

NightHawk Radiology Holdings Inc
Form 10-K
February 19, 2009
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2008

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission File Number 000-51786

NightHawk Radiology Holdings, Inc.

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of incorporation or organization)

87-0722777
(IRS Employer Identification No.)

601 Front Avenue, Suite #502, Coeur d'Alene, Idaho
(Address of principal executive offices)

83814
(Zip code)

(208) 676-8321

(Registrant's telephone number, including area code)

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

Common Stock, par value \$0.001 per share

NASDAQ Global Market

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

None

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

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

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 No

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

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

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

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

As of June 30, 2008 (the last business day of the registrant's most recently completed second quarter), the aggregate market value of the voting stock held by non-affiliates of the Registrant was \$98.4 million. Shares of voting stock beneficially held by each officer and director and by each person who owns 5% or more of the outstanding voting stock have been excluded in that such persons may be deemed to be affiliates. This

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determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of February 6, 2009, 26,559,052 shares of the registrant's Common Stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

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

1. The Registrant's definitive proxy statement for use in connection with the Annual Meeting of Stockholders to be held on or about April 17, 2009 to be filed within 120 days after the Registrant's year ended December 31, 2008, portions of which are incorporated by reference into Part III of this Form 10-K.

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

This Annual Report contains forward-looking statements that involve risks and uncertainties. The statements contained in this Annual Report that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements include, without limitation, statements relating to future economic conditions in general and statements about our future:

strategy and business prospects;

development and expansion of services, and the size, growth, and leadership of the potential markets for these services;

development of new customer relationships and products;

sales, earnings, income, expenses, operating results, tax rates, operating and gross profit and profit margins, valuations, receivables, reserves, liquidity, investment income, currency rates, employee stock option exercises, capital resource needs, customers, and competition;

ability to obtain and protect our intellectual property and proprietary rights; and

acquisitions and transaction costs and adjustments.

All of these forward-looking statements are based on information available to us on the date of this Annual Report. Our actual results could differ materially from those discussed in this Annual Report. The forward-looking statements contained in this Annual Report, and other written and oral forward-looking statements made by us from time to time, are subject to certain risks and uncertainties that could cause actual results to differ materially from those anticipated in the forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed in Item 1A of this report entitled Risk Factors.

**ITEM 1. Business
Overview**

NightHawk Radiology Holdings, Inc. (NightHawk), headquartered in Coeur d Alene, Idaho, is leading the transformation of the practice of radiology by providing high-quality, cost-effective solutions to radiology groups and hospitals throughout the United States. NightHawk provides the most complete suite of solutions, including professional services, business services, and its proprietary workflow technology, all designed to increase efficiencies and improve the quality of patient care and the lives of physicians who provide it. NightHawk s team of affiliated, U.S. board-certified, state-licensed and hospital-privileged physicians are located in the United States and around the world to provide services 24 hours per day, seven days a week, for approximately 780 customers and the 26% of all U.S. hospitals they serve.

Our team of affiliated, American Board of Radiology-certified, U.S. state-licensed and hospital-privileged radiologists uses our proprietary workflow technology to provide professional services (interpretations , exams , scans or reads) to our customers in the United States. The reads that we provide consist primarily of off-hours preliminary reads, but increasingly include final and sub-specialty interpretations. In addition to these professional services, we also provide our customers with cardiac 3D reconstructions, workflow technology, and business services, all designed to enhance the care they provide to patients and improve the efficiency of their practices.

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

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The U.S. healthcare market continues to experience an increase in the development and use of diagnostic imaging technologies and procedures. This increase is driven by an aging population, advances in diagnostic imaging technologies, the growing availability and accessibility of imaging equipment in hospitals and clinics and more frequent physician referrals for diagnostic imaging procedures. Additionally, advances in digital technology now allow for the transmission of radiological images in a high quality, standardized, cost-effective and encrypted format, which permits radiologists to provide their professional services from locations other than where the imaging services are performed.

While the volume of diagnostic imaging procedures is expected to continue to grow, the number of practicing radiologists is expected to grow at a slower pace. The challenges associated with these trends are further compounded by the fact that radiology groups are required to provide their hospital customers with services 24 hours per day, seven days a week, in order to accommodate the growing number of off-hour procedures. Consequently, radiology practice groups and hospitals are increasingly seeking the assistance of outside providers to assist their own radiology staffs with both day and night coverage. Although the growth in the number of practicing radiologists has been slowing in recent years, some evidence suggests that this trend may be weakening. If the growth in the number of radiologists accelerates, we could face diminished demand for our services and increased competition.

We help our customers manage these challenges by providing an attractive way to increase their productivity and efficiency and improve their quality of life, while improving the quality of patient care. We assist our customers by providing them with business services designed to streamline the administration of their practices and with access to highly-qualified sub-specialty-trained radiologists to perform reads, day or night. Our professional services include both preliminary reads, which are performed for emergent care purposes, and final and sub-specialty reads, which are performed for both emergent and non-emergent care purposes. Our ability to provide coverage 24 hours per day supports our customers when their workloads during the day require further assistance and relieves the burden of performing reads overnight, and during holidays, weekends and other difficult-to-staff times. We believe this allows our customers to provide seamless patient care and to better attract and retain radiologists in their practices.

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

Industry Background

Diagnostic Imaging

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

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

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Our Solution Suite

We are the leading provider of radiology solutions to radiology groups and hospitals across the United States. We offer our customers a broad suite of solutions to meet a wide range of needs, including professional services (including preliminary, final and sub-specialty interpretations) and business services.

Professional Services

Preliminary Interpretations

Eighty-seven percent of the professional services we currently provide are preliminary reads from images generated from hospital emergency departments. These reads are used by the treating physician to determine whether any immediate action is required in response to symptoms being presented by a patient. Typically, the preliminary diagnosis is followed the next morning by a more exhaustive final read. Because third-party payors and patients pay only for the final reads and not the preliminary reads that we provide, our services related to these preliminary reads do not result in any incremental costs to third-party payors or patients nor are we currently dependent on payments by them for these reads.

Final & Sub-specialty Interpretations

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

Business Services

In addition to the professional radiology services we offer, we also offer our customers a complete suite of business services. Our business services include our TALON workflow technology platform, revenue cycle management, facilities and human resources management, transcription, and other services required to effectively operate a radiology practice. These business services are extremely valuable to radiology groups seeking to reduce the administrative burdens of their practices, allowing them to focus on growing their operations and improving their efficiencies, all while enhancing the quality of patient care. We currently provide our business services to our clients, including St. Paul Radiology, P.A., one of the largest diagnostic imaging and interventional radiology providers in the country. We believe the combination of these business services with our professional services provides a one-stop shop with end-to-end solutions for small to large radiology groups.

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

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

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Enhanced patient care. Customers use our full suite of services to enhance patient care. By providing our customers with access 24 hours per day, seven days a week to highly-qualified sub-specialty-trained radiologists to perform reads, we believe that our solutions provide our customers an attractive and economical way to improve service levels, increase the effectiveness of their work environment and enhance the quality of patient care. Our services can improve the quality of patient care in underserved or rural communities due to improvements in image routing technology and to the increased availability of broadband connectivity. These communities are often the most challenged in recruiting radiologists to practice in their locales.

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

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

Operations

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

Affiliated radiologists. As of December 31, 2008, we had 128 affiliated radiologists who were providing services for us. We structure our relationships with our affiliated radiologists as independent contractors and we have no control over the radiological services or interpretations rendered by the radiologists or their independent judgment concerning the practice of medicine. The contracts we have with our affiliated radiologists typically provide that we will make available a minimum number of hours that the radiologists can work per year. In each case, the contract is structured so that the radiologist has significant flexibility in determining, and control of, the radiologist's work schedule. We believe that our affiliated radiologists consider this flexibility an attractive and unique aspect of their relationship with us.

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

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

Image transmission. We process all incoming images and patient data at one of our centralized facilities located in Sydney, Australia, Zurich, Switzerland, Austin, Texas, or Coeur d'Alene, Idaho,

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depending on the time of day. These facilities are connected to hospitals through VPNs, which encrypt the patient and clinical data for secure delivery. Typically, the radiological images are initially transferred to the Internet via the hospital's Internet service provider. The images and data then traverse the Internet through standard networking infrastructure and are automatically directed to one of our reading facilities.

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

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

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

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

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

Licensing and Privileging

For each hospital from which an affiliated radiologist receives radiological images, the affiliated radiologist must hold a current license in good standing to practice medicine in the state in which the hospital is located and must have been granted privileges to practice at that particular hospital. As a result, and because we were providing services to more than 1,500 hospitals as of December 31, 2008, we have licensed each of our affiliated radiologists in an average of 36 states and have privileged each of our affiliated radiologists at an average of 526 hospitals. By ensuring that our affiliated radiologists are licensed and privileged at many of our hospital sites, we design redundancy into our solution in order to minimize or eliminate the periods of time during which we do not have an affiliated radiologist available to provide services to a particular hospital.

The licensing procedures and requirements vary according to each state's laws and regulations governing the issuance of medical licenses. These procedures typically include an extensive application process that covers

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significant aspects of the applicant's professional and personal life. In addition, to maintain a license to practice medicine in a given state, the state will often require the physician to undergo continuing education and training and maintain minimum thresholds of medical liability insurance.

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

Technology Development and Innovation

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

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

Software development. We focus our research and development efforts on improving and enhancing our existing workflow solutions, as well as on developing new solutions to enable us to more efficiently and effectively deliver our services to our customers.

Customers

As of December 31, 2008, we provided professional radiology services to nearly 780 radiology practices serving more than 1,500 hospitals. In addition, we provided our business services to nine customers, including St. Paul Radiology, P.A. None of our customers represent more than 10% of our annual revenue.

Our customer contracts typically have a one-year term and automatically renew for successive terms unless earlier terminated pursuant to the terms of the contract. Our customer contracts specify the agreed upon coverage periods and whether preliminary and/or final reads will be provided. We typically charge an agreed upon per-read fee that varies with type and complexity of the interpretation being preformed.

As the market for off-hours preliminary exams has matured, it has attracted national and regional teleradiology service providers that often offer their services at prices lower than ours and this increase in competition has resulted in some customer losses.

Sales and Marketing

Sales. We sell our services primarily through our direct sales force comprised of 25 telesales and field sales personnel who are organized by geographic regions in the United States. Our sales professionals focus their efforts on radiology groups of all sizes and, in some cases, cardiology groups and hospitals.

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

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Our principal marketing initiatives include:

direct mail campaigns,

participation in, and sponsorship of, radiology conferences and trade shows, and

using our website to provide service and company information.

Competition

The market for radiology services is highly competitive, rapidly evolving and fragmented, and subject to changing technology and market dynamics. Our primary competitors are Virtual Radiologic Corporation as well as other large and small scale service providers, some of which have only a local or regional presence. We believe that the primary competitive factors in our market include:

report accuracy/content,

clinical interactions with the teleradiology staff,

price of service,

turnaround time required to complete and return interpretations.

reputation of service provider,

quality of the service provided,

number of states in which radiologists are licensed,

market acceptance by radiology groups and hospitals,

quality and reliability of service-provider technology and workflow infrastructure,

quality of customer support,

sales and marketing capabilities of the service provider, and

financial stability of the service provider.

Government Regulation and Supervision

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

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

Corporate practice of medicine; fee splitting. The laws of many states, including states in which our customers are located, prohibit us from exercising control over the medical judgments or decisions of our affiliated radiologists and from engaging in certain financial arrangements, such as splitting professional fees

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with physicians. These laws and their interpretations vary from state to state and are enforced by state courts and regulatory authorities, each with broad discretion. We structure our relationships with our affiliated radiologists and our customers in a manner that we believe is in compliance with prohibitions against the corporate practice of medicine and fee splitting, and in a manner that requires that our affiliated radiologists exercise complete control over their own medical judgments and decisions.

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

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

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

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

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

The administrative provisions of HIPAA direct the federal government to adopt national electronic standards for automated transfer of certain healthcare data among healthcare payors, plans and providers. HIPAA is designed to enable the entire healthcare industry to communicate electronic data using a single set of standards.

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

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

Federal Deficit Reduction Act of 2005. The Federal Deficit Reduction Act of 2005, or the DRA, requires that medical providers receiving more than \$5,000,000 in annual Medicaid payments from a specific state must establish certain written policies to be disseminated to that provider's employees, contractors and agents. The written policies required by the DRA include information about the Federal False Claims Act, administrative remedies under the Program Fraud Civil Remedies Act, state and local laws regarding false claims for those localities in which the practice operates, and the protections given to whistleblowers under such laws. We believe that we are not currently subject to the informational and educational mandates of the DRA because we do not now receive more than the requisite amount of Medicaid payments from any state.

Intellectual Property

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

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

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

Employees and Independent Contractors

As of December 31, 2008, we had 494 employees. None of our employees are represented by a labor union. We consider our relationships with our employees to be good.

Also as of December 31, 2008, we had 128 affiliated radiologists who provide services to our customers. Our affiliated radiologists are independent contractors of NightHawk. We consider our relationships with our independent contractors to be good.

Website

Our website address is www.nighthawkrad.net and can be used to access, free of charge, through the investor relations category, our Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports, as soon as reasonably practicable after we electronically file

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such material with or furnish it to the SEC. The information on our website is not incorporated as a part of this Annual Report. The public can also obtain copies of these reports by visiting the SEC's Public Reference Room at 100 F Street, NE, Washington DC 20549, or by calling the SEC at 1-800-SEC-0330, or by accessing the SEC's website at <http://www.sec.gov>.

ITEM 1A. Risk Factors

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

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

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

effectively manage our business and technology,

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

develop new services that complement our existing business,

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

acquire additional customers and maintain current customers in a highly competitive environment,

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

manage rapid growth in personnel and operations,

effectively manage our medical liability risk, and

recruit and retain radiologists and other key personnel.

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

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

The market for professional radiology services and business process services is competitive and rapidly changing, barriers to entry are relatively low, and with the introduction of new technologies and market entrants,

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we expect competition to intensify in the future. In fact, in recent periods we have experienced an increase in competition from regional providers of services similar to ours. If we fail to compete effectively, our operating results will be harmed. Some of our principal competitors, including our largest competitor, Virtual Radiologic Corporation, offer their services at a lower price, which has resulted and may continue to result in pricing pressure and lost customers. If we are unable to maintain our current pricing or effectively revise the way we compensate our affiliated radiologists, our operating results could be negatively impacted. In addition, pricing pressures and increased competition could result in reduced revenue or reduced profits, either of which could harm our business.

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

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

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

difficulties or delays in integrating physician compensation models,

difficulties in integrating operations, technologies, services and personnel,

diversion of financial and management resources from existing operations,

risk of entering new markets,

potential write-offs of acquired assets,

potential loss of key employees, and

inability to generate sufficient revenue to offset acquisition costs.

We have in the past experienced, and may experience in the future, these difficulties as we integrate the operations of companies we acquire.

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

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

The laws of many states, including states in which our customers are located, prohibit us from exercising control over the medical judgments or decisions of physicians and from engaging in certain financial arrangements, such as splitting professional fees with physicians. These laws and their interpretations vary from state to state and are enforced by state courts and regulatory authorities, each with broad discretion. We enter into

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agreements with our affiliated radiologists pursuant to which the radiologists render professional medical services. In addition, we enter into agreements with our customers to deliver professional radiology interpretation services in exchange for a service fee. We structure our relationships with our affiliated radiologists and our customers in a manner that we believe is in compliance with prohibitions against the corporate practice of medicine and fee splitting. If any state regulatory or similar authority determines that we are engaged in the corporate practice of medicine or that the payment of service fees to us by our customers constitutes fee splitting, we could be subject to civil and criminal penalties and could be required to restructure or terminate the applicable contractual arrangements. A determination that these arrangements violate state statutes, or our inability to successfully restructure our relationships with our affiliated radiologists to comply with these statutes, could eliminate customers located in certain states from the market for our services, which would have a materially adverse effect on our business, financial condition and operations.

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

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

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

We structure our relationships with our affiliated radiologists in a manner that we believe results in an independent contractor relationship, not an employee relationship. An independent contractor is generally distinguished from an employee by his or her degree of autonomy and independence in providing services. A high degree of autonomy and independence is generally indicative of a contractor relationship, while a high degree of control is generally indicative of an employment relationship. Although we believe that our affiliated radiologists are properly characterized as independent contractors, tax or other regulatory authorities may in the future challenge our characterization of these relationships, if the Internal Revenue Service (or other state, federal or foreign courts) were to determine that our affiliated radiologists are employees, and not independent contractors, we would be required to withhold income taxes, to withhold and pay social security, Medicare and similar taxes and to pay unemployment and other related payroll taxes, would be liable for unpaid past taxes by our affiliated radiologists and may be subject to penalties, all of which may materially harm our business and operating results. In connection with its audit of our tax filing for the 2006 tax year, the Internal Revenue Service indicated that their preliminary finding would be that our affiliated radiologists should be characterized as employees as opposed to independent contractors. Although we would expect to appeal such a finding, we cannot provide assurances that such an appeal would be successful.

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

Our success is dependent upon our continuing ability to recruit and retain qualified radiologists. An inability to recruit and retain radiologists would have a material adverse effect on our ability to grow and would adversely affect our results of operations. We face competition for radiologists from other healthcare providers, including radiology groups, research and academic institutions, government entities and other organizations.

In addition to recruiting radiologists, we must identify, recruit and retain skilled executive, technical, administrative, sales, marketing and operations personnel for our headquarters in Coeur d'Alene, Idaho. Competition for highly qualified and experienced personnel is intense due to the limited number of people available with the necessary skills. In addition, Coeur d'Alene has a relatively small pool of potential employees with the skills that we require, and is a small city in a relatively rural part of the country, making it difficult for us to recruit employees from larger metropolitan areas of the country. Failure to attract and retain the necessary personnel would inhibit our growth and harm our business.

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

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

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

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

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

If our customers terminate their agreements with us or if our customers' businesses materially decline, our financial condition and operating results could be adversely affected.

Our revenue is derived primarily from fee-for-service billings to our radiology group customers. Our agreements with our customers generally provide for one-year terms and automatically renew for successive one-year terms unless terminated by our customers or us upon 30 days prior notice. Our customers may elect not to

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renew their contracts with us, they may seek to renegotiate the terms of their contracts or they may choose to reduce or eliminate our services. If our arrangements with our customers are canceled, or are not renewed or replaced with other arrangements having at least as favorable terms, our business, financial condition and results of operations could be adversely affected. In addition, if our radiology group customers' agreements with the hospitals that they serve are terminated, or if our radiology group customers' businesses begin to decline for other reasons (such as a material increase in the rate of uninsured patients or uncollectible accounts), our business, financial condition and results of operations could be adversely affected. For example, substantially all of our business process services revenue is generated from St. Paul Radiology, P.A. If the business of St. Paul Radiology, P.A. were to decline significantly or St. Paul Radiology, P.A. were to experience a material increase in uncollectible accounts, the revenue that we generate from the business process services that we provide would be adversely affected which, in turn, could adversely affect our business, financial condition and results of operation.

