATA)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
NET REVENUE	100.00%	100.00%	100.00%	100.00%
OPERATING EXPENSES				
Operating expenses	76.40%	76.05%	76.08%	77.12%
Depreciation and amortization	10.19%	9.99%	10.18%	10.67%
Provision for bad debts	6.29%	5.40%	6.30%	5.56%
Loss on sale of equipment	0.05%	1.16%	0.10%	0.40%
Severance costs	0.21%	0.10%	0.16%	0.05%
Total operating expenses	93.15%	92.71%	92.82%	93.80%
INCOME FROM OPERATIONS	6.85%	7.29%	7.18%	6.20%
OTHER EXPENSES (INCOME)				
Interest expense	9.27%	9.26%	9.61%	10.29%
Gain on bargain purchase	0.00%	0.00%	-0.35%	0.00%
Other expenses (income)	0.00%	-0.06%	0.32%	-0.04%
Total other expenses	9.27%	9.20%	9.57%	10.26%
LOSS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF JOINT VENTURES	-2.42%	-1.92%	-2.39%	-4.06%
Provision for income taxes	-0.17%	-0.01%	-0.07%	-0.04%
Equity in earnings of joint ventures	1.31%	2.05%	1.74%	2.10%
NET INCOME (LOSS)	-1.28%	0.13%	-0.72%	-2.00%
Net income attributable to noncontrolling interests	0.02%	0.02%	0.02%	0.02%
NET INCOME (LOSS) ATTRIBUTABLE TO RADNET, INC. COMMON SHAREHOLDERS	-1.29%	0.11%	-0.74%	-2.02%

Three Months Ended September 30, 2009 Compared to the Three Months Ended September 30, 2008

Net Revenue

Net revenue for the three months ended September 30, 2009 was $133.4 million compared to $130.9 million for the three months ended September 30, 2008, an increase of $2.5 million, or 2.4%.

Net revenue, including only those centers which were in operation throughout the third quarters of both 2009 and 2008, increased $82,000, or 0.06%. This 0.06% increase is mainly due to an increase in procedure volumes. This comparison excludes revenue contributions from centers that were acquired or divested subsequent to July 1, 2008. For the three months ended September 30, 2009, net revenue from centers that were acquired subsequent to

July 1, 2008 and excluded from the above comparison was $4.5 million. For the three months ended September 30, 2008, net revenue from centers that were acquired subsequent to July 1, 2008 and excluded from the above comparison was $662,000. Also excluded from the above comparison was $1.4 million from centers that were divested subsequent to July 1, 2008.

Operating Expenses

Operating expenses for the three months ended September 30, 2009 increased approximately $2.4 million, or 2.4%, from $99.5 million for the three months ended September 30, 2008 to $101.9 million for the three months ended September 30, 2009. The following table sets forth our operating expenses for the three months ended September 30, 2009 and 2008 (in thousands):

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008
Salaries and professional reading fees, excluding share-based compensation	$ 55,001	$ 54,217
Share-based compensation	712	831
Building and equipment rental	10,896	10,969
Medical supplies	8,070	8,488
Other operating expense *	27,245	25,047
Operating expenses	101,924	99,552
Depreciation and amortization	13,593	13,083
Provision for bad debts	8,386	7,065
Loss on sale of equipment, net	72	1,525
Severance costs	286	137
Total operating expenses	$ 124,261	$ 121,362

* Includes billing fees, office supplies, repairs and maintenance, insurance, business tax and license, outside services, utilities, marketing, travel and other expenses.

Salaries and professional reading fees, excluding share-based compensation and severance

Salaries and professional reading fees increased $784,000, or 1.5%, to $55.0 million for the three months ended September 30, 2009 compared to $54.2 million for the three months ended September 30, 2008.

Salaries and professional reading fees including only those centers which were in operation throughout the third quarters of both 2009 and 2008 increased $191,000, or 0.4%. This 0.4% increase is primarily due to increases is professional reading fees that are driven by procedure volumes. This comparison excludes contributions from centers that were acquired or divested subsequent to July 1, 2008. For the three months ended September 30, 2009, salaries and professional reading fees from centers that were acquired subsequent to July 1, 2008 and excluded from the above comparison was $1.5 million. For the three months ended September 30, 2008, salaries and professional reading fees from centers that were acquired subsequent to July 1, 2008 and excluded from the above comparison was $66,000. Also excluded from the above comparison was $848,000 from centers that were divested subsequent to July 1, 2008.

