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PRIMEDEX HEALTH SYSTEMS INC

Form 10-K/A

October 02, 2006

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON D.C. 20549

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FORM 10-K/A  
(AMENDMENT NO. 1)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF  
1934

For the fiscal year ended October 31, 2005  
Commission File Number 0-19019

PRIMEDEX HEALTH SYSTEMS, INC.  
(Exact name of registrant as specified in its charter)

NEW YORK  
(State or other jurisdiction of  
incorporation or organization)

13-3326724  
(I.R.S. Employer  
Identification No.)

1510 COTNER AVENUE  
LOS ANGELES, CALIFORNIA  
(Address of principal executive offices)

90025  
(Zip code)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (310) 478-7808

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT: NONE

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:  
COMMON STOCK, \$.01 PAR VALUE

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 and Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

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

The aggregate market value of the registrant's voting and non-voting common equity held by non-affiliates of the registrant was approximately \$15,209,521 on April 30, 2005 (the last business day of the registrant's most recently

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completed second quarter) based on the closing price for the common stock on the Nasdaq Over-the-Counter Bulletin Board on April 29, 2005.

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes  No

The number of shares of the registrant's common stock outstanding on January 9, 2006, was 41,406,813 shares (excluding treasury shares).

Explanatory Note: This Amendment No. 1 on Form 10-K/A (this "Amendment") to our Annual Report on Form 10-K for the fiscal year ended October 31, 2005 includes a new discussion in Item 7. under "Results of Operations" with respect to our evaluation of disclosure controls and procedures, clarifies our discussion in Item 9a. and adds a paragraph to our CEO and CFO certifications filed as Exhibits 31.1 and 31.2.

### PART I

#### ITEM 1. BUSINESS

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##### BUSINESS OVERVIEW

We operate a group of regional networks comprised of 57 fixed-site, freestanding outpatient diagnostic imaging facilities in California. We believe our group of regional networks is the largest of its kind in California. We have strategically organized our facilities into regional networks in markets that have both high-density and expanding populations, as well as attractive payor diversity.

All of our facilities employ state-of-the-art equipment and technology in modern, patient-friendly settings. Many of our facilities within a particular region are interconnected and integrated through our advanced information technology system. Thirty four of our facilities are multi-modality sites, offering various combinations of magnetic resonance imaging, or MRI, computed tomography, or CT, positron emission tomography, or PET, nuclear medicine, mammography, ultrasound, diagnostic radiology, or X-ray and fluoroscopy. Twenty three of our facilities are single-modality sites, offering either X-ray or MRI. Consistent with our regional network strategy, we locate our single-modality facilities near multi-modality sites to help accommodate overflow in targeted demographic areas.

At our facilities, we provide all of the equipment as well as all non-medical operational, management, financial and administrative services necessary to provide diagnostic imaging services. We give our facility managers authority to run our facilities to meet the demands of local market conditions, while our corporate structure provides economies of scale, corporate training programs, standardized policies and procedures and sharing of best practices across our networks. Each of our facility managers is responsible for meeting our standards of patient service, managing relationships with local physicians and payors and maintaining profitability.

Howard G. Berger, M.D. is our President and Chief Executive Officer, a

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member of our Board of Directors and owns approximately 30% of our outstanding common stock. Dr. Berger also owns, indirectly, 99% of the equity interests in Beverly Radiology Medical Group III, or BRMG. BRMG provides all of the professional medical services at 42 of our facilities under a management agreement with us, and contracts with various other independent physicians and physician groups to provide the professional medical services at most of our other facilities. We obtain professional medical services from BRMG, rather than provide such services directly or through subsidiaries, in order to comply with California's prohibition against the corporate practice of medicine. However, as a result of our close relationship with Dr. Berger and BRMG, we believe that we are able to better ensure that medical service is provided at our facilities in a manner consistent with our needs and expectations and those of our referring physicians, patients and payors than if we obtained these services from unaffiliated physician groups.

We derive substantially all of our revenue, directly or indirectly, from fees charged for the diagnostic imaging services performed at our facilities. For the year ended October 31, 2005, we performed 958,414 diagnostic imaging procedures and generated net revenue from continuing operations of \$145.6 million.

The following table illustrates our work performed over the five-year period ended October 31, 2005:

|   | YEAR ENDED OCTOBER 31 |         |         |         |
|---|-----------------------|---------|---------|---------|
|   | 2001                  | 2002    | 2003    | 2004    |
| Total number of MRI, CT and PET systems (at end of year)* | 52                    | 60      | 63      | 63      |
| Total number of procedures performed*                     | 690,484               | 877,574 | 947,032 | 947,032 |

\* All procedures. Excludes discontinued operation.

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### INDUSTRY OVERVIEW

Diagnostic imaging involves the use of non-invasive procedures to generate representations of internal anatomy and function that can be recorded on film or digitized for display on a video monitor. Diagnostic imaging procedures facilitate the early diagnosis and treatment of diseases and disorders and may reduce unnecessary invasive procedures, often minimizing the cost and amount of care for patients. Diagnostic imaging procedures include MRI, CT, PET, nuclear medicine, ultrasound, mammography, X-ray and fluoroscopy.

While general X-ray remains the most commonly performed diagnostic imaging procedure, the fastest growing and higher margin procedures are MRI, CT and PET. The rapid growth in PET scans is attributable to the recent introduction of reimbursement by payors of PET procedures. The number of MRI and CT scans continues to grow due to their wider acceptance by physicians and payors, an increasing number of applications for their use and a general increase in demand due to the aging population in the United States.

IMV, a provider of database and market information products and services to the analytical, clinical diagnostic, biotechnology, life science and medical imaging industries, estimates that over 24.2 million MRI procedures and 50.1

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million CT procedures were conducted in the United States in 2003, representing a 10% increase over the 2002 volume of both the MRI and CT procedures, respectively. This data is particularly relevant to us, given that revenue from MRI and CT scans constituted approximately 60% of our net revenue for the year ended October 31, 2005. In addition, IMV estimates that over 706,100 clinical PET patient studies were performed in the United States in 2003, representing a 58% increase over the 2002 volume of 447,200 clinical PET patient studies. Revenue from PET scans constituted approximately 6% of our net revenue for the year ended October 31, 2005.

### INDUSTRY TRENDS

We believe that the diagnostic imaging services industry will continue to grow as a result of a number of factors, including the following:

#### ESCALATING DEMAND FOR HEALTHCARE SERVICES FROM AN AGING POPULATION

Persons over the age of 65 comprise one of the fastest growing segments of the population in the United States. According to the United States Census Bureau, this group is expected to increase as much as 14% from 2000 to 2010. Because diagnostic imaging use tends to increase as a person ages, we believe the aging population will generate more demand for diagnostic imaging procedures.

#### NEW EFFECTIVE APPLICATIONS FOR DIAGNOSTIC IMAGING TECHNOLOGY

New technological developments are expected to extend the clinical uses of diagnostic imaging technology and increase the number of scans performed. Recent technological advancements include:

- o MRI spectroscopy, which can differentiate malignant from benign lesions;
- o MRI angiography, which can produce three-dimensional images of body parts and assess the status of blood vessels;
- o Enhancements in teleradiology systems, which permit the digital transmission of radiological images from one location to another for interpretation by radiologists at remote locations; and
- o The development of combined PET/CT scanners, which combine the technology from PET and CT to create a powerful diagnostic imaging system.

Additional improvements in imaging technologies, contrast agents and scan capabilities are leading to new non-invasive methods of diagnosing blockages in the heart's vital coronary arteries, liver metastases, pelvic diseases and vascular abnormalities without exploratory surgery. We believe that the use of the diagnostic capabilities of MRI and other imaging services will continue to increase because they are cost-effective, time-efficient and non-invasive, as compared to alternative procedures, including surgery, and that newer technologies and future technological advancements will continue the increased use of imaging services. In addition, we believe the growing popularity of elective full-body scans will further increase the use of imaging services. At

the same time, we believe the industry has increasingly used upgrades to existing equipment to expand applications, extend the useful life of existing equipment, improve image quality, reduce image acquisition time and increase the

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volume of scans that can be performed. We believe this trend toward equipment upgrades rather than equipment replacements will continue, as we do not foresee new imaging technologies on the horizon that will displace MRI, CT or PET as the principal advanced diagnostic imaging modalities.

### WIDER PHYSICIAN AND PAYOR ACCEPTANCE OF THE USE OF IMAGING

During the last 30 years, there has been a major effort undertaken by the medical and scientific communities to develop higher quality, cost-effective diagnostic imaging technologies and to minimize the risks associated with the application of these technologies. The thrust of product development during this period has largely been to reduce the hazards associated with conventional x-ray and nuclear medicine techniques and to develop new, harmless imaging technologies. As a result, the use of advanced diagnostic imaging modalities, such as MRI, CT and PET, which provide superior image quality compared to other diagnostic imaging technologies, has increased rapidly in recent years. These advanced modalities allow physicians to diagnose a wide variety of diseases and injuries quickly and accurately without exploratory surgery or other surgical or invasive procedures, which are usually more expensive, involve greater risk to patients and result in longer rehabilitation time. Because advanced imaging systems are increasingly seen as a tool for reducing long-term healthcare costs, they are gaining wider acceptance among payors.

### GREATER CONSUMER AWARENESS OF AND DEMAND FOR PREVENTIVE DIAGNOSTIC SCREENING

Diagnostic imaging is increasingly being used as a screening tool for preventive care such as elective full-body scans. Consumer awareness of and demand for diagnostic imaging as a less invasive and preventive screening method has added to the growth in diagnostic imaging procedures. We believe that further technological advancements will create demand for diagnostic imaging procedures as less invasive procedures for early diagnosis of diseases and disorders.

### DIAGNOSTIC IMAGING SETTINGS

Diagnostic imaging services are typically provided in one of the following settings:

#### FIXED-SITE, FREESTANDING OUTPATIENT DIAGNOSTIC FACILITIES

These facilities range from single-modality to multi-modality facilities and are not generally owned by hospitals or clinics. These facilities depend upon physician referrals for their patients and generally do not maintain dedicated, contractual relationships with hospitals or clinics. In fact, these facilities may compete with hospitals or clinics that have their own imaging systems to provide services to these patients. These facilities bill third-party payors, such as managed care organizations, insurance companies, Medicare or Medi-Cal. All of our facilities are in this category.

#### HOSPITALS OR CLINICS

Many hospitals provide both inpatient and outpatient diagnostic imaging services, typically on site. These inpatient and outpatient centers are owned and operated by the hospital or clinic, or jointly by both, and are primarily used by patients of the hospital or clinic. The hospital or clinic bills third-party payors, such as managed care organizations, insurance companies, Medicare or Medi-Cal.

#### MOBILE FACILITIES

Using specially designed trailers, imaging service providers transport

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imaging equipment and provide services to hospitals and clinics on a part-time or full-time basis, thus allowing small to mid-size hospitals and clinics that do not have the patient demand to justify an on-site setting access to advanced diagnostic imaging technology. Diagnostic imaging providers contract directly with the hospital or clinic and are typically reimbursed directly by them.

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### DIAGNOSTIC IMAGING MODALITIES

The principal diagnostic imaging modalities we use at our facilities are:

#### MRI

MRI has become widely accepted as the standard diagnostic tool for a wide and fast-growing variety of clinical applications for soft tissue anatomy, such as those found in the brain, spinal cord and interior ligaments of body joints such as the knee. MRI uses a strong magnetic field in conjunction with low energy electromagnetic waves that are processed by a computer to produce high-resolution, three-dimensional, cross-sectional images of body tissue, including the brain, spine, abdomen, heart and extremities. A typical MRI examination takes from 20 to 45 minutes. MRI systems can have either open or closed designs, routinely have magnetic field strength of 0.2 Tesla to 3.0 Tesla and are priced in the range of \$0.6 million to \$2.5 million.

#### CT

CT provides higher resolution images than conventional X-rays, but generally not as well-defined as those produced by MRI. CT uses a computer to direct the movement of an X-ray tube to produce multiple cross-sectional images of a particular organ or area of the body. CT is used to detect tumors and other conditions affecting bones and internal organs. It is also used to detect the occurrence of strokes, hemorrhages and infections. A typical CT examination takes from 15 to 45 minutes. CT systems are priced in the range of \$0.3 million to \$1.2 million.

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#### PET

PET scanning involves the administration of a radiopharmaceutical agent with a positron-emitting isotope and the measurement of the distribution of that isotope to create images for diagnostic purposes. PET scans provide the capability to determine how metabolic activity impacts other aspects of physiology in the disease process by correlating the reading for the PET with other tools such as CT or MRI. PET technology has been found highly effective and appropriate in certain clinical circumstances for the detection and assessment of tumors throughout the body, the evaluation of some cardiac conditions and the assessment of epilepsy seizure sites. The information provided by PET technology often obviates the need to perform further highly invasive or diagnostic surgical procedures. PET systems are priced in the range of \$0.8 million to \$2.5 million. We provide PET-only services through the use of mobile equipment services at a few of our sites. In addition, we have combined PET/CT systems that blend the PET and CT imaging modalities into one scanner. These combined systems are priced in the range of \$1.8 million to \$2.2 million.

#### NUCLEAR MEDICINE

Nuclear medicine uses short-lived radioactive isotopes that release small amounts of radiation that can be recorded by a gamma camera and processed by a computer to produce an image of various anatomical structures or to assess the

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function of various organs such as the heart, kidneys, thyroid and bones. Nuclear medicine is used primarily to study anatomic and metabolic functions. Nuclear medicine systems are priced in the range of \$300,000 to \$400,000.

### X-RAY

X-rays use roentgen rays to penetrate the body and record images of organs and structures on film. Digital X-ray systems add computer image processing capability to traditional X-ray images, which provides faster transmission of images with a higher resolution and the capability to store images more cost-effectively. X-ray systems are priced in the range of \$50,000 to \$250,000.

### ULTRASOUND

Ultrasound imaging uses sound waves and their echoes to visualize and locate internal organs. It is particularly useful in viewing soft tissues that do not X-ray well. Ultrasound is used in pregnancy to avoid X-ray exposure as well as in gynecological, urologic, vascular, cardiac and breast applications. Ultrasound systems are priced in the range of \$90,000 to \$250,000.

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### MAMMOGRAPHY

Mammography is a specialized form of radiology using low dosage X-rays to visualize breast tissue and is the primary screening tool for breast cancer. Mammography procedures and related services assist in the diagnosis of and treatment planning for breast cancer. Mammography systems are priced in the range of \$70,000 to \$100,000.

### FLUOROSCOPY

Fluoroscopy uses ionizing radiation combined with a video viewing system for real time monitoring of organs. Fluoroscopy systems are priced in the range of \$100,000 to \$300,000.

### COMPETITIVE STRENGTHS

#### SIGNIFICANT AND KNOWLEDGEABLE PARTICIPANT IN THE NATION'S LARGEST ECONOMY

We believe our group of regional networks of fixed-site, freestanding outpatient diagnostic imaging facilities is the largest of its kind in California, the nation's largest economy and most populous state. Our two decades of experience in operating diagnostic imaging facilities in almost every major population center in California gives us intimate, first-hand knowledge of these geographic markets, as well as close, long-term relationships with key payors, radiology groups and referring physicians within these markets.

#### ADVANTAGES OF REGIONAL NETWORKS WITH BROAD GEOGRAPHIC COVERAGE

The organization of our diagnostic imaging facilities into regional networks around major population centers offers unique benefits to our patients, our referring physicians, our payors and us.

- o We are able to increase the convenience of our services to patients by implementing scheduling systems within geographic regions, where practical. For example, many of our diagnostic imaging facilities within a particular region can access the patient appointment calendars of other facilities within the same

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regional network to efficiently allocate time available and to meet a patient's appointment, date, time or location preferences.

- o We have found that many third-party payors representing large groups of patients often prefer to enter into managed care contracts with providers that offer a broad array of diagnostic imaging services at convenient locations throughout a geographic area. We believe that our regional network approach and our utilization management system make us an attractive candidate for selection as a preferred provider for these third-party payors.
- o Through our advanced information technology systems, we can electronically exchange information between radiologists in real time, enabling us to cover larger geographic markets by using the specialized training of other practitioners in our networks. In addition, many of our facilities digitally transmit to our headquarters, on a daily basis, comprehensive data concerning the diagnostic imaging services performed, which our corporate management closely monitors to evaluate each facility's efficiency. Similarly, BRMG uses our advanced information technology system to closely monitor radiologists to ensure that they consistently perform at expected levels. o The grouping of our facilities within regional networks enables us to easily move technologists and other personnel, as well as equipment, from under-utilized to over-utilized facilities on an as-needed basis. This results in operating efficiencies and better equipment utilization rates and improved response time for our patients.

### COMPREHENSIVE DIAGNOSTIC IMAGING SERVICES

At each of our multi-modality facilities, we offer patients and referring physicians one location to serve their needs for multiple procedures. Furthermore, we have complemented many of our multi-modality sites with single-modality sites to accommodate overflow and to provide a full range of services within a local area consistent with demand. This can help patients avoid multiple visits or lengthy journeys between facilities, thereby decreasing costs and time delays.

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### STRONG RELATIONSHIPS WITH EXPERIENCED AND HIGHLY REGARDED RADIOLOGISTS

Our contracted radiologists generally have outstanding credentials and reputations, strong relationships with referring physicians, a broad mix of sub-specialties and a willingness to embrace our approach for the delivery of diagnostic imaging services. The collective experience and expertise of these radiologists translates into more accurate and efficient service to patients. Moreover, as a result of our close relationship with Dr. Berger and BRMG, we believe that we are able to better ensure that medical service is provided at our facilities in a manner consistent with our needs and expectations and those of our referring physicians, patients and payors than if we obtained these services from unaffiliated practice groups. We believe that physicians are drawn to BRMG and the other radiologist groups with whom we contract by the opportunity to work with the state-of-the-art equipment we make available to them, as well as the opportunity to receive specialized training through our fellowship programs, and engage in clinical research programs, which generally are available only in university settings and major hospitals. Also, through the use of options and warrants, we have made available to many of BRMG's key physicians the opportunity to own an equity stake in our company, which we believe further strengthens the commonality of their interests with ours.



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### DIVERSIFIED PAYOR MIX

Our revenue is derived from a diverse mix of payors, including private payors, managed care capitated payors and government payors. We believe our payor diversity mitigates our exposure to possible unfavorable reimbursement trends within any one payor class. In addition, our experience with capitation arrangements over the last several years has provided us with the expertise to manage utilization and pricing effectively, resulting in a predictable stream of profitable revenue. With the exception of Blue Cross/Blue Shield and government payors, no single payor accounted for more than 5% of our net revenue for the year ended October 31, 2005.

### EXPERIENCED AND COMMITTED MANAGEMENT TEAM

Dr. Howard Berger, Norman Hames, our Chief Operating Officer, and Dr. John Crues III, a Vice President of our company, together have close to 75 years of healthcare management experience. Our executive management team has created our differentiated approach based on their comprehensive understanding of the diagnostic imaging industry and the dynamics of our regional markets. Our management beneficially owns approximately 33% of our common stock.

### BUSINESS STRATEGY

#### MAXIMIZING PERFORMANCE AT OUR EXISTING FACILITIES

We intend to enhance our operations and increase scan volume and revenue at our existing facilities by:

- o Establishing new referring physician and payor relationships;
- o Increasing patient referrals through targeted marketing efforts to referring physicians;
- o Adding modalities and increasing imaging capacity through equipment upgrades to existing machinery, additional machinery and relocating machinery to meet the needs of our regional markets;
- o Leveraging our multi-modality offerings to increase the number of high-end procedures performed; and
- o Building upon our capitation arrangements to obtain fee-for-service business.

#### FOCUSING ON PROFITABLE CONTRACTING

We regularly evaluate our contracts with third-party payors and radiology groups, as well as our equipment and real property leases, to determine how we may improve the terms to increase our revenues and reduce our expenses. Because many of our contracts have one-year terms, we can regularly renegotiate these contracts, if necessary. We believe our position as a leading provider of diagnostic imaging services in California, our experience and knowledge of the various geographic markets in California, and the benefits offered by our regional networks enable us to obtain more favorable contract terms than would be available to smaller or less experienced organizations.

#### EXPANDING MRI AND CT APPLICATIONS

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We intend to continue to use expanding MRI and CT applications as they become commercially available. Most of these applications can be performed by our existing MRI and CT systems with upgrades to software and hardware. By way of example, in January 2005, we placed into service a new piece of equipment which functions in conjunction with the MRI and utilizes focused ultrasound as a completely non-invasive procedure to treat symptomatic uterine fibroids. The equipment costing \$750,000 received FDA approval in late October 2004 and we are the first organization in the Western United States to acquire the equipment. We also intend to introduce applications that will decrease scan and image-reading time to increase our productivity.

### OPTIMIZING OPERATING EFFICIENCIES

We intend to maximize our equipment utilization by adding, upgrading and re-deploying equipment where we experience excess demand. We will continue to trim excess operating and general and administrative costs where it is feasible to do so, including consolidating, divesting or closing under-performing facilities to reduce operating costs and improve operating income. We also may continue to use, where appropriate, high-trained radiology physician assistants to perform, under appropriate supervision of radiologists, basic services traditionally performed by radiologists. We will continue to upgrade our advanced information technology system to create cost reductions for our facilities in areas such as image storage, support personnel and financial management.

### EXPANDING OUR NETWORKS

We intend to expand our networks of facilities through new developments and acquisitions, using a disciplined approach for evaluating and entering new areas, including consideration of whether we have adequate financial resources to expand. We perform extensive due diligence before developing a new facility or acquiring an existing facility, including surveying local referral sources and radiologists, as well as examining the demographics, reimbursement environment, competitive landscape and intrinsic demand of the geographic market. We generally will only enter new markets where:

- o There is sufficient patient demand for outpatient diagnostic imaging services;
- o We believe we can gain significant market share;
- o We can build key referral relationships or we have already established such relationships; and
- o Payors are receptive to our entry into the market.

### OUR SERVICES

We offer the following services: MRI, CT, PET, nuclear medicine, X-ray, ultrasound, mammography and fluoroscopy. Our facilities provide standardized services, regardless of location, to ensure patients, physicians and payors consistency in service and quality. We monitor our level of service, including patient satisfaction, timeliness of services to patients and reports to physicians.

The key features of our services include:

- o Patient-friendly, non-clinical environments;
- o A 24-hour turnaround on routine examinations;
- o Interpretations within one to two hours, if needed;
- o Flexible patient scheduling, including same-day appointments;
- o Extended operating hours, including weekends;

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- o Reports delivered via courier, fax or email;
- o Availability of second opinions and consultations;
- o Availability of sub-specialty interpretations at no additional charge;
- o Standardized fee schedules by region; and
- o Fees that are more competitive than hospital fees.

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### RADIOLOGY PROFESSIONALS

In California, a lay person or any entity other than a professional corporation is not allowed to practice medicine, including by employing professional persons or by having any ownership interest or profit participation in or control over any medical professional practice. This doctrine is commonly referred to as the prohibition on the "corporate practice" of medicine. In order to comply with this prohibition, we contract, directly or through BRMG, with radiologists to provide professional medical services in our facilities, including the supervision and interpretation of diagnostic imaging procedures. The radiology practice maintains full control over the physicians it employs. Pursuant to each management contract, we make available the imaging facility and all of the furniture and medical equipment at the facility for use by the radiology practice, and the practice is responsible for staffing the facility with qualified professional medical personnel. In addition, we provide management services and administration of the non-medical functions relating to the professional medical practice at the facility, including among other functions, provision of clerical and administrative personnel, bookkeeping and accounting services, billing and collection, provision of medical and office supplies, secretarial, reception and transcription services, maintenance of medical records, and advertising, marketing and promotional activities. As compensation for the services furnished under contracts with radiologists, we generally receive an agreed percentage of the medical practice billings for, or collections from, services provided at the facility, typically varying between 79% to 84% of net revenue or collections.