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

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

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

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

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

The healthcare industry is heavily regulated and subject to frequent changes in governing laws and regulations as well as to evolving administrative interpretations. Our business could be adversely affected by

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

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

Our growth and our continued operations could strain our personnel, management and infrastructure resources, which may harm our business.

In recent periods, we have experienced rapid growth in our headcount and operations, which has placed, and will continue to place, a significant strain on our management, administrative, operational and financial infrastructure. We also anticipate that further growth will be required to address increases in the scope of our operations and size of our customer base. Our success will depend in part upon the ability of our senior management team to manage this growth.

In particular, our operations and our ability to provide professional services to our customers in a timely manner depend on the efficient performance of our information systems and related processes. We have determined that in order to effectively satisfy our customers' needs, our systems and related processes require improvement. Such improvements will require capital investments and, if we are not able to effectively manage the implementation of such improvements, customer satisfaction with our services may suffer.

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

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

Historically, we have experienced increased demand for and revenues from our services during the second and third fiscal quarters of each year. We believe that these increases are a result of increased outdoor and transportation activities during summer months. During the first and fourth quarters of each fiscal year, when weather conditions are colder for a large portion of the United States, we have historically experienced relatively lower revenues than those experienced during the second and third quarters. We may or may not continue to experience this or other seasonality in the future. These seasonal factors may lead to unpredictable variations in our quarterly operating results and cause the trading price of our common stock to decline. Additionally, our

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ability to schedule adequate radiologist coverage during the seasonal period of increased demand for our services may affect our ability to provide appropriate turnaround times in our services to clients.

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

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

We rely on broadband connections provided by third party suppliers to route digital images from hospitals in the United States to our facilities in Australia, Switzerland and the United States. Any interruption in the availability of the network connections between the hospitals and our reading facilities would reduce our revenue and profits. Frequent or persistent interruptions in our services could cause permanent harm to our reputation and brand and could cause current or potential customers to believe that our systems are unreliable, leading them to switch to our competitors. Because our customers may use our services for critical healthcare services, any system failures could result in damage to our customers' businesses and reputation. These customers could seek significant compensation from us for their losses, and our agreements with our customers do not limit the amount of compensation that they may receive. Any claim for compensation, even if unsuccessful, would likely be time consuming and costly for us to resolve.

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

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

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

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

The majority of our customers are radiology practices. These customers, and not us, typically bill and receive payments from Medicare and/or Medicaid for professional services which were either performed by our

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

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

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

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

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

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

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example, in some states, the Medicaid program budgets have been either cut or funds diverted to other programs, which have resulted in limiting the enrollment of participants. This has resulted in an increasing number of bankruptcies and difficulty in collecting accounts receivable at hospitals in certain states. Any reduction or elimination in coverage for our services could adversely impact our business.

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

In its Fiscal Year 2009 Work Plan, the U.S. Department of Health & Human Services Office of Inspector General, or HHS-OIG, indicated that it would conduct a study and issue a report assessing the appropriateness of Medicare billings for diagnostic tests performed in hospital emergency rooms. Part of the assessment may include a determination as to whether the tests were read contemporaneously with the patient's treatment. It is possible that, in the final report, the HHS-OIG could recommend to CMS that it change its reimbursement rules to clearly indicate that CMS will only pay for reads performed contemporaneously with a patient's treatment by a physician located within the United States. If CMS were to adopt this recommendation, final reads may no longer be eligible for reimbursement if performed by a physician other than the one who performed the preliminary read. In turn, if our customers were no longer able to be reimbursed for certain final reads, our customers may seek alternative arrangements for the performance of their preliminary reads, which could adversely impact our business.

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

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

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

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

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

We rely heavily on our proprietary workflow technology to distribute radiological images to the appropriately licensed and privileged radiologist best able to provide the necessary clinical insight in the least

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amount of turnaround time. If we fail to protect our intellectual property rights adequately, our competitors may gain access to our technology, and our business may be harmed. We currently do not hold any patents with respect to our technology. Although we have filed an application for a patent covering our workflow technology, we may be unable to obtain patent protection for this technology. In addition, any patents we may obtain may be challenged by third parties. Accordingly, despite our efforts, we may be unable to prevent third parties from using or misappropriating our intellectual property.

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

The information technology industry is characterized by the existence of a large number of patents, trademarks and copyrights and by frequent litigation based on allegations of infringement or other violations of intellectual property rights. As an example, we are aware that on July 31, 2007, Merge eMed, Inc., or Merge, filed a complaint against another teleradiology provider, Virtual Radiologic Corporation, or VRC, alleging that VRC has infringed on certain of Merge's patents relating to teleradiology. In connection with that litigation, VRC filed a Request for Reexamination with the U.S. Patent and Trademark Office, or US PTO, which asks the US PTO to re-examine the validity of the patents at issue. Based solely upon publicly available information from VRC, we understand that, in August 2008, the US PTO ruled invalid all of the claims in the patents upon which Merge had sued VRC. While we are not currently a party to any litigation, if Merge or another third party asserts that our technology violates that third-party's proprietary rights, or if a court holds that our technology violates such rights, we may be required to re-engineer our technology, obtain licenses from third parties to continue using our technology without substantial re-engineering or remove the infringing functionality or feature. In addition, we may incur substantial costs defending any such claim. We may also become subject to damage awards, which could cause us to incur additional losses and harm our financial position.

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

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

Our success depends largely upon the continued services of our executive officers, particularly David Engert, our newly-appointed President & Chief Executive Officer, Tim Murnane, our Chief Operating Officer, and David Sankaran, our Chief Financial Officer. The loss of any of these executive officers could have a material adverse effect on our business, financial condition, results of operations and the trading price of our common stock. The search for replacements for any of our executives could be time consuming and could distract our management team from the day-to-day operations of our business.

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

Effective internal controls are necessary for us to provide reliable financial reports in a timely manner and to prevent fraud. We cannot assure you that we will maintain an effective system of internal controls in the future. If we fail to adequately staff and train our accounting and finance personnel to meet the demands of operating as a public company, including the requirements of the Sarbanes-Oxley Act of 2002, or fail to maintain adequate internal controls, any resulting material weakness in internal controls could prevent our management from concluding the internal controls are effective and impair our ability to prevent material misstatements in our financial statements, which could cause our business to suffer. In addition, investors' perceptions that our internal

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controls are inadequate or that we are unable to produce accurate financial statements in a timely manner or prevent fraud may negatively affect the trading price of our stock or result in stockholder litigation.

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

Our independent contractor agreements with our affiliated radiologists typically provide that the radiologists may not compete with us for a period of time, typically one year, after the agreements terminate. These covenants not to compete are enforceable to varying degrees from jurisdiction to jurisdiction. In most jurisdictions, a covenant not to compete will be enforced only to the extent that it is necessary to protect the legitimate business interest of the party seeking enforcement, that it does not unreasonably restrain the party against whom enforcement is sought and that it is not contrary to the public interest. This determination is made based upon all the facts and circumstances of the specific case at the time enforcement is sought. It is unclear whether our interests will be viewed by courts as the type of protected business interest that would permit us to enforce a non-competition covenant against the radiologists. A determination that these provisions are not enforceable could have a material adverse effect on us.

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

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

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

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

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or caused our customers to submit allegedly false claims, any sanctions imposed under the Federal False Claims Act could result in substantial fines and penalties or exclusion from participation in federal and state healthcare programs which could have a material adverse effect on our business and financial condition.

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

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

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

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

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

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

variations in our operating results,

announcements of new services, strategic alliances or significant agreements by us or by our competitors,

recruitment or departure of key personnel,

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

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

In addition, if the market for healthcare stocks or healthcare services or the stock market in general experiences loss of investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, operating results or financial condition. The trading price of our common stock might

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also decline in reaction to events that affect other companies in our industry even if these events do not directly affect us.

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

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

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

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

Adverse changes in general economic conditions could adversely affect our operating results.

Our success depends upon our ability to continue to provide our services to our customers and the willingness of our customers to engage us for these services. The willingness and ability of our customers to engage us for our services depends upon a number of factors, including broader economic conditions and perceptions of such conditions by our customers. Adverse changes in the broader U.S. economy may have an adverse impact on the behavior of our customers and the extent to which they will be willing to engage us for our services. In addition, we may experience difficulty collecting accounts receivable in a timely manner, or at all, if our customers are adversely affected by prevailing economic conditions. Any of these factors could, in turn, have a material adverse effect on our business, financial condition, results of operations and cash flows.

A change in our customer composition may impact our collection rates.

An increasing number of our customers are hospitals or hospital groups. As changes occur in general economic conditions, hospitals may be required to modify their budgets and/or move funds to other programs as directed by their management or changes in government funding. Recently, we have noticed an increasing number of hospitals becoming insolvent as government funds decrease to hospitals in certain states. If this trend continues and impacts our customers, our collection rates may decrease and our bad debt expense increase which, in turn, could have a material adverse effect on our business, financial condition, results of operations and cash flows.

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

We maintain significant operations in Australia and Switzerland, and are exposed to adverse changes in exchange rates associated with the expenses of our operations in these countries. However, we do not currently engage in any hedging transactions to mitigate these risks. Although from time to time we review our foreign currency exposure and evaluate whether we should enter into hedging transactions, we may not adequately hedge against any future volatility in currency exchange rates and, if we engage in hedging transactions, the

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transactions will be based on forecasts which later may prove to be inaccurate. Any failure to hedge successfully or anticipate currency risks properly could adversely affect our operating results.

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

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

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

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

provide that directors may only be removed for cause,

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

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

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

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

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

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

ITEM 1B. Unresolved Staff Comments

None.

Table of Contents**ITEM 2. Properties**

The table below provides a summary of our principal facilities as of December 31, 2008:

| Location | Total Square Feet (1) | Leased or Owned | Principal Function |
|---------------------------|------------------------------|------------------------|---|
| St Paul, Minnesota | 58,000 | Leased | Staff operations |
| Coeur d Alene, Idaho | 23,000 | Leased | Corporate offices |
| Sydney, Australia | 9,000 | Leased | Reading facility and support staff operations |
| Milwaukee, Wisconsin | 9,000 | Leased | Information technology center |
| Zurich, Switzerland | 8,000 | Leased | Reading facility and support staff operations |
| Austin, Texas | 5,000 | Leased | Reading facility |
| San Francisco, California | 3,000 | Leased | Reading facility |

(1) Rounded to the nearest thousand square feet.

ITEM 3. Legal Proceedings

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

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

None.

Table of Contents**PART II****ITEM 5. Market for Registrant's Common Stock, Related Stockholder Matters and Issuer Purchases of Equity Securities**
Market for Our Common Stock

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

| | Common Stock Price | |
|-------------------------------------|---------------------------|------------|
| | High | Low |
| Year Ended December 31, 2008 | | |
| First Quarter | \$ 20.61 | \$ 8.87 |
| Second Quarter | \$ 9.49 | \$ 7.08 |
| Third Quarter | \$ 9.41 | \$ 6.69 |
| Fourth Quarter | \$ 6.99 | \$ 2.33 |
| Year Ended December 31, 2007 | | |
| First Quarter | \$ 26.98 | \$ 17.50 |
| Second Quarter | \$ 21.18 | \$ 16.96 |
| Third Quarter | \$ 24.51 | \$ 18.16 |
| Fourth Quarter | \$ 24.25 | \$ 19.09 |

Holder

On February 6, 2009, the last reported sale price for our common stock on the Nasdaq Global Market was \$4.00 per share. As of February 6, 2009, there were approximately 8,300 holders of our common stock.

Dividends

We have not declared any cash dividends on our common stock since our initial public offering. We currently intend to retain future earnings and do not expect to pay any dividends in the foreseeable future and certain covenants in our debt agreement restrict our ability to pay dividends or make other distributions with respect to our equity securities. See Note 11 to our consolidated financial statements included in Item 8 of this Annual Report on Form 10-K.

Securities Authorized for Issuance Under Equity Compensation Plans

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

Table of Contents**Performance Graph**

The performance graph below illustrates a comparison of cumulative total stockholder return data based on an initial investment of \$100 in our common stock, as compared with the Russell 2000 Index and the Dow Jones US Healthcare Index from February 6, 2006 through December 31, 2008.

| Dates | NightHawk Radiology | Russell 2000 | Dow Jones US Healthcare |
|--------------------|--------------------------------|-------------------------|------------------------------------|
| February 6, 2006 | \$ 100.00 | \$ 100.00 | \$ 100.00 |
| March 31, 2006 | \$ 115.69 | \$ 106.75 | \$ 100.30 |
| June 30, 2006 | \$ 86.88 | \$ 100.95 | \$ 95.35 |
| September 30, 2006 | \$ 92.64 | \$ 101.65 | \$ 103.34 |
| December 31, 2006 | \$ 123.49 | \$ 110.17 | \$ 104.61 |
| March 31, 2007 | \$ 88.09 | \$ 111.69 | \$ 104.95 |
| June 30, 2007 | \$ 87.41 | \$ 116.76 | \$ 109.40 |
| September 30, 2007 | \$ 118.69 | \$ 113.00 | \$ 111.66 |
| December 31, 2007 | \$ 101.94 | \$ 107.19 | \$ 111.47 |
| March 31, 2008 | \$ 45.33 | \$ 96.22 | \$ 98.11 |
| June 30, 2008 | \$ 34.29 | \$ 97.28 | \$ 96.91 |
| September 30, 2008 | \$ 34.96 | \$ 96.00 | \$ 97.82 |
| December 31, 2008 | \$ 23.54 | \$ 69.52 | \$ 84.68 |

Recent Sales of Unregistered Securities

On March 4, 2008, 181,971 shares of our common stock were issued as consideration to stockholders of American Teleradiology Nighthawks, Inc. (ATN) as of the acquisition date of September 30, 2005. The additional consideration was calculated in accordance with the provisions of the purchase agreement. The

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issuance was made in reliance upon the exemption afforded by the provisions of Section 4(2) of the Securities Act of 1933, as amended.

Issuer Purchases of Equity Securities

We announced on December 9, 2008 that we were initiating a program previously approved by our Board of Directors to repurchase up to \$10.0 million in shares of our common stock in the open market. The following table sets forth details regarding the shares repurchased in 2008 pursuant to such program. We did not repurchase any shares of our stock outside of such program. We completed the program with the repurchase of approximately 2.2 million additional shares in January 2009.

| Period | (a) Total Number of Shares Purchased | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Program | (d) Maximum Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program |
|---------------------------------------|---|---|---|---|
| December 12, 2008 - December 31, 2008 | 1,063,849 | \$ 4.21 | 1,063,849 | \$ 5,490,487 |

Table of Contents**ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA**

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

| | For the Years Ended December 31, (In thousands, except per share amounts) | | | | |
|--|--|------------|-------------|-------------|-----------|
| | 2008 | 2007 | 2006 | 2005 | 2004 |
| Service Revenue | \$ 167,607 | \$ 151,662 | \$ 92,168 | \$ 64,062 | \$ 39,283 |
| Operating Income | 21,630 | 26,127 | 23,399 | 17,322 | 11,714 |
| Net Income (Loss) | 9,442 | 14,694 | (28,401) | (29,960) | 3,325 |
| Net Income (Loss) Applicable to Common Stockholders | \$ 9,442 | \$ 14,694 | \$ (28,519) | \$ (36,509) | \$ 2,560 |
| Earnings (Loss) Per Common Share: | | | | | |
| Basic | \$ 0.32 | \$ 0.49 | \$ (1.00) | \$ (2.11) | \$.11 |
| Diluted | \$ 0.31 | \$ 0.47 | \$ (1.00) | \$ (2.11) | \$.11 |
| Cash Flow Data | | | | | |
| Net cash provided by operating activities | 29,087 | 23,637 | 19,131 | 11,529 | 10,245 |
| Net cash provided by (used in) investing activities | 18,261 | (123,425) | (40,049) | (3,305) | (2,844) |
| Net cash provided by (used in) financing activities | (32,144) | 85,243 | 54,808 | (1,427) | (3,771) |
| Total Assets | 245,149 | 263,466 | 116,066 | 35,536 | 17,262 |
| Total Long-Term Debt (including current portion) | 94,100 | 99,500 | | 24,003 | 12,000 |
| Total Liabilities | 115,382 | 128,777 | 13,437 | 85,184 | 23,468 |
| Common Stock Data | | | | | |
| Market price at year end | \$ 4.86 | \$ 21.05 | \$ 25.50 | N/A | N/A |
| Average number of common shares outstanding (1) | 29,483 | 30,083 | 28,528 | 17,274 | 24,196 |
| Dividends declared per common share | | | | \$ 0.844 | |
| Preferred Stock Data | | | | | |
| Redeemable convertible preferred shares outstanding | | | | 6,500 | 6,500 |
| Dividends declared per convertible preferred share | | | \$ 0.844 | \$ 0.295 | |

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

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

Overview

NightHawk Radiology Holdings, Inc. is leading the transformation of the practice of radiology by providing high-quality, cost-effective solutions to radiology groups and hospitals throughout the United States. We provide the most complete suite of solutions, including professional services, business services, and our advanced, proprietary clinical workflow technology, all designed to increase efficiencies and improve the quality of patient care and the lives of physicians who provide it. Our independent contractor team of U.S. board-certified, state-licensed and hospital-privileged physicians located in the United States and around the world provides services 24 hours per day, seven days a week, for approximately 780 customers and the 26% of all U.S. hospitals.

Our team of American Board of Radiology-certified, U.S. state-licensed and hospital-privileged affiliated radiologists uses our proprietary workflow technology to provide professional services (interpretations , exams , scans or reads) to our customers in the United States. The reads that we provide consist primarily of off-hours preliminary reads, but increasingly include final and sub-specialty interpretations. In addition to these professional services, we also provide our customers with cardiac 3D reconstructions, clinical workflow technology, and business services, all designed to enhance the care they provide to patients and improve the efficiency of their practices. For more information, visit www.nighthawkrad.net.

2008 Highlights

Market conditions. General economic conditions were poor during 2008 and worsened throughout the year. We believe economic conditions have adversely impacted our business as we have observed lower hospital admission rates, lower emergency room admissions and some deferral of elective healthcare by patients. These trends have lessened the growth in the number of radiological reads and have impacted the overall growth in the teleradiology market. In addition, we have noticed slowing in collection rates from our customers, specifically hospital customers, which resulted in higher bad debt expense.

Integration of acquisitions. During 2008, we completed the integration of our acquisitions made in 2007 of Midwest Physicians Services, LLC (MPS), Emergency Radiology Services, LLC (ERS), The Radlinx Group, Ltd. (Radlinx) and Teleradiology Diagnostic Service, Inc. (TDS). We consolidated office space and restructured our staffing levels in order to streamline our business processes and to better utilize our leased office facilities.