Share-based compensation

Share-based compensation decreased $119,000, or 14.3%, to $712,000 for the three months ended September 30, 2009 compared to $831,000 for the three months ended September 30, 2008. Share-based compensation for the three months ended September 30, 2008 includes additional expense related to certain options granted during the third quarter of 2008 that were fully vested on the date of grant.

Building and equipment rental

Building and equipment rental expenses decreased $73,000, or 0.7%, to $10.9 million for the three months ended September 30, 2009 compared to $11.0 million for the three months ended September 30, 2008.

Building and equipment rental expenses including only those centers which were in operation throughout the third quarters of both 2009 and 2008, decreased $533,000, or 4.9%. This 4.9% decrease is primarily due to the conversion of certain equipment lease contracts from operating to capital leases in the first quarter of 2009. This comparison excludes contributions from centers that were acquired or divested subsequent to July 1, 2008. For the three months ended September 30, 2009, building and equipment rental expenses from centers that were acquired subsequent to July 1, 2008 and excluded from the above comparison was $584,000. For the three months ended September 30, 2008, building and equipment rental expenses from centers that were acquired subsequent to July 1, 2008 and excluded from the above comparison was $47,000. Also excluded from the above comparison was $77,000 from centers that were divested subsequent to July 1, 2008.

Medical supplies

Medical supplies expense decreased $418,000, or 4.9%, to $8.1 million for the three months ended September 30, 2009 compared to $8.5 million for the three months ended September 30, 2008.

Medical supplies expenses, including only those centers which were in operation throughout the third quarters of both 2009 and 2008, decreased $393,000, or 4.7%. This 4.7% decrease is primarily due to a change in vendors supplying certain drugs used in operating our Breastlink centers. This comparison excludes contributions from centers that were acquired or divested subsequent to July 1, 2008. For the three months ended September 30, 2009, medical supplies expense from centers that were acquired subsequent to July 1, 2008 and excluded from the above comparison was $142,000. For the three months ended September 30, 2008, medical supplies expense from centers that were acquired subsequent to July 1, 2008 and excluded from the above comparison was $19,000. Also excluded from the above comparison was $148,000 from centers that were divested subsequent to July 1, 2008.

Depreciation and amortization

Depreciation and amortization increased $510,000, or 3.9%, to $13.6 million for the three months ended September 30, 2009 compared to the same period last year. The increase is primarily due to the addition of equipment at new and existing centers as well as the capitalization of certain equipment previously held under operating leases.

Provision for bad debts

Provision for bad debts increased $1.3 million, or 18.7%, to $8.4 million, or 6.3% of net revenue, for the three months ended September 30, 2009 compared to $7.1 million, or 5.4% of net revenue, for the three months ended September 30, 2008. We increased our provision for bad debts as a percentage of net revenue in light of the current economic slow down and our expectations concerning a decrease in collections related to the patient portion of our total billings that we may experience in subsequent quarters.

Interest expense

Interest expense for the three months ended September 30, 2009 was $12.4 million compared to $12.1 million for the three months ended September 30, 2008. The interest expense for the three months ended September 30, 2009 includes $1.8 million of amortization of Other Comprehensive Income associated with the modification of two interest rate swaps designated as cash flow hedges (see Liquidity and Capital Resources below) and amortization of deferred loan costs of $670,000.

Income tax expense

For the three months ended September 30, 2009 and 2008, we recorded $231,000 and $14,000, respectively, for income tax expense primarily related to taxable income generated in the states of Maryland and Delaware.

Equity in earnings from unconsolidated joint ventures

For the three months ended September 30, 2009, we recognized equity in earnings from unconsolidated joint ventures of $1.8 million compared to $2.7 million for the three months ended September 30, 2008. This variance is due to a combination of decreases in our collection rates and increases in our repair and maintenance costs associated with new equipment transitioning from warranty to maintenance contracts in the third quarter of 2009.