At 42 of our facilities, BRMG is our contracted radiology group. At October 31, 2005, BRMG employed approximately 48 fulltime and 9 part-time radiologists. At the balance of our facilities we contract, directly or through BRMG, with other radiology groups to provide the professional medical services. Two imaging facilities previously owned by Burbank Advanced Imaging Center LLC and Rancho Bernardo Advanced Imaging Center LLC were charged a fee, for our services as manager of the limited liability companies, of 10% of the collected revenue of each company after deduction of the professional fees. In addition, as a member owning 75% of the equity interests of those limited liability companies, we were entitled to 75% of income after a deduction of all expenses, including amounts paid for medical services and medical supervision. In the fourth quarter of fiscal 2004, we purchased the interest we did not own in both centers.

Under our management agreement with BRMG, BRMG pays us, as compensation for the use of our facilities and equipment and for our services, a percentage of the amounts collected for the professional services it renders. The percentage is adjusted annually, if necessary, to ensure that the parties receive the fair value for the services they render.

The following are the other principal terms of our management agreement with BRMG:

- o The agreement expires on January 1, 2014. However, the agreement automatically renews for consecutive 10-year periods, unless

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either party delivers a notice of non-renewal to the other party no later than six months prior to the scheduled expiration date. In addition, either party may terminate the agreement if the other party defaults under its obligations, after notice and an opportunity to cure, and we may terminate the agreement if Dr. Berger no longer owns at least 60% of the equity of BRMG.

- o At its expense, BRMG employs or contracts with an adequate number of physicians necessary to provide all professional medical services at all of our facilities.
- o At our expense, we provide all furniture, furnishings and medical equipment located at the facilities and we manage and administer all non-medical functions at, and provide all nurses and other non-physician personnel required for the operation of, the facilities.
- o If BRMG wants to open a new facility, we have the right of first refusal to provide the space and services for the facility under the same terms and conditions set forth in the management agreement.

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- o If we want to open a new facility, BRMG must use its best efforts to provide medical personnel under the same terms and conditions set forth in the management agreement. If BRMG cannot provide such personnel, we have the right to contract with other physicians to provide services at the facility.
- o BRMG must maintain medical malpractice insurance for each of its physicians with coverage limits not less than \$1 million per incident and \$3 million in the aggregate per year. BRMG also has agreed to indemnify us for any losses we suffer that arise out of the acts or omissions of BRMG and its employees, contractors and agents.

### PAYORS

We derive substantially all of our revenue, directly or indirectly, from fees charged for the diagnostic imaging services performed at our facilities. These fees are paid by a diverse mix of payors, as illustrated for the year ended October 31, 2005 by the following table:

| PAYOR TYPE                           | PERCENTAGE OF NET<br>REVENUE |
|--------------------------------------|------------------------------|
| -----                                | -----                        |
| Insurance(1)                         | 41%                          |
| Managed Care Capitated Payors        | 26%                          |
| Medicare/Medi-Cal                    | 18%                          |
| Other(2)                             | 11%                          |
| Workers Compensation/Personal Injury | 4%                           |

- 1 Includes Blue Cross/Blue Shield, which represented 15% of our net revenue for the year ended October 31, 2005.
- 2 Includes co-payments, direct patient payments and payments through contracts with physician groups and other non-insurance company payors.

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With the exception of Blue Cross/Blue Shield and government payors, no single payor accounted for more than 5% of our net revenue for the year ended October 31, 2005.

We have described below the types of reimbursement arrangements we have, directly or indirectly, including through BRMG, with third-party payors.

### INSURANCE

Generally, insurance companies reimburse us, directly or indirectly, including through BRMG, on the basis of agreed upon rates. These rates are on average approximately the same as the rates set forth in the Medicare Fee Schedule for the particular service. The patients are generally not responsible for any amount above the insurance allowable amount.

### MANAGED CARE CAPITATION AGREEMENTS

Under these agreements, which are generally between BRMG and the payor, typically an independent physicians group or other medical group, the payor pays a pre-determined amount per-member per-month in exchange for BRMG providing all necessary covered services to the managed care members included in the agreement. These contracts pass much of the financial risk of providing outpatient diagnostic imaging services, including the risk of over-use, from the payor to BRMG and, as a result of our management agreement with BRMG, to us.

We believe that through our comprehensive utilization management, or UM, program we have become highly skilled at assessing and moderating the risks associated with the capitation agreements, so that these agreements are profitable for us. Our UM program is managed by our UM department, which consists of administrative and nursing staff as well as BRMG medical staff who are actively involved with the referring physicians and payor management in both prospective and retrospective review programs. Our UM program includes the following features, all of which are designed to manage our costs while ensuring that patients receive appropriate care:

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#### o PHYSICIAN EDUCATION

At the inception of a new capitation agreement, we provide the new referring physicians with binders of educational material comprised of proprietary information that we have prepared and third-party information we have compiled, which are designed to address diagnostic strategies for common diseases. We distribute additional material according to the referral practices of the group as determined in the retrospective analysis described below.

#### o PROSPECTIVE REVIEW

Referring physicians are required to submit authorization requests for non-emergency high-intensity services: MRI, CT, special procedures and nuclear medicine studies. The UM medical staff, according to accepted practice guidelines, considers the necessity and appropriateness of each request. Notification is then sent to the imaging facility, referring physician and medical group. Appeals for cases not approved are directed to us. The capitated payor has the final authority to uphold or deny our recommendation.

#### o RETROSPECTIVE REVIEW

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We collect and sort encounter activity by payor, place of service, referring physician, exam type and date of service. The data is then presented in quantitative and analytical form to facilitate understanding of utilization activity and to provide a comparison between fee-for-service and Medicare equivalents. Our Medical Director prepares a quarterly report for each payor and referring physician, which we send to them. When we find that a referring physician is over utilizing services, we work with the physician to modify referral patterns.

### MEDICARE/MEDI-CAL

Medicare is the national health insurance program for people age 65 or older and people under age 65 with certain disabilities. Medi-Cal is the California health insurance program for qualifying low income persons. Medicare and Medi-Cal reimburse us, directly or indirectly, including through BRMG, in accordance with the Medicare Fee Schedule, which is a schedule of rates applicable to particular services and annually adjusted upwards or downwards, typically, within a 4-8% range. Medicare patients are not responsible for any amount above the Medicare allowable amount. Medi-Cal patients are not responsible for any unreimbursed portion.

### CONTRACTS WITH PHYSICIAN GROUPS AND OTHER NON-INSURANCE COMPANY PAYORS

These payors reimburse us, directly or indirectly, on the basis of agreed upon rates. These rates are typically set at 70-80% of the rates set forth in the Medicare Fee Schedule for the particular service. However, we often agree to a specified rate for MRI and CT procedures that is not tied to the Medicare Fee Schedule. The patients are generally not responsible for the unreimbursed portion.

### FACILITIES

Through our wholly owned subsidiaries, we operate 57 fixed-site, freestanding outpatient diagnostic imaging facilities in California. We lease the premises at which these facilities are located, with the exception of two facilities located in buildings we own. We lease the land on which both of those buildings are located.

Our facilities are located in regional networks that we refer to as regions. Thirty four of our facilities are multi-modality sites, offering various combinations of MRI, CT, PET, nuclear medicine, ultrasound, X-ray and fluoroscopy services. Twenty three of our facilities are single-modality sites, offering either X-ray or MRI services. Consistent with our regional network strategy, we locate our single-modality facilities near multi-modality facilities, to help accommodate overflow in targeted demographic areas.

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The following table sets forth the number of our facilities for each year during the five-year period ended October 31, 2005:

|  | YEAR ENDED OCTOBER 31 |      |      |      |
|--|-----------------------|------|------|------|
|  | 2001                  | 2002 | 2003 | 2004 |
| Total facilities owned or managed (at beginning of year) | 42                    | 46   | 58   | 58   |
| Facilities added by:                                     |                       |      |      |      |
| Acquisition  | 3                     | 1    | --   | --   |

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|   |        |        |        |       |
|---|--------|--------|--------|-------|
| Internal development                        | 4      | 11     | 3      |       |
| Facilities closed or sold                   | (3)    | --     | (6)    |       |
| <br>Total facilities owned (at end of year) | <br>46 | <br>58 | <br>55 | <br>5 |

### DIAGNOSTIC IMAGING EQUIPMENT

The following table indicates, as of December 31, 2005, the quantity of principal diagnostic equipment available at our facilities, by region:

|                     | MRI    | OPEN<br>MRI | CT     | PET/CT | MAMMO-<br>GRAPHY | ULTRA-<br>SOUND | X-RAY  | NUCLEAR<br>MEDICINE |
|---------------------|--------|-------------|--------|--------|------------------|-----------------|--------|---------------------|
| Beverly Hills       | 4      | 1           | 2      | 1      | 3                | 4               | 3      | 1                   |
| Ventura             | 2      | 2           | 1      | 2      | 5                | 9               | 15     | 2                   |
| San Fernando Valley | 3      | 3           | 3      | 1      | 2                | 6               | 7      | 1                   |
| Antelope Valley     | 1      | 1           | 1      | --     | 1                | 1               | 2      | 1                   |
| Central California  | 3      | 3           | 5      | --     | 5                | 10              | 12     | 2                   |
| Northern California | 1      | 2           | 2      | --     | --               | --              | 1      | --                  |
| Orange              | 2      | 1           | 1      | 1      | 3                | 7               | 4      | 1                   |
| Long Beach          | 1      | --          | 1      | --     | 3                | 4               | 7      | 1                   |
| Northern San Diego  | --     | 1           | 1      | --     | --               | --              | 1      | --                  |
| Palm Springs        | 1      | 1           | 2      | --     | 2                | 7               | 7      | 1                   |
| Inland Empire       | 5      | 1           | 4      | 1      | 8                | 12              | 12     | 3                   |
| <br>Total           | <br>23 | <br>16      | <br>23 | <br>6  | <br>32           | <br>60          | <br>71 | <br>13              |

The average age of our MRI and CT units is less than six years, and the average age of our PET units is less than four years. The useful life of our MRI, CT and PET units is typically ten years.

### INFORMATION TECHNOLOGY

Our corporate headquarters and substantially all of our 57 facilities are interconnected through a state-of-the-art information technology system. This system, which is compliant with the Health Insurance Portability and Accountability Act of 1996, is comprised of a number of integrated applications, provides a single operating platform for billing and collections, electronic medical records, practice management and image management.

This technology has created cost reductions for our facilities in areas such as image storage, support personnel and financial management and has further allowed us to optimize the productivity of all aspects of our business by enabling us to:

- o Capture all necessary patient demographic, history and billing information at point-of-service;
- o Automatically generate bills and electronically file claims with third-party payors;
- o Record and store diagnostic report images in digital format;
- o Digitally transmit on a real time basis diagnostic images from one location to another, thus enabling networked radiologists to cover larger geographic markets by using the specialized training of other networked radiologists;
- o Perform claims, rejection and collection analysis; and

- o Perform sophisticated financial analysis, such as analyzing cost and profitability, volume, charges, current activity and patient case mix, with respect to each of our managed care contracts.

Currently diagnostic reports and images are accessible via the Internet to our referring providers. We have worked with some of the larger medical groups with whom we have contracts to provide access to this content via their web portals.

#### PERSONNEL

At October 31, 2005, we had a total of 615 full-time, 41 part-time and 89 per-diem employees. These numbers do not include the 48 full-time and 9 part-time radiologists or the 288 full-time, 40 part-time and 161 per-diem technologists.

We employ a site manager who is responsible for overseeing day-to-day and routine operations at each of our facilities, including staffing, modality and schedule coordination, referring physician and patient relations and purchasing of materials. In turn, our 8 regional managers and directors are responsible for oversight of the operations of all facilities within their region, including sales, marketing and contracting. The regional managers and directors, along with our directors of contracting, marketing, facilities, management/purchasing and human resources report to our chief operating officer. Our chief financial officer, director of information services and our medical director report to our chief executive officer.

None of our employees is subject to a collective bargaining agreement nor have we experienced any work stoppages. We believe our relationship with our employees is good.

#### MARKETING

Our marketing team, which consists of one director of marketing, five territory sales managers and eighteen customer service representatives, one of which is part-time, employs a multi-pronged approach to marketing:

##### PHYSICIAN MARKETING

Each customer service representative is responsible for marketing activity on behalf of one or more facilities. The representatives act as a liaison between the facility and referring physicians, holding meetings periodically and on an as-needed basis with them and their staff to present educational programs on new applications and uses of our systems and to address particular patient service issues that have arisen. In our experience, consistent hands-on contact with a referring physician and his or her staff generates goodwill and increases referrals. The representatives also continually seek to establish referral relationships with new physicians and physician groups. In addition to a base salary and a car allowance, each representative receives a quarterly bonus if the facility or facilities on behalf of which he or she markets meets specified net revenue goals for the quarter.

##### PAYOR MARKETING

Our marketing team regularly meets with managed care organizations and insurance companies to solicit contracts and meet with existing contracting payors to solidify those relationships. The comprehensiveness of our services, the geographic location of our facilities and the reputation of the physicians



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with whom we contract all serve as tools for obtaining new or repeat business from payors.

### SPORTS MARKETING PROGRAM

We have a sports marketing program designed to increase our public profile. We provide X-ray equipment and a technician for all of the games of the Lakers, Clippers, Kings, Avengers and Sparks held at the Staples Center in Los Angeles, Ducks games held at the Arrowhead Pond in Anaheim, and University of Southern California football games held in Los Angeles. In exchange for this service, we receive an advertisement in each team program throughout the season. In addition, we have a close relationship with the physicians for some of these teams.

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### SUPPLIERS

Historically, we have acquired almost all of our diagnostic imaging equipment from GE Medical Systems, Inc., and we purchase medical supplies from various national vendors. We believe that we have excellent working relationships with all of our major vendors. However, there are several comparable vendors for our supplies that would be available to us if one of our current vendors becomes unavailable.

We acquire our equipment primarily through various financing arrangements directly with an affiliate of General Electric Corporation, or GE, involving the use of capital leases with purchase options at minimal prices at the end of the lease term. At October 31, 2005, capital lease obligations, excluding interest, totaled approximately \$62.8 million through 2010, including current installments totaling approximately \$58.6 million (see Note 7). If we open or acquire additional imaging facilities, we may have to incur material capital lease obligations.

Timely, effective maintenance is essential for achieving high utilization rates of our imaging equipment. We have an arrangement with GE Medical Systems under which it has agreed to be responsible for the maintenance and repair of a majority of our equipment for a fee that is based upon a percentage of our revenue, subject to a minimum payment. Net revenue is reduced by the provision for bad debt, mobile PET revenue and other professional reading service revenue to obtain adjusted net revenue. The fiscal 2005 annual service fee was the higher of 3.50% of our adjusted net revenue, or \$4,970,000. The fiscal 2006 annual service rate will be the higher of 3.62% of our adjusted net revenue, or \$5,393,800. For the fiscal years 2007, 2008 and 2009, the annual service fee will be the higher of 3.62% of our adjusted net revenue, or \$5,430,000. We believe this framework of basing service costs on usage is an effective and unique method for controlling our overall costs on a facility-by-facility basis.

### COMPETITION

The market for diagnostic imaging services in California is highly competitive. We compete principally on the basis of our reputation, our ability to provide multiple modalities at many of our facilities, the location of our facilities and the quality of our diagnostic imaging services. We compete locally with groups of radiologists, established hospitals, clinics and other independent organizations that own and operate imaging equipment. Our major national competitors include Radiologix, Inc., Alliance Imaging, Inc., Healthsouth Corporation and Insight Health Services. Some of our competitors may now or in the future have access to greater financial resources than we do and may have access to newer, more advanced equipment.

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In addition, in the past some non-radiologist physician practices have refrained from establishing their own diagnostic imaging facilities because of the federal physician self-referral legislation. Final regulations issued in January 2001 clarify exceptions to the physician self-referral legislation, which created opportunities for some physician practices to establish their own diagnostic imaging facilities within their group practices and to compete with us. In the future, we could experience significant competition as a result of those final regulations.

### INSURANCE

We maintain insurance policies with coverage that we believe are appropriate in light of the risks attendant to our business and consistent with industry practice. However, adequate liability insurance may not be available to us in the future at acceptable costs or at all. We maintain general liability insurance and professional liability insurance in commercially reasonable amounts. Additionally, we maintain workers' compensation insurance on all of our employees. Coverage is placed on a statutory basis and responds to California's requirements.

Pursuant to our agreements with physician groups with whom we contract, including BRMG, each group must maintain medical malpractice insurance for the group, having coverage limits of not less than \$1.0 million per incident and \$3.0 million in the aggregate per year.

California's medical malpractice cap further reduces our exposure. California places a \$250,000 limit on non-economic damages for medical malpractice cases. Non-economic damages are defined as compensation for pain, suffering, inconvenience, physical impairment, disfigurement and other non-pecuniary injury. The cap applies whether the case is for injury or death, and it allows only one \$250,000 recovery in a wrongful death case. No cap applies to economic damages.

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We maintain a \$5.0 million key-man life insurance policy on the life of Dr. Berger. We are the beneficiary under the policy.

### REGULATION

#### GENERAL

The healthcare industry is highly regulated, and we can give no assurance that the regulatory environment in which we operate will not change significantly in the future. Our ability to operate profitably will depend in part upon us, and the contracted radiology practices and their affiliated physicians obtaining and maintaining all necessary licenses and other approvals, and operating in compliance with applicable healthcare regulations. We believe that healthcare regulations will continue to change. Therefore, we monitor developments in healthcare law and modify our operations from time to time as the business and regulatory environment changes. Although we intend to continue to operate in compliance, we cannot ensure that we will be able to adequately modify our operations so as to address changes in the regulatory environment.

#### LICENSING AND CERTIFICATION LAWS

Ownership, construction, operation, expansion and acquisition of diagnostic imaging facilities are subject to various federal and state laws, regulations and approvals concerning licensing of facilities and personnel. In

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addition, free-standing diagnostic imaging facilities that provide services not performed as part of a physician office must meet Medicare requirements to be certified as an independent diagnostic testing facility to bill the Medicare program. We may not be able to receive the required regulatory approvals for any future acquisitions, expansions or replacements, and the failure to obtain these approvals could limit the market for our services.

### CORPORATE PRACTICE OF MEDICINE

In California, a lay person or any entity other than a professional corporation is not allowed to practice medicine, including by employing professional persons or by having any ownership interest or profit participation in or control over any medical professional practice. The laws of the State of California also prohibit a lay person or a non-professional entity 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. We structure our relationships with the radiology practices, including the purchase of diagnostic imaging facilities, in a manner that we believe keeps us from engaging in the practice of medicine or exercising control over the medical judgments or decisions of the radiology practices or their physicians or violating the prohibitions against fee-splitting. However, because challenges to these types of arrangements are not required to be reported, we cannot substantiate our belief. There can be no assurance that our present arrangements with BRMG or the physicians providing medical services and medical supervision at our imaging facilities will not be challenged, and, if challenged, that they will not be found to violate the corporate practice prohibition, thus subjecting us to a potential combination of damages, injunction and civil and criminal penalties or require us to restructure our arrangements in a way that would affect the control or quality of our services or change the amounts we receive under our management agreements, or both.

### MEDICARE AND MEDICAID FRAUD AND ABUSE

Our revenue is derived through our ownership, operation and management of diagnostic imaging centers and from service fees paid to us by contracted radiology practices. During the year ended October 31, 2005, approximately 18% of our revenue generated at our diagnostic imaging centers was derived from government sponsored healthcare programs (principally Medicare and Medicaid).

Federal law prohibits the knowing and willful offer, payment, solicitation or receipt of any form of remuneration in return for, or to induce, (i) the referral of a person, (ii) the furnishing or arranging for the furnishing of items or services reimbursable under the Medicare, Medicaid or other governmental programs or (iii) the purchase, lease or order or arranging or recommending purchasing, leasing or ordering of any item or service reimbursable under the Medicare, Medicaid or other governmental programs. Enforcement of this anti-kickback law is a high priority for the federal government, which has substantially increased enforcement resources and is scheduled to continue increasing such resources. The applicability of the anti-kickback law to many business transactions in the healthcare industry has not yet been subject to judicial or regulatory interpretation. Noncompliance with the federal anti-kickback legislation can result in exclusion from the Medicare, Medicaid or other governmental programs and civil and criminal penalties.

We receive fees under our service agreements for management and administrative services, which include contract negotiation and marketing services. We do not believe we are in a position to make or influence referrals

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of patients or services reimbursed under Medicare or other governmental programs to radiology practices or their affiliated physicians or to receive referrals. However, we may be considered to be in a position to arrange for items or services reimbursable under a federal healthcare program. Because the provisions of the federal anti-kickback statute are broadly worded and have been broadly interpreted by federal courts, it is possible that the government could take the position that our arrangements with the contracted radiology practices implicate the federal anti-kickback statute. Violation of the law can result in monetary fines, civil and criminal penalties, and exclusion from participation in federal or state healthcare programs, any of which could have an adverse effect on our business and results of operations. While our service agreements with the contracted radiology practices will not meet a safe harbor to the federal anti-kickback statute, failure to meet a safe harbor does not mean that agreements violate the anti-kickback statute. We have sought to structure our agreements to be consistent with fair market value in arms' length transactions for the nature and amount of management and administrative services rendered. For these reasons, we do not believe that service fees payable to us should be viewed as remuneration for referring or influencing referrals of patients or services covered by such programs as prohibited by statute.

Significant prohibitions against physician referrals have been enacted by Congress. These prohibitions are commonly known as the Stark Law. The Stark Law prohibits a physician from referring Medicare patients to an entity providing designated health services, as defined under the Stark Law, including, without limitation, radiology services, in which the physician has an ownership or investment interest or with which the physician has entered into a compensation arrangement. The penalties for violating the Stark Law include a prohibition on payment by these governmental programs and civil penalties of as much as \$15,000 for each violative referral and \$100,000 for participation in a circumvention scheme. We believe that, although we receive fees under our service agreements for management and administrative services, we are not in a position to make or influence referrals of patients.

On January 4, 2001, the Centers for Medicare and Medicaid Services published final regulations to implement the Stark Law. Under the final regulations, radiology and certain other imaging services and radiation therapy services and supplies are services included in the designated health services subject to the self-referral prohibition. Under the final regulations, such services include the professional and technical components of any diagnostic test or procedure using X-rays, ultrasound or other imaging services, CT, MRI, radiation therapy and diagnostic mammography services (but not screening mammography services). The final regulations, however, exclude from designated health services: (i) X-ray, fluoroscopy or ultrasound procedures that require the insertion of a needle, catheter, tube or probe through the skin or into a body orifice; (ii) radiology procedures that are integral to the performance of, and performed during, nonradiological medical procedures; (iii) nuclear medicine procedures; and (iv) invasive or interventional radiology, because the radiology services in these procedures are merely incidental or secondary to another procedure that the physician has ordered.

The Stark Law provides that a request by a radiologist for diagnostic radiology services or a request by a radiation oncologist for radiation therapy, if such services are furnished by or under the supervision of such radiologist or radiation oncologist pursuant to a consultation requested by another physician, does not constitute a referral by a referring physician. If such requirements are met, the Stark Law self-referral prohibition would not apply to such services. The effect of the Stark Law on the radiology practices, therefore, will depend on the precise scope of services furnished by each such practice's radiologists and whether such services derive from consultations or are self-generated. We believe that, other than self-referred patients, all of the services covered by the Stark Law provided by the contracted radiology practices derive from requests for consultation by non-affiliated physicians.

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Therefore, we believe that the Stark Law is not implicated by the financial relationships between our operations and the contracted radiology practices.

In addition, we believe that we have structured our acquisitions of the assets of existing practices, and we intend to structure any future acquisitions, so as not to violate the anti-kickback and Stark Law and regulations. Specifically, we believe the consideration paid by us to physicians to acquire the tangible and intangible assets associated with their practices is consistent with fair market value in arms' length transactions and is not intended to induce the referral of patients. Should any such practice be deemed to constitute an arrangement designed to induce the referral of Medicare or

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Medicaid patients, then our acquisitions could be viewed as possibly violating anti-kickback and anti-referral laws and regulations. A determination of liability under any such laws could have an adverse effect on our business, financial condition and results of operations.

The federal government embarked on an initiative to audit all Medicare carriers, which are the companies that adjudicate and pay Medicare claims. These audits are expected to intensify governmental scrutiny of individual providers. An unsatisfactory audit of any of our diagnostic imaging facilities or contracted radiology practices could result in any or all of the following: significant repayment obligations, exclusion from the Medicare, Medicaid or other governmental programs, and civil and criminal penalties.