Management turnover. We experienced management turnover in 2008. In February 2008, we announced Mr. Tim Murnane as our new Chief Operating Officer, replacing outgoing Chief Operating Officer, Timothy Mayleben. In May 2008, we announced the appointment of Mr. David Sankaran as our new Chief Financial Officer, who replaced Glenn Cole as the outgoing Chief Financial Officer. Finally, in November 2008, we announced that Mr. David Engert would be succeeding Dr. Paul Berger as our President and Chief Executive Officer and that Mr. Jon Berger, one of our founders, would no longer be serving in an active role with the company.

Capital structure. During the year, we made some significant investments to realign our capital structure. First, in June 2008, we completed a tender offer which resulted in the purchase and retirement of 2.2 million shares at a cost of \$18.6 million. Then, in December 2008, we commenced a

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\$10.0 million open-market share repurchase plan. As of December 31, 2008, we had purchased and retired an additional 1.1 million shares at a cost of \$4.5 million, and the remaining \$5.5 million under the plan was purchased in January 2009 and resulted in the retirement of another 1.1 million shares. In addition to these share repurchase activities, we also applied approximately \$10 million of our cash to lower our outstanding debt and lock in lower interest rates on the debt. Specifically, in December 2008, we took advantage of historically low interest rates and utilized approximately \$5.3 million to settle our two existing interest rate swap contracts and entered into new interest rate swap contracts with more favorable rates. In addition, we paid \$4.4 million for a principal prepayment on our debt.

Trends in our Business and Results of Operations

Service Revenue.

We generate revenue from a number of sources, including off-hours preliminary exams, business services offerings and final and subspecialty interpretations. The revenue growth that we have historically experienced has been due in large part to the growth of our off-hours preliminary business, which continues to make up the bulk of our revenue. The market for off-hours preliminary interpretations has historically experienced rapid volume growth. This volume growth has been driven by an increase in our customer base, an increase in utilization of our services by our customers, acquisitions, an expansion of our service hours, a high customer retention rate and growth in the use of diagnostic imaging technologies and procedures in the healthcare industry in general. In recent quarters, however, our volume growth has moderated as the market for these services has matured. In addition, the off-hours preliminary market has attracted a number of national and regional teleradiology service providers that often offer their services at prices lower than ours and the increase in competition has resulted in some customer losses. These trends have resulted in downward pressure on our average prices and on our volumes and revenues. We expect these trends to continue in the foreseeable future. In response to such trends, our strategy is to sell new services (including final interpretations and business services) to our existing customers by communicating their value and demonstrating the advantages we offer over our competitors. Our future growth depends primarily upon our ability to successfully execute that strategy while also effectively responding to competitive pressures in the market for off-hours preliminary exams. These new services accounted for approximately 21% of our total revenue in 2008, up from 14% in the prior year.

Professional Services.

Professional service expenses consist primarily of the fees we pay to affiliated radiologists, any physician stock-based compensation, the premiums for medical liability insurance, and any medical liability claims loss expenses. Since inception, our professional service fees have increased in absolute dollars each year, primarily due to the addition of new affiliated radiologists to perform an increased workload volume as our business has grown. We expect that our professional service fees will continue to fluctuate in absolute dollars as volumes vary.

Our medical liability expense has also increased in absolute dollars each year since inception, primarily due to increases in our medical liability premiums as our business has grown. The increase is also due to an increasing reserve for incurred but not reported (IBNR) claims based on growing volumes, which are estimated using historical claims information and industry indices. We expect our medical liability premiums and our IBNR expense to continue to increase in absolute dollars in future periods as our scan volumes continue to grow. In addition, if we have claims in future periods for which we deem a liability to be probable, our medical liability expense will increase.

We record physician stock-based compensation expense in connection with any equity-based grants to our affiliated radiologists in accordance with Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment* (SFAS 123(R)) and Emerging Issues Task Force Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services* (EITF 96-18) and present this expense in our consolidated statements of operations as part of our professional services expense. The amount of physician stock-based compensation expense we record in a given period depends primarily on the number of shares subject to equity-based grants held by our affiliated

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radiologists, the number of hours worked, and the change in the value of our common stock in that period. Our expense in future periods for physician stock-based compensation will be driven primarily by changes in our stock price, new equity-based grants we make to our affiliated radiologists, and the rate at which those equity-based grants are earned over such periods.

Sales, General and Administrative Expenses.

Our sales, general and administrative expense consists primarily of salaries and related expenses for all employees, employee stock-based compensation, information technology and telecommunications expenses, costs associated with licensing and privileging our affiliated radiologists, facilities and office-related expenses, sales and marketing expenses and other general and administrative expenses. Our sales, general and administrative expense has increased in absolute dollars each year since inception primarily as a result of increased payroll expenses in connection with higher headcount in support of the growth in our business. In 2008, the increase was also partially due to severance costs related to the departure of certain of our executives. We expect our general and administrative expenses to level-off in response to the moderating growth in our business and as we see the results of our cost reduction initiatives that began in 2008.

The amount of employee stock-based compensation expense we record in a given period depends primarily on the number of shares subject to outstanding options and the valuation criteria used at the time of the grant. The amount of expense is also impacted by the accelerated method we use to expense these options and by forfeitures of non-vested options. Our employee non-cash stock-based compensation expense may increase in future periods if we issue additional equity-based instruments.

Interest Expense.

We incur interest on our credit facility at variable rates. Since 2007, we have hedged the risk associated with fluctuations in interest rates by entering into interest rate swap contracts. While in effect, our original interest rate swap contracts maintained an effective interest rate of approximately 7.4%. In December 2008, in response to interest rates falling to historically low levels, we settled our original interest rate swap contracts and entered into new interest rate swap contracts. Our new effective interest rate and actual cash payments for interest under these hedges will be approximately 5% and the swap contracts expire in June 2014. Over the next six quarters our reported interest rate will be higher than that reported in recent quarters due to the amortization of losses from our original swap contracts.

Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America, or U.S. GAAP. The preparation of these financial statements in accordance with U.S. GAAP requires us to utilize accounting policies and make certain estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingencies as of the date of the financial statements and the reported amounts of revenue and expenses during a fiscal period. The SEC considers an accounting policy to be critical if it is important to a company's financial condition and results of operations, and if it requires the exercise of significant judgment and the use of estimates on the part of management in its application. We have discussed the selection and development of the critical accounting policies with the audit committee of our Board of Directors, and the audit committee has reviewed our related disclosures in this report. Although we believe that our judgments and estimates are appropriate, actual results may differ from those estimates.

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

use of estimates;

stock-based compensation;

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purchase accounting and long-lived assets including goodwill and other acquired intangible assets;

income taxes; and

derivative accounting.

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

Use of Estimates

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

Accounts receivable allowance. We monitor customer payments and the aging of our accounts receivable and maintain a reserve for estimated losses resulting from our customers' inability to make required payments. In estimating the reserve, we evaluate the collectibility of our accounts receivable from a specific customer when we become aware of circumstances that may impair the customer's ability to meet its financial obligations and record an allowance against amounts due. We believe that the potential aggregate amount of nonpayment by our customers is limited in part by the frequency of our billing cycle and the ease with which we may discontinue service to customers during periods of nonpayment. However, actual future losses from uncollectible accounts may differ from our estimates due to the difficulty in predicting the future payment practices and ability of our customers. As of December 31, 2008 and 2007, we had reserved \$1.1 million and \$0.6 million, respectively, for doubtful accounts based on our estimate of the collectibility of outstanding receivables as of that date.

Loss contingency for medical liability claims. We record a loss contingency for a medical liability claim at the time we deem such liability to be probable. Our determination of the probability of the liability is based upon a review of the claim by our internal legal counsel, external legal counsel and medical liability insurance carrier. Upon the determination that a liability is probable, we record a loss contingency for the potential claim up to the amount of the deductible specified in our medical liability insurance policy. Actual future losses from medical liability claims may differ from our estimates to the extent that we suffer an adverse determination for a claim that we did not deem the liability probable, did not record a loss contingency up to the maximum amount of our insurance deductible, the loss was in excess of our coverage limits, or do not have insurance coverage or indemnification rights.

Incurred But Not Reported Claims. We use actuarial assumptions to estimate and record a liability for IBNR professional liability claims. Our estimated IBNR liability is based on long-term industry trends and averages, and considers a number of factors, including changes in claim reporting patterns, claim settlement patterns, judicial and legislative decisions, and economic conditions. Our estimated IBNR liability will fluctuate as claims experience and volumes change over time.

Stock-Based Compensation

Physician Stock-Based Compensation. We record stock-based compensation expense in connection with any equity instrument awarded to our affiliated radiologists in accordance with EITF 96-18. We calculate the stock-based compensation expense related to such issuance by determining the then current fair value of the award using a Black-Scholes model at the date of grant and at the end of each subsequent financial reporting period thereafter when service is delivered. Physician stock-based compensation expense is included in professional services expense.

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Non-Physician Stock-Based Compensation. We also record stock-based compensation expense in connection with any grant of stock options, restricted stock units, warrants or other issuance of shares of common stock to employees and directors. We calculate the stock-based compensation expense associated with the issuance of stock options and warrants to our employees and directors in accordance with SFAS 123(R) by determining the fair value using a Black-Scholes model. We calculate the stock-based compensation expense related to the issuance of restricted stock units or shares of our common stock to our employees and directors based on the fair value of our common stock on the date the restricted stock units or shares are issued. Stock-based compensation to employees and directors is included in sales, general and administrative expense.

Determination of Fair Value of our Stock Options. To determine the fair value of our stock options, we use a Black-Scholes model which takes into account the exercise price of the stock option, the fair value of the common stock underlying the stock option, as measured on the date of grant (or at each reporting date for grants to non-employees that require future service), expected dividends, risk free interest rates, expected term and an estimation of the volatility of the common stock underlying the stock option.

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

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

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

Income Taxes

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

Developing our provision for income taxes, including our effective tax rate and analysis of potential tax exposure items, if any, requires significant judgment and expertise in federal and state income tax laws, regulations and strategies, including the determination of deferred tax assets and liabilities and any estimated valuation allowances we deem necessary to value deferred tax assets. Our judgments and tax strategies are subject to audit by various taxing authorities. While we believe we have provided adequately for our income tax

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liabilities in our consolidated financial statements, adverse determinations by these taxing authorities could have a material adverse effect on our consolidated financial condition, results of operations or cash flows.

Derivative Accounting

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

Results of Operations

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

| | Year Ended December 31, | | |
|---|-------------------------|------|-------|
| | 2008 | 2007 | 2006 |
| Service revenue | 100% | 100% | 100% |
| Operating costs and expenses: | | | |
| Professional services | 41 | 42 | 42 |
| Sales, general and administrative | 39 | 36 | 30 |
| Depreciation and amortization | 7 | 5 | 2 |
| Total operating costs and expenses | 87 | 83 | 74 |
| Operating income | 13 | 17 | 26 |
| Other income (expense): | | | |
| Interest expense | (5) | (4) | (1) |
| Interest income | 1 | 2 | 3 |
| Other, net | | | |
| Change in fair value of redeemable preferred stock conversion feature | | | (48) |
| Total other income (expense) | (4) | (2) | (46) |
| Income (loss) before income taxes | 9 | 15 | (20) |
| Income tax expense | 3 | 6 | 11 |
| Net income (loss) applicable to common stockholders | 6% | 9% | (31)% |

Comparison of Years Ended December 31, 2008 and December 31, 2007*Service Revenue*

Year Ended
December 31, Change

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| | | (Dollars in thousands) | | |
|-----------------|------------|------------------------|------------|------------|
| | 2008 | 2007 | In Dollars | Percentage |
| Service revenue | \$ 167,607 | \$ 151,662 | \$ 15,945 | 11% |

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The increase in service revenue for the year ended December 31, 2008 relative to the year ended December 31, 2007 consists of a \$17.5 million increase from the full-year effect of acquisitions completed during 2007, a \$2.2 million increase in organic final read revenue driven largely by an increase in the average price due to a modality shift towards higher-priced, more complex exams, partially offset by a \$4.0 million decrease in organic preliminary read revenue. The net decrease in organic preliminary read revenue resulted from 3% higher volumes, which were more than offset by the impact of declines in average selling prices.

*Operating Costs and Expenses**Professional Services*

| | Year Ended December 31, | | Change | |
|-------------------------------|----------------------------|-----------|------------|------------|
| | (Dollars in thousands) | | In Dollars | Percentage |
| | 2008 | 2007 | | |
| Professional services | \$ 68,932 | \$ 63,618 | \$ 5,314 | 8% |
| Percentage of service revenue | 41% | 42% | | |

The increase in professional services expense for the year ended December 31, 2008 compared to the year ended December 31, 2007 is primarily attributable to an increase in professional service fees and medical liability expenses related to higher read volumes partially offset by a decrease in physician stock-based compensation expense due to lower NightHawk common stock prices during 2008.

Sales, General and Administrative

| | Year Ended December 31, | | Change | |
|-----------------------------------|----------------------------|-----------|------------|------------|
| | (Dollars in thousands) | | In Dollars | Percentage |
| | 2008 | 2007 | | |
| Sales, general and administrative | \$ 65,683 | \$ 54,018 | \$ 11,665 | 22% |
| Percentage of service revenue | 39% | 36% | | |

The increase in sales, general and administrative expense for the year ended December 31, 2008 compared to the year ended December 31, 2007 resulted primarily from a \$9.6 million increase in payroll expense resulting from costs associated with the employees added from the acquisitions and also from \$2.0 million of severance costs related to the departure of certain former executive officers. We also experienced a \$1.2 million increase in licensing and credentialing expenses, a \$1.0 million increase in facility expenses and a \$1.4 million increase in telecommunications expenses due primarily from the impact of prior year acquisitions. These increases were partially offset by a decrease in employee stock compensation expense and cost reductions resulting from restructurings which optimized office space utilization and streamlined operations.

*Other Income (Expense)**Interest Expense*

| | Year Ended December 31, | | Change | |
|-------------------------------|----------------------------|----------|------------|------------|
| | (Dollars in thousands) | | In Dollars | Percentage |
| | 2008 | 2007 | | |
| Interest expense | \$ 8,508 | \$ 5,885 | \$ 2,623 | 45% |
| Percentage of service revenue | (5)% | (4)% | | |

Our interest expense for the 2007 consists of the interest expense incurred on our Term Loan. On April 5, 2007 we borrowed \$53.0 million in connection with the Radlinx acquisition and an additional \$47.0 million on

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July 10, 2007 in connection with the MPS and ERS acquisitions. Also included in interest expense is \$0.4 million of amortized deferred loan fees. Our interest expense for 2008 consists of a full year impact of the above debt.

Income Tax Expense

| | Year Ended December 31, | | Change | |
|--------------------------------------|----------------------------|-----------|------------|------------|
| | 2008 | 2007 | In Dollars | Percentage |
| Income tax expense | \$ 5,257 | \$ 8,615 | \$ (3,358) | (39)% |
| <i>Percentage of service revenue</i> | <i>3%</i> | <i>6%</i> | | |

We recorded income tax expense of \$5.3 million for 2008 and \$8.6 million for 2007. The change in income tax expense is due primarily to a corresponding change in pre-tax income.

Comparison of Years Ended December 31, 2007 and December 31, 2006*Service Revenue*

| | Year Ended December 31, | | Change | |
|-----------------|----------------------------|-----------|------------|------------|
| | 2007 | 2006 | In Dollars | Percentage |
| Service revenue | \$ 151,662 | \$ 92,168 | \$ 59,494 | 65% |

The increase in service revenue for the year ended December 31, 2007 relative to the year ended December 31, 2006 resulted primarily from \$21.4 million increase in organic revenue and \$38.1 million in additional revenue from the TDS, Radlinx, MPS and ERS acquisitions. The organic growth is driven by a 27% increase in read volumes due to an increase in utilization by our customers of our hours of service, an increase in the number of our customers and their affiliated sites, new services and the growth in the use of diagnostic imaging technologies and procedures in the healthcare industry.

*Operating Costs and Expenses**Professional Services*

| | Year Ended December 31, | | Change | |
|--------------------------------------|----------------------------|------------|------------|------------|
| | 2007 | 2006 | In Dollars | Percentage |
| Professional services | \$ 63,618 | \$ 38,963 | \$ 24,655 | 63% |
| <i>Percentage of service revenue</i> | <i>42%</i> | <i>42%</i> | | |

The increase in professional services expense for the year ended December 31, 2007 relative to the year ended December 31, 2006 resulted primarily from an increased volume of radiological interpretations performed by our affiliated radiologists due to our continued growth and increase in the number of our affiliated radiologists due partially from the acquisitions of TDS and Radlinx. This was in some measure offset by a decrease in physician stock-based compensation and medical liability expenses.

Sales, General and Administrative

Change

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| | Year Ended December 31, | | | |
|--------------------------------------|----------------------------|------------|--------------------------------------|------------|
| | 2007 | 2006 | (Dollars in thousands) In Dollars | Percentage |
| Sales, general and administrative | \$ 54,018 | \$ 27,607 | \$ 26,411 | 96% |
| <i>Percentage of service revenue</i> | <i>36%</i> | <i>30%</i> | | |

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The increase in our sales, general and administrative expense for the year ended December 31, 2007 relative to the year ended December 31, 2006 resulted primarily from investments in new service offerings and infrastructure, as well as the expansion of our management team along with temporary duplicative costs related to the recent acquisitions that had not yet been eliminated. Significant changes include a \$20.3 million payroll increase due to additional hiring and employees added from the acquisitions, \$2.4 million increase in facilities and telecommunications expense, \$2.3 million increase in accounting, legal, travel, and consulting services expenses and \$1.0 million increase in sales, licensing and privileging expense.

*Other Income (Expense)**Interest Expense*

| | Year Ended December 31, | | Change | |
|--------------------------------------|----------------------------|-------------|------------|------------|
| | 2007 | 2006 | In Dollars | Percentage |
| Interest expense | \$ 5,885 | \$ 562 | \$ 5,323 | 947% |
| <i>Percentage of service revenue</i> | <i>(4)%</i> | <i>(1)%</i> | | |

Our interest expense for the 2007 consists of the interest expense incurred on our Term Loan. On April 5, 2007 we borrowed \$53.0 million in connection with the Radlinx acquisition and an additional \$47.0 million on July 10, 2007 in connection with the MPS and ERS acquisitions. Also included in interest expense is \$0.4 million of amortized deferred loan fees. Our interest expense for 2006 consisted primarily of interest payable under our credit facility with Comerica Bank which was repaid in conjunction with our initial public offering in February 2006.