Nine Months Ended September 30, 2009 Compared to the Nine Months Ended September 30, 2008

Net Revenue

Net revenue for the nine months ended September 30, 2009 was $392.6 million compared to $371.4 million for the nine months ended September 30, 2008, an increase of $21.2 million, or 5.7%.

Net revenue, including only those centers which were in operation throughout the three quarters of both 2009 and 2008, increased $6.9 million, or 2.0%. This 2.0% increase is mainly due to an increase in procedure volumes. This comparison excludes revenue contributions from centers that were acquired or divested subsequent to December 31, 2007. For the nine months ended September 30, 2009, net revenue from centers that were acquired subsequent to December 31, 2007 and excluded from the above comparison was $50.2 million. For the nine months ended September 30, 2008, net revenue from centers that were acquired subsequent to December 31, 2007 and excluded from the above comparison was $31.1 million. Also excluded from the above comparison was $4.8 million from centers that were divested subsequent to December 31, 2007.

Operating Expenses

Operating expenses for the nine months ended September 30, 2009 increased approximately $12.3 million, or 4.3%, from $286.4 million for the nine months ended September 30, 2008 to $298.7 million for the nine months ended September 30, 2009. The following table sets forth our operating expenses for the nine months ended September 30, 2009 and 2008 (in thousands):

	Nine Months Ended September 30, 2009	2008
Salaries and professional reading fees, excluding share-based compensation	$ 160,839	$ 157,279
Share-based compensation	2,936	1,887
Building and equipment rental	32,518	31,861
Medical supplies	24,529	21,912
Other operating expense *	77,831	73,465
Operating expenses	298,653	286,404
Depreciation and amortization	39,979	39,623
Provision for bad debts	24,729	20,640
Loss on sale of equipment, net	375	1,495
Severance costs	643	172
Total operating expenses	$ 364,379	$ 348,334

* Includes billing fees, office supplies, repairs and maintenance, insurance, business tax and license, outside services, utilities, marketing, travel and other expenses.

24

Salaries and professional reading fees, excluding share-based compensation and severance

Salaries and professional reading fees increased $3.5 million, or 2.3%, to $160.8 million for the nine months ended September 30, 2009 compared to $157.3 million for the nine months ended September 30, 2008.

Salaries and professional reading fees, including only those centers which were in operation throughout the three quarters of both 2009 and 2008, decreased $1.7 million, or 1.2%. This 1.2% decrease is primarily due to cost cutting measures implemented in the third quarter of 2008. This comparison excludes contributions from centers that were acquired or divested subsequent to December 31, 2007. For the nine months ended September 30, 2009, salaries and professional reading fees from centers that were acquired subsequent to December 31, 2007 and excluded from the above comparison was $18.9 million. For the nine months ended September 30, 2008, salaries and professional reading fees from centers that were acquired subsequent to December 31, 2007 and excluded from the above comparison was $11.3 million. Also excluded from the above comparison was $2.4 million from centers that were divested subsequent to December 31, 2007.

Share-based compensation

Share-based compensation increased $1.0 million, or 55.6%, to $2.9 million for the nine months ended September 30, 2009 compared to $1.9 million for the nine months ended September 30, 2008. The increase is primarily due to additional options granted during the first half of 2009 some of which were fully vested on the date of grant.

Building and equipment rental

Building and equipment rental expenses increased $657,000, or 2.1%, to $32.5 million for the nine months ended September 30, 2009 compared to $31.9 million for the nine months ended September 30, 2008.

Building and equipment rental expenses, including only those centers which were in operation throughout the three quarters of both 2009 and 2008, decreased $1.0 million, or 3.5%. This 3.5% decrease is primarily due to the conversion of certain equipment lease contracts from operating to capital leases in the first quarter of 2009. This comparison excludes contributions from centers that were acquired or divested subsequent to December 31, 2007. For the nine months ended September 30, 2009, building and equipment rental expenses from centers that were acquired subsequent to December 31, 2007 and excluded from the above comparison was $4.0 million. For the nine months ended September 30, 2008, building and equipment rental expenses from centers that were acquired subsequent to December 31, 2007 and excluded from the above comparison was $2.1 million. Also excluded from the above comparison was $260,000 from centers that were divested subsequent to December 31, 2007.