Federal regulatory and law enforcement authorities have recently increased enforcement activities with respect to Medicare, Medicaid fraud and abuse regulations and other reimbursement laws and rules, including laws and regulations that govern our activities and the activities of the radiology practices. Our or the radiology practices' activities may be investigated, claims may be made against us or the radiology practices and these increased enforcement activities may directly or indirectly have an adverse effect on our business, financial condition and results of operations.

### CALIFORNIA ANTI-KICKBACK AND PHYSICIAN SELF-REFERRAL LAWS

California has adopted a form of anti-kickback law and a form of Stark Law. The scope of these laws and the interpretations of them are enforced by California courts and by regulatory authorities with broad discretion. Generally, California law covers all referrals by all healthcare providers for all healthcare services. A determination of liability under such laws could result in fines and penalties and restrictions on our ability to operate.

### FEDERAL FALSE CLAIMS ACT

The Federal False Claims Act provides, in part, that the federal government may bring a lawsuit against any person who 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 Federal False Claims Act further provides that a lawsuit thereunder may be initiated in the name of the United States by an individual who is an original source of the allegations. The government has taken the position that claims presented in violation of the federal anti-kickback law or Stark Law may be considered a violation of the Federal False Claims Act. Penalties include civil penalties of not less than \$5,500 and not more than \$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 in compliance with the rules and regulations that apply

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to the Federal False Claims Act. However, we could be found to have violated certain rules and regulations resulting in sanctions under the Federal False Claims Act, and if we are so found in violation, any sanctions imposed could result in fines and penalties and restrictions on and exclusion from participation in federal and California healthcare programs that are integral to our business.

### HEALTHCARE REFORM INITIATIVES

Healthcare laws and regulations may change significantly in the future. We continuously monitor these developments and modify our operations from time to time as the regulatory environment changes. We cannot assure you, however, that we will be able to adapt our operations to address new regulations or that new regulations will not adversely affect our business. In addition, although we believe that we are operating in compliance with applicable federal and state laws, neither our current or anticipated business operations nor the operations of the contracted radiology practices has been the subject of judicial or regulatory interpretation. We cannot assure you 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.

### HEALTH INSURANCE PORTABILITY AND ACCOUNTABILITY ACT OF 1996

In an effort to combat healthcare fraud, Congress enacted the Health Insurance Portability and Accountability Act of 1996, or HIPAA. HIPAA, among other things, amends existing crimes and criminal penalties for Medicare fraud and enacts new federal healthcare fraud crimes, including actions affecting non-government payors. Under HIPAA, a healthcare benefit program includes any private plan or contract affecting interstate commerce under which any medical benefit, item or service is provided. A person or entity that knowingly and willfully obtains the money or property of any healthcare benefit program by

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means of false or fraudulent representations in connection with the delivery of healthcare services is subject to a fine or imprisonment, or potentially both. In addition, HIPAA authorizes the imposition of civil money penalties against entities that employ or enter into contracts with excluded Medicare or Medicaid program participants if such entities provide services to federal health program beneficiaries. A finding of liability under HIPAA could have a material adverse effect on our business, financial condition and results of operations.

Further, HIPAA requires healthcare providers and their business associates to maintain the privacy and security of individually identifiable health information. HIPAA imposes federal standards for electronic transactions with health plans, the security of electronic health information and for protecting the privacy of individually identifiable health information. Organizations such as ours were obligated to be compliant with the initial HIPAA regulations by April 14, 2003, and with the electronic data interchange mandates by October 16, 2003. The final security regulations were issued in February 2003 with a compliance date of April 2005. We believe that we are in compliance with the current requirements, but we anticipate that we may encounter certain costs associated with future compliance. A finding of liability under HIPAA's privacy or security provisions may also result in criminal and civil penalties, and could have a material adverse effect on our business, financial condition, and results of operations.

Although our electronic systems are HIPAA compatible, consistent with the HIPAA regulations, we cannot guarantee the enforcement agencies or courts will

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not make interpretations of the HIPAA standards that are inconsistent with ours, or the interpretations of the contracted radiology practices or their affiliated physicians. A finding of liability under the HIPAA standards may result in criminal and civil penalties. Noncompliance also may result in exclusion from participation in government programs, including Medicare and Medicaid. These actions could have a material adverse effect on our business, financial condition, and results of operations.

### COMPLIANCE PROGRAM

We maintain a program to monitor compliance with federal and state laws and regulations applicable to healthcare entities. We have a compliance officer who is charged with implementing and supervising our compliance program, which includes the adoption of (i) Standards of Conduct for our employees and affiliates and (ii) a process that specifies how employees, affiliates and others may report regulatory or ethical concerns to our compliance officer. We believe that our compliance program meets the relevant standards provided by the Office of Inspector General of the Department of Health and Human Services.

An important part of our compliance program consists of conducting periodic audits of various aspects of our operations and that of the contracted radiology practices. We also conduct mandatory educational programs designed to familiarize our employees with the regulatory requirements and specific elements of our compliance program.

### U.S. FOOD AND DRUG ADMINISTRATION OR FDA

The FDA has issued the requisite premarket approval for all of the MRI and CT systems we use. We do not believe that any further FDA approval is required in connection with the majority of equipment currently in operation or proposed to be operated. Except under regulations issued by the FDA pursuant to the Mammography Quality Standards Act of 1992, where all mammography facilities are required to be accredited by an approved non-profit organization or state agency. Pursuant to the accreditation process, each facility providing mammography services must comply with certain standards including annual inspection.

Compliance with these standards is required to obtain payment for Medicare services and to avoid various sanctions, including monetary penalties, or suspension of certification. Although the Mammography Accreditation Program of the American College of Radiology currently accredits all of our facilities, which provide mammography services, and we anticipate continuing to meet the requirements for accreditation, the withdrawal of such accreditation could result in the revocation of certification. Congress has extended Medicare benefits to include coverage of screening mammography subject to the prescribed quality standards described above. The regulations apply to diagnostic mammography and image quality examination as well as screening mammography.

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### RADIOLOGIST LICENSING

The radiologists providing professional medical services at our facilities are subject to licensing and related regulations by the State of California. As a result, we require BRMG and the other radiology groups with which we contract to require those radiologists to have and maintain appropriate licensure. We do not believe that such laws and regulations will either prohibit or require licensure approval of our business operations, although no assurances can be made that such laws and regulations will not be interpreted to extend such prohibitions or requirements to our operations.

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## INSURANCE LAWS AND REGULATION

California has adopted certain laws and regulations affecting risk assumption in the healthcare industry, including those that subject any physician or physician network engaged in risk-based managed care to applicable insurance laws and regulations. These laws and regulations may require physicians and physician networks to meet minimum capital requirements and other safety and soundness requirements. Implementing additional regulations or compliance requirements could result in substantial costs to the contracted radiology practices, limiting their ability to enter into capitated or other risk-sharing managed care arrangements and indirectly affecting our revenue from the contracted practices.

## ENVIRONMENTAL MATTERS

The facilities we operate or manage generate hazardous and medical waste subject to federal and state requirements regarding handling and disposal. We believe that the facilities that we operate and manage are currently in compliance in all material respects with applicable federal, state and local statutes and ordinances regulating the handling and disposal of such materials. We do not believe that we will be required to expend any material additional amounts in order to remain in compliance with these laws and regulations or that compliance will materially affect our capital expenditures, earnings or competitive position.

## ITEM 2. PROPERTIES

Information with respect to our facilities within our regional networks is as follows:

| REGIONAL NETWORKS               | NUMBER OF FACILITIES (1) | APPROXIMATE SQUARE FOOTAGE | LEASE EXPIRATION (WITH OPTIONS TO EXTEND)   |
|---------------------------------|--------------------------|----------------------------|---|
| <b>BEVERLY HILLS (3):</b>       |                          |                            |   |
| Roxsan                          | 1                        | 8,031                      | Various through 2012                        |
| Wilshire                        | 1                        | 13,778                     | September 2028                              |
| Women's                         | 1                        | 3,830                      | February 2029                               |
| <b>VENTURA (9):</b>             |                          |                            |   |
| Camarillo                       | 2                        | 2,035                      | Various through May 2013                    |
| Oxnard                          | 2                        | 5,622                      | Various Month-to-month                      |
| Thousand Oaks                   | 3                        | 12,914                     | Various through November 2019               |
| Ventura                         | 3                        | 12,959                     | Various through July 2012                   |
| <b>SAN FERNANDO VALLEY (8):</b> |                          |                            |   |
| Burbank                         | 2                        | 6,500                      | Various through August 2010                 |
| Northridge                      | 2                        | 9,050                      | Various through February 2019               |
| Santa Clarita                   | 2                        | 7,293                      | One through June 2019; other Month-to-month |
| Tarzana                         | 2                        | 6,320                      | Various through December 2021               |
| <b>ANTELOPE VALLEY (3):</b>     |                          |                            |   |
| Antelope Valley                 | 1                        | 2,890                      | April 2008                                  |
| Lancaster                       | 2                        | 6,827                      | Various through October 2006                |
| <b>CENTRAL CALIFORNIA (5):</b>  |                          |                            |   |
| Fresno                          | 1                        | 7,231                      | June 2008                                   |
| Modesto                         | 1                        | 17,852                     | December 2014                               |
| Sacramento                      | 1                        | 8,083                      | June 2023                                   |
| Stockton                        | 1                        | 4,808                      | December 2006                               |
| Vacaville                       | 1                        | 5,927                      | March 2012                                  |
| <b>NORTHERN CALIFORNIA (3):</b> |                          |                            |   |



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|               |   |       |                               |
|---------------|---|-------|-------------------------------|
| Emeryville    | 1 | 2,086 | Various through December 2018 |
| San Francisco | 1 | 1,240 | Month-to-month                |
| Santa Rosa    | 1 | 4,235 | July 2011                     |

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|                         |    |        |                              |
|-------------------------|----|--------|------------------------------|
| ORANGE (5):             |    |        |                              |
| Orange                  | 4  | 15,955 | Various through October 2022 |
| Tustin                  | 1  | 2,139  | January 2008                 |
| LONG BEACH (4):         |    |        |                              |
| Long Beach              | 4  | 16,338 | Various through July 2010    |
| NORTHERN SAN DIEGO (1): |    |        |                              |
| Rancho Bernardo         | 1  | 9,557  | May 2012                     |
| PALM SPRINGS (5):       |    |        |                              |
| Palm Desert             | 3  | 9,024  | Various through May 2021     |
| Palm Springs            | 2  | 9,042  | Various through June 2013    |
| INLAND EMPIRE (10):     |    |        |                              |
| Chino                   | 1  | 2,700  | June 2012                    |
| Rancho Cucamonga        | 3  | 11,128 | Various through May 2023     |
| Riverside               | 1  | 12,534 | Various through January 2018 |
| San Gabriel Valley      | 1  | 2,871  | December 2007                |
| Temecula                | 4  | 14,496 | Various through January 2021 |
| -----                   |    |        |                              |
| TOTAL                   | 57 |        |                              |
| =====                   |    |        |                              |

(1) Includes leased facilities and three facilities operated pursuant to managed care capitation agreements.

Our corporate headquarters are located in adjoining premises at 1510 and 1516 Cotner Avenue, Los Angeles, California 90025, in approximately 16,500 square feet occupied under leases, which expire (with options to extend) on June 30, 2017. In addition, we lease 52,941 square feet of warehouse and other space under leases, which expire at various dates between February 2006 and January 2018.

ITEM 3. LEGAL PROCEEDINGS

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We are involved in the following litigation:

- (a) In Re DVI, Inc. Securities Litigation  
 United States District Court, Eastern District of PA, Docket No.  
 -----  
 2:03-CV-05336-LDD  
 -----

This is a class action securities fraud case under Section 10(b) of the Securities Exchange Act and Rule 10b-5. It was brought by shareholders of DVI, Inc. ("DVI"), one of our former major lenders, against DVI officers and directors and a number of third party defendants, including us. The case arises from bankruptcy proceedings instituted by DVI in August 2003. We were named as a defendant in the Third Amended Complaint filed in July 2004.

The putative plaintiff class consists of those persons who purchased or otherwise acquired DVI, Inc. securities between August of 1999 and August of 2003. Plaintiffs allege that in 2000, we acquired from a third party one or more unprofitable imaging centers in order to help DVI conceal the fact that existing DVI loans on the centers were delinquent. Plaintiffs argue that we should have

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known that DVI was engaging in fraudulent practices to conceal losses, and our alleged "lack of due diligence" in investigating DVI's finances in the course of these acquisitions amounted to complicity in deceptive and misleading practices.

We have answered the complaint. The matter is still in its initial stages with discovery just beginning. We intend to vigorously contest the allegations.

(b) Fleet Nat'l Bank v. Boyle et. al., U.S. district Court for the  
-----  
Eastern District of Pennsylvania, Docket No. 04-CV-1277  
-----

This case is related to In re DVI Securities Litigation, but was filed by several of DVI's lenders. It, too, arises from the DVI bankruptcy (referenced in the matter above) and was brought against DVI officers and directors and a number of third party defendants, including us. We were named in the First Amended Complaint filed in this action in September 2004.

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The plaintiff alleges violations of the Racketeering Influenced and Corrupt Organizations Act, 18 U.S.C. 1961 et seq., ("RICO"), and common-law claims, including conspiracy to commit fraud, tortious interference with a contract, conspiracy to commit tortious interference with a contract, conspiracy to commit conversion and aiding and abetting fraud. Plaintiffs allege that in 2000, we acquired from a third party one or more unprofitable imaging centers in order to help DVI conceal the fact that existing DVI loans on the centers were delinquent.

We filed a motion to dismiss the complaint that was granted as to all claims except the RICO claim. We have filed an answer to the complaint. The case is in its initial stages. We intend to vigorously contest the remaining claims.

(c) Broadstream Capital Partners, LLC v. Primedex Health Systems,  
-----  
Inc., Los Angeles Superior Court Case No. SC 084691.  
-----

This case arises in connection with a financing agreement we entered into with a third party. James Goldfarb, a partner of Broadstream Capital Partners, LLC ("Broadstream"), and once a member of our Board of Directors, arranged a meeting between us and a third party to discuss the third party financing the purchase of a portion of our debt owed to DVI Financial Services, which had filed for bankruptcy. Goldfarb alleges that, on behalf of Broadstream, he entered into an oral agreement with us under which we owe Broadstream a "finder's fee" for setting up this meeting. Broadstream has filed suit against us, and Howard G. Berger, M.D., our president, for damages.

The complaint alleges claims for breach of contract, breach of the covenant of good faith and fair dealing, fraud, unjust enrichment, and bad faith denial of contract. Broadstream claims that it is entitled to damages in excess of \$300,000, as well as punitive damages.

We have responded to the complaint, and discovery is continuing. The matter is scheduled to go to trial on March 13, 2006. We intend to pursue our defense vigorously.

GENERAL

We are engaged from time to time in the defense of lawsuits arising out

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

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

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We did not submit any matters to a vote of security holders during the fourth fiscal quarter of fiscal 2005.

## PART II

### ITEM 5. MARKET FOR THE REGISTRANT'S COMMON STOCK, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

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Our common stock is quoted on the Nasdaq Over-the-Counter, or OTC, Bulletin Board under the symbol "PMDX.OB". The following table indicates the high and low prices for our common stock for the periods indicated based upon information supplied by the National Quotation Bureau, Inc. Such quotations reflect interdealer prices without adjustment for retail mark-up, markdown or commission, and may not necessarily represent actual transactions.

| QUARTER ENDED<br>----- | LOW<br>--- | HIGH<br>---- |
|------------------------|------------|--------------|
| January 31, 2005       | \$0.41     | \$0.60       |
| April 30, 2005         | 0.24       | 0.49         |
| July 31, 2005          | 0.26       | 0.43         |
| October 31, 2005       | 0.26       | 0.43         |
| January 31, 2004       | 0.40       | 0.71         |
| April 30, 2004         | 0.41       | 0.70         |
| July 31, 2004          | 0.27       | 0.45         |
| October 31, 2004       | 0.30       | 0.67         |

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The last reported closing high and low prices for our common stock on the OTC Bulletin Board on January 13, 2006 were \$0.32 and \$0.29, respectively. As of January 13, 2006, the number of holders of record of our common stock was 3,966. However, Cede & Co., the nominee for The Depository Trust Company, the clearing agency for most broker-dealers, owned a substantial number of our outstanding shares of common stock of record on that date. Our management believes that customers of these broker-dealers beneficially own these shares and that the number of beneficial owners of our common stock is substantially greater than 3,966.

We did not pay dividends in fiscal 2004 or 2005 and we do not expect to pay any dividends in the foreseeable future.

### CONVERTIBLE SUBORDINATED DEBENTURES

At October 31, 2005, we had \$16.2 million convertible subordinated debentures outstanding which mature June 30, 2008 and bear interest, payable quarterly, at an annual rate of 11.5%. The debentures are convertible into our common stock at a price of \$2.50 per share.

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### RECENT SALES OF UNREGISTERED SECURITIES

During the fiscal year ended October 31, 2005, we sold the following securities pursuant to an exemption from registration provided under Section 4(2) of the Securities Act of 1933, as amended:

- o In June 2005, we issued to one of BRMG's radiologists a five-year warrant exercisable at a price of \$0.36 per share, which was the public market closing price for our common stock on the transaction date, to purchase 100,000 shares of our common stock.
- o In June 2005, we issued to one of BRMG's radiologists and a director of our Company a five-year warrant exercisable at a price of \$0.36 per share, which was the public market closing price for our common stock on the transaction date, to purchase 500,000 shares of our common stock.
- o In March 2005 and July 2005, we issued to two of our independent directors five-year warrants exercisable at \$0.32 per share and \$0.40 per share, respectively, which was the public market price closing price for our common stock on each of the respective transaction dates, for each to purchase 50,000 shares of our common stock.
- o In October 2005, we issued to one of BRMG's radiologists a five-year warrant exercisable at a price of \$0.30 per share, which was the public market closing price for our common stock on the transaction date, to purchase 100,000 shares of our common stock.
- o In October 2005, we issued to one of our key employees five-year warrants exercisable at a price of \$0.30 per share, which was the public market closing price for our common stock on the transaction date, to purchase 100,000 shares of our common stock.

### EQUITY COMPENSATION PLAN INFORMATION

The following table summarizes information with respect to options, warrants and other rights under our equity compensation plans at October 31, 2005:

| PLAN CATEGORY   | NUMBER OF SECURITIES<br>TO BE ISSUED UPON<br>EXERCISE OF<br>OUTSTANDING OPTIONS<br>WARRANTS AND RIGHTS | WEIGHTED-AVERAGE<br>EXERCISE PRICE OF<br>OUTSTANDING OPTIONS<br>WARRANTS AND RIGHTS | NUMBER OF<br>REMAINING<br>FOR FUTURE<br>UNDER<br>COMPENSATION |
|---|--|---|---|
| Equity compensation plans approved<br>by security holders     | 687,167  | \$ 0.51   | 1,30  |
| Equity compensation plans not<br>approved by security holders | 12,004,770   | \$ 0.60   |   |
| <b>Total</b>  | <b>12,691,937</b>  | <b>\$ 0.60</b>  | <b>1,30</b>   |

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### ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following table sets forth our selected historical consolidated financial data. The selected consolidated statements of operations data set forth below for each of the years in the three year period ended October 31, 2005 and the consolidated balance sheet data set forth below as of October 31, 2004 and 2005 are derived from our audited consolidated financial statements and notes thereto included elsewhere herein. The selected historical consolidated statements of operations data set forth below for the years ended October 31, 2001 and 2002, and the consolidated balance sheet data set forth below as of October 31, 2001, 2002 and 2003 are derived from our audited consolidated financial statements not included herein. The selected historical consolidated financial data set forth below should be read in conjunction with and is qualified in its entirety by reference to the audited consolidated financial statements and the related notes included elsewhere in this Form 10-K and "Management's Discussion and Analysis of Financial Condition and Results of Operations."

The financial data set forth below and discussed in this Annual Report are derived from the consolidated financial statements of Primedex, its subsidiaries and certain affiliates. As a result of the contractual and operational relationship among BRMG, Dr. Berger and us, we are considered to have a controlling financial interest in BRMG pursuant to guidance issued by the Emerging Issues Task Force, or EITF, of the Financial Accounting Standards Board, or FASB, in EITF's release 97-2. Due to the deemed controlling financial interest, we are required to include BRMG as a consolidated entity in our consolidated financial statements. This means, for example, that revenue generated by BRMG from the provision of professional medical services to our patients, as well as BRMG's costs of providing those services, are included as net revenue in our consolidated statement of operations, whereas the management fee that BRMG pays to us under our management agreement with BRMG is eliminated as a result of the consolidation of our results with those of BRMG. Also, because BRMG is a consolidated entity in our financial statements, any borrowings or advances we have received from or made to BRMG are not reflected in our consolidated balance sheet. If BRMG were not treated as a consolidated entity in our consolidated financial statements, the presentation of certain items in our income statement, such as net revenue and costs and expenses, would change but our net income would not, because in operation and historically, the annual revenue of BRMG from all sources closely approximates its expenses, including Dr. Berger's compensation, fees payable to us and amounts payable to third parties.

|  | YEAR ENDED OCTOBER 31, |            |            |            |    |
|--|------------------------|------------|------------|------------|----|
|  | 2001                   | 2002       | 2003       | 2004       |    |
|  | ----                   | ----       | ----       | ----       |    |
| STATEMENT OF OPERATIONS DATA:            | (DOLLARS IN THOUSANDS) |            |            |            |    |
| Net revenue                              | \$ 107,567             | \$ 134,078 | \$ 140,259 | \$ 137,277 | \$ |
| Operating expenses:                      |                        |            |            |            |    |
| Operating expenses                       | 75,457                 | 102,286    | 106,078    | 105,828    |    |
| Depreciation and amortization            | 10,315                 | 15,010     | 16,874     | 17,762     |    |
| Provision for bad debts                  | 3,851                  | 6,892      | 4,944      | 3,911      |    |
| Loss on disposal of equipment, net       | --                     | --         | --         | --         |    |
| Income (loss) from continuing operations | 13,813                 | (6,435)    | (5,464)    | (14,576)   |    |
| Income from discontinued operation       | 688                    | 884        | 3,197      | --         |    |
| Net income (loss)                        | 14,501                 | (5,551)    | (2,267)    | (14,576)   |    |

#### BALANCE SHEET DATA:

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|                                |          |          |          |          |    |
|--------------------------------|----------|----------|----------|----------|----|
| Cash and cash equivalents      | \$ 40    | \$ 36    | \$ 30    | \$ 1     | \$ |
| Total assets                   | 128,429  | 151,639  | 142,035  | 127,451  |    |
| Total long-term liabilities    | 110,188  | 121,830  | 122,096  | 139,980  |    |
| Total liabilities              | 174,071  | 202,560  | 195,122  | 195,006  |    |
| Working capital (deficit)      | (26,987) | (44,668) | (44,615) | (32,172) | (  |
| Stockholders' equity (deficit) | (45,642) | (50,921) | (53,087) | (67,555) | )  |

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

OVERVIEW

We operate a group of regional networks comprised of 57 fixed-site, freestanding outpatient diagnostic imaging facilities in California. We believe our group of regional networks is the largest of its kind in California. We have strategically organized our facilities into regional networks in markets, which have both high-density and expanding populations, as well as attractive payor diversity.

All of our facilities employ state-of-the-art equipment and technology in modern, patient-friendly settings. Many of our facilities within a particular region are interconnected and integrated through our advanced information technology system. Thirty four of our facilities are multi-modality sites, offering various combinations of MRI, CT, PET, nuclear medicine, ultrasound, X-ray and fluoroscopy services. Twenty three of our facilities are single-modality sites, offering either X-ray or MRI services. Consistent with our regional network strategy, we locate our single-modality sites near multi-modality sites to help accommodate overflow in targeted demographic areas.

We derive substantially all of our revenue, directly or indirectly, from fees charged for the diagnostic imaging services performed at our facilities. For the year ended October 31, 2005, we derived 60% of our net revenue from MRI and CT scans. Over the past three fiscal years, we have increased net revenue primarily through improvements in net reimbursement, expansions of existing facilities, upgrades in equipment and development of new facilities.