Change in Fair Value of Redeemable Preferred Stock Conversion Feature

| | Year Ended December 31, | | Change | |
|---|----------------------------|--------------|------------|------------|
| | 2007 | 2006 | In Dollars | Percentage |
| Change in fair value of redeemable preferred stock conversion feature | \$ | \$ 44,184 | \$ 44,184 | (100)% |
| <i>Percentage of service revenue</i> | <i>%</i> | <i>(48)%</i> | | |

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

Income Tax Expense

| | Year Ended December 31, | | Change | |
|--------------------------------------|----------------------------|------------|------------|------------|
| | 2007 | 2006 | In Dollars | Percentage |
| Income tax expense | \$ 8,615 | \$ 10,048 | \$ (1,432) | (14)% |
| <i>Percentage of service revenue</i> | <i>6%</i> | <i>11%</i> | | |

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

Liquidity and Capital Resources

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

| | December 31, 2008 | December 31, 2007 |
|--|----------------------|----------------------|
| Capital resources | | |
| Cash and cash equivalents | \$ 47.2 | \$ 31.9 |
| Marketable securities | | 30.6 |
| Total | \$ 47.2 | \$ 62.5 |
| Cash flow activities | | |
| Net cash provided (used) by: | | |
| Operating activities | \$ 29.1 | \$ 23.6 |
| Investing activities | 18.2 | (123.4) |
| Financing activities | (32.1) | 85.2 |
| Increase (decrease) in cash and cash equivalents | \$ 15.2 | \$ (14.6) |

Operating Activities

Since our inception in August 2001, we have funded our operations primarily from cash flows generated by our operating activities, the issuance of stock and the incurrence of debt. Net cash provided by operating activities in 2008, 2007 and 2006 was \$29.1 million, \$23.6 million and \$19.1 million, respectively.

For the year ended December 31, 2008, we generated net cash from operations of \$29.1 million from net income of \$9.4 million. Significant non-cash charges included in net income that did not impact our net cash from operations during this period include depreciation and amortization of \$11.4 million and stock compensation expense of \$8.3 million. For the year ended December 31, 2007, we generated net cash from operations of \$23.6 million from net income of \$14.7 million. Significant non-cash charges included in net income that did not impact our net cash from operations during this period include depreciation and amortization of \$7.9 million and stock compensation expense of \$15.0 million.

The changes in our operating assets and liabilities, net of acquired balances, and the associated impacts on our net cash from operations during the year ended December 31, 2008 as compared to the changes during the year ended December 31, 2007 are primarily due to the change in accounts receivable. In 2007, accounts receivable increased \$8.2 million due to an absolute increase in our total revenue due to growth and acquisition. In 2008, although our revenue increased over prior years, our accounts receivable dropped \$0.4 million due to increased collection efforts and improved customer management. Prepaid, accounts payable and accrued balances also changed mostly due to the timing of cash payments to vendors and for payroll.

Investing Activities

Net cash provided by investing activities was \$18.2 million for the year ended December 31, 2008. Net cash provided by investing activities was primarily attributable to sales and maturities of marketable securities of \$23.3 million and \$33.8 million, respectively. Partially offsetting this increase was an earn-out payment to the

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former Radlinx owners of \$6.5 million, an escrow payment to the former TDS owners of \$1.2 million, capital spending of \$4.8 million, and purchases of marketable securities of \$26.4 million.

Net cash used in investing activities was \$123.4 million for the year ended December 31, 2007. Net cash used by investing activities was primarily attributable to the use of \$22.7 million for the acquisition of TDS, \$41.2 million for the acquisition of Radlinx and \$62.9 million for the acquisitions of MPS and ERS. Investment activity during 2007 included the purchase of \$34.2 million in marketable securities, offset by cash receipts of \$41.8 million as a result of certain investments reaching maturity during the period. We also invested \$4.6 million in property and equipment during 2007. The majority of these capital expenditures were associated with computer equipment and the continued investment in our information technology infrastructure.

Financing Activities

Net cash used in financing activities was \$32.1 million for the year ended December 31, 2008. The use of funds was primarily attributable to our effort to optimize our capitalization through repurchases of our common stock of \$22.2 million, a principal payment of \$4.4 million on our term loan in December 2008, and the early settlement of our interest rate swap contracts of \$5.3 million.

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

Financial condition and liquidity

We expect our short and long-term liquidity needs to consist primarily of working capital, capital expenditures and any future acquisitions. We may also have liquidity needs arising from any repurchases of shares of our common stock and if we make additional principal repayments under our term loan agreement. Finally, our term loan is subject to mandatory prepayment under certain circumstances, including in connection with the Company's receipt of proceeds from certain issuances of equity or debt, sales of assets and casualty events and excess cash flow, which if triggered would require additional principal payment.

We intend to fund future liquidity needs from current capital resources and cash generated from operations. In late 2008, we sold all of our marketable securities and reinvested the proceeds in short-term money market accounts as a conservative measure against the unfavorable conditions in the credit market and to better ensure access and recoverability of our cash investments. We believe our capital resources are invested in appropriate investments and will be sufficient to meet our anticipated cash needs for at least the next 12 months.

Off-Balance Sheet Arrangements and Contractual Obligations

Off-Balance Sheet Arrangements

Our Sydney and San Francisco office leases and our medical liability insurance policy are collateralized by letters of credit totaling \$0.6 million and \$0.7 million as of December 31, 2008 and 2007, respectively.

Table of Contents*Contractual Obligations*

The following table presents a summary of our contractual obligations as of December 31, 2008:

| (in millions) | Payments Due Within | | | | Total |
|--------------------------------------|------------------------|----------------|----------------|----------------------|-----------------|
| | Less than 1 Year | 1-3 Years | 3-5 Years | More than 5 Years | |
| Long-term debt obligations (a) | \$ 1.0 | \$ 1.9 | \$ 1.9 | \$ 89.3 | \$ 94.1 |
| Interest on long-term borrowings (b) | 4.6 | 9.1 | 8.9 | 1.5 | 24.1 |
| Operating lease commitments | 2.3 | 3.4 | 2.3 | 3.6 | 11.6 |
| License agreement (c) | 2.4 | 4.0 | 2.0 | 0.0 | 8.4 |
| Total contractual obligations | \$ 10.3 | \$ 18.4 | \$ 15.1 | \$ 94.4 | \$ 138.2 |

(a) See Note 6 of the Notes to Consolidated Financial Statements in Item 8.

(b) Interest paid in all years may differ due to future refinancing of debt. Interest on our floating rate debt was calculated for all years using the effective rate as of December 31, 2008 including the impact of current interest rate swap contracts. The amounts given above do not include the \$5.3 million spent to settle the interest rate swap contracts held within Accumulated Other Comprehensive Income which will be amortized to interest expense through September 2010. See Note 12 of the Notes to Consolidated Financial Statements in Item 8.

(c) See Note 7 of the Notes to Consolidated Financial Statements in Item 8.

Total contractual obligations exclude our FIN 48 liability of \$2.3 million as of December 31, 2008 because we were unable to make reasonable estimates as to the period of settlement with the respective taxing authorities.

New Accounting Pronouncements

See Note 1 to our consolidated financial statements included in Item 8 of this Annual Report on Form 10-K for a discussion of SFAS 141(R), *Business Combinations*, issued by the FASB in December 2007, SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements - an amendment to ARB No. 51*, issued by the FASB in February 2007, FASB Staff Position (FSP) SFAS 142-3, *Determination of Useful Life of Intangible Assets*, issued by the FASB in April 2008, and SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities*. We are currently evaluating the impact of these accounting pronouncements, if any, on our financial statements.

During 2008, we adopted SFAS 157, *Fair Value Measurements*, issued by the FASB in September 2006, and found the impact to not be significant. See Note 11 to our consolidated financial statements included in Item 8 of this Annual Report on Form 10-K for additional disclosures required by the provision. We also assessed SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, issued by the FASB in February 2007 and determined not to elect to measure any permissible financial instruments at fair value.

ITEM 7A. Quantitative and Qualitative Disclosures about Market Risk
Foreign Currency Exchange Risk

During the periods covered by this Annual Report, substantially all of our customers are in the United States and this revenue is denominated in U.S. dollars. Although some of our affiliated radiologists work from our centralized reading facilities in Australia and Switzerland, the professional service fees we pay to our affiliated radiologists are denominated primarily in U.S. dollars. As a result, only our support personnel and facility costs in those countries present foreign currency exchange risks. Because we are not currently subject to material foreign currency exchange risk, we have not, to date, entered into any hedging contracts. If a weakening U.S. dollar requires us to increase the amounts we pay to our affiliated radiologists in the future in order to maintain a

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constant level of compensation, our results of operations and cash flows could be affected. Currently, any foreign exchange risks are related to the foreign currency exchange rates between the U.S. dollar and the Australian dollar and between the U.S. dollar and the Swiss franc.

Interest Rate Sensitivity

We had cash and cash equivalents totaling \$47.2 million at December 31, 2008. These amounts were invested primarily in interest-bearing money market accounts and are held for working capital purposes. We do not enter into investments for trading or speculative purposes. We believe that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates. However, any declines in interest rates will reduce future investment income.

As of December 31, 2008, we had \$94.1 million in variable interest rate debt. Because of the interest rate swap contracts in place at December 31, 2008 such debt will not be subject to risks associated with fluctuations in interest rates until such contracts expire on June 30, 2014. For more information on our hedging activities, see Notes 6 and 12 of the Notes to Consolidated Financial Statements in Item 8.

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ITEM 8. Financial Statements and Supplementary Data

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

NightHawk Radiology Holdings, Inc.

Coeur d'Alene, ID

We have audited the accompanying consolidated balance sheets of NightHawk Radiology Holdings, Inc. and subsidiaries (the Company) as of December 31, 2008 and 2007, and the related consolidated statements of operations, comprehensive income (loss), stockholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 2008. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of NightHawk Radiology Holdings, Inc. and subsidiaries as of December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

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

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2008, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 18, 2009, expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP

Boise, ID

February 18, 2009

Table of Contents**NIGHTHAWK RADIOLOGY HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS***(In thousands, except share and per share data)*

| | For the Years Ended December 31, | | |
|---|----------------------------------|------------|-------------|
| | 2008 | 2007 | 2006 |
| Service revenue | \$ 167,607 | \$ 151,662 | \$ 92,168 |
| Operating costs and expenses: | | | |
| Professional services | 68,932 | 63,618 | 38,963 |
| Sales, general, and administrative | 65,683 | 54,018 | 27,607 |
| Depreciation and amortization | 11,362 | 7,899 | 2,199 |
| Total operating costs and expenses | 145,977 | 125,535 | 68,769 |
| Operating income | 21,630 | 26,127 | 23,399 |
| Other income (expense): | | | |
| Interest expense | (8,508) | (5,885) | (562) |
| Interest income | 1,380 | 3,130 | 3,028 |
| Other, net | 197 | (63) | (34) |
| Change in fair value of redeemable preferred stock conversion feature | | | (44,184) |
| Total other income (expense) | (6,931) | (2,818) | (41,752) |
| Income (loss) before income taxes | 14,699 | 23,309 | (18,353) |
| Income tax expense | 5,257 | 8,615 | 10,048 |
| Net income (loss) | 9,442 | 14,694 | (28,401) |
| Redeemable preferred stock accretion | | | (118) |
| Net income (loss) applicable to common stockholders | \$ 9,442 | \$ 14,694 | \$ (28,519) |
| Earnings (loss) per common share: | | | |
| Basic | \$ 0.32 | \$ 0.49 | \$ (1.00) |
| Diluted | \$ 0.31 | \$ 0.47 | \$ (1.00) |
| Weighted average of common shares outstanding: | | | |
| Basic | 29,482,536 | 30,083,080 | 28,528,079 |
| Diluted | 30,561,942 | 31,083,971 | 28,528,079 |

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

Table of Contents**NIGHTHAWK RADIOLOGY HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS***(In thousands, except share data)*

| | December 31, | |
|---|--------------|------------|
| | 2008 | 2007 |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 47,160 | \$ 31,956 |
| Marketable securities | | 30,625 |
| Trade accounts receivable, net | 24,393 | 25,665 |
| Deferred income taxes | 855 | 655 |
| Prepaid expenses and other current assets | 6,231 | 2,812 |
| Total current assets | 78,639 | 91,713 |
| Property and equipment, net | 10,528 | 10,555 |
| Goodwill | 68,718 | 68,601 |
| Intangible assets, net | 79,616 | 87,133 |
| Deferred income taxes | 4,082 | 1,251 |
| Other assets, net | 3,566 | 4,213 |
| Total assets | \$ 245,149 | \$ 263,466 |
| LIABILITIES | | |
| Current liabilities: | | |
| Accounts payable | \$ 6,327 | \$ 6,072 |
| Accrued expenses | 3,617 | 12,881 |
| Accrued payroll and related benefits | 3,783 | 4,569 |
| Long-term debt, due within one year | 955 | 1,000 |
| Total current liabilities | 14,682 | 24,522 |
| Professional liability reserve | 3,705 | 3,038 |
| Long-term debt | 93,145 | 98,500 |
| Other liabilities | 3,850 | 2,717 |
| Total liabilities | 115,382 | 128,777 |
| Commitments and contingencies | | |
| STOCKHOLDERS EQUITY: | | |
| Common stock 150,000,000 shares authorized; \$.001 par value; 27,590,774 and 30,312,322 shares issued and outstanding at December 31, 2008 and 2007, respectively | 28 | 30 |
| Additional paid-in capital | 237,429 | 249,274 |
| Retained earnings (deficit) | (103,516) | (112,957) |
| Accumulated other comprehensive income (deficit) | (4,174) | (1,658) |
| Total stockholders' equity | 129,767 | 134,689 |
| Total liabilities and stockholders' equity | \$ 245,149 | \$ 263,466 |

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

Table of Contents**NIGHTHAWK RADIOLOGY HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY (DEFICIT)***(In thousands, except share data)*

| | Common Stock | | | Other Comprehensive Income (Loss) | Retained Earnings (Deficit) | Total |
|--|--------------|--------|----------------------------------|--|-----------------------------------|-------------|
| | Shares | Amount | Additional Paid-in Capital | | | |
| Balance December 31, 2005 | 15,838,139 | \$ 16 | \$ 9,434 | \$ | \$ (87,612) | \$ (78,161) |
| Net loss | | | | | (28,401) | (28,401) |
| Shares issued upon exercise of stock options | 134,498 | | 404 | | | 404 |
| Issuance of stock options employees | | | 880 | | | 880 |
| Issuance of stock options non-employees | | | 5,080 | | | 5,080 |
| Issuance of stock initial public offering | 5,800,000 | 6 | 86,298 | | | 86,304 |
| Stock issuance costs | | | (2,112) | | | (2,112) |
| Conversion of redeemable preferred stock | 6,500,003 | 6 | 13,268 | | | 13,274 |
| Reclassification of redeemable common stock | 1,671,429 | 2 | 26,741 | | | 26,743 |
| Termination of redeemable preferred stock conversion feature | | | 89,440 | | | 89,440 |
| Accretion of redeemable common stock | | | | | (11,387) | (11,387) |
| Accretion of redeemable preferred stock | | | | | (117) | (117) |
| Excess tax benefit from stock options exercised | | | 684 | | | 684 |
| Balance December 31, 2006 | 29,944,069 | \$ 30 | \$ 230,117 | \$ | \$ (127,517) | \$ 102,631 |
| Cumulative impact of change in accounting for in income taxes | | | | | (135) | (135) |
| Net income | | | | | 14,694 | 14,694 |
| Shares issued upon exercise of stock options and vesting of restricted stock units (RSU) | 368,253 | | 1,163 | | | 1,163 |
| Issuance of stock options and RSUs employees | | | 8,330 | | | 8,330 |
| Issuance of stock options and RSUs non-employees | | | 4,705 | | | 4,705 |
| Excess tax benefit from stock options exercised and RSU vesting | | | 1,625 | | | 1,625 |
| Issuance of warrants in acquisitions | | | 3,334 | | | 3,334 |
| Change in fair value of derivatives, net of tax | | | | | (1,658) | (1,658) |
| Balance December 31, 2007 | 30,312,322 | \$ 30 | \$ 249,274 | \$ (1,658) | \$ (112,957) | \$ 134,689 |
| Net income | | | | | 9,442 | 9,442 |
| Shares issued upon exercise of stock options and vesting of restricted stock units | 370,999 | | 477 | | | 477 |
| Shares issued for acquisition earnout | 181,971 | | 2,078 | | | 2,078 |
| Shares issued for accrued bonus | 30,214 | | 1,751 | | | 1,751 |
| Shares acquired and retired, net of costs | (3,304,732) | (2) | (23,099) | | | (23,101) |
| Issuance of stock options and RSUs employees | | | 6,890 | | | 6,890 |
| Issuance of stock options and RSUs non-employees | | | 1,440 | | | 1,440 |
| Excess tax benefit (deficit) from stock options exercised and RSU vesting | | | (1,382) | | | (1,382) |
| Change in fair value of derivatives, net of tax | | | | | (2,516) | (2,516) |
| Balance December 31, 2008 | 27,590,774 | \$ 28 | \$ 237,429 | \$ (4,174) | \$ (103,516) | \$ 129,767 |

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

Table of Contents**NIGHTHAWK RADIOLOGY HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS***(In thousands)*

| | For the Years Ended December 31, | | |
|--|---|------------------|-----------------|
| | 2008 | 2007 | 2006 |
| Cash flows from operating activities: | | | |
| Net income (loss) | \$ 9,442 | \$ 14,694 | \$ (28,401) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | | |
| Depreciation and amortization | 11,362 | 7,899 | 2,199 |
| Accretion of discounts on marketable securities | (21) | (355) | (635) |
| Amortization of debt issuance costs | 648 | 395 | |
| Loss on disposal of fixed assets and other, net | 646 | 199 | 365 |
| Deferred income taxes (excluding effects of acquisitions) | (1,210) | (6,098) | (3,418) |
| Change in fair value of redeemable preferred stock conversion feature | | | 44,184 |
| Non-cash stock compensation expense | 8,330 | 15,030 | 5,960 |
| Excess tax benefit from exercise of stock options | (234) | (1,625) | (684) |
| Provision for doubtful accounts | 1,127 | 404 | 256 |
| Changes in operating assets and liabilities (excluding effects of acquisitions): | | | |
| Trade accounts receivable | 371 | (8,245) | (2,477) |
| Prepaid expenses and other assets | (3,420) | (274) | (1,355) |
| Accounts payable | 527 | 2,701 | 4,664 |
| Accrued expenses and other liabilities | 346 | (641) | (1,545) |
| Accrued payroll and related benefits | 1,173 | (447) | 18 |
| Net cash provided by operating activities | 29,087 | 23,637 | 19,131 |
| Cash flows from investing activities: | | | |
| Purchase of marketable securities | (26,390) | (34,221) | (84,823) |
| Proceeds from maturities of marketable securities | 33,755 | 41,763 | 47,647 |
| Proceeds from sale of marketable securities | 23,303 | | |
| Purchase of property and equipment | (4,757) | (4,546) | (2,872) |
| Cash paid for acquisitions, net | (7,650) | (126,760) | |
| Cash and cash equivalents received from acquisitions | | 339 | |
| Net cash provided by (used in) investing activities | 18,261 | (123,425) | (40,048) |
| Cash flows from financing activities: | | | |
| Repayment of notes payable and debt | (5,400) | (11,366) | (31,004) |
| Settlement of interest rate swap contracts | (5,331) | | |
| Proceeds from exercise of stock options | 559 | 1,163 | 404 |
| Excess tax benefit from exercise of stock options | 234 | 1,625 | 684 |
| Purchase and retirement of common stock shares | (22,206) | | |
| Proceeds from notes payable and debt | | 100,000 | 7,000 |
| Repayments of lines of credit | | (1,679) | |
| Debt issuance costs | | (4,500) | |
| Proceeds from issuance of common stock, net of issuance costs | | | 84,724 |
| Dividends paid | | | (7,000) |
| Net cash (used in) provided by financing activities | (32,144) | 85,243 | 54,808 |
| Net increase (decrease) in cash and cash equivalents | 15,204 | (14,545) | 33,891 |