Medical supplies

Medical supplies expense increased $2.6 million, or 11.9%, to $24.5 million for the nine months ended September 30, 2009 compared to $21.9 million for the nine months ended September 30, 2008.

Medical supplies expenses, including only those centers which were in operation throughout the three quarters of both 2009 and 2008, increased $803,000, or 5.3%. This 5.3% increase is in line with procedure volumes and net revenues generated at these existing centers. This comparison excludes contributions from centers that were acquired or divested subsequent to December 31, 2007. For the nine months ended September 30, 2009, medical supplies expense from centers that were acquired subsequent to December 31, 2007 and excluded from the above comparison was $8.7 million. For the nine months ended September 30, 2008, medical supplies expense from centers that were acquired subsequent to December 31, 2007 and excluded from the above comparison was $6.5 million. Also excluded from the above comparison was $404,000 from centers that were divested subsequent to December 31, 2007.

Depreciation and amortization

Depreciation and amortization increased $356,000, or 0.9%, to $40.0 million for the nine months ended September 30, 2009 compared to the same period last year. The increase is due in part to increases to depreciation expense on new imaging equipment offset by the completion of amortization schedules related to covenant-not-to-compete contracts in early 2009.

Provision for bad debts

Provision for bad debts increased $4.1 million, or 19.8%, to $24.7 million, or 6.3% of net revenue, for the nine months ended September 30, 2009 compared to $20.6 million, or 5.6% of net revenue, for the nine months ended September 30, 2008. We increased our provision for bad debts as a percentage of net revenue in light of the current economic slow down and our expectations concerning a decrease in collections related to the patient portion of our total billings that we may experience in subsequent quarters.

Interest expense

Interest expense for the nine months ended September 30, 2009 was $37.7 million compared to $38.2 million for the nine months ended September 30, 2008. The interest expense for the nine months ended September 30, 2009 includes $4.9 million of amortization of Other Comprehensive Income associated with the modification of two interest rate swaps designated as cash flow hedges (see Liquidity and Capital Resources below) and amortization of deferred loan costs of $2.0 million.

Gain on bargain purchase

On June 12, 2009, we acquired the assets and business of nine imaging centers located in New Jersey from Medical Resources, Inc. (see Note 3 to the interim condensed consolidated financial statement for more details).

In accordance with ASC Topic 805, any excess of fair value of acquired net assets over the acquisition consideration results in a gain on bargain purchase. Prior to recording a gain, the acquiring entity must reassess whether all acquired assets and assumed liabilities have been identified and recognized and perform re-measurements to verify that the consideration paid, assets acquired, and liabilities assumed have been properly valued. The Company underwent such a reassessment, and as a result, has recorded a gain on bargain purchase of approximately $1.4 million. If new information is obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement of the amounts recognized for assets acquired and liabilities assumed, the Company will retrospectively adjust the amounts recognized as of the acquisition date. The final acquisition consideration and allocation thereof may change significantly from these estimates.

We believe that the gain on bargain purchase resulted from various factors that impacted the sale of these New Jersey assets. The seller was performing a full liquidation of its assets for the benefit of its creditors. Upon liquidation of all of its assets, the seller intended to close its business. The New Jersey assets were the only remaining assets to be sold before a full wind-down of the seller’s business could be completed. We believe that the seller was willing to accept a bargain purchase price from us in return for our ability to act more quickly and with greater certainty than any other prospective acquirer. The decline in the credit markets made it difficult for other acquirers who relied upon third party financing to complete the transaction. The relatively small size of the transaction for us, the lack of required third-party financing and our expertise in completing similar transactions in the past gave the seller confidence that we could complete the transaction expeditiously and without difficulty.

Other expense (income)

For the nine months ended September 30, 2009 we recorded $1.2 million of other expense primarily related to litigation.

Income tax expense

For the nine months ended September 30, 2009 and 2008, we recorded $281,000 and $151,000, respectively, for income tax expense primarily related to taxable income generated in the states of Maryland and Delaware.