The fees charged for diagnostic imaging services performed at our facilities are paid by a diverse mix of payors, as illustrated for the year ended October 31, 2005 by the following table:

| PAYOR TYPE                           | PERCENTAGE<br>OF NET<br>REVENUE |
|--------------------------------------|---------------------------------|
| -----                                | -----                           |
| Insurance (1)                        | 41%                             |
| Managed Care Capitated Payors        | 26                              |
| Medicare/Medi-Cal                    | 18                              |
| Other (2)                            | 11                              |
| Workers Compensation/Personal Injury | 4                               |

(1) Includes Blue Cross/Blue Shield, which represented 15% of our net revenue for the year ended October 31, 2005.

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- (2) Includes co-payments, direct patient payments and payments through contracts with physician groups and other non-insurance company payors.

Our eligibility to provide service in response to a referral often depends on the existence of a contractual arrangement between the radiologists providing the professional medical services or us and the referred patient's insurance carrier or managed care organization. These contracts typically describe the negotiated fees to be paid by each payor for the diagnostic imaging services we provide. With the exception of Blue Cross/Blue Shield and government payors, no single payor accounted for more than 5% of our net revenue for the year ended October 31, 2005. Under our capitation agreements, we receive from the payor a pre-determined amount per member, per month. If we do not successfully manage the utilization of our services under these agreements, we could incur unanticipated costs not offset by additional revenue, which would reduce our operating margins.

The principal components of our fixed operating expenses, excluding depreciation, include professional fees paid to radiologists, except for those radiologists who are paid based on a percentage of revenue, compensation paid to technologists and other facility employees, and expenses related to equipment rental and purchases, real estate leases and insurance, including errors and omissions, malpractice, general liability, workers' compensation and employee medical. The principal components of our variable operating expenses include expenses related to equipment maintenance, medical supplies, marketing, business development and corporate overhead. Because a majority of our expenses are fixed, increased revenue as a result of higher scan volumes per system or improvements in net reimbursement can significantly improve our margins.

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BRMG strives to maintain qualified radiologists and technologists while minimizing turnover and salary increases and avoiding the use of outside staffing agencies, which are considerably more expensive and less efficient. In recent years, there has been a shortage of qualified radiologists and technologists in some of the regional markets we serve. As turnover occurs, competition in recruiting radiologists and technologists may make it difficult for our contracted radiology practices to maintain adequate levels of radiologists and technologists without the use of outside staffing agencies. At times, this has resulted in increased costs for us.

For a discussion of other factors that may have an impact on our business and our future results of operations, see "Risks Related to our Business."

### OUR RELATIONSHIP WITH BRMG

Howard G. Berger, M.D. is our President and Chief Executive, a member of our Board of Directors, and owns approximately 30% of Primedex's outstanding common stock. Dr. Berger also owns, indirectly, 99% of the equity interests in BRMG. BRMG provides all of the professional medical services at 42 of our facilities under a management agreement with us, and contracts with various other independent physicians and physician groups to provide all of the professional medical services at most of our other facilities. We obtain professional medical services from BRMG, rather than providing such services directly or through subsidiaries, in order to comply with California's prohibition against the corporate practice of medicine. However, as a result of our close relationship with Dr. Berger and BRMG, we believe that we are able to better ensure that professional medical services are provided at our facilities in a manner consistent with our needs and expectations and those of our referring physicians, patients and payors than if we obtained these services from unaffiliated practice groups.

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Under our management agreement with BRMG, which expires on January 1, 2014, BRMG pays us, as compensation for the use of our facilities and equipment and for our services, a percentage of the gross amounts collected for the professional services it renders. The percentage, which was 79% at October 31, 2005, is adjusted annually, if necessary, to ensure that the parties receive fair value for the services they render. In operation and historically, the annual revenue of BRMG from all sources closely approximates its expenses, including Dr. Berger's compensation, fees payable to us and amounts payable to third parties. For administrative convenience and in order to avoid inconveniencing and confusing our payors, a single bill is prepared for both the professional medical services provided by the radiologists and our non-medical, or technical, services, generating a receivable for BRMG. BRMG finances these receivables under a working capital facility with Bridge Healthcare Finance LLC and regularly advances to us the funds that it draws under this working capital facility, which we use for our own working capital purposes. We repay or offset these advances with periodic payments from BRMG to us under the management agreement. We guarantee BRMG's obligations under this working capital facility.

As a result of our contractual and operational relationship with BRMG and Dr. Berger, we are required to include BRMG as a consolidated entity in our consolidated financial statements. See "Selected Consolidated Financial Data."

### FINANCIAL CONDITION

#### LIQUIDITY AND CAPITAL RESOURCES

We had a working capital deficit of \$143.4 million at October 31, 2005 and had losses from continuing operations of \$14.6 million and \$3.1 million during fiscal 2004 and 2005, respectively. The loss in fiscal 2004 includes a \$5.2 million expense resulting from the increase in the valuation allowance for deferred income taxes. We also had a stockholders' deficit of \$70.6 million at October 31, 2005.

The working capital deficit increased in fiscal 2005 due to the reclassification of approximately \$109 million in notes and capital lease obligations as current liabilities that are expected to be refinanced. We are subject to financial covenants under our current debt agreements. We believe that we may be unable to continue to be in compliance with our existing financial covenants during fiscal 2006. As such, the associated debt has been classified as a current liability. We expect to refinance these obligations presented as current liabilities in the second quarter of fiscal 2006. On January 31, 2006, we executed a commitment letter with an institutional lender to which such lender provided us with a commitment, subject to final documentation and legal due diligence, for a \$160 million senior secured credit facility to be used to refinance all of our existing indebtedness (except for \$16.1 million of outstanding subordinated debentures and \$6.1 million of capital lease obligations). The commitment provides for a \$15 million five-year revolving credit facility, an \$85 million term loan due in five years and \$60 million second lien term loan due in six years. The loans are subject to

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acceleration on February 28, 2008, unless we have made arrangements to discharge or extend our outstanding subordinated debentures by that date. The loans are essentially payable interest only monthly at varying rates that are yet to be finalized but will be based upon market conditions. Finalization of the credit facility is subject to customary conditions, including legal due diligence and final documentation that is scheduled for completion on or about March 7, 2006.

We operate in a capital intensive, high fixed-cost industry that requires



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significant amounts of capital to fund operations. In addition to operations, we require significant amounts of capital for the initial start-up and development expense of new diagnostic imaging facilities, the acquisition of additional facilities and new diagnostic imaging equipment, and to service our existing debt and contractual obligations. Because our cash flows from operations are insufficient to fund all of these capital requirements, we depend on the availability of financing under credit arrangements with third parties. Historically, our principal sources of liquidity have been funds available for borrowing under our existing lines of credit, now with Bridge Healthcare Finance LLC. Even though the line of credit matures in 2008, we classify the line of credit as a current liability primarily because it is collateralized by accounts receivable and the eligible borrowing base is classified as a current asset. We finance the acquisition of equipment mainly through capital and operating leases.

During fiscal 2004 and 2005, we took the actions described below to continue to fund our obligations.

BRMG and Wells Fargo Foothill were parties to a credit facility under which BRMG could borrow the lesser of 85% of the net collectible value of eligible accounts receivable plus one month of average capitation receipts for the prior six months, two times the trailing month cash collections, or \$20,000,000. Eligible accounts receivable excluded those accounts older than 150 days from invoice date and were net of customary reserves. In addition, Wells Fargo Foothill set up a term loan where they could advance up to the lesser of \$3,000,000 or 80% of the liquidation value of the equipment value servicing the loan. Under this term loan, we borrowed \$880,000 in February 2005 to acquire medical equipment. The five-year term loan had interest only payments through February 28, 2005 with the first quarterly principal payments due on April 1, 2005. Access to additional funds under the term loan expired soon after the February 2005 draw.

Under the \$20,000,000 revolving loan, an overadvance subline was available not to exceed \$2,000,000, or one month of the average capitation receipts for the prior six months, until June 30, 2005. From July 1 to September 30, 2005, the overadvance subline was available not to exceed \$1,500,000, or one month of the average capitation receipts for the prior six months. Beginning October 1, 2005, the maximum overadvance could not exceed the lesser of \$1,000,000 or one month of the average capitation receipts for the prior six months. Also under the revolving loan, we were entitled to request that Wells Fargo Foothill issue guarantees of payment in an aggregate amount not to exceed \$5,000,000 at any one time outstanding.

Advances outstanding under the revolving loan bore interest at the base rate plus 1.5%, or the LIBOR rate plus 3.0%. Advances under the overadvance subline and term loan bore interest at the base rate plus 4.75%. Letter of credit fees bore interest of 3.0% per annum times the undrawn amount of all outstanding lines of credit. The base rate refers to the rate of interest announced within Wells Fargo Bank at its principal office in San Francisco as its prime rate. The line was collateralized by substantially all of our accounts receivable and requires us to meet certain financial covenants including minimum levels of EBITDA, fixed charge coverage ratios and maximum senior debt/EBITDA ratios as well as limitations on annual capital expenditures.

Effective September 14, 2005, we established a new \$20 million working capital revolving credit facility with Bridge Healthcare Finance, or Bridge, a specialty lender in the healthcare industry. Upon the establishment of this credit facility, we borrowed \$15.5 million that was used to pay off the entire balance of our existing credit facility with Wells Fargo Foothill. Upon repayment, the existing credit facility with Wells Fargo Foothill was terminated. Additionally, Bridge provided us approximately \$0.8 million in the form of a term loan, which we used to pay the balance of a term loan owed to

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Wells Fargo Foothill.

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Under the Bridge revolving credit facility, we may borrow the lesser of 85% of the net collectible value of eligible accounts receivable plus one month capitation receipts for the preceding month, or \$20,000,000. An overadvance subline is available not to exceed \$2,000,000, so long as after giving effect to the overadvance subline, the revolver usage does not exceed \$20,000,000. Eligible accounts receivable shall exclude those accounts older than 150 days from invoice date and will be net of customary reserves. Dr. Berger has agreed to personally guaranty the repayment of any monies under the overadvance subline. Advances under the revolving loan bear interest at the base rate plus 3.25%. The base rate refers to the prime rate publicly announced by La Salle Bank National Association, in effect from time to time. The term loan bears interest at the annual rate of 12.50%. The revolving credit facility is collateralized by substantially all of our accounts receivable and requires us to meet certain financial covenants including minimum levels of EBITDA, fixed charge coverage ratios and maximum senior debt/EBITDA ratios. The term loan is collateralized by specific imaging equipment used by us at certain of our locations.

Until November 2004, we had a line of credit with an affiliate of DVI Financial Services, Inc. ("DVI"), when we issued \$4.0 million in principal amount of notes to Post Advisory Group, LLC ("Post"), a Los Angeles-based investment advisor, and Post purchased the DVI affiliate's line of credit facility with the residual funds utilized by us as working capital. The new note payable has monthly interest only payments at 12% per annum until its maturity in July 2008.

On December 19, 2003, we issued a \$1.0 million convertible subordinated note payable to Galt Financial, Ltd., at a stated rate of 11% per annum with interest payable quarterly. The note payable is convertible at the holder's option anytime after January 1, 2006 at \$0.50 per share. As additional consideration for the financing we issued a warrant for the purchase of 500,000 shares at an exercise price of \$.50 per share. We have allocated \$0.1 million to the value of the warrants and believe the value of the conversion feature is nominal. In November 2005, subsequent to year-end, the right to convert was waived and the warrant for the purchase of 500,000 shares of common stock was terminated in exchange for the issuance of a five-year warrant to purchase 300,000 shares of our common stock at a price of \$0.50 per share, the public market price on the date the warrant, with the underlying note being extended to July 1, 2006.

During the third quarter of fiscal 2004, we renegotiated our existing notes and capital lease obligations with our three primary lenders, General Electric ("GE"), DVI Financial Services and U.S. Bank extending terms and reducing monthly payments on approximately \$135.1 million of combined outstanding debt. At the time of the debt restructuring, outstanding principal balances for DVI, GE and U.S. Bank were \$15.2 million, \$54.3 million and \$65.6 million respectively.

DVI's restructured note payable was six payments of interest only from July to December 2004 at 9%, 41 payments of principal and interest of \$273,988, and a final balloon payment of \$7.6 million on June 1, 2008 if and only if our subordinated bond debentures, then due, are not extended and paid in full. If the bond debenture payment is deferred, we would make monthly payments of \$290,785 to DVI for the next 29 months. Effective November 30, 2004, Post acquired the DVI note payable and the debt was restructured. The new note payable has monthly interest only payments at 11% per annum until its maturity

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in June 2008. The assignment of the note payable to Post will not result in any actual total dollar savings to us over the term of the new obligation, but it will defer cash outlays of approximately \$1.3 million per year until its maturity.

GE's restructured note payable is six payments of interest only at 9%, or \$407,210, beginning on August 1, 2004, 40 payments of principal and interest at \$1,127,067 beginning on February 1, 2005, and a final balloon payment of \$21 million due on June 1, 2008 if and only if our subordinated bond debentures, then due, are not extended and paid in full. If the bond debenture payment is deferred, we will continue to make monthly payments of \$1,127,067 to GE for the next 20 months.

U.S. Bank's restructured note payable is six payments of interest only at 9%, or \$491,933, beginning on August 1, 2004, 40 payments of principal and interest of \$1,055,301 beginning on February 1, 2005, and a final balloon payment of \$39.7 million due on June 1, 2008 if and only if our subordinated bond debentures, then due, are not extended and paid in full. If the bond debenture payment is deferred, we will continue to make monthly payments of \$1,055,301 to U.S. Bank for the next 44 months.

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In October 2003, we successfully consummated a "pre-packaged" Chapter 11 plan of reorganization with the United States Bankruptcy Court, Central District of California, in order to modify the terms of our convertible subordinated debentures by extending the maturity to June 30, 2008, increasing the annual interest rate from 10.0% to 11.5%, reducing the conversion price from \$12.00 to \$2.50 and restricting our ability to redeem the debentures prior to July 1, 2005. The plan of reorganization did not affect any of our operations or obligations, other than the subordinated debentures.

To assist with our financial liquidity in June 2005, Howard G. Berger, M.D., our president, director and largest shareholder loaned us \$1,370,000. Interest and principal payments to Dr. Berger will not be made until such time as our loans to Post Advisory Group (approximately \$16.8 million at October 31, 2005) have been paid in full.

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

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

Our ability to generate sufficient cash flow from operations to make payments on our debt and other contractual obligations will depend on our future financial performance. A range of economic, competitive, regulatory, legislative and business factors, many of which are outside of our control, will affect our financial performance.

Taking these factors into account, including our historical experience and our discussions with our lenders to date, although no assurance can be given, we believe that through implementing our strategic plans and continuing to restructure our financial obligations, we will obtain sufficient cash to satisfy our obligations as they become due in the next twelve months.

SOURCES AND USES OF CASH

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Cash increased for fiscal 2005 by \$1,000 and decreased for fiscal 2004 by \$29,000.

Cash provided by operating activities for the year ended October 31, 2005 was \$11.1 million compared to \$17.1 million for the same period in 2004. The primary reason for the fiscal 2005 decrease in cash provided by operating activities was due to imputed interest expense which decreased approximately \$5.3 million for the year ended October 31, 2005 compared to the same period in 2004. Imputed interest is interest accrued and unpaid on outstanding notes and capital lease obligations, as well as interest on capitalized debt restructuring charges which are amortized over the term of the new note payable or capital lease obligation. During the first three quarters of fiscal 2004, we deferred payments on the majority of our notes payable with DVI while negotiating with external third parties and the existing lender. In addition, during fiscal 2004, a \$5.2 million expense was recorded resulting from the increase in the valuation allowance for deferred income taxes.

Cash used by investing activities for fiscal 2005 was \$4.0 million compared to \$3.8 million for the same period in 2004. For fiscal 2005 and 2004, we purchased property and equipment for approximately \$4.1 million and \$3.8 million, respectively, and received proceeds from the sale of medical equipment of \$65,000 in fiscal 2005 and purchased the balance of our former majority-owned subsidiary's common stock for \$35,000 in fiscal 2004.

Cash used for financing activities for fiscal 2005 was \$7.1 million compared to \$13.3 million for the same period in 2004. For fiscal 2005 and 2004, we made principal payments on capital leases, notes payable and lines of credit of approximately \$14.1 million and \$13.2 million, respectively, and received proceeds from borrowings under existing lines of credit, refinancing arrangements and related parties of approximately \$6.1 million and \$1.0 million, respectively. During fiscal 2005, we also increased our cash disbursements in transit by \$0.9 million compared to a decrease in cash disbursements of \$0.3 million in fiscal 2004. In addition, during fiscal 2004, we purchased subordinated debentures for approximately \$60,000 and made payments to limited partners of \$650,000.

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### CONTRACTUAL COMMITMENTS

Our future obligations for notes payable, equipment under capital leases, lines of credit, subordinated debentures, equipment and building operating leases and purchase and other contractual obligations for the next five years and thereafter include (dollars in thousands):

|                         | 2006      | 2007     | 2008      | 2009     | 2010     | THERE-<br>AFTER | TOTAL     |
|-------------------------|-----------|----------|-----------|----------|----------|-----------------|-----------|
|                         | -----     | -----    | -----     | -----    | -----    | -----           | -----     |
| Notes payable*          | \$ 87,768 | \$ --    | \$ --     | \$ --    | \$ --    | \$ --           | \$ 87,768 |
| Capital leases*         | 69,288    | 1,713    | 1,429     | 1,353    | 226      | --              | 74,009    |
| Lines of credit         | 13,341    | --       | --        | --       | --       | --              | 13,341    |
| Subordinated debentures | --        | --       | 16,147    | --       | --       | --              | 16,147    |
| Operating leases(1)     | 7,697     | 6,976    | 6,933     | 6,795    | 6,834    | 58,907          | 94,132    |
| Purchase obligations(2) | 2,500     | --       | --        | --       | --       | --              | 2,500     |
| Tower settlement        | 174       | --       | --        | --       | --       | --              | 174       |
|                         | -----     | -----    | -----     | -----    | -----    | -----           | -----     |
| TOTAL(3)                | \$180,768 | \$ 8,689 | \$ 24,509 | \$ 8,148 | \$ 7,060 | \$ 58,907       | \$288,081 |

- 
- \* Includes interest and excludes discount on notes payable.
  - 1 Includes all existing options to extend lease terms
  - 2 Includes a three-year obligation to purchase imaging film from Fuji. We must purchase an aggregate of \$7.5 million of film at a rate of approximately \$2.5 million per year over the term of the agreement in which two years have already been completed.
  - 3 Does not include our obligation under our maintenance agreement with GE Medical Systems described below.

We have an arrangement with GE Medical Systems under which it has agreed to be responsible for the maintenance and repair of a majority of our equipment for a fee that is based upon a percentage of our revenue, subject to a minimum payment. Net revenue is reduced by the provision for bad debt, mobile PET revenue and other professional reading service revenue to obtain adjusted net revenue. The fiscal 2005 annual service fee was the higher of 3.50% of our adjusted net revenue, or \$4,970,000. The fiscal 2006 annual service rate will be the higher of 3.62% of our adjusted net revenue, or \$5,393,800. For the fiscal years 2007, 2008 and 2009, the annual service fee will be the higher of 3.62% of our adjusted net revenue, or \$5,430,000. We believe this framework of basing service costs on usage is an effective and unique method for controlling our overall costs on a facility-by-facility basis.

#### CRITICAL ACCOUNTING ESTIMATES

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

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

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

The Securities and Exchange Commission, or SEC, defines critical accounting estimates as those that are both most important to the portrayal of a company's financial condition and results of operations and require management's most difficult, subjective or complex judgment, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods. In Note 2 to our consolidated financial statements, we discuss our significant accounting policies, including those that do not require management to make difficult, subjective or complex judgments or estimates. The most significant areas involving management's judgments and estimates are described below.

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Revenue is recognized when diagnostic imaging services are rendered. Revenue is recorded net of contractual adjustments and other arrangements for providing services at less than established patient billing rates. We estimate contractual allowances based on the patient mix at each diagnostic imaging facility, the impact of managed care contract pricing and historical collection information. We operate 57 facilities, each of which has multiple managed care contracts and a different patient mix. We review the estimated contractual allowance rates for each diagnostic imaging facility on a monthly basis. We adjust the contractual allowance rates, as changes to the factors discussed above become known. Depending on the changes we make in the contractual allowance rates, net revenue may increase or decrease.

### ACCOUNTS RECEIVABLE

Substantially all of our accounts receivable are due under fee-for-service contracts from third party payors, such as insurance companies and government-sponsored healthcare programs, or directly from patients. Services are generally provided pursuant to one-year contracts with healthcare providers. Receivables generally are collected within industry norms for third-party payors. We continuously monitor collections from our clients and maintain an allowance for bad debts based upon any specific payor collection issues that we have identified and our historical experience. For fiscal 2003, 2004 and 2005 our provision for bad debts as a percentage of net revenue was 3.5%, 2.8% and 3.4% respectively.

### DEFERRED TAX ASSETS

We evaluate the realizability of the net deferred tax assets and assess the valuation allowance periodically. If future taxable income or other factors are not consistent with our expectations, an adjustment to our allowance for net deferred tax assets may be required. Even though we expect to utilize our net operating loss carry forwards in the future, the last three fiscal year losses and available evidence cause the valuation of our net deferred tax assets to be uncertain in the near term. As of October 31, 2005, we have fully allowed for our net deferred tax assets.

### VALUATION OF GOODWILL AND LONG-LIVED ASSETS

Our net goodwill at October 31, 2005 was \$23.1 million. Goodwill is recorded as a result of our acquisition of operating facilities. The operating facilities are grouped by region into reporting units. We evaluate goodwill, at a minimum, on an annual basis and whenever events and changes in circumstances suggest that the carrying amount may not be recoverable in accordance with Statement of Financial Accounting Standards, or SFAS, No. 142, "Goodwill and Other Intangible Assets." Impairment of goodwill is tested at the reporting unit level by comparing the reporting unit's carrying amount, including goodwill, to the fair value of the reporting unit. The fair values of the reporting units are estimated using a combination of the income or discounted cash flows approach and the market approach, which uses comparable market data. If the carrying amount of the reporting unit exceeds its fair value, goodwill is considered impaired and a second step is performed to measure the amount of impairment loss, if any.

Our long-lived assets at October 31, 2005 consist of net property and equipment of \$68.1 million and other net intangible assets of \$1.2 million. We evaluate long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." An asset is considered impaired if its carrying amount exceeds the future net cash flow the asset is expected to generate. If such asset is considered to be impaired, the impairment to be recognized is

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measured by the amount by which the carrying amount of the asset exceeds its fair market value. We assess the recoverability of our long-lived and intangible assets by determining whether the unamortized balances can be recovered through undiscounted future net cash flows of the related assets.

For each of the three years in the period ended October 31, 2005, we recorded no impairment of goodwill or property and equipment. However, if our estimates or the related assumptions change in the future, we may be required to record impairment charges to reduce the carrying amount of these assets.

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### SIGNIFICANT EVENTS

#### NEW FINANCING

Subsequent to year-end, on January 31, 2006, we executed a commitment letter with an institutional lender to which such lender provided us with a commitment, subject to final documentation and legal due diligence, for a \$160 million senior secured credit facility to be used to refinance all of our existing indebtedness (except for \$16.1 million of outstanding subordinated debentures and \$6.1 million of capital lease obligations). The commitment provides for a \$15 million five-year revolving credit facility, an \$85 million term loan due in five years and \$60 million second lien term loan due in six years. The loans are subject to acceleration on February 28, 2008, unless we have made arrangements to discharge or extend our outstanding subordinated debentures by that date. The loans are essentially payable interest only monthly at varying rates that are yet to be finalized but will be based upon market conditions. Finalization of the credit facility is subject to customary conditions, including legal due diligence and final documentation that is scheduled for completion on or about March 7, 2006.