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| | | | | |
|---------------------------|-------------------|-----------|-----------|-----------|
| Cash and cash equivalents | beginning of year | 31,956 | 46,501 | 12,610 |
| Cash and cash equivalents | end of year | \$ 47,160 | \$ 31,956 | \$ 46,501 |

Table of Contents**NIGHTHAWK RADIOLOGY HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)**

| | For the Years Ended December 31, | | |
|--|----------------------------------|-----------|---------|
| | 2008 | 2007 | 2006 |
| Supplemental disclosures of cash flow information: | | | |
| Cash paid for interest | \$ 7,838 | \$ 5,460 | \$ 648 |
| Cash paid for income taxes | 6,885 | 13,210 | 14,119 |
| Non-cash investing and financing activities: | | | |
| Purchases of equipment included in accounts payable | \$ 271 | \$ 176 | \$ 78 |
| Earnout liability included in accrued expenses settled in stock | 2,078 | | |
| Issuance of common stock in connection with settlement of accrued bonuses | 2,107 | | |
| Accrual for unsettled share repurchases | 895 | | |
| Acquisition costs included in accrued expenses and accounts payable | | 105 | |
| Accretion of redeemable preferred stock | | | 118 |
| Accretion of redeemable common stock | | | 11,387 |
| Conversion of redeemable convertible preferred stock | | | 13,274 |
| Conversion of redeemable common stock | | | 26,743 |
| Termination of preferred stock conversion feature | | | 89,440 |
| Stock issuance costs paid in 2005 reclassified to additional paid-in capital | | | 533 |
| Details of American Teleradiology Nighthawks, Inc. Acquisition: | | | |
| Property and equipment | | | \$ 106 |
| Goodwill | | | (3,578) |
| Deferred income tax liabilities | | | (39) |
| Contingently issuable common stock | | | 3,511 |
| Net cash received in acquisition | | | \$ |
| Details of Teleradiology Diagnostic Service, Inc. Acquisition: | | | |
| Cash | | \$ 79 | |
| Receivables | | 1,316 | |
| Other assets | | 85 | |
| Property and equipment | | 197 | |
| Deferred income tax assets | | 26 | |
| Goodwill | | 16,078 | |
| Intangible assets | | 12,250 | |
| Accounts payable and other liabilities | | (1,394) | |
| Deferred income tax liabilities | | (4,816) | |
| Contingent liability in escrow, paid in 2008 | | (1,150) | |
| Net cash paid for acquisition | | \$ 22,671 | |
| Details of The Radlinx Group , LTD. Acquisition: | | | |
| Cash | | \$ 8 | |
| Receivables | | 3,356 | |
| Other assets | | 277 | |
| Property and equipment | | 663 | |
| Goodwill | | 40,450 | |
| Intangible assets | | 19,400 | |
| Accounts payable and other liabilities | | (2,235) | |
| Deferred income tax liabilities | | (3,308) | |
| Debt assumed | | (12,545) | |
| Contingent consideration, paid in 2008 | | (4,925) | |

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| | |
|---|-----------|
| Net cash paid for acquisition | \$ 41,141 |
| Details of Midwest Physicians Services, LLC and Emergency Radiology Services, LLC acquisitions: | |
| Cash | \$ 252 |
| Receivables | 446 |
| Other assets | 111 |
| Property and equipment | 1,814 |
| Goodwill | 7,054 |
| Intangible assets | 57,590 |
| Accounts payable and other liabilities | (987) |
| Warrants issued | (3,334) |
| Net cash paid for acquisition | \$ 62,946 |

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

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NIGHTHAWK RADIOLOGY HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands)

| | For the Years Ended December 31, | | |
|--|---|------------------|--------------------|
| | 2008 | 2007 | 2006 |
| Net income (loss) | \$ 9,442 | \$ 14,694 | \$ (28,401) |
| Other comprehensive income (loss): | | | |
| Change in fair value of interest rate swaps | (4,043) | (2,717) | |
| Less deferred income taxes | 1,527 | 1,059 | |
| Net other comprehensive income (loss) | (2,516) | (1,658) | |
| Comprehensive income (loss) | \$ 6,926 | \$ 13,036 | \$ (28,401) |

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

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NIGHTHAWK RADIOLOGY HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006

1. SUMMARY OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

Background NightHawk Radiology Holdings, Inc. and its subsidiaries (the Company) provide professional services, business services, and clinical workflow technology to radiology groups and hospitals across the United States. The Company reports as one segment and its functional currency is the U.S. dollar.

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

Basis of Presentation The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany transactions have been eliminated.

Use of Estimates The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Some of these estimates require difficult, subjective or complex judgments about matters that are inherently uncertain. Actual results could differ from those estimates.

On an ongoing basis, the Company evaluates its estimates, including those related to the accounts receivable allowance, fair value of acquired intangible assets and goodwill, useful lives of intangible assets and property and equipment, income taxes, the loss contingency for medical liability claims, reserves for incurred but not reported (IBNR) medical liability claims, for determining stock-based compensation, the fair value of interest rate swap contracts and the Company's business services customers' expected net collections.

Cash and Cash Equivalents The Company considers all highly liquid investments with a remaining maturity of three months or less at the date of purchase to be cash equivalents.

Trade Accounts Receivable Trade accounts receivable represent receivables for services and are recorded at the invoiced amount and are non-interest bearing. Company management reviews past due accounts receivable to identify specific customers with known disputes or collectibility issues. As of December 31, 2008 and 2007, the Company had reserved \$1.1 million and \$0.6 million, respectively, for doubtful accounts based on its estimate of the collectibility of outstanding receivables as of those dates.

Marketable Securities The Company determines the appropriate classification of investments in marketable debt and equity securities at the time of purchase and reevaluates such designation at each balance sheet date. Marketable debt and equity securities have been classified and accounted for as available for sale. The Company may or may not hold securities with stated maturities greater than twelve months until maturity. In response to changes in the availability of and the yield on alternative investments as well as liquidity requirements, the Company occasionally sells these securities prior to their stated maturities. The Company primarily invests in high-credit-quality debt instruments with an active resale market and money market funds to ensure liquidity and the ability to readily convert these investments into cash to fund current operations, or satisfy other cash requirements as needed. Accordingly, all marketable securities have been classified as current assets in the accompanying balance sheets. These securities are carried at fair value, with the unrealized gains and

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losses, net of taxes, reported as a component of stockholders' equity, except for unrealized losses determined to be other than temporary which would be recorded as other income or expense. Any realized gains or losses on the sale of marketable securities are determined on a specific identification method, and such gains and losses are reflected as a component of other income or expense.

Property and Equipment Property and equipment are stated at cost. Depreciation is provided using the straight-line method over the estimated useful lives of each asset, which range as follows:

| | |
|---|---|
| Computers, diagnostic workstations and telecommunications systems | 3 - 5 years |
| Office furniture and equipment | 7 - 10 years |
| Software | 3 - 7 years |
| Leasehold improvements | Term of lease or asset life, whichever is shorter |

Expenditures for maintenance and repairs are charged to operating expense as incurred and expenditures for renewals and betterments are capitalized. Upon sale or retirement of depreciable assets, the related cost and accumulated depreciation are removed from the records and any gain or loss is reflected in operating expenses.

The cost of computer software developed for internal use is capitalized and accounted for in accordance with Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. Capitalized costs are amortized based on their expected useful lives.

Medical Liability Insurance The Company is exposed to various risks of loss related to litigation that may arise related to malpractice and maintains insurance for medical liabilities in amounts considered adequate by Company management. The Company's claims-made policy provides coverage up to the policy limits for claims filed within the period of the policy term, subject to deductible requirements and coverage limits. Coverage for affiliated radiologists is initiated when they begin providing services on behalf of the Company.

The Company records reserves for both asserted and IBNR amounts. Asserted claims are reserved based upon the Company's best estimate of future probable costs in accordance with Statement of Financial Accounting Standards (SFAS) No. 5, *Accounting for Contingencies*. The IBNR reserve is intended to cover potential medical claims that might arise related to past medical services performed by the Company's affiliated radiologists which have not yet been asserted. IBNR amounts are estimated using historical claims information and actuarial-based industry indices.

Operating Leases The Company leases various office space under operating leases. Certain lease arrangements contain rent escalation clauses for which the lease expense is recognized on a straight-line method over the term of the leases.

Long-Lived Assets Including Goodwill and Other Acquired Intangible Assets Goodwill is the amount by which the cost of acquired net assets in a business acquisition exceeds the fair values of net identifiable assets on the date of purchase. Goodwill is not subject to amortization; however it is subject to periodic impairment assessments. Under the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets*, (SFAS 142) the Company is required to perform at least an annual goodwill impairment test and to consider other indicators that may arise throughout the year to re-evaluate carrying value. To the extent carrying value exceeds fair value at the date impairment is tested, the Company reduces goodwill by recording a charge to operations. The annual impairment test is performed as of October 1 of each year and the conclusion was reached that goodwill was not impaired at October 1, 2008 or 2007. Goodwill impairment tests will continue to be performed at least annually and more frequently if circumstances indicate a possible impairment.

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, the Company periodically reviews long-lived assets for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable or that the useful lives

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of those assets are no longer appropriate. The Company performs impairment tests using discounted cash flows, valuation analyses or comparisons to recent sales or purchase transactions to determine estimated fair value. If impairment is indicated, the asset is written down to its estimated fair value based on a discounted cash flow analysis.

Revenue Recognition and Presentation Service revenue is recognized when all significant contractual obligations have been satisfied and collection of the resulting receivable is reasonably assured. Radiological service revenue is recognized in the month when the radiological interpretation is complete and delivered to the customer. Business service revenue is recognized in the period the service is provided.

Professional Services Expenses Professional service expenses consist primarily of the fees the Company pays to affiliated radiologists, any physician stock-based compensation, the premiums for medical liability insurance, and any medical liability claims loss expenses. Affiliated radiologists are independent contractors compensated using a formula that is generally based upon the number of hours worked, with additional incentives for the workload completed. Professional services expenses are recognized in the month in which the services are performed. The Company recognizes expenses associated with medical liability premiums in the month in which the expense is incurred. The Company records medical liability loss contingency expenses in the month in which the Company deems such liability probable.

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

Stock-Based Compensation The Company records stock-based compensation expense in connection with any grant of stock options or restricted stock units to affiliated radiologists. The Company follows the provisions of SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS 123 (R)). As a result, the Company calculates the stock-based compensation expense associated with the issuance of stock-based compensation to affiliated radiologists in accordance with SFAS 123 (R), and Emerging Issues Task Force (EITF) Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services* (EITF 96-18). The Company calculates the stock-based compensation expense related to the issuance of common stock or restricted stock units to affiliated radiologists based on the fair value of common stock at the date the shares or restricted stock units were earned. Stock-based compensation related to affiliated radiologists is included in professional services expenses.

The Company also records stock-based compensation expense in connection with any grant of stock options or restricted stock units to employees, directors and non-physician contractors. The Company calculates the stock-based compensation expense associated with the issuance of options or restricted stock units to the Company's employees, directors and non-physician contractors in accordance with SFAS 123 (R). Stock-based compensation related to employees, directors and non-physician contractors is included in sales, general and administrative expenses.

Income Taxes The Company recognizes income taxes under the asset and liability method in accordance with SFAS No. 109, *Accounting for Income Taxes* (SFAS 109). This approach requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities.

The provision for income taxes, including the effective tax rate and analysis of potential tax exposure items, if any, requires significant judgment and expertise in federal and state income tax laws, regulations and strategies, including the determination of deferred tax assets and liabilities and any estimated valuation

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allowances deemed necessary to value deferred tax assets. The Company's judgment and tax strategies are subject to audit by various taxing authorities. While the Company believes it has provided adequately for its income tax liabilities in the consolidated financial statements, adverse determinations by these taxing authorities could have a material adverse effect on the consolidated financial condition, results of operations or cash flows.

Earnings Per Common Share Basic earnings per common share is calculated based on the weighted-average number of outstanding common shares during the applicable period. Diluted earnings per common share are based on the weighted-average number of outstanding common shares plus the weighted-average number of potential outstanding common shares. Potential common shares that would increase earnings per share amounts or decrease loss per share amounts are anti-dilutive and are, therefore, excluded from the earnings per common share computations. Earnings per common share are computed separately for each period presented.

Concentration of Credit Risk Financial instruments that potentially expose the Company to concentration of credit risk consist primarily of cash, cash equivalents, marketable securities and accounts receivable. The Company maintains its cash, cash equivalents and marketable securities with high quality credit institutions. As of December 31, 2008 and 2007, a total of \$7.5 million and \$12.0 million, respectively, of cash and cash equivalents exceeded federal government insured amounts. None of our customers represent more than 10% of our annual revenue.

Fair Value of Financial Instruments The carrying amounts of the Company's financial instruments, including cash and cash equivalents, marketable securities, accounts receivable and current liabilities approximate their fair value because of their short duration. See also Note 13 for fair value disclosure.

Derivative Financial Instruments Accounting for derivative instruments and hedging activities requires the Company to recognize all derivatives on the consolidated balance sheet at fair value in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133). If the derivative is a qualifying cash flow hedge, changes in its fair value are recognized in other comprehensive income until the hedged item is recognized in earnings. The Company does not generally engage in speculative transactions, nor does it hold or issue financial instruments for trading purposes.

The Company formally documents hedging instruments, as well as its risk management objective and strategy for undertaking hedged items. This process includes linking all derivatives that are cash flow hedges to forecasted payments. The Company also formally assesses, both at inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair value or cash flows of hedged items. If it is determined that a derivative is not highly effective, the Company discontinues hedge accounting prospectively for that specific hedge instrument and the ineffective portion is recognized in earnings.

Recently Issued Accounting Standards In April 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) SFAS 142-3, *Determination of Useful Life of Intangible Assets* (FSP SFAS 142-3). FSP SFAS 142-3 amends the factors that should be considered in developing the renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS 142, *Goodwill and Other Intangible Assets* (SFAS 142). FSP SFAS 142-3 also requires expanded disclosure related to the determination of intangible asset useful lives. FSP SFAS 142-3 will be effective for the Company on January 1, 2009. Earlier adoption is not permitted. The Company does not expect the adoption of FSP SFAS 142-3 to have a significant impact on its financial position or results of operations.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (SFAS 161) which amends and expands the disclosure requirements of SFAS No. 133. SFAS 161 will be effective for the Company on January 1, 2009. The Company is currently evaluating the impact of adopting SFAS 161 to its financial statement footnotes.

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In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value according to accounting principles generally accepted in the United States of America, and expands disclosure requirements regarding fair value measurements. SFAS 157 emphasizes that fair value should be determined based on assumptions market participants would use to price the asset or liability. The provisions of SFAS 157 were effective for fiscal years beginning after November 15, 2007. The Company adopted this new accounting pronouncement as of January 1, 2008 and the impact of adoption was not significant. See Note 13 for disclosures regarding fair value measurements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159) which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS 159 was effective for the Company on January 1, 2008. The Company has assessed this option and elected not to measure any existing financial instruments at fair value.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (SFAS 141(R)) which establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any controlling interest; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effect of the business combination. SFAS 141(R) is to be applied prospectively to business combinations for which the acquisition date is on or after an entity's fiscal year that begins after December 15, 2008. SFAS 141(R) will be effective for the Company on January 1, 2009. The Company does not expect the adoption of SFAS No. 141(R) to have a significant impact on its financial position or results of operations.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements - an amendment of ARB No. 51* (SFAS 160). SFAS 160 requires that all entities in which its parent has a controlling financial interest be consolidated into the parent at 100 percent of fair value and the parent's consolidated net income include amounts attributable to both the parent and noncontrolling interest. SFAS 160 clarifies that non-controlling interests in subsidiaries be presented as equity and any changes to the ownership interest are considered equity transactions providing the parent maintains its controlling financial interest in the subsidiary. SFAS 160 will be effective for the Company on January 1, 2009. The Company does not expect the adoption of SFAS 160 to have a significant impact on its financial position and results of operations.

2. ACQUISITIONS

MIDWEST PHYSICIANS SERVICES, LLC AND EMERGENCY RADIOLOGY SERVICES, LLC.

On July 16, 2007, the Company acquired all of the outstanding equity interests of Midwest Physicians Services, LLC (MPS) and Emergency Radiology Services, LLC (ERS) from SPR Holdings II, LLC (SPR Holdings), a privately held company located in St. Paul, Minnesota. ERS is an off-hours teleradiology services company. MPS was formed by St. Paul Radiology, P.A. (SPR) to provide a suite of business process services including revenue cycle management, administrative, information technology and other services critical to the operation of a radiology group. The Company has combined these services with its professional services and proprietary workflow technology to offer its customers a more complete suite of professional and business process solutions.

The consideration for this acquisition consisted of (i) \$62.9 million in cash, including \$0.5 million in costs associated with the acquisition, and (ii) a warrant, issued to SPR, entitling SPR to purchase 300,000 shares of common stock of the Company at any time after July 16, 2010 and before July 16, 2017 at an exercise price of \$18.75 per share. The fair value of the warrant was calculated using a Black-Scholes model as \$3.3 million. Of the purchase price, \$57.5 million of the cash portion was paid to SPR Holdings at closing and the remaining

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\$5.0 million was placed into a third-party escrow account to secure SPR Holdings' indemnification obligations under the terms of the acquisition agreement. The funds placed in the escrow account, net of any indemnification obligations, will be released to SPR Holdings on the second anniversary of the acquisition.

In connection with its acquisition of ERS, the Company (through ERS) entered into a professional services agreement with SPR pursuant to which ERS engaged SPR to perform radiology interpretations for the customers of ERS. Prior to January 1, 2008, pursuant to the terms of the professional services agreement, SPR received compensation for those reads by billing the patients and their related third party payors. As a result, the Company only received revenue for such services to its customers solely through the administrative services provided to SPR through the Company's administrative services agreement with SPR. Effective January 1, 2008, in order to achieve consistency with how the Company records professional services revenue and the associated cost of professional services with its contracted radiology providers, the Company and SPR amended the professional services agreement to provide for direct payment by ERS to SPR for the professional services rendered by SPR. ERS began recording fully the associated services revenue from such customer contracts.