Equity in earnings from unconsolidated joint ventures

For the nine months ended September 30, 2009, we recognized equity in earnings from unconsolidated joint ventures of $6.8 million compared to $7.8 million for the nine months ended September 30, 2008. This variance is due to a combination of decreases in our collection rates and increases in our repair and maintenance costs associated with new equipment transitioning from warranty to maintenance contracts in the third quarter of 2009.

Liquidity and Capital Resources

On November 15, 2006, we entered into a $405 million senior secured credit facility with GE Commercial Finance Healthcare Financial Services (the “November 2006 Credit Facility”). This facility was used to finance our acquisition of Radiologix, refinance existing indebtedness, pay transaction costs and expenses relating to our acquisition of Radiologix, and provide financing for working capital needs post-acquisition. The facility consists of a revolving credit facility of up to $45 million, a $225 million first lien Term Loan and a $135 million second lien Term Loan. The revolving credit facility has a term of five years, the term loan has a term of six years and the second lien term loan has a term of six and one-half years. Interest is payable on all loans initially at an Index Rate plus the Applicable Index Margin, as defined. The Index Rate is initially a floating rate equal to the higher of the rate quoted from time to time by The Wall Street Journal as the "base rate on corporate loans posted by at least 75% of the nation's largest 30 banks" or the Federal Funds Rate plus 50 basis points. The Applicable Index Margin on each of the revolving credit facility and the term loan is 2% and on the second lien term loan is 6%. We may request that the interest rate instead be based on LIBOR plus the Applicable LIBOR Margin, which is 3.5% for the revolving credit facility and the term loan and 7.5% for the second lien term loan. The credit facility includes customary covenants for a facility of this type, including minimum fixed charge coverage ratio, maximum total leverage ratio, maximum senior leverage ratio, limitations on indebtedness, contingent obligations, liens, capital expenditures, lease obligations, mergers and acquisitions, asset sales, dividends and distributions, redemption or repurchase of equity interests, subordinated debt payments and modifications, loans and investments, transactions with affiliates, changes of control, and payment of consulting and management fees.

On August 23, 2007, we secured an incremental $35 million (“Incremental Facility”) as part of our existing credit facilities with GE Commercial Finance Healthcare Financial Services. The Incremental Facility consists of an additional $25 million as part of our first lien Term Loan and $10 million of additional capacity under our existing revolving line of credit. Borrowings under the Incremental Facility were used to fund strategic initiatives and for general corporate purposes.

On February 22, 2008, we secured a second incremental $35 million (“Second Incremental Facility”) of capacity as part of our existing credit facilities with GE Commercial Finance Healthcare Financial Services. The Second Incremental Facility consists of an additional $35 million as part of our second lien term loan and the first lien term loan or revolving credit facility may be increased by up to an additional $40 million sometime in the future. As part of the transaction, partly due to the drop in LIBOR of over 2.00% since the credit facilities were established in November 2006, we increased the Applicable LIBOR Margin to 4.25% for the revolving credit facility and first lien term loan and to 9.0% for the second lien term loan. The additions to our existing credit facilities are intended to provide capital for near-term opportunities and future expansion.

As part of our senior secured credit facility financing, we swapped 50% of the aggregate principal amount of the facilities to a floating rate within 90 days of the closing. On April 11, 2006, effective April 28, 2006, we entered into an interest rate swap on $73.0 million fixing the LIBOR rate of interest at 5.47% for a period of three years. This swap was made in conjunction with the $161.0 million credit facility that closed on March 9, 2006. In addition, on November 15, 2006, we entered into an interest rate swap, designated as a cash flow hedge, on $107.0 million fixing the LIBOR rate of interest at 5.02% for a period of three years, and on November 28, 2006, we entered into an interest rate swap, also designated as a cash flow hedge, on $90.0 million fixing the LIBOR rate of interest at 5.03% for a period of three years. Previously, the interest rate on the above $270.0 million portion of the credit facility was based upon a spread over LIBOR which floats with market conditions.

In the first quarter of 2009, we modified the two interest rate swaps designated as cash flow hedges mentioned above. The modifications, commonly referred to as “blend and extends”, extended the maturity of, and re-priced these two interest rate swaps originally executed in 2006, for an additional 36 months, resulting in an annualized cash interest expense savings of $2.9 million.