#### SALE OF JOINT VENTURE INTEREST - DISCONTINUED OPERATION

Effective March 31, 2003, we sold our 50% share of Westchester Imaging Group, or Westchester, to our joint venture partner for \$3.0 million. As part of the transaction, we acquired 100% of the accounts receivable generated through March 31, 2003 for \$1.3 million and reimbursed Westchester \$0.3 million, which represented 50% of the remaining liabilities, resulting in net cash proceeds of approximately \$1.4 million. We recognized a gain on the transaction of approximately \$2.9 million in fiscal 2003.

Westchester's results from fiscal 2003 were as follows:

|                    |             |
|--------------------|-------------|
|                    | 2003(1)     |
|                    | -----       |
| Net revenue        | \$2,230,000 |
| Operating expenses | 1,703,000   |
| Net income         | 255,000     |

(1) Represents operations through March 31, 2003

#### FACILITY OPENINGS

In January 2004, we entered into a new building lease for approximately 3,963 square feet of space in Murrietta, California, near Temecula. The center opened in December 2004 and offers MRI, CT, PET, nuclear medicine and x-ray services. The equipment was financed by GE. During fiscal 2004, we had used

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existing lines of credit for the payment of approximately \$840,000 in leasehold improvements for Murietta.

In July 2003, we entered into a new building lease for approximately 3,533 square feet of space in Westlake, California, near Thousand Oaks. The center opened in March 2005 and offers MRI, mammography, ultrasound and x-ray services. During fiscal 2005, we used existing lines of credit for the payment of approximately \$873,000 in leasehold improvements for the new facility.

In December 2002, we opened an imaging center in Rancho Bernardo, California. Prior to its opening, in late November 2001, we entered into a new building lease arrangement for 9,557 square feet in Rancho Bernardo in anticipation of opening the new multi-modality imaging center. The center was 75%-owned by us and 25%-owned by two physicians who invested \$250,000. Effective July 31, 2004, we purchased the 25% minority interest from the two physicians for \$200,000 that consisted of an \$80,000 down payment and monthly payments of \$10,000 due from September 2004 to August 2005. All payments due were made during fiscal 2005. There was no goodwill recorded in the transaction.

In addition, during fiscal 2003, upon entering into new capitation arrangements, we opened two facilities adjacent to our Burbank and Santa Clarita facilities to provide X-ray services. In fiscal 2004, we opened an additional three satellite facilities servicing our Northridge, Rancho Cucamonga and Thousand Oaks centers.

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### FACILITY CLOSURES

In early fiscal 2004, we first downsized and later closed our San Diego facility. The center's location was no longer productive and business could be sent to our new facility in Rancho Bernardo. The equipment was moved to other locations and our leasehold improvements were written off. During the years ended October 31, 2003 and 2004, the center generated net revenue of \$1,067,000 and \$49,000, respectively. During the year ended October 31, 2004, the center incurred a net loss of \$122,000, and during the year ended October 31, 2003, the center generated net income of \$33,000.

In addition, during fiscal 2004, we closed two satellite facilities servicing our Antelope Valley and Lancaster regions.

In July 2003, we closed our La Habra facility. The center's location was no longer a productive asset in our network and business could be sent to our facilities in Orange County. The equipment was moved to other locations or returned to the vendor and its leasehold improvements were written off. During the year ended October 31, 2003, the center generated net revenue of \$368,000 and incurred a net loss of \$155,000.

In addition, during fiscal 2003, we closed three satellite facilities servicing our Long Beach region and one satellite facility servicing our Riverside region.

Due to low volume, RadNet Heartcheck Management, Inc., one of our subsidiaries, ceased doing business in early fiscal 2003. We wrote-off a receivable related to Heartcheck of approximately \$0.2 million during fiscal 2003.

At various times, we may open or close small x-ray facilities acquired primarily to service larger capitation arrangements over a specific geographic region. Over time, patient volume from these contracts may vary, or we may end



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the arrangement, resulting in the subsequent closures of these smaller satellite facilities.

### TERMINATION OF CONTRACT WITH TOWER IMAGING MEDICAL GROUP, INC.

In February 2003, we commenced an action against Tower Imaging Medical Group, Inc., or Tower, and certain of its affiliated entities alleging Tower's breach of a covenant not to compete in our existing management agreement with them. Tower had been providing the professional medical services at our Wilshire, Roxsan and Women's facilities located in Beverly Hills. Effective October 20, 2003, as part of the final settlement of the litigation, we terminated our management agreement with Tower. We were required to pay Tower \$1.5 million, comprised of 24 monthly installments of \$50,000 and a final balloon payment, less a residual balance, in settlement of the action. As part of the settlement, we acquired use of the "Tower" name in connection with our Beverly Hills facilities. We capitalized the \$1.5 million payment as an intangible asset for the "Tower" name, which was offset by a related \$1.5 million of accrued expense. At October 31, 2005, we still owed approximately \$174,000 to Tower that was paid in November 2005. Historically, the Tower physicians were entitled to 17.5% of the collections. BRMG is now providing the professional medical services at those facilities. During fiscal 2004, BRMG rehired seven former key Tower radiologists in the Beverly Hills area for the Beverly Hill's facilities to solidify our staffing and related referral base. We believe that with BRMG providing the professional medical services at our Beverly Hills facilities, we should not experience further significant physician turnover at those facilities.

### DEBT RESTRUCTURING

During fiscal 2004 and 2005, we continued our focused efforts to improve our financial position and liquidity by restructuring and reducing our indebtedness on favorable terms. For a discussion of these efforts, see "Financial Condition - Liquidity and Capital Resources."

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### RESULTS OF OPERATIONS

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

|                                    | YEAR ENDED OCTOBER 31, |        |        |
|------------------------------------|------------------------|--------|--------|
|                                    | 2003                   | 2004   | 2005   |
|                                    | -----                  | -----  | -----  |
| Net revenue                        | 100.0%                 | 100.0% | 100.0% |
| Operating expenses:                |                        |        |        |
| Operating expenses                 | 75.6                   | 77.1   | 74.9   |
| Depreciation and amortization      | 12.0                   | 12.9   | 11.7   |
| Provision for bad debts            | 3.6                    | 2.8    | 3.4    |
| Loss on disposal of equipment, net | --                     | --     | 0.5    |
|                                    | -----                  | -----  | -----  |
| Total operating expense            | 91.2                   | 92.8   | 90.5   |
| Income from operations             | 8.8                    | 7.2    | 9.5    |
| Other expense (income):            |                        |        |        |
| Interest expense                   | 12.8                   | 12.6   | 12.0   |
| Other income                       | (0.4)                  | (0.1)  | (0.6)  |
| Other expense                      | 0.2                    | 1.2    | 0.2    |

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|   |                         |                          |                         |
|---|-------------------------|--------------------------|-------------------------|
| Total other expense   | -----<br>12.6           | -----<br>13.7            | -----<br>11.6           |
| Loss before provision for income taxes,<br>minority interest and discontinued operation | (3.8)                   | (6.5)                    | (2.1)                   |
| Income tax expense  | -----<br>--             | -----<br>(3.8)           | -----<br>--             |
| Loss before minority interest and<br>discontinued operation                             | (3.8)                   | (10.3)                   | (2.1)                   |
| Minority interest in earnings<br>of subsidiaries  | 0.1                     | 0.3                      | --                      |
| Loss from continuing operations   | -----<br>(3.9)          | -----<br>(10.6)          | -----<br>(2.1)          |
| Discontinued operation:   |                         |                          |                         |
| Income from operations of Westchester<br>Imaging Group                                  | 0.2                     | --                       | --                      |
| Gain on sale of discontinued operation  | 2.1                     | --                       | --                      |
| Income from discontinued operation  | -----<br>2.3            | -----<br>--              | -----<br>--             |
| Net loss  | -----<br>(1.6)<br>===== | -----<br>(10.6)<br>===== | -----<br>(2.1)<br>===== |

YEAR ENDED OCTOBER 31, 2005 COMPARED TO THE YEAR ENDED OCTOBER 31, 2004

During fiscal 2005, we continued our efforts to enhance our operations and expand our network, while improving our financial position and significantly reducing our net loss. Our results for fiscal 2005 were aided by the opening and integration of new facilities in prior periods, increases in PET volume, and improvements in reimbursement from managed care capitated contracts and other payors. As a result of these factors and the other matters discussed below, we experienced an increase in income from operations of \$4.1 million.

During fiscal 2005, we made more progress in solidifying our financial condition. Effective November 30, 2004, we issued \$4.0 million in principal amount of notes to Post and Post repurchased the DVI affiliate's line of credit facility with the residual funds utilized by us as working capital. The new note payable has monthly interest only payments at 12% per annum until its maturity in July 2008. In addition, Post acquired \$15.2 million of our notes payable from an affiliate of DVI and the indebtedness was restructured by Post and us. The new note payable has monthly interest only payments at 11% per annum until its maturity in June 2008. The assignment of the note payable to Post will not result in any actual total dollar savings to us over the term of the new obligation, but it will defer cash flow outlays of approximately \$1.3 million per year until maturity. See "Financial Condition - Liquidity and Capital Resources."

As part of our evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the fiscal year ended October 31, 2005, we concluded that we had insufficient personnel resources and technical accounting expertise within the accounting function to resolve the following non-routine or complex accounting matters: the recording of non-typical cost-based investments and unusual debt-related transactions and the appropriate analysis of the amortization lives of leasehold improvements in accordance with GAAP. We are committed to establishing the necessary environment to ensure the effectiveness of these controls in the future and quality financial reporting. We experienced no impact on our financial statements for the year ended October 31, 2005 as a result of the ineffective controls over non-routine matters.

## NET REVENUE

Net revenue from continuing operations for fiscal 2005 was \$145.6 million compared to \$137.3 million for fiscal 2004, an increase of approximately \$8.3 million, or 6.0%. The largest net revenue increases were at the following facilities:

|                        | Fiscal 05<br>Increase | %     |
|------------------------|-----------------------|-------|
|                        | -----                 | ----- |
| Orange (4 sites)       | \$2,383,000           | 17.6% |
| Tarzana (2 sites)      | \$1,775,000           | 24.2% |
| Palm Springs (5 sites) | \$1,618,000           | 21.7% |
| Temecula (4 sites)     | \$1,366,000           | 21.9% |

Orange's and Palm Springs' net revenue increases were primarily due to increased patient volume, improved contracting and increases in reimbursement from its managed care capitated payors. Temecula's net revenue increase was primarily due to the return of a managed care capitated contract and the opening of an additional facility in Murrietta providing MRI, CT, PET, nuclear medicine and x-ray services in December 2004. Tarzana's net revenue increase was primarily due to increased PET volume with the hiring of a new physician and the upgrade of one of its MRI machines that increased throughput and patient volume.

Managed care capitated payor revenue increased from 25% of net revenue, or approximately \$34 million, to 26% of net revenue, or approximately \$38 million, for the years ended October 31, 2004 and 2005, respectively. We have been successful in retaining existing contracts while obtaining increases in reimbursement from the payors coupled with receiving increases in co-payments from the individual patients upon service. We anticipate maintaining a similar mix of managed care capitated payor business in fiscal 2006.

## OPERATING EXPENSES

Operating expenses from continuing operations for fiscal 2005 increased approximately \$4.2 million, or 3.3%, from \$127.5 million in fiscal 2004 to \$131.7 million in fiscal 2005. The following table sets forth our operating expenses for fiscal 2004 and 2005 (dollars in thousands):

|  | Year Ended October 31, |           |
|--|------------------------|-----------|
|  | -----                  | -----     |
|  | 2004                   | 2005      |
|  | -----                  | -----     |
| Salaries and professional reading fees | \$ 64,932              | \$ 66,674 |
| Building and equipment rental          | 7,804                  | 7,919     |
| General administrative expenses        | 33,092                 | 34,419    |
|  | -----                  | -----     |
| Total operating expenses               | 105,828                | 109,012   |
| Depreciation and amortization          | 17,762                 | 17,101    |
| Provision for bad debt                 | 3,911                  | 4,929     |
| Loss on disposal of equipment, net     | --                     | 696       |

## o SALARIES AND PROFESSIONAL READING FEES

Salaries and professional reading fees increased \$1.7 million from fiscal

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2004 to 2005. The majority of the increase is due to the increase in net revenue from \$137.3 million to \$145.6 million in fiscal 2004 and 2005, respectively. In addition to the hiring of additional employees to staff two new centers in Murrieta and Westlake, California, professional fees increased at certain sites due to contracts where compensation to the professionals is based upon a percentage of net revenue.

### o BUILDING AND EQUIPMENT RENTAL

Building and equipment rental expenses increased \$0.1 million in fiscal year 2005 when compared to the same period last year. The increase is primarily due to cost of living rental increases within existing building lease agreements and the addition of new facilities and the related rental expense.

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### o GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses include billing fees, medical supplies, office supplies, repairs and maintenance, insurance, business tax and license, outside services, utilities, marketing, travel and other expenses. Many of these expenses are variable in nature. These expenses increased \$1.3 million, or 4.0%, in fiscal 2005 compared to the previous period primarily due to the increase in net revenue. The largest fiscal 2005 increases were expenditures for billing fees and medical supplies that increased \$711,000 and \$635,000, respectively, when compared to the same period last year.

### o DEPRECIATION AND AMORTIZATION

Depreciation and amortization decreased by \$0.7 million in fiscal year 2005 when compared to the same period last year. The primary reason for the decrease is the reduction in capital expenditures. During fiscal 2004 and 2005, capital expenditures were \$13.1 million and \$8.8 million, respectively.

### o PROVISION FOR BAD DEBT

The \$1.0 million increase in provision for bad debt was primarily a result of increased net revenue and the increase in bad debts as a percentage of net revenue from 2.8% to 3.4% in fiscal 2004 and 2005, respectively. The bad debt percentage increased due to maturing accounts receivable and the faster write-off of slower-paying receivables to collection agencies to expedite cash receipts and accounts receivable turnover.

### o LOSS ON DISPOSAL OF EQUIPMENT, NET

The \$0.7 million increase in losses on disposal of equipment is primarily due to the trade-in and upgrade of an MRI at our Tarzana Advanced facility that was initiated to improve the existing equipment increasing throughput and patient volume at the site.

### INTEREST EXPENSE

Interest expense for fiscal 2005 increased approximately \$0.2 million, or 1.2%, from the same period in fiscal 2004. Interest expense is primarily from our outstanding notes payable and capital lease obligations, subordinated bond debentures, related party payables and our outstanding line of credit.

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### OTHER INCOME

In fiscal 2004 and 2005, we earned other income of \$0.2 million and \$0.9 million, respectively, principally comprised of sublease income, medical record copying income, deferred rent income, other income related to certain write-offs of liabilities and business interruption and insurance refunds. During fiscal 2005, we had gains on the settlement of debt of approximately \$0.7 million.

### OTHER EXPENSE

In fiscal 2004 and 2005, we incurred other expense of \$1.7 million and \$0.3 million, respectively, principally comprised of write-offs of miscellaneous receivables and other assets, losses on disposal of equipment, forgiveness of notes, losses on the sale or disposal of assets, and costs related to bond offerings and debt restructures. During fiscal 2004, we incurred approximately \$1.6 million of legal and professional service costs related to our earlier attempts to solidify financing and the related bond offering that was not completed.

### INCOME TAX EXPENSE

In fiscal 2004, we increased the valuation allowance for the net deferred tax asset by \$5.2 million due to our recurring losses from continuing operations over the prior three fiscal years. In fiscal 2005, the valuation allowance was fully reserved.

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### MINORITY INTEREST IN EARNINGS OF SUBSIDIARIES

Minority interest in earnings of subsidiaries represents the minority investors' 25% share of the income from the Burbank Advanced Imaging Center LLC and 25% share of the Rancho Bernardo Advanced LLC for the period. Both center's residual interests were purchased by us in September and July 2004, respectively. We now own 100% of all our locations and our minority interest liabilities have been eliminated. Minority interest expense was \$351,000 in fiscal 2004.

YEAR ENDED OCTOBER 31, 2004 COMPARED TO THE YEAR ENDED OCTOBER 31, 2003

During fiscal 2004, we continued our efforts to enhance our operations and expand our network, while improving our financial position and cash flows. Our results for fiscal 2004 were affected by the opening and integration of new facilities and the closure of underperforming operations, the increase in the valuation allowance for net deferred tax assets of \$5.2 million, the expenses involved with a bond offering which did not materialize, the slower than expected improvements in net revenue at Beverly Tower, and our continuing focus on controlling operating expenses. As a result of these factors and the other matters discussed below, we experienced a decrease in income from operations of \$2.6 million and an increase in net loss from continuing operations of \$9.1 million.

Also during fiscal 2004, we made significant progress in solidifying our financial condition. We restructured the majority of our existing notes and capital lease obligations consolidating balances, extending terms and improving future net cash flows for debt service, and we restructured our working capital line with a new lender, Wells Fargo Foothill. Net cash used by financing activities changed from \$20.3 million in fiscal 2003 to \$13.3 million in fiscal

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2004, and our working capital deficit improved from \$44.6 million in fiscal 2003 to \$32.2 million in fiscal 2004. At the same time, however, net cash provided by operating activities decreased in fiscal 2004.

### NET REVENUE

Net revenue from continuing operations for fiscal 2004 was \$137.3 million compared to \$140.3 million for fiscal 2003, a decrease of approximately \$3.0 million, or 2.1%. Of the net revenue decrease, \$1.4 million is attributable to two facilities, La Habra and North County, which were closed in fiscal 2003 and 2004, respectively. The decrease was offset by \$0.4 million in net revenue from one facility, Rancho Bernardo, which opened in December 2002. Our same store facilities', which we define as facilities open two years or more, net revenue in 2003 and 2004 was \$137.7 million and \$135.8 million, respectively. The same store facilities' net revenue was affected by a \$3.4 million decrease in net revenue at our Beverly Tower facilities over the same period. The decreases in net revenue at our Beverly Tower facilities were attributable to disruptions arising from the dispute described under "Significant Events - Termination of Contract with Tower Imaging Medical Group, Inc." Exclusive of Beverly Tower, our same store facilities had an increase in net revenue of approximately \$1.4 million from fiscal 2003 to fiscal 2004. We present same store facilities as those open two years or more because we believe that this presentation eliminates the effect of facilities opened only a partial year.

Managed care capitated payor revenue increased from 22% of net revenue, or approximately \$31 million, to 25% of net revenue, or approximately \$34 million, for the years ended October 31, 2003 and 2004, respectively. We have been successful in retaining existing contracts while obtaining increases in reimbursement from the payors coupled with receiving increases in co-payments from the individual patients upon service. We anticipate maintaining a similar mix of managed care capitated payor business in fiscal 2005 due to increases in reimbursement from existing payors, offset by expected decreases in contracts that will not be renewed.

### OPERATING EXPENSES

Operating expenses from continuing operations for fiscal 2004 decreased approximately \$0.4 million, or 0.3%, from \$127.9 million in fiscal 2003 to \$127.5 million in fiscal 2004. The decrease includes \$1.4 million of net operating expenses related to two facilities, La Habra and North County, which were closed during the last two fiscal years. This was offset by \$0.1 million for Rancho Bernardo which opened in December 2002.

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The following table sets forth our operating expenses for fiscal 2003 and 2004 (dollars in thousands):

|  | Year Ended October 31, |           |
|--|------------------------|-----------|
|  | 2003                   | 2004      |
| Salaries and professional reading fees | \$ 62,454              | \$ 64,932 |
| Building and equipment rental          | 9,375                  | 7,804     |
| General administrative expenses        | 34,249                 | 33,092    |
|  | -----                  | -----     |
| Total operating expenses               | 106,078                | 105,828   |
| Depreciation and amortization          | 16,874                 | 17,762    |

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Provision for bad debt

4,944

3,911

### o SALARIES AND PROFESSIONAL READING FEES

Salaries and professional reading fees increased \$2.5 million from fiscal 2003 to 2004. The amount is net of \$0.4 million relating to two closed facilities, La Habra and North County, and one new facility, Rancho Bernardo, which opened in December 2002. For our same store facilities, salaries increased \$2.2 million and professional reading fees decreased \$0.7 million from fiscal 2003 to fiscal 2004. The \$0.7 million improvement in same store professional reading fees was due to changes in the fee arrangement at our Beverly Tower facilities. In October 2003, the radiologists, who had previously been compensated based on a percentage of net revenue, were eliminated and those physicians rehired by BRMG are now paid a fixed salary. See "Significant Events - Termination of Contract with Tower Imaging Medical Group, Inc." For fiscal 2003 and 2004, professional reading fees at Beverly Tower were \$3.9 million and \$2.9 million, respectively.

The \$2.2 million increase in salaries is due to the higher costs associated with recruiting and retaining key personnel, the hiring of a chief financial officer, the solidifying of Beverly Tower's non physician staff due to the disruption in October 2003, the hiring of physician assistants, and the costs of additional personnel necessary to open additional satellite locations and the build-out of a new center in Murietta.

### o BUILDING AND EQUIPMENT RENTAL

Building and equipment rental expenses decreased \$1.6 million in fiscal year 2004 when compared to the same period last year. The decrease is primarily due to the elimination of equipment operating leases including GE operating leases which were converted into \$6.0 million in capital leases in November 2003, and \$250,000 for Toshiba MR equipment which was converted into a capital lease in April 2004. During fiscal 2003 and 2004, we had equipment rental expenses of \$2.2 million and \$0.3 million, respectively.

### o GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses include billing fees, medical supplies, office supplies, repairs and maintenance, insurance, business tax and license, outside services, utilities, marketing, travel and other expenses. Many of these expenses are variable in nature. These expenses decreased \$1.2 million, or 3.4%, in fiscal 2004 compared to the previous period primarily due to the decrease in net revenue. In addition, general and administrative expenses decreased \$0.4 million for two facilities which were closed during the last two fiscal periods, offset by one center which was opened in December 2002.

### o DEPRECIATION AND AMORTIZATION

Depreciation and amortization increased by \$0.9 million in fiscal year 2004 when compared to the same period last year. The increase was primarily due to the conversion of \$6.2 million in equipment operating leases into capital leases during fiscal 2004 coupled with a full-year's amortization of the Tower tradename purchased in October 2003 for \$1.5 million and amortized over 10 years.

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### o PROVISION FOR BAD DEBT

The \$1.0 million decrease in provision for bad debt was primarily a result of decreased bad debt write-offs, the improvement in billing and collections with the conversion to a single internal system, increased capitation business which has no bad debt, decreased net revenue, and no significant payor dissolutions in fiscal 2004.

### INTEREST EXPENSE

Interest expense for fiscal 2004 decreased approximately \$0.7 million, or 3.7%, from the same period in fiscal 2003. The decrease was primarily due to the consolidation and restructuring of notes payable and capital lease obligations with new terms and interest rates.

### OTHER INCOME

In fiscal 2003 and 2004, we earned other income of \$0.6 million and \$0.2 million, respectively, principally comprised of sublease income, record copy income, deferred rent income, other income related to certain write-offs of liabilities and business interruption and insurance refunds. During fiscal 2004, we had no write-offs of liabilities nor business interruption or insurance refunds.

### OTHER EXPENSE

In fiscal 2003 and 2004, we incurred other expense of \$0.3 million and \$1.7 million, respectively, principally comprised of write-offs of miscellaneous receivables and other assets, losses on disposal of equipment, forgiveness of notes, losses on the sale or disposal of assets, and costs related to bond offerings and debt restructures. During fiscal 2004, we incurred approximately \$1.6 million of legal and professional service costs related to our earlier attempts to solidify financing and the related bond offering that was not completed.

### INCOME TAX EXPENSE

In fiscal 2004, we increased the valuation allowance for the net deferred tax asset by \$5.2 million due to our recurring losses from continuing operations over the last three fiscal years.

### MINORITY INTEREST IN EARNINGS OF SUBSIDIARIES

Minority interest in earnings of subsidiaries represents the minority investors' 25% share of the income from the Burbank Advanced Imaging Center LLC and 25% share of the Rancho Bernardo Advanced LLC for the period. The residual interests of both centers were purchased by us in September and July 2004, respectively. We now own 100% of all our locations and our minority interest liabilities have been eliminated. Minority interest in earnings of subsidiaries increased \$250,000 in fiscal 2004 compared to the same period in the prior period primarily due to the earnings incurred by Rancho Bernardo.