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition. The following table presents the allocation of the purchase price to the acquired assets and liabilities

| | (In thousands) |
|----------------------------|------------------|
| Current assets | \$ 810 |
| Fixed assets | 1,814 |
| Intangible assets | 57,590 |
| Goodwill | 6,933 |
| Assets acquired | 67,147 |
| Current liabilities | 555 |
| Long-term liabilities | 311 |
| Liabilities assumed | 866 |
| Purchase price | \$ 66,281 |

The Company recorded the assets acquired and liabilities assumed in the acquisition of MPS and ERS based on their estimated fair values on the acquisition date. Goodwill of \$6.9 million, representing the excess of the purchase price over the fair value of tangible and identifiable intangible assets acquired and liabilities assumed, will not be amortized, consistent with the guidance in SFAS 142. The total goodwill balance is deductible for tax purposes over 15 years. The results of operations of MPS and ERS have been included in the Company's consolidated statements of operations and cash flows starting on July 17, 2007.

The determination of the estimated fair value of the intangible assets acquired required the Company's management to make significant estimates and assumptions. These assumptions included future expected cash flows from customer contracts, certain noncompete agreements and tradenames, and the useful lives of the intangible assets.

The amount allocated to intangible assets was attributed to the following categories:

| | Acquired Value (In thousands) | Estimated Useful Life |
|--------------------------|-------------------------------------|--------------------------|
| Customer contracts | \$ 57,180 | 20 years |
| Tradename and trademarks | 130 | 5 years |
| Noncompete agreements | 280 | 5 years |
| | \$ 57,590 | |

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All intangible assets are being amortized on a straight-line basis over their expected useful lives. See Note 4.

THE RADLINX GROUP, LTD.

On April 5, 2007, the Company completed the acquisition of all of the outstanding equity interests of The Radlinx Group, Ltd. (Radlinx), a privately held radiology services company, for consideration consisting of (i) \$53.0 million in cash at closing, including the assumption of \$12.6 million in liabilities which were paid in full immediately following the acquisition and \$0.3 million of certain costs associated with the acquisition, (ii) an additional \$0.4 million paid in the fourth quarter of 2007 as settlement of a contractual working capital adjustment and (iii) \$6.5 million in cash, equal to 25% of the revenues generated by certain identified customers during the one-year period following the closing, and paid in May 2008.

Of the purchase price, \$5.3 million was paid at closing and placed into a third party escrow account to secure Radlinx's indemnification obligations under the terms of the acquisition agreement. In the first quarter 2008, as a result of the settlement of a medical malpractice claim that originated prior to the Company's acquisition of Radlinx, the previous owners of Radlinx utilized the entire \$5.3 million in the escrow account to satisfy their portion of the settlement arrangement. The Company also participated in the settlement arrangement; however, its total payment to the plaintiff was limited to \$0.2 million which was recorded to goodwill.

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition. The following table presents the allocation of the purchase price to the acquired assets and liabilities:

| | (In thousands) |
|--|-----------------------|
| Current assets | \$ 3,572 |
| Fixed assets | 663 |
| Intangible assets | 19,400 |
| Goodwill | 42,120 |
| Assets acquired | 65,755 |
| Current liabilities | 2,371 |
| Long-term debt (current and long-term portion) | 12,608 |
| Deferred income tax payable | 3,135 |
| Liabilities assumed | 18,114 |
| Purchase price | \$ 47,641 |

The Company recorded the assets acquired and liabilities assumed in the Radlinx acquisition based on their estimated fair values on the acquisition date. Goodwill of \$42.1 million, representing the excess of the purchase price over the fair value of tangible and identifiable intangible assets acquired and liabilities assumed, will not be amortized, consistent with the guidance in SFAS 142. The Company estimates that \$30.0 million of the goodwill balance is deductible for tax purposes. The results of operations of Radlinx have been included in the Company's consolidated statements of operations and cash flows starting on April 6, 2007.

The determination of the estimated fair value of the intangible assets acquired required the Company's management to make significant estimates and assumptions. These assumptions included future expected cash flows from customer contracts, certain noncompete agreements, customer lists, the Radlinx tradename, and the useful lives of the intangible assets.

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The amount allocated to intangible assets was attributed to the following categories:

| | Acquired Value (In thousands) | Estimated Useful Life |
|----------------------------------|-------------------------------------|--------------------------|
| Customer lists and relationships | \$ 16,800 | 10 years |
| Tradename and trademarks | 1,500 | 5 years |
| Noncompete agreements | 1,100 | 2 years |
| | \$ 19,400 | |

All intangible assets are being amortized on a straight-line basis over their expected useful lives. See Note 4.

TELERRADIOLOGY DIAGNOSTIC SERVICE, INC.

On February 9, 2007, the Company acquired all of the outstanding capital stock of Teleradiology Diagnostic Service, Inc. (TDS), for \$23.8 million in cash, including certain costs associated with the acquisition. Of the \$23.8 million paid, \$1.2 million was held by the Company as escrow to secure the indemnification obligations of TDS under the terms of the acquisition agreement and then released to the former owners of TDS in the third quarter of 2008, the 18 month anniversary of the acquisition.

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition. The following table presents the allocation of the purchase price to the acquired assets and liabilities:

| | (In thousands) |
|-----------------------------|------------------|
| Current assets | \$ 1,506 |
| Fixed assets | 197 |
| Intangible assets | 12,250 |
| Goodwill | 16,078 |
| Assets acquired | 30,031 |
| Current liabilities | 1,394 |
| Deferred income tax payable | 4,816 |
| Liabilities assumed | 6,210 |
| Purchase price | \$ 23,821 |

The Company recorded the assets acquired and liabilities assumed in the acquisition of TDS based on their estimated fair values on the acquisition date. Goodwill of \$16.1 million, representing the excess of the purchase price over the fair value of tangible and identifiable intangible assets acquired and liabilities assumed, will not be amortized, consistent with the guidance in SFAS 142. None of the goodwill balance is deductible for tax purposes. The results of operations of TDS have been included in the Company's consolidated statements of operations and cash flows starting on February 9, 2007.

The determination of the estimated fair value of the intangible assets acquired required the Company's management to make significant estimates and assumptions. These assumptions included future expected cash flows from customer contracts, certain noncompete agreements, customer lists, the TDS tradename, and the useful lives of the intangible assets.

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The amount allocated to intangible assets was attributed to the following categories:

| | Acquired Value (In thousands) | Estimated Useful Life |
|----------------------------------|-------------------------------------|--------------------------|
| Customer lists and relationships | \$ 11,350 | 10 years |
| Tradename and trademarks | 400 | 5 years |
| Noncompete agreements | 500 | 3 years |
| | \$ 12,250 | |

All intangible assets are being amortized on a straight-line basis over their expected useful lives. See Note 4.

AMERICAN TELERADIOLOGY NIGHTHAWKS, INC.

On September 30, 2005, the Company acquired American Teleradiology Nighthawks, Inc. (ATN). The acquisition of ATN was considered by the Company as an acquisition of two distinct businesses: (i) an off-hours teleradiology business that was supplemental to the Company's off-hours business and (ii) a nascent hospital business that focused on partnering with radiologists in order to supplement the services they provide to their hospitals. The acquisition agreement provided that if the hospital business proved to be profitable as established under the terms of the agreement in the 18 months following the acquisition, additional shares of Company common stock would be issued. During the quarter ended March 31, 2007, the Company determined that the hospital business did not meet the profitability metrics set forth in the acquisition agreement and that no amount was earned as contingent consideration. This contingent consideration amount is currently subject to dispute. Although the Company does not believe that additional shares will be issued, the contingent consideration ultimately due is subject to resolution of this dispute by the parties. On March 4, 2008, 181,971 shares of common stock were issued as consideration to stockholders of ATN as of the acquisition date for the off-hours business. The additional consideration was calculated in accordance with the provisions of the purchase agreement.

3. MARKETABLE SECURITIES

Marketable securities include various available-for-sale securities. These securities are carried at fair value, with the unrealized gains and losses, net of taxes, reported as a component of stockholders' equity. Gross unrealized gains and losses on marketable securities were not significant at December 31, 2007. During 2008, all marketable securities were sold and the proceeds reinvested in short-term money market funds as a conservative measure against the unfavorable conditions in the credit market and to better ensure access and recoverability.

Below are the Company's marketable securities at fair value:

| | December 31, 2008 | December 31, 2007 |
|---|----------------------|----------------------|
| | (In thousands) | |
| Due in one year or less: | | |
| U.S. Government and Federal Agency securities | \$ | \$ 13,430 |
| Municipal securities | | 17,195 |
| Due after three years: | | |
| Municipal securities | | |
| Total marketable securities | \$ | \$ 30,625 |

Table of Contents**4. INTANGIBLE ASSETS**

The Company records intangible assets at historical cost. The Company amortizes its intangible assets using the straight-line method over their estimated useful lives. The Company reviews intangible assets subject to amortization quarterly to determine if any adverse conditions exist or a change in circumstances has occurred that would indicate impairment or a change in the remaining useful life. A summary of intangible assets at December 31 is as follows:

| | Estimated Useful Life | Historical Amount | 2008 Accumulated Amortization | Net Amount | Historical Amount | 2007 Accumulated Amortization | Net Amount |
|----------------------------------|-----------------------|-------------------|-------------------------------|------------|-------------------|-------------------------------|------------|
| (In thousands) | | | | | | | |
| Customer lists and relationships | 6-10 years | \$ 30,770 | \$ 6,368 | \$ 24,402 | \$ 30,770 | \$ 3,156 | \$ 27,614 |
| Tradename and trademarks | 5 years | 2,820 | 1,143 | 1,677 | 2,820 | 510 | 2,310 |
| Customer contracts | 1-20 years | 57,180 | 4,169 | 53,011 | 57,280 | 1,410 | 55,870 |
| Noncompete agreements | 2-5 years | 1,880 | 1,354 | 526 | 2,090 | 751 | 1,339 |
| | | \$ 92,650 | \$ 13,034 | \$ 79,616 | \$ 92,960 | \$ 5,827 | \$ 87,133 |

Amortization expense was \$7.5 million, \$5.0 million and \$0.5 million for the years ended December 31, 2008, 2007 and 2006, respectively.

| Estimated Amortization Expense: | Amount |
|---------------------------------|------------------|
| Year ending December 31, 2009 | \$ 7,064 |
| Year ending December 31, 2010 | 6,687 |
| Year ending December 31, 2011 | 6,452 |
| Year ending December 31, 2012 | 5,879 |
| Year ending December 31, 2013 | 5,748 |
| Thereafter | 47,786 |
| Total | \$ 79,616 |

5. PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

| | December 31, | |
|--|----------------|-----------|
| | 2008 | 2007 |
| | (in thousands) | |
| Computers, diagnostic workstations, and telecommunications systems | \$ 7,544 | \$ 7,274 |
| Office furniture and equipment | 1,861 | 1,550 |
| Software | 6,695 | 4,882 |
| Leasehold improvements | 3,178 | 2,810 |
| | 19,278 | 16,516 |
| Less accumulated depreciation | (8,750) | (5,961) |
| | \$ 10,528 | \$ 10,555 |

Depreciation expense for the years ended December 31, 2008, 2007 and 2006 was \$3.8 million, \$2.9 million and \$1.7 million, respectively.

Table of Contents**6. LONG-TERM DEBT**

On February 14, 2006, the Company repaid in full the debt and interest outstanding with Comerica Bank in the amount of \$30.1 million with proceeds from the Company's initial public offering. Subsequent to repaying this outstanding debt, the Company terminated its term and revolving loan facilities with Comerica Bank.

On April 5, 2007, the Company entered into a credit agreement with Morgan Stanley Senior Funding (Credit Agreement) relating to a term loan in an amount of \$53.0 million, with an option for the Company to request that the lenders advance up to an additional \$97.0 million in term loans for a total credit facility of up to \$150.0 million (Credit Facility). The Company used proceeds from the Credit Facility to fund the acquisition of Radlinx. On July 10, 2007, the Company drew down an additional \$47.0 million to help fund the acquisitions of MPS and ERS. Immediately subsequent to this draw, the Company converted the Credit Agreement into a fully syndicated term loan (Term Loan).

Interest under the Term Loan is based, at the option of the Company, on either: (i) a floating per annum rate based on prime rate plus 1.50% or (ii) a floating per annum rate (based upon one, two, three or six-month interest periods) based on LIBOR plus a margin of 2.50% (3.96% at December 31, 2008). The Company entered into two interest rate swap contracts during 2007. These swap contracts, while in effect, maintained an effective rate of approximately 7.40%. On December 31, 2008, the Company settled these two contracts for a cash payment of \$5.3 million. Simultaneously, the Company entered into five new interest rate swap contracts with a combined notional amount of \$93.5 million which, while in place will maintain an effective rate of approximately 4.95%. The Term Loan will be repaid in quarterly installments of \$0.2 million with the projected remaining balance of \$89.1 million payable on the maturity date of July 10, 2014.

The Term Loan contains customary covenants, restrictions and is guaranteed by certain of the Company's wholly owned operating subsidiaries, including NightHawk Radiology Services, LLC, the Company's primary operating entity, and is collateralized by substantially all of the Company's assets. The Term loan is also subject to mandatory prepayment under certain circumstances, including in connection with the Company's receipt of proceeds from certain issuances of equity or debt, sales of assets and casualty events and from the Company's excess cash flow. The term loan may be voluntarily prepaid without premium or penalty. On December 31, 2008, the Company made a voluntary prepayment of \$4.4 million bringing the total outstanding borrowings to \$94.1 million.

As of December 31, 2008, the fair value of long-term debt, including the current portion, is estimated to be approximately \$73.4 million.

7. COMMITMENTS AND CONTINGENCIES

Leases The Company has operating leases expiring at various future dates for offices around the world. Total rent expense was \$2.2 million, \$1.9 million and \$1.1 million for the years ended December 31, 2008, 2007 and 2006, respectively.

The following is a schedule of approximate minimum future rental payments under non-cancelable operating leases having remaining terms in excess of one year as of December 31, 2008:

| | (In thousands) |
|------------|----------------|
| 2009 | \$ 2,340 |
| 2010 | 1,802 |
| 2011 | 1,632 |
| 2012 | 1,299 |
| 2013 | 1,047 |
| Thereafter | 3,473 |
| | \$ 11,593 |

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Licenses In the fourth quarter of 2008, we entered into a term software license agreement pursuant to which we may, if we elect to continue to use the software, spend approximately \$8.4 million over the next 4 years. Pursuant to the terms of the agreement, if we elect not to use the software in 2009 or in any year thereafter, our obligations to pay continued license fees shall cease.

Letters of Credit The Company maintains various letters of credit associated with its office leases and malpractice insurance. Letters of credit amounted to \$0.6 million as of December 31, 2008 and 2007.

Litigation From time to time, the Company is involved in litigation in the normal course of business. After consultation with legal counsel, management has concluded that as of December 31, 2008 and 2007 the Company has no pending litigation that would have a material adverse effect on the Company's financial position, results of operations, or cash flows.

Medical Liability Insurance The Company is exposed to various risks of loss related to litigation that may arise related to malpractice and maintains insurance for medical liabilities in amounts considered adequate by Company management. The Company's claims-made policy provides coverage up to the policy limits for claims filed within the period of the policy term, subject to deductible requirements. Coverage for affiliated radiologists is initiated when they begin providing services on behalf of the Company.

The Company records reserves for both reported and IBNR amounts. Reported amounts are reserved based upon the Company's best estimate of future probable costs and totaled \$0.4 million and \$0.5 million at December 31, 2008 and 2007, respectively. The Company also accrues IBNR amounts using actuarial calculations, models and assumptions based on historical claims experience and industry indices. In 2006, the Company recorded a \$2.0 million reserve that was intended to cover potential medical claims that might arise related to all of the radiological interpretations performed by the Company's affiliated radiologists since inception. During 2008 and 2007, the Company recorded an additional \$0.7 million and \$1.0 million, respectively, for estimated IBNR amounts based on increased volumes. IBNR amounts, recorded as professional liability reserve on the balance sheet at December 31, 2008 and 2007 totaled \$3.7 million and \$3.0 million, respectively.

8. STOCK COMPENSATION

Share Based Award Plans. The Company has two stock-based award plans, the 2004 Stock Plan (the "2004 Plan") and the 2006 Equity Incentive Plan (the "2006 Plan"). In February 2006, all shares available for grant under the 2004 Plan were rolled over and became available for grant under the 2006 Plan. In addition, on the first day of each fiscal year beginning in 2007, the number of shares available for issuance under the 2006 Plan may be increased by an amount equal to the lesser of (i) 3% of the outstanding shares of the Company's common stock on the first day of the fiscal year, and (ii) such other amount as the Company's Board of Directors may determine. As of December 31, 2008 and 2007, the Company had an aggregate of 4,298,397 and 4,742,746 shares of its common stock reserved for issuance under the 2004 Plan and 2006 Plan. Of these shares, 107,272 and 81,592 shares were available for future grants and 4,191,125 and 3,751,784 shares were subject to outstanding stock awards as of December 31, 2008 and 2007, respectively.

The Company's Board of Directors administers the plans and establishes to whom the awards are granted, and the terms and conditions, including the exercise period, of such awards. All stock options granted have an exercise price equal to or greater than the fair value of the Company's common stock on the date the option is granted. All restricted stock units ("RSUs") are granted with an exercise price of zero. Both stock options and RSUs granted generally have contractual terms of ten years and vest over three years. Options and RSUs granted to employees and directors are valued using the multiple valuation approach, and the resulting expense is recognized using the accelerated method over the service period for the entire award.

Non-Employee Grants. The Company records stock-based compensation expense in connection with any grant of stock options, restricted stock units, or other issuance of shares of common stock to the Company's affiliated radiologists. Stock-based compensation expense associated with the issuance of stock options to the

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Company's affiliated radiologists is calculated in accordance with SFAS 123 (R) and EITF 96-18, by determining the fair value using a Black-Scholes model.

In accordance with EITF 96-18, because the Company's affiliated radiologists are independent contractors, the Company calculates the fair value of the stock-based compensation expense in each period. The expense amount is determined by calculating the fair value of the shares earned in each period and recording that amount as expense during such period. If the price of the Company's common stock increases over a given period, this accounting treatment results in compensation expense that exceeds the expense the Company would have recorded if these individuals were employees. Stock-based compensation to the Company's affiliated radiologists is included in professional services expense.