On the LIBOR hedge modification for a notional amount of $107 million of LIBOR exposure, the Company on January 29, 2009 replaced the existing fixed LIBOR rate of 5.02% with a new rate of 3.47% maturing on November 15, 2012. On the second LIBOR hedge modification for a notional amount of $90 million of LIBOR exposure, the Company on February 5, 2009 replaced the existing fixed LIBOR rate of 5.03% with a new rate of 3.61% also maturing on November 15, 2012. Both modified interest swaps have been designated as cash flow hedges.

As part of these modifications, the negative fair values of the original interest rate swaps, as well as a certain amount of accrued interest, associated with the original cash flow hedges were incorporated into the fair values of the new modified cash flow hedges. The related Accumulated Other Comprehensive Loss (AOCL) associated with the negative fair values of the original cash flow hedges on their dates of modification, which totaled $6.1 million, is being amortized on a straight-line basis to interest expense through November 15, 2009, the maturity date of the original cash flow hedges. As of September 30, 2009, after amortization of $4.9 recorded in the first three quarters of 2009, the remaining unamortized AOCL associated with the original cash flow hedges was $1.2 million.

We document our risk management strategy and hedge effectiveness at the inception of the hedge, and, unless the instrument qualifies for the short-cut method of hedge accounting, over the term of each hedging relationship. Our use of derivative financial instruments is limited to interest rate swaps, the purpose of which is to hedge the cash flows of variable-rate indebtedness. We do not hold or issue derivative financial instruments for speculative purposes. In accordance with ASC Topic 815, derivatives that have been designated and qualify as cash flow hedging instruments are reported at fair value. The gain or loss on the effective portion of the hedge (i.e., change in fair value) is initially reported as a component of accumulated other comprehensive loss in the Company's Consolidated Statement of Stockholders' Equity Deficit. The remaining gain or loss, if any, is recognized currently in earnings.

A tabular presentation of the fair value of derivative instruments as of September 30, 2009 is as follows (amounts in thousands):

	Balance Sheet Location	Fair Value – Asset (Liability) Derivatives
Derivatives designated as hedging instruments under ASC Topic 815		
Interest rate contracts	Other non-current liabilities	$(9,929)

A tabular presentation of the effect of derivative instruments on our statement of operations is as follows (amounts in thousands):

For the Three Months Ended September 30, 2009

Derivatives in ASC Topic 815 – Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain (Loss) Recognized in OCI During the Term of the Hedge Relationship Reclassified into Income (Effective Portion)	Location of Gain (Loss) Recognized in OCI During the Term of the Hedge Relationship Reclassified into Income (Effective Portion)
Interest rate contracts	($ 1,856)	Interest income/ (expense)	* ($1,836)	Interest income/(expense)

For the Nine Months Ended September 30, 2009

Derivatives in ASC Topic 815 – Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Loss Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain (Loss) Recognized in OCI During the Term of the Hedge Relationship Reclassified into Income (Effective Portion)	Location of Gain (Loss) Recognized in OCI During the Term of the Hedge Relationship Reclassified into Income (Effective Portion)
Interest rate contracts	($ 2,341)	Interest income/ (expense)	* ($4,895)	Interest income/(expense)

* Amortization of OCI associated with the original cash flow hedges prior to modification (see discussion above).

28

We operate in a capital intensive, high fixed-cost industry that requires significant amounts of capital to fund operations. In addition to operations, we require significant amounts of capital for the initial start-up and development expense of new diagnostic imaging facilities, the acquisition of additional facilities and new diagnostic imaging equipment, and to service our existing debt and contractual obligations. Because our cash flows from operations have been insufficient to fund all of these capital requirements, we have depended on the availability of financing under credit arrangements with third parties.

Our business strategy with regard to operations will focus on the following:

- Maximizing performance at our existing facilities;
- Focusing on profitable contracting;
- Expanding MRI, CT and PET applications;
- Optimizing operating efficiencies; and
- Expanding our networks

Our ability to generate sufficient cash flow from operations to make payments on our debt and other contractual obligations will depend on our future financial performance. A range of economic, competitive, regulatory, legislative and business factors, many of which are outside of our control, will affect our financial performance. Taking these factors into account, including our historical experience and our discussions with our lenders to date, although no assurance can be given, we believe that through implementing our strategic plans and continuing to restructure our financial obligations, we will obtain sufficient cash to satisfy our obligations as they become due in the next twelve months.