### DISCONTINUED OPERATION

The income from operations of Westchester was \$0.3 million for fiscal 2003. Net revenue was \$2.2 million for fiscal 2003. Effective March 31, 2003, we sold our 50% share of Westchester to our joint venture partner for \$3.0 million. As part of the transaction, we acquired 100% of the accounts receivable generated through March 31, 2003 for \$1.3 million and reimbursed Westchester \$0.3 million, which represented 50% of the remaining liabilities, resulting in



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net cash proceeds of approximately \$1.4 million. We recognized a gain on the transaction of approximately \$2.9 million in fiscal 2003.

### SUMMARY OF OPERATIONS BY QUARTER

The following table presents unaudited quarterly operating results for each of our last eight fiscal quarters. We believe that all necessary adjustments have been included in the amounts stated below to present fairly the quarterly results when read in conjunction with the consolidated financial statements. Results of operations for any particular quarter are not necessarily indicative of results of operations for a full year or predictive of future periods.

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|                                      | 2004 Quarter Ended     |           |           |           |           | A  |
|--------------------------------------|------------------------|-----------|-----------|-----------|-----------|----|
|                                      | Jan 31                 | Apr 30    | Jul 31(1) | Oct 31(2) | Jan 31    |    |
|                                      | (dollars in thousands) |           |           |           |           |    |
| <b>STATEMENT OF OPERATIONS DATA:</b> |                        |           |           |           |           |    |
| Net revenue                          | \$ 34,047              | \$ 35,853 | \$ 33,900 | \$ 33,477 | \$ 34,110 | \$ |
| Operating expenses                   | 31,086                 | 32,774    | 32,820    | 30,821    | 32,097    |    |
| Total other expense                  | 4,265                  | 4,965     | 5,363     | 4,173     | 4,211     |    |
| Income tax expense                   | --                     | --        | --        | 5,235     | --        |    |
| Net income (loss)                    | (1,305)                | (1,897)   | (4,517)   | (6,857)   | (2,198)   |    |
| <b>Basic earnings per share:</b>     |                        |           |           |           |           |    |
| Basic net loss per share             | (.03)                  | (.05)     | (.11)     | (.16)     | (.05)     |    |
| <b>Diluted earnings per share:</b>   |                        |           |           |           |           |    |
| Diluted net loss per share           | (.03)                  | (.03)     | (.11)     | (.16)     | (.05)     |    |

- 1 Includes costs related to some of our earlier attempts to solidify financing and the related bond offering that was not completed including \$660,000 in professional and legal fees and \$555,000 in interest expense.
- 2 Includes \$5.2 million of expense for the increase in the valuation allowance for the net deferred tax asset.

### RELATED PARTY TRANSACTIONS

We describe certain transactions between us and certain related parties under "Certain Relationships and Related Transactions" below.

### RECENT ACCOUNTING PRONOUNCEMENTS

#### SHARE-BASED PAYMENT

In December 2004, the FASB issued SFAS No. 123 (Revised 2004), "Share-Based Payment" which was amended effective April 2005. The new rule requires that the compensation cost relating to share-based payment transactions be recognized in financial statements based on the fair value of the equity or

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liability instruments issued. We will be required to apply Statement 123R as of the first annual reporting period starting after June 15, 2005, which is our first quarter beginning November 1, 2005. We routinely use share-based payment arrangements as compensation for our employees. During fiscal 2003, 2004 and 2005, had this rule been in effect, we would have recorded the non-cash expense of \$82,000, \$379,000 and \$341,000, respectively.

### DETERMINING AMORTIZATION PERIOD FOR LEASEHOLD IMPROVEMENTS

In June 2005, the EITF issued EITF Issue No. 05-06, "Determining the Amortization Period for Leasehold Improvements Purchased after Lease Inception or Acquired in a Business Combination" ("EITF 05-06"). EITF 05-06 provides that the amortization period for leasehold improvements acquired in a business combination or purchased after the inception of a lease be the shorter of (a) the useful life of the assets or (b) a term that includes required lease periods and renewals that are reasonably assured upon the acquisition or the purchase. The provision of EITF 05-06 are effective on a prospective basis for leasehold improvements purchased or acquired beginning July 1, 2005. The adoption of EITF 05-06 during the three months ended October 31, 2005 did not have a material affect on the Company's consolidated financial statements.

### EXCHANGES OF NONMONETARY ASSETS

In December 2004, the FASB issued FASB Statement No. 153, "Exchanges of Nonmonetary Assets - An Amendment of APB Opinion No. 29." The amendments made by Statement 153 are based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. Further, the amendments eliminate the narrow exception for nonmonetary exchanges of similar productive assets and replace it with a broader exception for exchanges of nonmonetary assets that do not have "commercial substance." The provisions in Statement 153 are effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Adoption of this standard is not expected to have a material impact on the consolidated financial statements.

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### DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION

In September 2004, the Emerging Issues Task Force (EITF) reached a consensus on EITF Issue No. 04-10, "Applying Paragraph 19 of FAS 131 in Determining Whether to Aggregate Operating Segments That Do Not Meet the Quantitative Thresholds." The consensus states that operating segments that do not meet the quantitative thresholds can be aggregated only if aggregation is consistent with the objective and basic principles of SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," the segments have similar economic characteristics, and the segments share a majority of the aggregation criteria (a)-(e) listed in paragraph 17 of SFAS 131. The consensus was ratified by the FASB at their October 13, 2004 meeting. The effective date of the consensus in this Issue has been postponed indefinitely at the November 17-18 EITF meeting. The Company does not anticipate a material impact on the financial statements from the adoption of this consensus.

### DETERMINING WHETHER TO REPORT DISCONTINUED OPERATIONS

In November 2004, the Emerging Issues Task Force (EITF) reached a consensus on EITF Issue No. 03-13, "Applying the Conditions in Paragraph 42 of FASB Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," in Determining Whether to Report Discontinued Operations. The consensus provides guidance in determining: (a) which cash flows should be taken into consideration when assessing whether the cash flows of the disposal component

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have been or will be eliminated from the ongoing operations of the entity, (b) the types of involvement ongoing between the disposal component and the entity disposing of the component that constitute continuing involvement in the operations of the disposal component, and (c) the appropriate (re)assessment period for purposes of assessing whether the criteria in paragraph 42 have been met. The consensus was ratified by the FASB at their November 30, 2004 meeting and should be applied to a component of an enterprise that is either disposed of or classified as held for sale in fiscal periods beginning after December 15, 2004. The Company does not anticipate a material impact on the financial statements from the adoption of this consensus.

### FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains "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 reflect, among other things, management's current expectations and anticipated results of operations, all of which are subject to known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements, or industry results, to differ materially from those expressed or implied by such forward-looking statements. Therefore, any statements contained herein that are not statements of historical fact may be forward-looking statements and should be evaluated as such. Without limiting the foregoing, the words "believes," "anticipates," "plans," "intends," "will," "expects," "should" and similar words and expressions are intended to identify forward-looking statements. Except as required under the federal securities laws or by the rules and regulations of the SEC, we assume no obligation to update any such forward-looking information to reflect actual results or changes in the factors affecting such forward-looking information. The factors included in "Risks Relating to Our Business," among others, could cause our actual results to differ materially from those expressed in, or implied by, the forward-looking statements.

Specific factors that might cause actual results to differ from our expectations, include, but are not limited to:

- o economic, competitive, demographic, business and other conditions in our markets;
- o a decline in patient referrals;
- o changes in the rates or methods of third-party reimbursement for diagnostic imaging services;
- o the enforceability or termination of our contracts with radiology practices;
- o the availability of additional capital to fund capital expenditure requirements;
- o burdensome lawsuits against our contracted radiology practices and us;
- o reduced operating margins due to our managed care contracts and capitated fee arrangements;
- o any failure on our part to comply with state and federal anti-kickback and anti-self-referral laws or any other applicable healthcare regulations;
- o our substantial indebtedness, debt service requirements and liquidity constraints;

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- o the interruption of our operations in certain regions due to earthquake or other extraordinary events;
- o the recruitment and retention of technologists by us or by

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- o radiologists of our contracted radiology groups; and
- o other factors discussed in the "Risk Factors" section or elsewhere in this report.

All future written and verbal forward-looking statements attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this report might not occur.

### RISKS RELATING TO OUR BUSINESS

WE MAY NOT BE ABLE TO GENERATE SUFFICIENT CASH FLOW TO MEET OUR DEBT SERVICE OBLIGATIONS.

Our ability to generate sufficient cash flow from operations to make payments on our debt and other contractual obligations will depend on our future financial performance. A range of economic, competitive, regulatory, legislative and business factors, many of which are outside of our control, will affect our financial performance. Our inability to generate sufficient cash flow to satisfy our debt and other contractual obligations would adversely impact our business, financial condition and results of operations.

OUR ABILITY TO GENERATE REVENUE DEPENDS IN LARGE PART ON REFERRALS FROM PHYSICIANS.

A significant reduction in referrals would have a negative impact on our business. We derive substantially all of our net revenue, directly or indirectly, from fees charged for the diagnostic imaging services performed at our facilities. We depend on referrals of patients from unaffiliated physicians and other third parties who have no contractual obligations to refer patients to us for a substantial portion of the services we perform. If a sufficiently large number of these physicians and other third parties were to discontinue referring patients to us, our scan volume could decrease, which would reduce our net revenue and operating margins. Further, commercial third-party payors have implemented programs that could limit the ability of physicians to refer patients to us. For example, prepaid healthcare plans, such as health maintenance organizations, sometimes contract directly with providers and require their enrollees to obtain these services exclusively from those providers. Some insurance companies and self-insured employers also limit these services to contracted providers. These "closed panel" systems are now common in the managed care environment, including California. Other systems create an economic disincentive for referrals to providers outside the system's designated panel of providers. If we are unable to compete successfully for these managed care contracts, our results and prospects for growth could be adversely affected.

CHANGES IN THIRD-PARTY REIMBURSEMENT RATES OR METHODS FOR DIAGNOSTIC IMAGING SERVICES COULD RESULT IN A DECLINE IN OUR NET REVENUE AND NEGATIVELY IMPACT OUR BUSINESS.

The fees charged for the diagnostic imaging services performed at our facilities are paid by insurance companies, Medicare and Medi-Cal, workers compensation, private and other payors. Any change in the rates of or conditions for reimbursement from these sources of payment could substantially reduce the amounts reimbursed to us or to our contracted radiology practices for services provided, which could have an adverse effect on our net revenue. For example, recent legislative changes in California's workers compensation rules had a negative impact on reimbursement rates for diagnostic imaging services, although because we derive only a small portion of our net revenue from workers compensation, we did not experience a significant impact.

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PRESSURE TO CONTROL HEALTHCARE COSTS COULD HAVE A NEGATIVE IMPACT ON OUR RESULTS.

One of the principal objectives of health maintenance organizations and preferred provider organizations is to control the cost of healthcare services. Managed care contracting has become very competitive, and reimbursement schedules are at or below Medicare reimbursement levels. The development and expansion of health maintenance organizations, preferred provider organizations and other managed care organizations within the geographic areas covered by our network could have a negative impact on the utilization and pricing of our services, because these organizations will exert greater control over patients' access to diagnostic imaging services, the selections of the provider of such services and reimbursement rates for those services.

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IF BRMG OR ANY OF OUR OTHER CONTRACTED RADIOLOGY PRACTICES TERMINATE THEIR AGREEMENTS WITH US, OUR BUSINESS COULD SUBSTANTIALLY DIMINISH.

Our relationship with BRMG is an integral part of our business. Through our management agreement, BRMG provides all of the professional medical services at 42 of our 57 facilities, contracts with various other independent physicians and physician groups to provide all of the professional medical services at most of our other facilities, and must use its best efforts to provide the professional medical services at any new facilities that we open or acquire. In addition, BRMG's strong relationships with referring physicians are largely responsible for the revenue generated at the facilities it services. Although our management agreement with BRMG runs until 2014, BRMG has the right to terminate the agreement if we default on our obligations and fail to cure the default. Also, BRMG's ability to continue performing under the management agreement may be curtailed or eliminated due to BRMG's financial difficulties, loss of physicians or other circumstances. If BRMG cannot perform its obligation to us, we would need to contract with one or more other radiology groups to provide the professional medical services at the facilities serviced by BRMG. We may not be able to locate radiology groups willing to provide those services on terms acceptable to us, if at all. Even if we were able to do so, any replacement radiology group's relationships with referring physicians may not be as extensive as those of BRMG. In any such event, our business could be seriously harmed. In addition, BRMG is party to substantially all of the managed care contracts from which we derive revenue. If we were unable to readily replace these contracts, our revenue would be negatively affected.

Except for our management agreement with BRMG, most of the agreements we, or BRMG, have with contracted radiology practices typically have terms of one year, which automatically renew unless either party delivers a non-renewal notice to the other within a prescribed period. Most of these agreements may be terminated by either party under some conditions, including, with respect to some of those agreements, the right of either party to terminate the agreement without cause upon 30 to 120 days notice. For example, in October 2003, our management agreement with Tower Imaging Medical Group, Inc. was terminated as the result of the settlement of litigation between Tower and us. The termination or material modification of any of the agreements we, or BRMG, have with the radiologists that provide professional medical services at our facilities could reduce our revenue, at least in the short term.

IF OUR CONTRACTED RADIOLOGY PRACTICES, INCLUDING BRMG, LOSE A SIGNIFICANT NUMBER OF THEIR RADIOLOGISTS, OUR FINANCIAL RESULTS COULD BE ADVERSELY AFFECTED.

Recently, there has been a shortage of qualified radiologists in some of the regional markets we serve. In addition, competition in recruiting

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radiologists may make it difficult for our contracted radiology practices to maintain adequate levels of radiologists. If a significant number of radiologists terminate their relationships with our contracted radiology practices and those radiology practices cannot recruit sufficient qualified radiologists to fulfill their obligations under our agreements with them, our ability to maximize the use of our diagnostic imaging facilities and our financial results could be adversely affected. For example, in fiscal 2002, due to a shortage of qualified radiologists in the marketplace, BRMG experienced difficulty in hiring and retaining physicians and thus engaged independent contractors and part-time fill-in physicians. Their cost was double the salary of a regular BRMG full-time physician. Increased expenses to BRMG will impact our financial results because the management fee we receive from BRMG, which is based on a percentage of BRMG's collections, is adjusted annually to take into account the expenses of BRMG. Neither we, nor our contracted radiology practices, maintain insurance on the lives of any affiliated physicians.

WE MAY NOT BE ABLE TO SUCCESSFULLY GROW OUR BUSINESS.

As part of our business strategy, we intend to increase our presence in California through selectively acquiring facilities, developing new facilities, adding equipment at existing facilities, and directly or indirectly through BRMG entering into contractual relationships with high-quality radiology practices.

However, our ability to successfully expand depends upon many factors, including our ability to:

- o Identify attractive and willing candidates for acquisitions;
- o Identify locations in existing or new markets for development of new facilities;
- o Comply with legal requirements affecting our arrangements with contracted radiology practices, including California prohibitions on fee-splitting, corporate practice of medicine and self-referrals;

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- o Obtain regulatory approvals where necessary and comply with licensing and certification requirements applicable to our diagnostic imaging facilities, the contracted radiology practices and the physicians associated with the contracted radiology practices;
- o Recruit a sufficient number of qualified radiology technologists and other non-medical personnel;
- o Expand our infrastructure and management; and
- o Compete for opportunities. We may not be able to compete effectively for the acquisition of diagnostic imaging facilities. Our competitors may have more established operating histories and greater resources than we do. Competition also may make any acquisitions more expensive.

Acquisitions involve a number of special risks, including the following:

- o Obtain adequate financing.
- o Possible adverse effects on our operating results;
- o Diversion of management's attention and resources;
- o Failure to retain key personnel;
- o Difficulties in integrating new operations into our existing infrastructure; and
- o Amortization or write-offs of acquired intangible assets.

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WE MAY BECOME SUBJECT TO PROFESSIONAL MALPRACTICE LIABILITY.

Providing medical services subjects us to the risk of professional malpractice and other similar claims. The physicians that our contracted radiology practices employ are from time to time subject to malpractice claims. We structure our relationships with the practices under our management agreements with them in a manner that we believe does not constitute the practice of medicine by us or subject us to professional malpractice claims for acts or omissions of physicians employed by the contracted radiology practices. Nevertheless, claims, suits or complaints relating to services provided by the contracted radiology practices have been asserted against us in the past and may be asserted against us in the future. In addition, we may be subject to professional liability claims, including, without limitation, for improper use or malfunction of our diagnostic imaging equipment. We may not be able to maintain adequate liability insurance to protect us against those claims at acceptable costs or at all.

Any claim made against us that is not fully covered by insurance could be costly to defend, result in a substantial damage award against us and divert the attention of our management from our operations, all of which could have an adverse effect on our financial performance. In addition, successful claims against us may adversely affect our business or reputation. Although California places a \$250,000 limit on non-economic damages for medical malpractice cases, no limit applies to economic damages.

SOME OF OUR IMAGING MODALITIES USE RADIOACTIVE MATERIALS, WHICH GENERATE REGULATED WASTE AND COULD SUBJECT US TO LIABILITIES FOR INJURIES OR VIOLATIONS OF ENVIRONMENTAL AND HEALTH AND SAFETY LAWS.

Some of our imaging procedures use radioactive materials, which generate medical and other regulated wastes. For example, patients are injected with a radioactive substance before undergoing a PET scan. Storage, use and disposal of these materials and waste products present the risk of accidental environmental contamination and physical injury. We are subject to federal, California and local regulations governing storage, handling and disposal of these materials. We could incur significant costs and the diversion of our management's attention in order to comply with current or future environmental and health and safety laws and regulations. Also, we cannot completely eliminate the risk of accidental contamination or injury from these hazardous materials. In the event of an accident, we could be held liable for any resulting damages, and any liability could exceed the limits of or fall outside the coverage of our insurance.

WE EXPERIENCE COMPETITION FROM OTHER DIAGNOSTIC IMAGING COMPANIES AND HOSPITALS. THIS COMPETITION COULD ADVERSELY AFFECT OUR REVENUE AND BUSINESS.

The market for diagnostic imaging services in California is highly competitive. We compete principally on the basis of our reputation, our ability to provide multiple modalities at many of our facilities, the location of our facilities and the quality of our diagnostic imaging services. We compete locally with groups of radiologists, established hospitals, clinics and other independent organizations that own and operate imaging equipment. Our major

national competitors include Radiologix, Inc., Alliance Imaging, Inc., Healthsouth Corporation and Insight Health Services. Some of our competitors may now or in the future have access to greater financial resources than we do and may have access to newer, more advanced equipment.

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In addition, in the past some non-radiologist physician practices have refrained from establishing their own diagnostic imaging facilities because of the federal physician self-referral legislation. Final regulations issued in January 2001 clarify exceptions to the physician self-referral legislation, which created opportunities for some physician practices to establish their own diagnostic imaging facilities within their group practices and to compete with us. In the future, we could experience significant competition as a result of those final regulations.

TECHNOLOGICAL CHANGE IN OUR INDUSTRY COULD REDUCE THE DEMAND FOR OUR SERVICES AND REQUIRE US TO INCUR SIGNIFICANT COSTS TO UPGRADE OUR EQUIPMENT.

The development of new technologies or refinements of existing modalities may require us to upgrade and enhance our existing equipment before we may otherwise intend. Many companies currently manufacture diagnostic imaging equipment. Competition among manufacturers for a greater share of the diagnostic imaging equipment market may result in technological advances in the speed and imaging capacity of new equipment. This may accelerate the obsolescence of our equipment, and we may not have the financial ability to acquire the new or improved equipment. In that event, we may be unable to deliver our services in the efficient and effective manner that payors, physicians and patients expect and thus our revenue could substantially decrease. During fiscal 2005, we traded-in and upgraded our existing MRI at Tarzana Advanced to increase throughput and patient volume and compete in the marketplace. We incurred a loss on disposal of equipment of approximately \$696,000 for the upgrade.

WE HAVE EXPERIENCED OPERATING LOSSES AND WE HAVE A SUBSTANTIAL ACCUMULATED DEFICIT. IF WE ARE UNABLE TO IMPROVE OUR FINANCIAL PERFORMANCE, WE MAY BE UNABLE TO PAY OUR OBLIGATIONS.

We have incurred net losses of \$14.6 million and \$3.1 million during the years ended October 31, 2004 and 2005, respectively, and at October 31, 2005 we had an accumulated stockholders' deficit of \$70.6 million. Also, in recent periods, we have suffered liquidity shortfalls which have led us to, among other things, undertake and complete a "pre-packaged" Chapter 11 plan of reorganization and modify the terms of various of our financial obligations. While we believe that by taking these and other actions in the future we be able to address these issues and solidify our financial condition, we cannot give assurances that we will be able to generate sufficient cash flow from operations to satisfy our debt obligations.

A FAILURE TO MEET OUR CAPITAL EXPENDITURE REQUIREMENTS COULD ADVERSELY AFFECT OUR BUSINESS.

We operate in a capital intensive, high fixed-cost industry that requires significant amounts of capital to fund operations, particularly the initial start-up and development expenses of new diagnostic imaging facilities and the acquisition of additional facilities and new diagnostic imaging equipment. We incur capital expenditures to, among other things, upgrade and replace existing equipment for existing facilities and expand within our existing markets and enter new markets. To the extent we are unable to generate sufficient cash from our operations, funds are not available from our lenders or we are unable to structure or obtain financing through operating leases, long-term installment notes or capital leases, we may be unable to meet our capital expenditure requirements.

BECAUSE WE HAVE HIGH FIXED COSTS, LOWER SCAN VOLUMES PER SYSTEM COULD ADVERSELY AFFECT OUR BUSINESS.

The principal components of our expenses, excluding depreciation, consist of compensation paid to technologists, salaries, real estate lease expenses and equipment maintenance costs. Because a majority of these expenses are fixed, a



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relatively small change in our revenue could have a disproportionate effect on our operating and financial results depending on the source of our revenue. Thus, decreased revenue as a result of lower scan volumes per system could result in lower margins, which would adversely affect our business.

OUR SUCCESS DEPENDS IN PART ON OUR KEY PERSONNEL AND WE MAY NOT BE ABLE TO RETAIN SUFFICIENT QUALIFIED PERSONNEL. IN ADDITION, FORMER EMPLOYEES COULD USE THE EXPERIENCE AND RELATIONSHIPS DEVELOPED WHILE EMPLOYED WITH US TO COMPETE WITH US.

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Our success depends in part on our ability to attract and retain qualified senior and executive management, managerial and technical personnel. Competition in recruiting these personnel may make it difficult for us to continue our growth and success. The loss of their services or our inability in the future to attract and retain management and other key personnel could hinder the implementation of our business strategy. The loss of the services of Dr. Howard G. Berger, our President and Chief Executive Officer, or Norman R. Hames, our Chief Operating Officer, could have a significant negative impact on our operations. We believe that they could not easily be replaced with executives of equal experience and capabilities. We do not maintain key person insurance on the life of any of our executive officers with the exception of a \$5.0 million policy on the life of Dr. Berger. Also, if we lose the services of Dr. Berger, our relationship with BRMG could deteriorate, which would adversely affect our business.

Unlike many other states, California does not enforce agreements that prohibit a former employee from competing with the former employer. As a result, any of our employees whose employment is terminated is free to compete with us, subject to prohibitions on the use of confidential information and, depending on the terms of the employee's employment agreement, on solicitation of existing employees and customers. A former executive, manager or other key employee who joins one of our competitors could use the relationships he or she established with third party payors, radiologists or referring physicians while our employee and the industry knowledge he or she acquired during that tenure to enhance the new employer's ability to compete with us.

### CAPITATION FEE ARRANGEMENTS COULD REDUCE OUR OPERATING MARGINS.

For fiscal 2005, we derived approximately 26% of our net revenue from capitation arrangements, and we intend to increase the revenue we derive from capitation arrangements in the future. Under capitation arrangements, the payor pays a pre-determined amount per-patient per-month in exchange for us providing all necessary covered services to the patients covered under the arrangement. These contracts pass much of the financial risk of providing diagnostic imaging services, including the risk of over-use, from the payor to the provider. Our success depends in part on our ability to negotiate effectively, on behalf of the contracted radiology practices and our diagnostic imaging facilities, contracts with health maintenance organizations, employer groups and other third-party payors for services to be provided on a capitated basis and to efficiently manage the utilization of those services. If we are not successful in managing the utilization of services under these capitation arrangements or if patients or enrollees covered by these contracts require more frequent or extensive care than anticipated, we would incur unanticipated costs not offset by additional revenue, which would reduce operating margins.