A summary of the Company's stock-based award activity for employees and non-employees under the 2004 and 2006 plans are as follows:

| Stock Options | Number of Stock Options | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life (Yrs) | Aggregate Intrinsic Value (In thousands) |
|---|------------------------------------|--|--|---|
| Outstanding as of January 1, 2008 | 3,497,210 | \$ 14.85 | | |
| Granted | 1,280,315 | 7.73 | | |
| Exercised | (228,023) | 2.45 | | |
| Cancelled | (898,732) | 17.38 | | |
| Outstanding as of December 31, 2008 | 3,650,770 | \$ 12.27 | 8.10 | \$ 1,938 |
| Exercisable as of December 31, 2008 | 1,487,685 | \$ 12.34 | 7.09 | \$ 1,610 |
| Vested and expected to vest as of December 31, 2008 | 3,553,498 | \$ 12.31 | 8.01 | \$ 1,921 |

Intrinsic value represents the amount by which the fair market value of the underlying stock exceeds the exercise price of the options. The weighted-average grant date fair value of stock options granted, the total intrinsic value of options exercised and the fair value of shares that have vested during each of the past three years is as follows:

| | Years Ended December 31, | | |
|--|---------------------------------|-------------|-------------|
| | 2008 | 2007 | 2006 |
| Weighted-average grant date fair value | \$ 3.24 | \$ 7.16 | \$ 8.39 |
| Intrinsic value of exercised options (<i>in thousands</i>) | 1,671 | 6,094 | 2,180 |
| Fair value of shares vested (<i>in thousands</i>) | 5,713 | 877 | 407 |

During the year ended December 31, 2008, options to purchase 228,023 shares of common stock were exercised for proceeds of \$0.6 million.

During the year ended December 31, 2007, options to purchase 343,531 shares of common stock were exercised for proceeds of \$1.2 million.

A reconciliation of the non-vested options as of December 31, 2008, and changes during the year then ended is as follows:

| Outstanding Non-Vested Stock Options | Number of Stock Options | Weighted Average Grant Date Fair Value |
|---|------------------------------------|---|
| Outstanding as of January 1, 2008 | 2,819,178 | \$ 6.43 |
| Granted | 1,280,315 | 3.24 |
| Vested | (1,037,676) | 5.51 |
| Cancelled | (898,732) | 6.43 |
| Outstanding as of December 31, 2008 | 2,163,085 | \$ 4.87 |

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Activity related to the Company's restricted stock unit awards is as follows:

| Restricted Stock Unit Awards | Number of Awards | Weighted Average Fair Value | Weighted Average Remaining Contractual Life (Yrs) | Aggregate Intrinsic Value (In thousands) |
|---|-------------------------|------------------------------------|--|---|
| Outstanding as of January 1, 2008 | 254,574 | \$ 21.03 | | |
| Granted | 530,421 | 10.75 | | |
| Vested (1) | (216,326) | 9.02 | | |
| Cancelled | (28,314) | 20.51 | | |
| Outstanding as of December 31, 2008 | 540,355 | \$ 13.72 | 1.78 | \$ 2,626 |
| Vested and expected to vest as of December 31, 2008 | 496,200 | \$ 13.72 | 1.77 | \$ 2,412 |

(1) The number of restricted stock unit awards vested includes shares withheld on behalf of employees to satisfy the statutory tax withholding requirements.

As of December 31, 2008, the total remaining unrecognized compensation cost related to unvested stock-based employee/director arrangements, net of an estimated forfeiture rate of 8.9%, was \$4.8 million and is expected to be recognized over a weighted average period of 1.07 years.

Recognition of compensation expense. Stock-based compensation expense, along with the related income tax benefit, for each of the past three years was approximately as follows:

| | Years Ended December 31, | | |
|---|---------------------------------|-----------------|-----------------|
| | 2008 | 2007 | 2006 |
| | <i>(In thousands)</i> | | |
| Stock-based compensation expense recognized | \$ 8,330 | \$ 15,030 | \$ 5,960 |
| Income tax benefit recognized | (3,187) | (5,862) | (2,316) |
| After-tax stock-based compensation expense | \$ 5,143 | \$ 9,168 | \$ 3,644 |

The Company measures the compensation cost associated with stock-based payments by estimating the fair value of stock options as of the grant date using the Black-Scholes option pricing model. The Company believes that the valuation technique and the approach utilized to develop the underlying assumptions are appropriate in calculating the fair values of the stock options granted. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by the employees who receive equity awards.

The weighted average fair values of stock-based arrangements on the date of grant and the assumptions used to estimate the fair value of the stock-based arrangements were as follows:

| | Year Ended December 31, 2008 | Year Ended December 31, 2007 | Year Ended December 31, 2006 |
|--|-------------------------------------|-------------------------------------|-------------------------------------|
| Dividend yield | | | |
| Expected volatility | 50% | 36% | 39% |
| Risk-free interest rates | 2.40% | 4.60% | 4.84% |
| Expected term for employees (years) | 4.2 | 4.1 | 4.7 |
| Expected/remaining term for non-employee (years) | 10 | 10 | 10 |

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Expected volatility is estimated based primarily on evaluating similar companies' volatility rates and the Company's limited trading history. The Company started incorporating its trading history into the estimates on January 1, 2007. The risk-free interest rate is based on the U.S. Treasury yields in effect at the time of grant corresponding with the expected term of the options. The expected option term for employees is the number of years estimated that options will be outstanding prior to exercise considering vesting schedules, historical exercise experience and other relevant factors.

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Performance Bonuses. In connection with the employment agreements with key executives, the Company may pay to each executive an annual performance bonus, in cash and/or restricted stock of the Company, as determined by the Compensation Committee at its sole discretion. At December 31, 2007, \$1.6 million was accrued for performance bonuses that were paid in restricted stock unit awards and was expensed as stock compensation expense in 2007. No performance bonuses to be paid in restricted stock unit awards were accrued at December 31, 2008.

9. EARNINGS PER SHARE

The following table presents a reconciliation of the numerators and denominators used in the basic and diluted earnings per common share computations:

| | Years Ended December 31, | | |
|---|--------------------------|---------------|-----------------|
| | 2008 | 2007 | 2006 |
| Numerator: | | | |
| Net income (loss) available in basic calculation | \$ 9,442,000 | \$ 14,694,000 | \$ (28,519,000) |
| Plus: Income impact of assumed conversions of preferred stock dividends | | | (b) |
| Income (loss) available to common stockholders plus assumed conversions | \$ 9,442,000 | \$ 14,694,000 | \$ (28,519,000) |
| Denominator: | | | |
| Weighted-average common shares outstanding basic | 29,482,536 | 30,083,080 | 28,528,079 |
| Effect of dilutive stock options, restricted stock units, and warrants | 1,048,221 | 817,356 | (a) |
| Effect of convertible preferred stock | | | (b) |
| Effect of contingently issuable shares | 31,185 | 183,535 | (c) |
| Weighted average common shares outstanding dilutive | 30,561,942 | 31,083,971 | 28,528,079 |
| Earnings (loss) per common share basic | \$ 0.32 | \$ 0.49 | \$ (1.00) |
| Earnings (loss) per common share diluted | 0.31 | 0.47 | (1.00) |
| Anti-dilutive shares excluded from calculation | 2,913,752 | 1,652,514 | 1,577,486 |

- (a) The effects of the shares which would be issued upon exercise of these options and restricted stock units have been excluded from the calculation of diluted earnings (loss) per common share because they are anti-dilutive.
- (b) The income impact of assumed conversions of the preferred stock dividends and the effect of the convertible preferred stock in the denominator are anti-dilutive.
- (c) The effects of the shares which would be issued upon finalization of the Company's ATN purchase have been excluded from the calculation of diluted earnings (loss) per common share because they are anti-dilutive.

10. INCOME TAXES

On February 9, 2007, the Company entered into a share purchase agreement with TDS, each of the shareholders of TDS and certain other related parties, pursuant to which the Company acquired all of the outstanding stock of TDS. The acquisition was a share purchase with the assets of TDS retaining their historical tax basis. In accordance with SFAS 109, deferred assets and liabilities are recognized for temporary differences between the assigned values and the tax bases of the assets and liabilities recognized in a business combination. The effect of recognizing these deferred items was a net deferred tax liability of \$4.8 million and is included in the business combination at February 9, 2007.

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On April 5, 2007, the Company completed the acquisition of all of the outstanding equity interests of Radlinx. Radlinx is a domestic limited partnership organized under the laws of the State of Texas. Certain of the acquired partnership interests were subject to a step-up in the tax basis of the underlying assets acquired, pursuant to Section 743(b) of the Internal Revenue Code of 1986, as amended. The remaining partnership interests were obtained by purchasing the shares of corporate partners. The underlying assets of such acquired interests retain their historical tax basis. In accordance with SFAS 109, deferred assets and liabilities are recognized for temporary differences between the assigned values and the tax bases of the assets and liabilities recognized in a business combination. The effect of recognizing these deferred items was a net deferred tax liability of \$3.3 million and is included in the business combination at April 5, 2007.

On July 16, 2007, the Company acquired all of the outstanding equity interests of MPS and ERS from SPR Holdings. MPS and ERS are single member limited liability companies organized under the laws of the State of Minnesota. Single member limited liability companies are disregarded for tax purposes. Accordingly, the purchase was treated as an asset purchase, with no material differences between the assigned values and the tax bases of the acquired assets and liabilities.

Deferred income taxes are recognized for temporary differences between the financial statements and tax basis of assets and liabilities using presently enacted tax rates and laws.

Deferred tax assets and liabilities consist of the following:

| | 2008 | December 31, 2007 <i>(In thousands)</i> | 2006 |
|--|-----------------|---|-----------------|
| Deferred tax assets: | | | |
| Accrued compensation and employee benefits | \$ 8,666 | \$ 8,222 | \$ 3,081 |
| Professional liability reserve | 1,586 | 1,364 | 1,051 |
| Fair value of derivatives | 2,586 | 1,060 | |
| Liability for unrecognized state tax benefits | 686 | | |
| Allowance for doubtful accounts | 478 | 254 | 157 |
| Deferred rent | 230 | 221 | 60 |
| Other, net | 173 | 11 | 12 |
| Total deferred tax assets | 14,405 | 11,132 | 4,361 |
| Deferred tax liabilities: | | | |
| Basis difference in intangible assets | 7,613 | 7,866 | 567 |
| Basis difference in property and equipment | 1,146 | 695 | 474 |
| Effect of change from cash to accrual accounting for tax | | 359 | 338 |
| Prepaid expenses | 709 | 306 | 135 |
| Total deferred tax liabilities | 9,468 | 9,226 | 1,514 |
| Net deferred tax assets | \$ 4,937 | \$ 1,906 | \$ 2,847 |

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Income tax expense consists of the following:

| <i>(In thousands)</i> | Year Ended December 31, 2008 | Year Ended December 31, 2007 | Year Ended December 31, 2006 |
|---------------------------------|------------------------------------|------------------------------------|------------------------------------|
| Current: | | | |
| Federal | \$ 5,611 | \$ 12,091 | \$ 11,182 |
| State | 402 | 2,235 | 2,049 |
| Foreign | 454 | 387 | 235 |
| Total current | 6,467 | 14,713 | 13,466 |
| Deferred: | | | |
| Federal | (1,141) | (5,473) | (3,074) |
| State | (69) | (625) | (344) |
| Total deferred | (1,210) | (6,098) | (3,418) |
| Total income tax expense | \$ 5,257 | \$ 8,615 | \$ 10,048 |

The reconciliation between the federal statutory tax rate and the Company's effective tax rate is as follows:

| <i>(In thousands)</i> | Year Ended December 31, 2008 | | Year Ended December 31, 2007 | | Year Ended December 31, 2006 | |
|--|---------------------------------------|--------------|------------------------------------|--------------|------------------------------------|----------------|
| Computed federal income tax expense (benefit) at the statutory rate | \$ 5,144 | 35.0% | \$ 8,158 | 35.0% | \$ (6,424) | 35.0% |
| State income taxes, net of federal income tax benefit | 217 | 1.5% | 828 | 3.6% | 987 | (5.4)% |
| Change in fair market value of redeemable preferred stock conversion feature | | 0.0% | | 0.0% | 15,464 | (84.2)% |
| Other, net | (104) | (0.7)% | (371) | (1.6)% | 21 | (0.1)% |
| | \$ 5,257 | 35.8% | \$ 8,615 | 37.0% | \$ 10,048 | (54.7)% |

The components of the reconciliation between the federal statutory rate and the Company's effective tax rate are shown net of the effect of uncertain tax positions.

For the years ended December 31, 2008 and 2007, income considered to be permanently reinvested in non-U.S. subsidiaries totaled \$0.5 million and \$0.3 million, respectively. Deferred U.S. income taxes have not been provided on this income, as the Company does not plan to initiate any action that would require the payment of U.S. income. It is not practical to estimate the amount of additional tax that might be payable on this undistributed foreign income.

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* (FIN 48), which clarifies the accounting for uncertainty in tax positions. FIN 48 requires that the impact of a tax position be recognized in the financial statements if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The Company adopted the provisions of FIN 48 on January 1, 2007. As a result, the Company recorded \$0.7 million of unrecognized tax benefits. Final recognition of those benefits would result in corresponding unrecognized tax obligations of \$0.6 million. Accordingly, the net impact on retained earnings for the cumulative effect of adopting FIN 48 was \$0.1 million. The Company recorded an additional \$2.2 million and \$44,400 of net unrecognized tax benefits in the years ended December 31, 2008 and 2007, respectively.

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A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

| | Year ended December 31, 2008 | Year ended December 31, 2007 |
|--|---------------------------------------|------------------------------------|
| | <i>(In thousands)</i> | |
| Unrecognized tax benefits at beginning of year | \$ 104 | \$ 60 |
| Gross increases prior year tax positions | 96 | |
| Gross decreases prior year tax positions | | (33) |
| Gross increases current year tax positions | 2,034 | 77 |
| Lapse of statute of limitations | 93 | |
| Unrecognized tax benefits at end of year | \$ 2,327 | \$ 104 |

Of the balance of unrecognized tax benefits at December 31, 2008, \$2.0 million relates to positions taken with regard to certain state income tax filings. A corresponding deferred tax asset in the amount of \$0.7 million has been established for the related federal tax benefit. Of the \$2.3 million unrecognized income tax benefits at December 31, 2008, \$1.6 million would affect the Company's effective tax rate if recognized. The Company does not anticipate a material change to the total amount of unrecognized tax benefits within the next twelve months.

Interest and penalties related to income tax liabilities are included in Other Expense. As a result of the implementation of FIN 48, the Company recorded a cumulative effect adjustment to retained earnings of \$6,700 for accrued interest and \$68,200 for penalties on unrecognized tax benefits. During the years ended December 31, 2008 and 2007, the Company recorded \$33,300 and \$6,800 of additional interest, respectively, and \$8,800 and \$71,300 of additional penalties, respectively, on unrecognized tax benefits.

The Company files U.S., state and foreign income tax returns in jurisdictions with various statutes of limitations. The 2005 through 2008 tax years remain subject to examination at December 31, 2008. The Company's consolidated Federal tax return for the year ended December 31, 2006 is currently under examination. Annual tax provisions include amounts considered necessary to pay assessments that may result from examination of prior year tax returns, however, the amount ultimately paid upon resolution of issues may differ materially from the amount accrued. No significant state tax returns nor any foreign tax returns are currently under examination. At December 31, 2008 and 2007, the Company had no net operating loss or credit carry forwards.

11. STOCKHOLDERS EQUITY AND MEMBERS EQUITY

On January 23, 2006, the Company completed a reverse stock split, 1 for 1.25, of its common and preferred stock and correspondingly adjusted the number of options issued and available for issuance under the 2004 Plan. All numbers of common stock, preferred stock and per share data in the accompanying consolidated financial statements and related notes have been retroactively restated to give effect to the reverse stock split and the changes to the 2004 Plan.

On February 9, 2006, the Company completed an initial public offering (IPO) of 5.8 million shares of its common stock, from which the Company received net proceeds of \$86.3 million (after deducting the underwriting discounts and commissions). The Company had incurred \$2.1 million in stock issuance costs. Subsequent to the IPO, these costs were charged against additional paid in capital on the consolidated balance sheet. In addition, at the closing of the IPO, all outstanding shares of the Company's redeemable convertible preferred stock converted into common stock and, as a result, the Company did not record any additional charge associated with the change in fair value of the conversion feature of the redeemable convertible preferred stock after such date. Prior to the IPO, this redeemable convertible preferred stock was classified as mezzanine equity on the consolidated balance sheet and the fair value of the related conversion feature was classified as a liability

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on the consolidated balance sheet. Also as a result of the conversion of all outstanding shares of redeemable convertible preferred stock into shares of common stock, all rights of the holders of such shares to receive accrued dividends or to exercise redemption rights terminated. As a result, the accretion relating to the Company's redeemable convertible preferred stock also terminated.

Finally, as a result of the Company's IPO, the rights of certain holders of the Company's common stock to have their shares redeemed by the Company terminated. Prior to the IPO, this redeemable common stock was classified as mezzanine equity on the consolidated balance sheet and the Company recorded periodic accretions of the redemption value of such shares at each balance sheet date. Because this redemption right expired upon the IPO, the Company will no longer be recording the periodic accretions related to these redemption rights, and these shares of common stock will no longer be recorded as mezzanine equity on the consolidated balance sheet but, instead, as shares of common stock within shareholders' equity.

On May 7, 2008, the Company announced that the Board of Directors had authorized a tender offer to purchase shares of its common stock not to exceed an aggregate purchase price of \$50.0 million. The tender offer commenced on May 14, 2008 and settled on June 19, 2008 with the Company purchasing and retiring 2.2 million shares at a cost of \$18.6 million, including expenses.

In December 2008 the Company initiated a program previously approved by the board of directors to repurchase up to \$10.0 million in shares of Company common stock. As of December 31, 2008, the Company had purchased and retired 1.1 million shares at a cost of \$4.5 million pursuant to such program. The remaining \$5.5 million authorized to be repurchased under the program was purchased in January 2009 and resulted in the retirement of another 1.1 million shares. All shares were repurchased in the open market at the discretion of the Company.

Redeemable Common Stock At any time subsequent to March 31, 2006, three of the Company's common stockholders who are also executives of the Company could require the Company to repurchase up to 1,671,429 shares of common stock. The repurchase price was the estimated market value of the common stock at the date of repurchase. Each of the stockholders could require a redemption one time only. This redeemable common stock was classified as mezzanine equity on the consolidated balance sheet and periodic accretions were recorded such that the recorded value was equal to the redemption value at each balance sheet date. This redemption right expired upon completion of the IPO. On the date of issuance, March 31, 2004, the estimated fair value of the redeemable common stock was approximately \$1.3 million which was recorded as mezzanine equity. The Company accreted the carrying value of such stock to its redemption value for each reporting period until expiration in 2006.

Dividends In September 2005, the Company's Board of Directors declared two special dividends. The first dividend was \$13.0 million or \$0.549 per share for each share of common stock and preferred stock outstanding as of September 9, 2005, the record date. This dividend was distributed to the Company's stockholders in September 2005 and was funded by a term loan facility from Comerica Bank (see Note 6). The second dividend was paid on February 9, 2006, when the Company borrowed an additional \$7.0 million under its term loan facility and distributed the full amount as a special dividend to the holders of common stock and then-outstanding redeemable convertible preferred stock.

