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)

x **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)

Delaware	**87-0722777**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**
601 Front Avenue, Suite #502, C ur d Alene, Idaho	**83814**
(Address of principal executive offices)	**(Zip code)**

(208) 676-8321

(Registrant s telephone number, including area code)

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

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 x

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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 x	Non-accelerated filer ¨ (do not check if a smaller reporting company)	Smaller reporting company ¨

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

As of June 30, 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 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.

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 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 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.

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 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.

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 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 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 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 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 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 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 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.

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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.

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PART II

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

Our common stock 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

Holders

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.

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Performance Graph

The performance graph below illustrates a comparison of cumulative total stockholder return data based on an initial investment of $100 in 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

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ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

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

	For the Years Ended December 31, (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

$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 Service*s (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;

- 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.

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 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

	(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)			
	2008	2007	In Dollars	Percentage
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)			
	2008	2007	In Dollars	Percentage
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)			
	2008	2007	In Dollars	Percentage
Interest expense	$ 8,508	$ 5885	$ 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	
	(Dollars in thousands)			
	2008	2007	In Dollars	Percentage
Income tax expense	$ 5,257	$ 8,615	$ (3,358)	(39)%
Percentage of service revenue	*3%*	*6%*		

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	
	(Dollars in thousands)			
	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	
	(Dollars in thousands)			
	2007	2006	In Dollars	Percentage
Professional services	$ 63,618	$ 38,963	$ 24,655	63%
Percentage of service revenue	*42%*	*42%*		

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

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

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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	
	(Dollars in thousands)			
	2007	2006	In Dollars	Percentage
Interest expense	$ 5,885	$ 562	$ 5,323	947%
Percentage of service revenue	*(4)%*	*(1)%*		

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	
	(Dollars in thousands)			
	2007	2006	In Dollars	Percentage
Change in fair value of redeemable preferred stock conversion feature	$	$ 44,184	$ 44,184	(100)%
Percentage of service revenue	*%*	*(48)%*		

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

Income Tax Expense

	Year Ended December 31,		Change	
	(Dollars in thousands)			
	2007	2006	In Dollars	Percentage
Income tax expense	$ 8,615	$ 10,048	$ (1,432)	(14)%
Percentage of service revenue	*6%*	*11%*		

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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

	December 31, 2008	December 31, 2007
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

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.

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Contractual Obligations

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

(in millions)	Payments Due Within				
	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years	Total
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

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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.

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NIGHTHAWK RADIOLOGY HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

	December 31, 2008	December 31, 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.

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NIGHTHAWK RADIOLOGY HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY (DEFICIT)

(In thousands, except share data)

	Common Stock			Other Comprehensive	Retained	
	Shares	Amount	Additional Paid-in Capital	Income (Loss)	Earnings (Deficit)	Total
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.

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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

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

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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)	

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