WE MAY BE UNABLE TO EFFECTIVELY MAINTAIN OUR EQUIPMENT OR GENERATE REVENUE WHEN OUR EQUIPMENT IS NOT OPERATIONAL.

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Timely, effective service is essential to maintaining our reputation and high use rates on our imaging equipment. Although we have an agreement with GE Medical Systems pursuant to which it maintains and repairs the majority of our imaging equipment, this agreement does not compensate us for loss of revenue when our systems are not fully operational and our business interruption insurance may not provide sufficient coverage for the loss of revenue. Also, GE Medical Systems may not be able to perform repairs or supply needed parts in a timely manner. Therefore, if we experience more equipment malfunctions than anticipated or if we are unable to promptly obtain the service necessary to keep our equipment functioning effectively, our ability to provide services would be adversely affected and our revenue could decline.

DISRUPTION OR MALFUNCTION IN OUR INFORMATION SYSTEMS COULD ADVERSELY AFFECT OUR BUSINESS.

Our information technology system is vulnerable to damage or interruption from:

- o Earthquakes, fires, floods and other natural disasters;
- o Power losses, computer systems failures, internet and telecommunications or data network failures, operator negligence, improper operation by or supervision of employees, physical and electronic losses of data and similar events; and
- o Computer viruses, penetration by hackers seeking to disrupt operations or misappropriate information and other breaches of security.

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We, and BRMG, rely on this system to perform functions critical to our and its ability to operate, including patient scheduling, billing, collections, image storage and image transmission. Accordingly, an extended interruption in the system's function could significantly curtail, directly and indirectly, our ability to conduct our business and generate revenue.

OUR ACTUAL FINANCIAL RESULTS MAY VARY SIGNIFICANTLY FROM THE PROJECTIONS WE FILED WITH THE BANKRUPTCY COURT.

In connection with our "pre-packaged" Chapter 11 plan of reorganization that was confirmed by the Bankruptcy Court on October 20, 2003, we were required to prepare projected financial information to demonstrate to the Bankruptcy Court the feasibility of the plan of reorganization and our ability to continue operations upon our emergence from bankruptcy. As indicated in the disclosure statement with respect to the plan of reorganization and the exhibits thereto, the projected financial information and various estimates of value discussed therein should not be regarded as representations or warranties by us or any other person as to the accuracy of that information or that those projections or valuations will be realized. We, and our advisors, prepared the information in the disclosure statement, including the projected financial information and estimates of value. This information was not audited or reviewed by our independent accountants. The significant assumptions used in preparation of the information and estimates of value were included as an exhibit to the disclosure statement.

Those projections are not included in this report and you should not rely upon them in any way or manner. We have not updated, nor will we update, those projections. At the time we prepared the projections, they reflected numerous assumptions concerning our anticipated future performance with respect to

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prevailing and anticipated market and economic conditions which were and remain beyond our control and which may not materialize. Projections are inherently subject to significant and numerous uncertainties and to a wide variety of significant business, economic and competitive risks and the assumptions underlying the projections may be wrong in many material respects. Our actual results may vary significantly from those contemplated by the projections. As a result, we caution you not to rely upon those projections.

### WE ARE VULNERABLE TO EARTHQUAKES AND OTHER NATURAL DISASTERS.

Our headquarters and all of our facilities are located in California, an area prone to earthquakes and other natural disasters. An earthquake or other natural disaster could seriously impair our operations, and our insurance may not be sufficient to cover us for the resulting losses.

COMPLYING WITH FEDERAL AND STATE REGULATIONS IS AN EXPENSIVE AND TIME-CONSUMING PROCESS, AND ANY FAILURE TO COMPLY COULD RESULT IN SUBSTANTIAL PENALTIES.

We are directly or indirectly through the radiology practices with which we contract subject to extensive regulation by both the federal government and the State of California, including:

- o The federal False Claims Act;
- o The federal Medicare and Medicaid anti-kickback laws, and California anti-kickback prohibitions;
- o Federal and California billing and claims submission laws and regulations;
- o The federal Health Insurance Portability and Accountability Act of 1996;
- o The federal physician self-referral prohibition commonly known as the Stark Law and the California equivalent of the Stark Law;
- o California laws that prohibit the practice of medicine by non-physicians and prohibit fee-splitting arrangements involving physicians;
- o Federal and California laws governing the diagnostic imaging and therapeutic equipment we use in our business concerning patient safety, equipment operating specifications and radiation exposure levels; and
- o California laws governing reimbursement for diagnostic services related to services compensable under workers compensation rules.

If our operations are found to be in violation of any of the laws and regulations to which we or the radiology practices with which we contract are subject, we may be subject to the applicable penalty associated with the violation, including civil and criminal penalties, damages, fines and the curtailment of our operations. Any penalties, damages, fines or curtailment of our operations, individually or in the aggregate, could adversely affect our ability to operate our business and our financial results. The risks of our being found in violation of these laws and regulations is increased by the fact that many of them have not been fully interpreted by the regulatory authorities

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or the courts, and their provisions are open to a variety of interpretations. Any action brought against us for violation of these laws or regulations, even if we successfully defend against it, could cause us to incur significant legal expenses and divert our management's attention from the operation of our business. For a more detailed discussion of the various federal and California laws and regulations to which we are subject, see "Business - Government Regulation."

IF WE FAIL TO COMPLY WITH VARIOUS LICENSURE, CERTIFICATION AND ACCREDITATION STANDARDS, WE MAY BE SUBJECT TO LOSS OF LICENSURE, CERTIFICATION OR ACCREDITATION, WHICH WOULD ADVERSELY AFFECT OUR OPERATIONS.

Ownership, construction, operation, expansion and acquisition of our diagnostic imaging facilities are subject to various federal and California laws, regulations and approvals concerning licensing of personnel, other required certificates for certain types of healthcare facilities and certain medical equipment. In addition, freestanding diagnostic imaging facilities that provide services independent of a physician's office must be enrolled by Medicare as an independent diagnostic testing facility to bill the Medicare program. Medicare carriers have discretion in applying the independent diagnostic testing facility requirements and therefore the application of these requirements may vary from jurisdiction to jurisdiction. We may not be able to receive the required regulatory approvals for any future acquisitions, expansions or replacements, and the failure to obtain these approvals could limit the opportunity to expand our services.

Our facilities are subject to periodic inspection by governmental and other authorities to assure continued compliance with the various standards necessary for licensure and certification. If any facility loses its certification under the Medicare program, then the facility will be ineligible to receive reimbursement from the Medicare and Medi-Cal programs. For the year ended October 31, 2005, approximately 18% of our net revenue came from the Medicare and Medi-Cal programs. A change in the applicable certification status of one of our facilities could adversely affect our other facilities and in turn us as a whole.

OUR AGREEMENTS WITH THE CONTRACTED RADIOLOGY PRACTICES MUST BE STRUCTURED TO AVOID THE CORPORATE PRACTICE OF MEDICINE AND FEE-SPLITTING.

California law prohibits 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 are enforced by state courts and regulatory authorities, each with broad discretion. A component of our business has been to enter into management agreements with radiology practices. We provide management, administrative, technical and other non-medical services to the radiology practices in exchange for a service fee typically based on a percentage of the practice's revenue. We structure our relationships with the radiology practices, including the purchase of diagnostic imaging facilities, in a manner that we believe keeps us from engaging in the practice of medicine or exercising control over the medical judgments or decisions of the radiology practices or their physicians or violating the prohibitions against fee-splitting. However, because challenges to these types of arrangements are not required to be reported, we cannot substantiate our belief. There can be no assurance that our present arrangements with BRMG or the physicians providing medical services and medical supervision at our imaging facilities will not be challenged, and, if challenged, that they will not be found to violate the corporate practice prohibition, thus subjecting us to potential damages, injunction and/or civil and criminal penalties or require us to restructure our arrangements in a way that would affect the control or quality of our services and/or change the amounts we receive under our management agreements. Any of these results could jeopardize our business.

FUTURE FEDERAL LEGISLATION COULD LIMIT THE PRICES WE CAN CHARGE FOR OUR SERVICES, WHICH WOULD REDUCE OUR REVENUE AND ADVERSELY AFFECT OUR OPERATING RESULTS.

In addition to extensive existing government healthcare regulation, there are numerous initiatives affecting the coverage of and payment for healthcare services, including proposals that would significantly limit reimbursement under the Medicare and Medi-Cal programs. Limitations on reimbursement amounts and other cost containment pressures have in the past resulted in a decrease in the revenue we receive for each scan we perform.

THE REGULATORY FRAMEWORK IN WHICH WE OPERATE IS UNCERTAIN AND EVOLVING.

Healthcare laws and regulations may change significantly in the future. We continuously monitor these developments and modify our operations from time to time as the regulatory environment changes. We cannot assure you, however, that we will be able to adapt our operations to address new regulations or that new regulations will not adversely affect our business. In addition, although we believe that we are operating in compliance with applicable federal and California laws, neither our current or anticipated business operations nor the operations of the contracted radiology practices have been the subject of judicial or regulatory interpretation. We cannot assure you 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.

Certain states have enacted statutes or adopted regulations affecting risk assumption in the healthcare industry, including statutes and regulations that subject any physician or physician network engaged in risk-based managed care contracting to applicable insurance laws and regulations. These laws and regulations, if adopted in California, may require physicians and physician networks to meet minimum capital requirements and other safety and soundness requirements. Implementing additional regulations or compliance requirements could result in substantial costs to us and the contracted radiology practices and limit our ability to enter into capitation or other risk sharing managed care arrangements.

OUR SUBSTANTIAL DEBT COULD ADVERSELY AFFECT OUR FINANCIAL CONDITION AND PREVENT US FROM FULFILLING OUR OBLIGATIONS.

Our current substantial indebtedness and any future indebtedness we incur could have important consequences by adversely affecting our financial condition, which could make it more difficult for us to satisfy our obligations to our creditors. Our substantial indebtedness could also:

- o Require us to dedicate a substantial portion of our cash flow from operations to payments on our debt, reducing the availability of our cash flow to fund working capital, capital expenditures and other general corporate purposes;
- o Increase our vulnerability to adverse general economic and industry conditions;
- o Limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- o Place us at a competitive disadvantage compared to our competitors

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that have less debt; and

- o Limit our ability to borrow additional funds on terms that are satisfactory to us or at all.

### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

The majority of our interest expense is not sensitive to changes in the general level of interest in the United States because the majority of our indebtedness has interest rates that were fixed when we entered into the note payable or capital lease obligation. None of our long-term liabilities have variable interest rates. Our credit facility, classified as a current liability on our financial statements, is interest expense sensitive to changes in the general level of interest because it is based upon the current prime rate plus a factor.

### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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The Financial Statements are attached hereto and begin on page F-1.

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### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors of  
Primedex Health Systems, Inc.

We have audited the accompanying consolidated balance sheets of Primedex Health Systems, Inc. and affiliates as of October 31, 2004 and 2005 and the related consolidated statements of operations, stockholders' deficit and cash flows for each of the years in the three-year period ended October 31, 2005. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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.

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In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Primedex Health Systems, Inc. and affiliates as of October 31, 2004 and 2005, and the consolidated results of their operations and their cash flows for each of the years in the three-year period ended October 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

/s/ MOSS ADAMS LLP

Los Angeles, California  
February 13, 2006

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PRIMEDEX HEALTH SYSTEMS, INC. AND AFFILIATES  
CONSOLIDATED BALANCE SHEETS  
OCTOBER 31,

|  | 2004           | 2005           |
|--|----------------|----------------|
| <b>ASSETS</b>                                |                |                |
| <b>CURRENT ASSETS</b>                        |                |                |
| Cash and cash equivalents                    | \$ 1,000       | \$ 2,000       |
| Accounts receivable, net                     | 20,029,000     | 22,319,000     |
| Unbilled receivables and other receivables   | 966,000        | 476,000        |
| Other  | 1,858,000      | 1,799,000      |
| Total current assets                         | 22,854,000     | 24,596,000     |
| PROPERTY AND EQUIPMENT, NET                  | 77,333,000     | 68,107,000     |
| <b>OTHER ASSETS</b>                          |                |                |
| Accounts receivable, net                     | 1,868,000      | 1,267,000      |
| Goodwill                                     | 23,099,000     | 23,099,000     |
| Trade name and other                         | 2,297,000      | 4,164,000      |
| Total other assets                           | 27,264,000     | 28,530,000     |
| Total assets                                 | \$ 127,451,000 | \$ 121,233,000 |
| <b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b> |                |                |
| <b>CURRENT LIABILITIES</b>                   |                |                |
| Cash disbursements in transit                | \$ 2,536,000   | \$ 3,425,000   |
| Line of credit                               | 14,011,000     | 13,341,000     |
| Accounts payable and accrued expenses        | 22,852,000     | 22,469,000     |
| Short-term notes expected to be refinanced:  |                |                |
| Notes payable                                | --             | 69,066,000     |
| Obligations under capital lease              | --             | 56,927,000     |
| Notes payable                                | 6,785,000      | 1,101,000      |
| Obligations under capital lease              | 8,842,000      | 1,697,000      |
|  | -----          | -----          |

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|  |                |                |
|--|----------------|----------------|
| Total current liabilities                                  | 55,026,000     | 168,026,000    |
|  | -----          | -----          |
| LONG-TERM LIABILITIES                                      |                |                |
| Subordinated debentures payable                            | 16,147,000     | 16,147,000     |
| Notes payable to related party                             | 2,119,000      | 3,533,000      |
| Notes payable, net of current portion                      | 62,828,000     | --             |
| Obligations under capital lease, net of<br>current portion | 58,557,000     | 4,129,000      |
| Accrued expenses   | 329,000        | 31,000         |
|  | -----          | -----          |
| Total long-term liabilities                                | 139,980,000    | 23,840,000     |
|  | -----          | -----          |
| COMMITMENTS AND CONTINGENCIES                              |                |                |
| STOCKHOLDERS' DEFICIT                                      | (67,555,000)   | (70,633,000)   |
|  | -----          | -----          |
| Total liabilities and stockholders' deficit                | \$ 127,451,000 | \$ 121,233,000 |
|  | =====          | =====          |

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PRIMEDEX HEALTH SYSTEMS, INC. AND AFFILIATES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
YEARS ENDED OCTOBER 31,

|   | 2003           | 2004           | 2005           |
|---|----------------|----------------|----------------|
|   | -----          | -----          | -----          |
| NET REVENUE   | \$ 140,259,000 | \$ 137,277,000 | \$ 145,570,000 |
| OPERATING EXPENSES  |                |                |                |
| Operating expenses  | 106,078,000    | 105,828,000    | 109,010,000    |
| Depreciation and amortization   | 16,874,000     | 17,762,000     | 17,100,000     |
| Provision for bad debts   | 4,944,000      | 3,911,000      | 4,920,000      |
| Loss on disposal of equipment, net  | --             | --             | 69,000         |
|   | -----          | -----          | -----          |
| Total operating expenses  | 127,896,000    | 127,501,000    | 131,730,000    |
|   | -----          | -----          | -----          |
| INCOME FROM OPERATIONS  | 12,363,000     | 9,776,000      | 13,830,000     |
| OTHER EXPENSE (INCOME)  |                |                |                |
| Interest expense  | 17,948,000     | 17,285,000     | 17,490,000     |
| Other income  | (556,000)      | (176,000)      | (87,000)       |
| Other expense   | 334,000        | 1,657,000      | 34,000         |
|   | -----          | -----          | -----          |
| Total other expense   | 17,726,000     | 18,766,000     | 16,970,000     |
|   | -----          | -----          | -----          |
| LOSS BEFORE INCOME TAXES, MINORITY<br>INTEREST AND DISCONTINUED OPERATION | (5,363,000)    | (8,990,000)    | (3,130,000)    |
| INCOME TAX EXPENSE  | --             | (5,235,000)    | --             |
|   | -----          | -----          | -----          |
| LOSS BEFORE MINORITY INTEREST AND<br>DISCONTINUED OPERATION               | (5,363,000)    | (14,225,000)   | (3,130,000)    |
| MINORITY INTEREST IN EARNINGS (LOSS) OF SUBSIDIARIES                      | 101,000        | 351,000        | --             |
|   | -----          | -----          | -----          |
| LOSS FROM CONTINUING OPERATIONS   | (5,464,000)    | (14,576,000)   | (3,130,000)    |
| DISCONTINUED OPERATION:   |                |                |                |
| Income from operation of Westchester Imaging Group                        | 255,000        | --             | --             |
| Gain on sale of discontinued operation                                    | 2,942,000      | --             | --             |
|   | -----          | -----          | -----          |



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|                                     |                |                 |                |
|-------------------------------------|----------------|-----------------|----------------|
| INCOME FROM DISCONTINUED OPERATION  | 3,197,000      | --              |                |
| NET LOSS                            | \$ (2,267,000) | \$ (14,576,000) | \$ (3,130,000) |
| BASIC EARNINGS PER SHARE            |                |                 |                |
| Loss from continuing operations     | \$ (0.13)      | \$ (0.35)       | \$ (0.13)      |
| Income from discontinued operation  | 0.08           | --              | --             |
| BASIC NET LOSS PER SHARE            | \$ (0.05)      | \$ (0.35)       | \$ (0.05)      |
| DILUTED EARNINGS PER SHARE          |                |                 |                |
| Loss from continuing operations     | \$ (0.13)      | \$ (0.35)       | \$ (0.13)      |
| Income from discontinued operation  | 0.08           | --              | --             |
| DILUTED NET LOSS PER SHARE          | \$ (0.05)      | \$ (0.35)       | \$ (0.05)      |
| WEIGHTED AVERAGE SHARES OUTSTANDING |                |                 |                |
| Basic                               | 41,090,768     | 41,106,813      | 41,200,000     |
| Diluted                             | 41,090,768     | 41,106,813      | 41,200,000     |

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PRIMEDEX HEALTH SYSTEMS, INC. AND AFFILIATES  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT  
YEARS ENDED OCTOBER 31, 2003, 2004 AND 2005

|                               | COMMON STOCK, \$.01 PAR<br>VALUE, 100,000,000 SHARES<br>AUTHORIZED |            | PAID-IN<br>CAPITAL | TREASURY STOCK, AT COST |              |
|-------------------------------|--|------------|--------------------|-------------------------|--------------|
|                               | SHARES   | AMOUNT     |                    | SHARES                  | AMOUNT       |
| BALANCE - OCTOBER 31, 2002    | 42,830,734   | 429,000    | 100,328,000        | (1,825,000)             | (695,000)    |
| Issuance of common stock      | 95,000   | 1,000      | 27,000             | --                      | --           |
| Conversion of bond debentures | 6,079  | --         | 73,000             | --                      | --           |
| Net loss                      | --   | --         | --                 | --                      | --           |
| BALANCE - OCTOBER 31, 2003    | 42,931,813   | 430,000    | 100,428,000        | (1,825,000)             | (695,000)    |
| Issuance of warrant           | --   | --         | 108,000            | --                      | --           |
| Net loss                      | --   | --         | --                 | --                      | --           |
| BALANCE - OCTOBER 31, 2004    | 42,931,813   | 430,000    | 100,536,000        | (1,825,000)             | (695,000)    |
| Issuance of common stock      | 300,000  | 3,000      | 54,000             | --                      | --           |
| Net loss                      | --   | --         | --                 | --                      | --           |
| BALANCE - OCTOBER 31, 2005    | 43,231,813   | \$ 433,000 | \$ 100,590,000     | (1,825,000)             | \$ (695,000) |

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PRIMEDEX HEALTH SYSTEMS, INC. AND AFFILIATES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

| YEARS ENDED OCTOBER 31,<br>-----  | 2003<br>-----  | 2004<br>-----   |
|---|----------------|-----------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                 |                |                 |
| Net loss  | \$ (2,267,000) | \$ (14,576,000) |
| Adjustments to reconcile net loss to net cash from<br>operating activities: |                |                 |
| Depreciation and amortization - continuing operations                       | 16,874,000     | 17,762,000      |
| Depreciation and amortization - discontinued operations                     | 63,000         | --              |
| Provision for bad debts   | 4,944,000      | 3,911,000       |
| Deferred income tax expense   | --             | 5,235,000       |
| Gain on write-downs and settlement of obligations                           | (8,000)        | (34,000)        |
| Loss (gain) on sale of assets and operating sites                           | (2,841,000)    | 27,000          |
| Imputed and accrued interest expense  | 1,497,000      | 6,565,000       |
| Minority interest in earnings of continuing subsidiaries                    | 101,000        | 351,000         |
| Minority interest in earnings of discontinued subsidiaries                  | 255,000        | --              |
| Changes in assets and liabilities:  |                |                 |
| Accounts receivable   | (629,000)      | 1,696,000       |
| Unbilled receivables  | 1,271,000      | (786,000)       |
| Other assets  | (475,000)      | (286,000)       |
| Accounts payable and accrued expenses                                       | 3,217,000      | (2,811,000)     |
|   | -----          | -----           |
| Net cash provided by operating activities                                   | 22,002,000     | 17,054,000      |
|   | -----          | -----           |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                 |                |                 |
| Acquisition of imaging centers  | --             | (35,000)        |
| Purchase of property and equipment  | (3,069,000)    | (3,774,000)     |
| Proceeds from sale of divisions, centers, and equipment                     | 1,367,000      | --              |
|   | -----          | -----           |
| Net cash used by investing activities                                       | (1,702,000)    | (3,809,000)     |
|   | -----          | -----           |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                 |                |                 |
| Cash disbursements in transit   | (1,731,000)    | (317,000)       |
| Principal payments on notes and leases payable                              | (25,694,000)   | (13,247,000)    |
| Proceeds from short and long-term borrowings                                | 7,394,000      | 1,000,000       |
| Proceeds from borrowings from related parties                               | --             | --              |
| Purchase of subordinated debentures   | (3,000)        | (60,000)        |
| Proceeds from issuance of common stock                                      | 28,000         | --              |
| Joint venture distributions   | (300,000)      | (650,000)       |
|   | -----          | -----           |
| Net cash used by financing activities                                       | (20,306,000)   | (13,274,000)    |
|   | -----          | -----           |
| NET INCREASE (DECREASE) IN CASH   | (6,000)        | (29,000)        |
| CASH, beginning of year   | 36,000         | 30,000          |
|   | -----          | -----           |
| CASH, end of year   | \$ 30,000      | \$ 1,000        |
|   | =====          | =====           |
| <b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>                     |                |                 |
| Cash paid during the year for interest                                      | \$ 16,379,000  | \$ 10,686,000   |
|   | =====          | =====           |

PRIMEDEX HEALTH SYSTEMS, INC. AND AFFILIATES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
YEARS ENDED OCTOBER 31, 2003, 2004 AND 2005

SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES

In October 2003, we paid \$1,500,000 to acquire exclusive rights to the use of the "Tower" trade name from Tower Radiology Medical Group, Inc. for its Beverly Hills facilities. The intangible asset was acquired with a note payable and will be amortized over ten years.

In July 2003, \$73,000 in face value of subordinated bond debentures was converted into 6,079 shares of common stock.

Effective March 31, 2003, we sold our share of Westchester Imaging Group and generated a gain on the sale of approximately \$2,942,000. As part of the transaction, we transferred \$239,000 in net equipment, \$52,000 in other assets, \$602,000 in accounts payable and accrued expenses, \$341,000 in capital lease obligations and \$923,000 in minority interest obligations.

We entered into capital leases or financed equipment through notes payable for approximately \$8,362,000, \$9,351,000 and \$4,781,000 for the years ended October 31, 2003, 2004 and 2005, respectively.