Sources and Uses of Cash

Cash provided by operating activities was $50.3 million for the nine months ended September 30, 2009 and $22.3 million for the nine months ended September 30, 2008.

Cash used in investing activities was $26.4 million and $50.2 million for the nine months ended September 30, 2009 and 2008, respectively. For the nine months ended September 30, 2009, we purchased property and equipment for approximately $22.8 million and acquired the assets and businesses of additional imaging facilities for approximately $3.3 million, which is net of proceeds generated from the immediate sale of one of these acquired centers (see Note 3). We also purchased additional equity interests in joint ventures totaling $315,000.

Cash used by financing activities was $22.7 million for the nine months ended September 30, 2009 compared to cash provided by financing activities of $27.8 million for the nine months ended September 30, 2008. The cash used by financing activities for the nine months ended September 30, 2009 was related to payments we made toward our term loans, capital leases and line of credit balances, as well as $3.2 million of cash payments, net of cash receipts, related to our modified cash flow hedges.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Foreign Currency Exchange Risk. We sell our services exclusively in the United States and receive payment for our services exclusively in United States dollars. As a result, our financial results are unlikely to be affected by factors such as changes in foreign currency, exchange rates or weak economic conditions in foreign markets.

Interest Rate Sensitivity. A large portion of our interest expense is not sensitive to changes in the general level of interest in the United States because the majority of our indebtedness has interest rates that were fixed when we entered into the note payable or capital lease obligation. Our credit facility however, which is classified as a long-term liability on our financial statements, is interest expense sensitive to changes in the general level of interest in the

United States because it is based upon an index rate plus a factor. As noted in "Liquidity and Capital Resources" above, we have entered into interest rate swaps to fix the interest rate on approximately $270 million of our credit facility. The remaining portion of the credit facility bears interest at rates that float as market conditions change, and as such, is subject to market risk.

ITEM 4. Controls and Procedures

Disclosure Controls and Procedures.

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that material information is: (1) gathered and communicated to our management, including our principal executive and financial officers, on a timely basis; and (2) recorded, processed, summarized, reported and filed with the SEC as required under the Securities Exchange Act of 1934, as amended.

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2009. Based on such evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective for their intended purpose described above.

Changes in Internal Control over Financial Reporting

No changes were made in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during our most recent fiscal quarter that has materially affected, or is likely to materially affect, our internal control over financial reporting.

Limitations On Disclosure Controls And Procedures.

Our management, including our chief executive officer and chief financial officer, does not expect that our disclosure controls or internal controls over financial reporting will prevent all errors or all instances of fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and any design may not succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitation of a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

PART II - OTHER INFORMATION

ITEM 1. Legal Proceedings

We are engaged from time to time in the defense of lawsuits arising out of the ordinary course and conduct of our business. We believe that the outcome of our current litigation will not have a material adverse impact on our business, financial condition and results of operations. However, we could be subsequently named as a defendant in other lawsuits that could adversely affect us.

ITEM 1A. Risk Factors

In addition to the other information set forth in this report, we urge you to carefully consider the factors discussed in Part I, "Item 1A Risk Factors" in our Form 10-K for the year ended December 31, 2008, which could materially affect our business, financial condition and results of operations. The risks described in our Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

ITEM 3. Defaults Upon Senior Securities

None

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

None

ITEM 5. Other Information

None

ITEM 6. Exhibits

The list of exhibits filed as part of this report is incorporated by reference to the Index to Exhibits at the end of this report.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	RADNET, INC. (Registrant)	
Date: November 9, 2009	By	/s/ Howard G. Berger, M.D. Howard G. Berger, M.D., President and Chief Executive Officer (Principal Executive Officer)
Date: November 9, 2009	By	/s/ Mark D. Stolper Mark D. Stolper, Chief Financial Officer (Principal Financial and Accounting Officer)

INDEX TO EXHIBITS

Exhibit Number	Description
31.1	Certification of Howard G. Berger, M.D. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Mark D. Stolper pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002 of Howard G. Berger, M.D.
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002 of Mark D. Stolper