Except for the special distributions noted above, the Company has never declared or paid any cash dividend in 2008, 2007, or 2006.

12. DERIVATIVE FINANCIAL INSTRUMENTS

The Company recognizes all derivatives on the consolidated balance sheet at fair value. The Company designates at inception whether the derivative contract is considered hedging or non-hedging in accordance with SFAS 133.

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During the year ended December 31, 2007, the Company entered into two interest rate swap contracts with a combined notional amount of \$100.0 million in connection with its outstanding debt. The contracts were to expire on September 30, 2009 and 2010, respectively. These contracts, while in effect, maintained an effective interest rate of approximately 7.40%.

In December 2008, the Company settled the two interest rate swap contracts entered into during 2007 resulting in a cash payment of \$5.3 million. The pre-tax net unrealized loss within accumulated other comprehensive income associated with the cancelled interest rate swap contracts of \$5.3 million will be amortized to interest expense over the original lives of the contracts. The cancelled swaps were replaced with five interest rate swaps with a combined notional amount of \$93.5 million. All contracts expire on June 30, 2014 and, while in effect, maintain an effective interest rate on the Company's outstanding debt of approximately 4.95%.

The contracts are in place to maintain compliance with debt requirements and to protect the Company against changes in the interest payments associated with its variable-rate long-term debt, and therefore are considered cash flow hedges. As a result, as long as the swap is deemed highly effective, changes in the fair value of the swaps are recorded as either an asset (a gain position), or a liability (a loss position) on the balance sheet, with the offset recorded in accumulated other comprehensive income, a separate component of shareholders' equity. For the year ended December 31, 2008 and 2007 the amount of hedge ineffectiveness was immaterial.

At December 31, 2008 and December 31, 2007, the fair value of the open interest rate swap contracts resulted in net unrealized losses of \$1.4 million and \$2.7 million, respectively.

13. FAIR VALUE MEASUREMENTS

SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The Company uses quoted market prices for identical assets to measure fair value of its money market funds and therefore considers all of the Company's money market funds as Level 1.

The inputs used to determine the fair value of the Company's interest rate swaps based on the fair value hierarchy described above are regarded as Level 2. As discussed in Note 6 above, the Company's interest rate swap is based on a LIBOR rate. Fair value for the interest rate swap is based on a model-derived valuation using the LIBOR rate, which is observable at commonly quoted intervals for the full term of the swap.

The Company does not have any financial assets or liabilities measured using Level 3 inputs of the fair value hierarchy.

The fair value of money market funds using Level 1 inputs on a recurring basis as of December 31, 2008 was \$35.3 million. The fair value of the interest rate swap contracts using Level 2 inputs on a recurring basis as of December 31, 2008 was a liability of \$1.4 million.

Table of Contents**14. RESTRUCTURING CHARGE**

During the year ended December 31, 2008, the Company recorded a pre-tax charge of \$0.7 million in accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* (SFAS 146). The charge was comprised of (i) \$0.5 million pertaining to vacated leased facilities, principally those located in Ann Arbor, Michigan and Coeur d Alene, Idaho and (ii) fixed asset impairment charges of \$0.2 million for leasehold improvements and furniture and fixtures within the vacated leased facilities that no longer have value to the Company. The accrual related to vacated facilities is calculated net of any estimated sublease income which is estimated based on current market quotes for similar properties. If the Company is unable to sublet the vacated properties on a timely basis or is forced to sublet them at lower rates due to changes in market conditions, the Company will adjust the accruals accordingly. The charge was recognized in sales, general, and administrative expense. The Company made cash payments and non-cash adjustments to the reserve of \$0.3 million. The reserve amount at December 31, 2008 totaled \$0.4 million.

15. QUARTERLY OPERATING RESULTS (unaudited)

The unaudited operating results for the Company by quarter for 2008 and 2007 are as follows:

| | March 31 | June 30 | Quarter Ended September 30 (in thousands) | December 31 |
|-------------------------------|-----------|-----------|---|-------------|
| 2008 | | | | |
| Operating Revenues | \$ 41,688 | \$ 42,758 | \$ 43,441 | \$ 39,720 |
| Operating Income | 2,853 | 6,300 | 6,905 | 5,572 |
| Net Income | 731 | 2,771 | 3,283 | 2,657 |
| Earnings Per Share (Basic): | 0.02 | 0.09 | 0.11 | 0.09 |
| Earnings Per Share (Diluted): | 0.02 | 0.09 | 0.11 | 0.09 |
| 2007 | | | | |
| Operating Revenues | \$ 25,882 | \$ 37,923 | \$ 45,151 | \$ 42,706 |
| Operating Income | 6,194 | 6,086 | 7,720 | 6,127 |
| Net Income | 4,332 | 3,514 | 3,788 | 3,060 |
| Earnings Per Share (Basic): | 0.14 | 0.12 | 0.13 | 0.10 |
| Earnings Per Share (Diluted): | 0.14 | 0.11 | 0.12 | 0.10 |

ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

During the years ended December 31, 2008 and 2007, there were no changes in, or disagreements with, accountants on accounting and financial disclosure matters.

ITEM 9A. Controls and Procedures**(a) Evaluation of disclosure controls and procedures.**

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the Exchange Act). In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

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Based on management's evaluation, our chief executive officer and chief financial officer concluded that, as of December 31, 2008, our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

(b) Changes in internal control over financial reporting.

We regularly review our system of internal control over financial reporting and make changes to our processes and systems to improve controls and increase efficiency, while ensuring that we maintain an effective internal control environment. Changes may include such activities as implementing new, more efficient systems, consolidating activities, and migrating processes.

There were no changes in our internal control over financial reporting that occurred during the period covered by this Annual Report on Form 10-K that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

(c) Management's report on internal control over financial reporting.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Exchange Act Rule 13a-15(f). Management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that our internal control over financial reporting was effective as of December 31, 2008. Management reviewed the results of its assessment with our Audit Committee. The effectiveness of our internal control over financial reporting as of December 31, 2008 has been audited by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in its report which is included below.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

NightHawk Radiology Holdings, Inc.

Coeur d'Alene, ID

We have audited the internal control over financial reporting of NightHawk Radiology Holdings, Inc. and subsidiaries (the Company) as of December 31, 2008, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule as of and for the year ended December 31, 2008 of the Company and our report dated February 18, 2009, expressed an unqualified opinion on those financial statements and financial statement schedule.

/s/ DELOITTE & TOUCHE LLP

Boise, ID

February 18, 2009

Table of Contents**ITEM 9B. Other Information**

None.

PART III**ITEM 10. Directors, Executive Officers and Corporate Governance**

Information required by Item 10 of Part III is included in our Proxy Statement relating to our 2009 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 11. Executive Compensation

Information required by Item 11 of Part III is included in our Proxy Statement relating to our 2009 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information required by Item 12 of Part III is included in our Proxy Statement relating to our 2009 Annual Meeting of Shareholders and is incorporated herein by reference.

Securities Authorized for Issuance Under Equity Compensation Plans

The following table sets forth information about our equity compensation plans as of December 31, 2008:

| Plan category | (a) Number of securities to be issued upon exercise of outstanding options, warrants and rights | (b) Weighted-average exercise price of outstanding options, warrants and rights (2) | (c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities) |
|---|---|---|---|
| Equity compensation plans approved by security holders | 944,084 | \$ 4.16 | |
| Equity compensation plans not approved by security holders (1) | 3,247,041 | 15.10 | 107,272 |
| Total | 4,191,125 | \$ 12.27 | 107,272 |

- (1) The 2004 Stock Plan permits only grants of nonstatutory stock options and therefore did not require stockholder approval. We did obtain the requisite consent from certain stockholders for the adoption of the 2004 Stock Plan pursuant to a contractual obligation.
- (2) The weighted-average exercise price does not take in to account the shares issuable upon vesting of outstanding restricted stock unit awards, which have no exercise price.

ITEM 13. Certain Relationships and Related Transactions and Director Independence

Information required by Item 13 of Part III is included in our Proxy Statement relating to our 2008 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 14. Principal Accounting Fees and Services

Information required by Item 14 of Part III is included in our Proxy Statement relating to our 2008 Annual Meeting of Shareholders and is incorporated herein by reference.

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PART IV

ITEM 15. Exhibits, Financial Statement Schedules

(a) The following documents are filed as part of this report:

1) Consolidated Financial Statements: See Index to Consolidated Financial Statements at Item 8 on page 44 of this report.

2) Financial Statement Schedule: Schedule II Consolidated Valuation and Qualifying Accounts

Financial statement schedules not listed above are omitted because they are not required or are not applicable, or the required information is presented in the financial statements including the notes thereto. Captions and column headings have been omitted where not applicable.

Table of Contents**NightHawk Radiology Holdings, Inc.****SCHEDULE II CONSOLIDATED VALUATION AND QUALIFYING ACCOUNTS**

| | Balance at Beginning of Period | Charged (Credited) to Costs and Expenses | Deductions/ Write-offs | Balance at End of Period |
|--|---|---|-----------------------------------|-------------------------------------|
| <i>Allowance for Doubtful Accounts</i> | | | | |
| Year ended December 31, 2006 | 311,681 | 468,407 | 400,493 | 379,595 |
| Year ended December 31, 2007 | 379,595 | 378,687 | 156,436 | 601,846 |
| Year ended December 31, 2008 | 601,846 | 1,301,827 | 753,944 | 1,149,729 |
| | Balance at Beginning of Period | Charged (Credited) to Costs and Expenses | Deductions/ Write-offs | Balance at End of Period |
| <i>Allowance for Sales Credits</i> | | | | |
| Year ended December 31, 2006 | 40,000 | 0 | 15,000 | 25,000 |
| Year ended December 31, 2007 | 25,000 | 25,000 | 0 | 50,000 |
| Year ended December 31, 2008 | 50,000 | 50,000 | 0 | 100,000 |

3) Exhibits are incorporated herein by reference or are filed with this report as set forth below:
The exhibits to this report are listed in the Exhibit Index set forth below.

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EXHIBIT INDEX

Exhibit

| Number | Description |
|---------------|--|
| 3.1(1) | Form of Amended and Restated Certificate of Incorporation of the registrant. |
| 3.2(1) | Form of Amended and Restated Bylaws of the registrant. |
| 4.1(2) | Form of registrant's common stock certificate. |
| 4.2(1) | Registration Agreement, dated March 31, 2004, between the registrant and certain holders of the registrant's common stock as named therein. |
| 10.1(1) | Form of Indemnification Agreement to be entered into between the registrant and its directors and officers. |
| 10.2(1)* | 2004 Stock Plan. |
| 10.3(1)* | Form of Stock Option Agreement under the 2004 Stock Plan. |
| 10.4(2)* | 2006 Equity Incentive Plan. |
| 10.5(2)* | Form of Stock Option Agreement under the 2006 Equity Incentive Plan. |
| 10.6(1) | Sublease Agreement, dated October 14, 2003, among Nighthawk Radiology Services, LLC, Commonwealth Funds Management Limited and BT Funds Management Limited for property in Sydney, Australia. |
| 10.7(1) | Sublease Agreement, dated October 1, 2004, among Nighthawk Radiology Services, LLC, Commonwealth Custodial Services Limited, Commonwealth Funds Management Limited and Investa Properties Limited for property in Sydney, Australia. |
| 10.8(1) | Lease Agreement, dated September 1, 2004, between NightHawk Radiology AG and PSP Real Estate for property in Zurich, Switzerland. |
| 10.9(1) | Agreement and Plan of Merger and Reorganization, dated September 30, 2005, among the registrant, ATN Merger Sub, Inc. and American Teleradiology Nighthawks, Inc. |
| 10.10(4) | Lease Agreement, dated October 18, 2005, between Nighthawk Radiology Services, LLC and Miller Stauffer Properties, L.L.C. for property in Coeur d'Alene, Idaho. |
| 10.11(5) | Business Lease, dated December 1, 2005, between Nighthawk Services GmbH and PSP Management AG for property in Zurich, Switzerland. |
| 10.12(6) | Building Lease, dated May 12, 2006, between Nighthawk Radiology Services, LLC and WT 215 North Water, LLC for property in Milwaukee, Wisconsin. |
| 10.13(9) | Office Lease, dated November 20, 2006, between NightHawk Radiology Services, LLC and Quatro Investments. |
| 10.14(11) | Office Lease, dated January 5, 2007, between NightHawk Radiology Services, LLC and Four Embarcadero Center Venture. |
| 10.15(12)* | Board of Directors Compensation Policy, dated February 14, 2007. |
| 10.16(13) | Membership Interest Purchase Agreement dated July 16, 2007 between the Company, SPR Holdings II, LLC, Midwest Physicians Services, LLC, and Emergency Radiology Services, LLC. |
| 10.17(14) | Amended and Restated Credit Agreement dated July 10, 2007 between the Company, Morgan Stanley Senior Funding, Inc. and the Lenders thereto. |
| 10.18(14) | Amended and Restated Guaranty and Collateral Agreement dated July 10, 2007 between the Company and Morgan Stanley & Co. Incorporated, as Collateral Agent. |

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Exhibit

| Number | Description |
|---------------|--|
| 10.19(14)** | Administrative Support Services Agreement dated July 16, 2007 between Midwest Physician Services, LLC (a wholly-owned subsidiary of the Company) and St. Paul Radiology P.A. |
| 10.20(14)** | Administrative Support Services Agreement dated July 16, 2007 between Midwest Physician Services, LLC (a wholly-owned subsidiary of the Company) and Midwest Radiology, LLC. |
| 10.21(15)* | Employment Agreement, dated February 19, 2008, between the Company and Tim Murnane. |
| 10.22(16)* | Employment Agreement, dated May 16, 2008, between the Company and David Sankaran. |
| 10.23(17)* | Transition and Separation Agreement, dated November 14, 2008, between the Company and Paul Berger, M.D. |
| 10.24(17)* | Transition and Separation Agreement, dated November 14, 2008, between the Company and Jon D. Berger. |
| 10.25(18)* | Employment Agreement, dated December 23, 2008, between the Company and David Engert. |
| 10.26* | Amended and Restated employment agreement, dated December 31, 2008, between the Company and Tim Murnane. |
| 10.27* | Amended and Restated employment agreement, dated December 31, 2008, between the Company and David Sankaran. |
| 10.28(19) | Registration Rights Agreement, dated January 6, 2009, between the Company and Dr. Paul Berger, M.D. and Mr. Jon Berger. |
| 21.1(20) | Subsidiaries of the registrant. |
| 23.1 | Consent of Deloitte & Touche LLP. |
| 24.1 | Power of Attorney (contained on the signature page hereto). |
| 31.1 | Certification of Principal Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Principal Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| (1) | Incorporated by reference to the Registration Statement on Form S-1 (No. 333-128820) filed by the registrant on October 5, 2005, as amended. |
| (2) | Incorporated by reference to the Registration Statement on Form S-1 (No. 333-128820) filed by the registrant on January 24, 2006, as amended. |
| (3) | Incorporated by reference to the Registration Statement on Form S-1 (No. 333-128820) filed by the registrant on November 25, 2005, as amended. |
| (4) | Incorporated by reference to the Registration Statement on Form S-1 (No. 333-128820) filed by the registrant on November 8, 2005, as amended. |
| (5) | Incorporated by reference to the Registration Statement on Form S-1 (No. 333-128820) filed by the registrant on December 22, 2005, as amended. |
| (6) | Incorporated by reference to Form 8-K (No. 000-51786) filed by the registrant on May 15, 2006. |
| (7) | Incorporated by reference to Form 8-K (No. 000-51786) filed by the registrant on June 26, 2006. |
| (8) | Incorporated by reference to Form 8-K (No. 000-51786) filed by the registrant on October 27, 2006. |
| (9) | Incorporated by reference to Form 8-K (No. 000-51786) filed by the registrant on November 24, 2006. |

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- (10) Incorporated by reference to Form 8-K (No. 000-51786) filed by the registrant on January 11, 2007.
 - (11) Incorporated by reference to Form 8-K (No. 000-51786) filed by the registrant on January 11, 2007.
 - (12) Incorporated by reference to the Registration Statement on Form 10-K (No. 000-51786) filed by the registrant on March 6, 2007.
 - (13) Incorporated by reference to Form 8-K (No. 000-51786) filed by the registrant on July 17, 2007.
 - (14) Incorporated by reference to the Registration Statement on Form 10-Q (No. 000-51786) filed by the registrant on August 1, 2007.
 - (15) Incorporated by reference to Form 8-K (No. 000-51786) filed by the registrant on February 25, 2008.
 - (16) Incorporated by reference to Form 8-K (No. 000-51786) filed by the registrant on May 19, 2008.
 - (17) Incorporated by reference to Form 8-K (No. 000-51786) filed by the registrant on November 17, 2008.
 - (18) Incorporated by reference to Form 8-K (No. 000-51786) filed by the registrant on December 24, 2008.
 - (19) Incorporated by reference to Form 8-K (No. 000-51786) filed by the registrant on January 8, 2009.
 - (20) Incorporated by reference to the Annual Report on Form 10-K (No. 000-51786) filed by the registrant on February 19, 2008.
- * Indicates a management contract or compensatory plan or arrangement.
- ** Registrant has omitted portions of the referenced exhibit and filed such exhibit separately with the Securities and Exchange Commission pursuant to a request for confidential treatment.

Table of Contents**SIGNATURES**

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

NIGHTHAWK RADIOLOGY HOLDINGS, INC.

By: /s/ DAVID M. ENGERT
David M. Engert

President and Chief Executive Officer

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints David M. Sankaran and Paul E. Cartee and each of them, with full power of substitution and resubstitution and full power to act without the other, as his or her true and lawful attorney-in-fact and agent to act in his or her name, place and stead and to execute in the name and on behalf of each person, individually and in each capacity stated below, and to file, any and all documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing, ratifying and confirming all that said attorneys-in-fact and agents or any of them or their and his or her substitute or substitutes, may lawfully do or cause to be done by virtue thereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated and on the dates indicated.

| Signature | Title | Date |
|---|--|-------------------|
| /s/ DAVID M. ENGERT David M. Engert | President, Chief Executive Officer and Director (Principal Executive Officer) | February 19, 2009 |
| /s/ DAVID M. SANKARAN David M. Sankaran | Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer) | February 19, 2009 |
| /s/ PAUL E. BERGER, M.D. Paul E. Berger, M.D. | Director | February 19, 2009 |
| /s/ DAVID J. BROPHY, PH.D. David J. Brophy, Ph.D. | Director | February 19, 2009 |
| /s/ PETER Y. CHUNG Peter Y. Chung | Director | February 19, 2009 |
| /s/ CHARLES R. BLAND Charles R. Bland | Director | February 19, 2009 |