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PRIMEDEX HEALTH SYSTEMS, INC. AND AFFILIATES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - NATURE OF BUSINESS

NATURE OF BUSINESS

Primedex Health Systems, Inc., or Primedex, incorporated on October 21, 1985, provides diagnostic imaging services in the state of California. Imaging services include magnetic resonance imaging, or MRI, computed tomography, or CT, positron emission tomography, or PET, nuclear medicine, mammography, ultrasound, diagnostic radiology, or X-ray, and fluoroscopy. Our operations comprise a single segment for financial reporting purposes.

LIQUIDITY AND CAPITAL RESOURCES

We had a working capital deficit of \$143.4 million at October 31, 2005 and had losses from continuing operations of \$14.6 million and \$3.1 million during fiscal 2004 and 2005, respectively. The loss in fiscal 2004 includes a \$5.2 million expense resulting from the increase in the valuation allowance for deferred income taxes. We also had a stockholders' deficit of \$70.6 million at October 31, 2005.

The working capital deficit increased in fiscal 2005 due to the reclassification of approximately \$109 million in notes and capital lease obligations as current liabilities that are expected to be refinanced. We are subject to financial covenants under our current debt agreements. We believe that we may be unable to continue to be in compliance with our existing financial covenants during fiscal 2006. As such, the associated debt has been

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classified as a current liability. We expect to refinance these obligations presented as current liabilities in the second quarter of fiscal 2006. On January 31, 2006, we executed a commitment letter with an institutional lender to which such lender provided us with a commitment, subject to final documentation and legal due diligence, for a \$160 million senior secured credit facility to be used to refinance all of our existing indebtedness (except for \$16.1 million of outstanding subordinated debentures and \$6.1 million of capital lease obligations). The commitment provides for a \$15 million five-year revolving credit facility, an \$85 million term loan due in five years and \$60 million second lien term loan due in six years. The loans are subject to acceleration on February 28, 2008, unless we have made arrangements to discharge or extend our outstanding subordinated debentures by that date. The loans are essentially payable interest only monthly at varying rates that are yet to be finalized but will be based upon market conditions. Finalization of the credit facility is subject to customary conditions, including legal due diligence and final documentation that is scheduled for completion on or about March 7, 2006.

We operate in a capital intensive, high fixed-cost industry that requires significant amounts of capital to fund operations. In addition to operations, we require significant amounts of capital for the initial start-up and development expense of new diagnostic imaging facilities, the acquisition of additional facilities and new diagnostic imaging equipment, and to service our existing debt and contractual obligations. Because our cash flows from operations are insufficient to fund all of these capital requirements, we depend on the availability of financing under credit arrangements with third parties. Historically, our principal sources of liquidity have been funds available for borrowing under our existing lines of credit, now with Bridge Healthcare Finance LLC. Even though the line of credit matures in 2008, we classify the line of credit as a current liability primarily because it is collateralized by accounts receivable and the eligible borrowing base is classified as a current asset. We finance the acquisition of equipment mainly through capital and operating leases.

During fiscal 2004 and 2005, we took the actions described below to continue to fund our obligations.

BRMG and Wells Fargo Foothill were parties to a credit facility under which BRMG could borrow the lesser of 85% of the net collectible value of eligible accounts receivable plus one month of average capitation receipts for the prior six months, two times the trailing month cash collections, or \$20,000,000. Eligible accounts receivable excluded those accounts older than 150 days from invoice date and were net of customary reserves. In addition, Wells Fargo Foothill set up a term loan where they could advance up to the lesser of \$3,000,000 or 80% of the liquidation value of the equipment value servicing the loan. Under this term loan, we borrowed \$880,000 in February 2005 to acquire medical equipment. The five-year term loan had interest only payments through February 28, 2005 with the first quarterly principal payments due on April 1, 2005. Access to additional funds under the term loan expired soon after the February 2005 draw.

Under the \$20,000,000 revolving loan, an overadvance subline was available not to exceed \$2,000,000, or one month of the average capitation receipts for the prior six months, until June 30, 2005. From July 1 to September 30, 2005, the overadvance subline was available not to exceed \$1,500,000, or one month of the average capitation receipts for the prior six months. Beginning October 1, 2005, the maximum overadvance could not exceed the lesser of \$1,000,000 or one month of the average capitation receipts for the prior six months. Also under the revolving loan, we were entitled to request that Wells Fargo Foothill issue guarantees of payment in an aggregate amount not to exceed \$5,000,000 at any one time outstanding.

PRIMEDEX HEALTH SYSTEMS, INC. AND AFFILIATES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 1 - NATURE OF BUSINESS - CONTINUED

Advances outstanding under the revolving loan bore interest at the base rate plus 1.5%, or the LIBOR rate plus 3.0%. Advances under the overadvance subline and term loan bore interest at the base rate plus 4.75%. Letter of credit fees bore interest of 3.0% per annum times the undrawn amount of all outstanding lines of credit. The base rate refers to the rate of interest announced within Wells Fargo Bank at its principal office in San Francisco as its prime rate. The line was collateralized by substantially all of our accounts receivable and requires us to meet certain financial covenants including minimum levels of EBITDA, fixed charge coverage ratios and maximum senior debt/EBITDA ratios as well as limitations on annual capital expenditures.

Effective September 14, 2005, we established a new \$20 million working capital revolving credit facility with Bridge Healthcare Finance, or Bridge, a specialty lender in the healthcare industry. Upon the establishment of this credit facility, we borrowed \$15.5 million that was used to pay off the entire balance of our existing credit facility with Wells Fargo Foothill. Upon repayment, the existing credit facility with Wells Fargo Foothill was terminated. Additionally, Bridge provided us approximately \$0.8 million in the form of a term loan, which we used to pay the balance of a term loan owed to Wells Fargo Foothill.

Under the Bridge revolving credit facility, we may borrow the lesser of 85% of the net collectible value of eligible accounts receivable plus one month capitation receipts for the preceding month, or \$20,000,000. An overadvance subline is available not to exceed \$2,000,000, so long as after giving effect to the overadvance subline, the revolver usage does not exceed \$20,000,000. Eligible accounts receivable shall exclude those accounts older than 150 days from invoice date and will be net of customary reserves. Dr. Berger has agreed to personally guaranty the repayment of any monies under the overadvance subline. Advances under the revolving loan bear interest at the base rate plus 3.25%. The base rate refers to the prime rate publicly announced by La Salle Bank National Association, in effect from time to time. The term loan bears interest at the annual rate of 12.50%. The revolving credit facility is collateralized by substantially all of our accounts receivable and requires us to meet certain financial covenants including minimum levels of EBITDA, fixed charge coverage ratios and maximum senior debt/EBITDA ratios. The term loan is collateralized by specific imaging equipment used by us at certain of our locations.

Until November 2004, we had a line of credit with an affiliate of DVI Financial Services, Inc. ("DVI"), when we issued \$4.0 million in principal amount of notes to Post Advisory Group, LLC ("Post"), a Los Angeles-based investment advisor, and Post purchased the DVI affiliate's line of credit facility with the residual funds utilized by us as working capital. The new note payable has monthly interest only payments at 12% per annum until its maturity in July 2008.

On December 19, 2003, we issued a \$1.0 million convertible subordinated note payable to Galt Financial, Ltd., at a stated rate of 11% per annum with interest payable quarterly. The note payable is convertible at the holder's option anytime after January 1, 2006 at \$0.50 per share. As additional consideration for the financing we issued a warrant for the purchase of 500,000 shares at an exercise price of \$.50 per share. We have allocated \$0.1 million to

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the value of the warrants and believe the value of the conversion feature is nominal. In November 2005, subsequent to year-end, the right to convert was waived and the warrant for the purchase of 500,000 shares of common stock was terminated in exchange for the issuance of a five-year warrant to purchase 300,000 shares of our common stock at a price of \$0.50 per share, the public market price on the date the warrant, with the underlying note being extended to July 1, 2006.

During the third quarter of fiscal 2004, we renegotiated our existing notes and capital lease obligations with our three primary lenders, General Electric ("GE"), DVI Financial Services and U.S. Bank extending terms and reducing monthly payments on approximately \$135.1 million of combined outstanding debt. At the time of the debt restructuring, outstanding principal balances for DVI, GE and U.S. Bank were \$15.2 million, \$54.3 million and \$65.6 million respectively.

DVI's restructured note payable was six payments of interest only from July to December 2004 at 9%, 41 payments of principal and interest of \$273,988, and a final balloon payment of \$7.6 million on June 1, 2008 if and only if our subordinated bond debentures, then due, are not extended and paid in full. If the bond debenture payment is deferred, we would make monthly payments of \$290,785 to DVI for the next 29 months. Effective November 30, 2004, Post acquired the DVI note payable and the debt was restructured. The new note payable has monthly interest only payments at 11% per annum until its maturity in June 2008. The assignment of the note payable to Post will not result in any actual total dollar savings to us over the term of the new obligation, but it will defer cash outlays of approximately \$1.3 million per year until its maturity.

GE's restructured note payable is six payments of interest only at 9%, or \$407,210, beginning on August 1, 2004, 40 payments of principal and interest at \$1,127,067 beginning on February 1, 2005, and a final balloon payment of \$21 million due on June 1, 2008 if and only if our subordinated bond debentures, then due, are not extended and paid in full. If the bond debenture payment is deferred, we will continue to make monthly payments of \$1,127,067 to GE for the next 20 months.

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PRIMEDEX HEALTH SYSTEMS, INC. AND AFFILIATES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - NATURE OF BUSINESS (CONTINUED)

U.S. Bank's restructured note payable is six payments of interest only at 9%, or \$491,933, beginning on August 1, 2004, 40 payments of principal and interest of \$1,055,301 beginning on February 1, 2005, and a final balloon payment of \$39.7 million due on June 1, 2008 if and only if our subordinated bond debentures, then due, are not extended and paid in full. If the bond debenture payment is deferred, we will continue to make monthly payments of \$1,055,301 to U.S. Bank for the next 44 months.

In October 2003, we successfully consummated a "pre-packaged" Chapter 11 plan of reorganization with the United States Bankruptcy Court, Central District of California, in order to modify the terms of our convertible subordinated debentures by extending the maturity to June 30, 2008, increasing the annual interest rate from 10.0% to 11.5%, reducing the conversion price from \$12.00 to \$2.50 and restricting our ability to redeem the debentures prior to July 1,

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2005. The plan of reorganization did not affect any of our operations or obligations, other than the subordinated debentures.

To assist with our financial liquidity in June 2005, Howard G. Berger, M.D., our president, director and largest shareholder loaned us \$1,370,000. Interest and principal payments to Dr. Berger will not be made until such time as our loans to Post Advisory Group (approximately \$16.8 million at October 31, 2005) have been paid in full.

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

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

Our ability to generate sufficient cash flow from operations to make payments on our debt and other contractual obligations will depend on our future financial performance. A range of economic, competitive, regulatory, legislative and business factors, many of which are outside of our control, will affect our financial performance.

Taking these factors into account, including our historical experience and our discussions with our lenders to date, although no assurance can be given, we believe that through implementing our strategic plans and continuing to restructure our financial obligations, we will obtain sufficient cash to satisfy our obligations as they become due in the next twelve months.

### NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**PRINCIPLES OF CONSOLIDATION** - The consolidated financial statements of Primedex include the accounts of Primedex, its wholly owned direct subsidiary, Radnet Management, Inc., or Radnet, and Beverly Radiology Medical Group III, or BRMG, which is a professional corporation, all collectively referred to as "us" or "we". The consolidated financial statements also include Radnet Sub, Inc., Radnet Management I, Inc., Radnet Management II, Inc., or Modesto, SoCal MR Site Management, Inc., Diagnostic Imaging Services, Inc., or DIS, Burbank Advanced LLC, or Burbank, and Rancho Bernardo Advanced LLC, or RB, all wholly owned subsidiaries of Radnet, and Westchester Imaging Group, a 50% owned subsidiary. Interests of minority shareholders are separately disclosed in the consolidated balance sheets and consolidated statements of operations of the Company. Westchester Imaging Group, which was sold in March 2003, is reflected as a discontinued operation in our consolidated statements of operations. Effective July 31, 2004 and September 30, 2004, we purchased the remaining 25% minority interests in Rancho Bernardo and Burbank, respectively.

The operations of BRMG are consolidated with us as a result of the contractual and operational relationship among BRMG, Dr. Berger and us. We are considered to have a controlling financial interest in BRMG pursuant to the guidance in EITF 97-2. Medical services and supervision at most of our imaging centers are provided through BRMG and through other independent physicians and physician groups. BRMG is consolidated with Pronet Imaging Medical Group, Inc. and Beverly Radiology Medical Group, both of which are 99%-owned by Dr. Berger. Radnet provides non-medical, technical and administrative services to BRMG for which they receive a management fee.

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PRIMEDEX HEALTH SYSTEMS, INC. AND AFFILIATES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Operating activities of subsidiary entities are included in the accompanying financial statements from the date of acquisition. All intercompany transactions and balances have been eliminated in consolidation.

USE OF ESTIMATES - The preparation of the financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. These estimates and assumptions affect various matters, including our reported amounts of assets and liabilities in its consolidated balance sheets at the dates of the financial statements; its disclosure of contingent assets and liabilities at the dates of the financial statements; and its reported amounts of revenues and expenses in its consolidated statements of operations during the reporting periods. These estimates involve judgments with respect to numerous factors that are difficult to predict and are beyond management's control. As a result, actual amounts could materially differ from these estimates.

REVENUE RECOGNITION - Revenue consists of net patient fee for service revenue and revenue from capitation arrangements, or capitation revenue.

Net patient service revenue is recognized at the time services are provided net of contractual adjustments based on our evaluation of expected collections resulting from their analysis of current and past due accounts, past collection experience in relation to amounts billed and other relevant information. Contractual adjustments result from the differences between the rates charged for services performed and reimbursements by government-sponsored healthcare programs and insurance companies for such services.

Capitation revenue is recognized as revenue during the period in which we were obligated to provide services to plan enrollees under contracts with various health plans. Under these contracts, we receive a per enrollee amount each month covering all contracted services needed by the plan enrollees.

The following table summarizes net revenue for the years ended October 31, 2003, 2004 and 2005:

|                     | 2003          | 2004          | 2005          |
|---------------------|---------------|---------------|---------------|
|                     | -----         | -----         | -----         |
| Net patient service | \$109,444,000 | \$103,271,000 | \$107,324,000 |
| Capitation          | 30,815,000    | 34,006,000    | 38,249,000    |
|                     | -----         | -----         | -----         |
| Net revenue         | \$140,259,000 | \$137,277,000 | \$145,573,000 |
|                     | =====         | =====         | =====         |

Accounts receivable are primarily amounts due under fee-for-service contracts from third party payors, such as insurance companies and patients and government-sponsored healthcare programs geographically dispersed throughout California. Receivables from government agencies made up approximately 15.0% and 17.0% of accounts receivable at October 31, 2004 and 2005, respectively.

Accounts receivable as of October 31, 2005 are presented net of allowances of approximately \$59,491,000, of which \$56,296,000 is included in current and \$3,195,000 is included in noncurrent. Accounts receivable as of October 31, 2004, are presented net of allowances of approximately \$58,641,000,



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of which \$53,639,000 is included in current and \$5,002,000 is included in noncurrent.

CREDIT RISKS - Financial instruments that potentially subject us to credit risk are primarily cash equivalents and accounts receivable. We have placed our cash and cash equivalents with one major financial institution. At times, the cash in the financial institution is temporarily in excess of the amount insured by the Federal Deposit Insurance Corporation, or FDIC.

With respect to accounts receivable, we routinely assesses the financial strength of our customers and third-party payors and, based upon factors surrounding their credit risk, establish a provision for bad debt. Net revenue by payor for the years ended October 31, 2003, 2004 and 2005 were:

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### PRIMEDEX HEALTH SYSTEMS, INC. AND AFFILIATES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

|                           | Net Revenue |       |       |
|---------------------------|-------------|-------|-------|
|                           | 2003        | 2004  | 2005  |
| Capitation contracts      | 22.0%       | 24.8% | 26.3% |
| HMO/PPO/Managed care      | 20.6%       | 21.3% | 21.7% |
| Special group contract    | 13.4%       | 12.3% | 9.2%  |
| Medicare                  | 12.7%       | 13.6% | 14.9% |
| Blue Cross/Shield/Champus | 12.0%       | 13.2% | 14.6% |
| Commercial insurance      | 8.1%        | 4.9%  | 4.2%  |
| Workers compensation      | 5.6%        | 3.8%  | 2.8%  |
| Medi-Cal                  | 2.3%        | 2.6%  | 2.9%  |
| Other                     | 3.3%        | 3.5%  | 3.4%  |

Management believes that its accounts receivable credit risk exposure, beyond allowances that have been provided, is limited.

CASH AND CASH EQUIVALENTS - For purposes of the statement of cash flows, we consider all highly liquid investments purchased that mature in three months or less when purchased to be cash equivalents. The carrying amount of cash and cash equivalents approximates their fair market value.

LOAN FEES - Costs of financing are deferred and amortized on a straight-line basis over the life of the respective loan.

PROPERTY AND EQUIPMENT - Property and equipment are stated at cost, less accumulated depreciation and amortization and valuation impairment allowances. Depreciation and amortization of property and equipment are provided using the straight-line method over their estimated useful lives, which range from 3 to 15 years. Leasehold improvements are amortized at the lower of lease term or their estimated useful lives, whichever is lower, which range from 3 to 20 years. Maintenance and repairs are charged to expenses as incurred.

GOODWILL - Goodwill at October 31, 2005 totaled \$23,099,000. Goodwill is recorded as a result of the acquisition of operating facilities. The operating facilities are grouped by territory into reporting units. Management evaluates goodwill, at a minimum, on an annual basis and whenever events and changes in

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circumstances suggest that the carrying amount may not be recoverable in accordance with Statement of Financial Accounting Standards, or SFAS, No. 142, "Goodwill and Other Intangible Assets." Impairment of goodwill is tested at the reporting unit level by comparing the reporting unit's carrying amount, including goodwill, to the fair value of the reporting unit. The fair values of the reporting units are estimated using a combination of the income or discounted cash flows approach and the market approach, which uses comparable market data. If the carrying amount of the reporting unit exceeds its fair value, goodwill is considered impaired and a second step is performed to measure the amount of impairment loss, if any. For each of the three year periods ended October 31, 2005, we recorded no impairment loss related to goodwill. However, if estimates or the related assumptions change in the future, we may be required to record impairment charges to reduce the carrying amount of these assets.

**LONG-LIVED ASSETS** - We evaluate our long-lived assets (property, plant and equipment) and definite-lived intangibles for impairment whenever indicators of impairment exist. The accounting standards require that if the sum of the undiscounted expected future cash flows from a long-lived asset or definite-lived intangible is less than the carrying value of that asset, an asset impairment charge must be recognized. The amount of the impairment charge is calculated as the excess of the asset's carrying value over its fair value, which generally represents the discounted future cash flows from that asset or in the case of assets we expect to sell, at fair value less costs to sell.

**INCOME TAXES** - Income tax expense is computed using an asset and liability method and using expected annual effective tax rates. Under this method, deferred income tax assets and liabilities result from temporary differences in the financial reporting bases and the income tax reporting bases of assets and liabilities. The measurement of deferred tax assets is reduced, if necessary, by the amount of any tax benefit that, based on available evidence, is not expected to be realized. When it appears more likely than not that deferred taxes will not be realized, a valuation allowance is recorded to reduce the deferred tax asset to its estimated realizable value. Income taxes are further explained in Note 9.

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### PRIMEDEX HEALTH SYSTEMS, INC. AND AFFILIATES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**STOCK OPTIONS** - We account for our stock-based employee compensation plans under the recognition and measurement principles of APB Opinion 25, "Accounting for Stock Issued to Employees," and related Interpretations. No stock-based employee compensation cost for the issuance of stock options is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

The following table illustrates the effect on net income and earnings per share if we had applied the fair value recognition principles of SFAS No. 123 to stock-based employee compensation.

|  | Year Ended October 31, |       |       |
|--|------------------------|-------|-------|
|  | 2003                   | 2004  | 2005  |
|  | -----                  | ----- | ----- |

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|  |                |                 |                |
|--|----------------|-----------------|----------------|
| Net loss as reported   | \$ (2,267,000) | \$ (14,576,000) | \$ (3,135,000) |
| Deduct: Total stock-based employee compensation expense determined under fair value-based method | (82,000)       | (379,000)       | (341,000)      |
| Pro forma net loss   | \$ (2,349,000) | \$ (14,955,000) | \$ (3,476,000) |
| Loss per share:  |                |                 |                |
| Basic - as reported  | \$ (0.05)      | \$ (0.35)       | \$ (0.35)      |
| Basic - pro forma  | \$ (0.06)      | \$ (0.36)       | \$ (0.36)      |
| Diluted - as reported  | \$ (0.06)      | \$ (0.35)       | \$ (0.35)      |
| Diluted - pro forma  | \$ (0.06)      | \$ (0.36)       | \$ (0.36)      |

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

| October 31, | Risk-free interest rate | Expected life | Expected volatility | Expected dividends |
|-------------|-------------------------|---------------|---------------------|--------------------|
| 2005        | 3.00%                   | 5 years       | 216.32%             | --                 |
| 2004        | 3.00%                   | 5 years       | 99.22%              | --                 |
| 2003        | 3.00%                   | 5 years       | 121.88%             | --                 |

RECLASSIFICATIONS - Certain prior year amounts have been reclassified to conform with the current year presentation. These changes have no effect on net income.

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PRIMEDEX HEALTH SYSTEMS, INC. AND AFFILIATES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

EARNINGS PER SHARE - Earnings per share are based upon the weighted average number of shares of common stock and common stock equivalents outstanding, net of common stock held in treasury, as follows:

|   | Year Ended October 31, |                 |                |
|---|------------------------|-----------------|----------------|
|   | 2003                   | 2004            | 2005           |
| Net loss from continuing operations         | \$ (5,464,000)         | \$ (14,576,000) | \$ (3,135,000) |
| Net income from discontinued operations     | 3,197,000              | --              | --             |
| Net loss for earnings per share computation | \$ (2,267,000)         | \$ (14,576,000) | \$ (3,135,000) |

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### BASIC EARNINGS (LOSS) PER SHARE

|   |            |            |            |
|---|------------|------------|------------|
| Weighted average number of common shares<br>outstanding during the year | 41,090,768 | 41,106,813 | 41,207,909 |
|   | =====      | =====      | =====      |
| Basic earnings (loss) per share:  |            |            |            |
| Loss from continuing operations   | \$ (0.13)  | \$ (0.35)  | \$ (0.08)  |
| Income from discontinued operation                                      | \$ 0.08    | \$ --      | \$ --      |
|   | -----      | -----      | -----      |
| Basic loss per share  | \$ (0.05)  | \$ (0.35)  | \$ (0.08)  |
|   | =====      | =====      | =====      |

### DILUTED EARNINGS (LOSS) PER SHARE

|  |            |            |            |
|--|------------|------------|------------|
| Weighted average number of common shares<br>outstanding during the year                    | 41,090,768 | 41,106,813 | 41,207,909 |
| Add additional shares issuable upon exercise<br>of stock options and warrants              | --         | --         | --         |
|  | -----      | -----      | -----      |
| Weighted average number of common shares used<br>in calculating diluted earnings per share | 41,090,768 | 41,106,813 | 41,207,909 |
|  | =====      | =====      | =====      |
| Diluted earnings (loss) per share:   |            |            |            |
| Loss from continuing operations  | \$ (0.13)  | \$ (0.35)  | \$ (0.08)  |
| Income from discontinued operation   | \$ 0.08    | \$ --      | \$ --      |
|  | -----      | -----      | -----      |
| Diluted loss per share   | \$ (0.05)  | \$ (0.35)  | \$ (0.08)  |
|  | =====      | =====      | =====      |

For the years ended October 31, 2003, 2004 and 2005, we excluded all options, warrants and convertible debentures in the calculation of diluted earnings per share because their effect would be antidilutive. However, these instruments could potentially dilute earnings per share in future years.

### RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

#### SHARE-BASED PAYMENT

In December 2004, the FASB issued SFAS No. 123 (Revised 2004), "Share-Based Payment" which was amended effective April 2005. The new rule requires that the compensation cost relating to share-based payment transactions be recognized in financial statements based on the fair value of the equity or liability instruments issued. We will be required to apply Statement 123R as of the first annual reporting period starting after June 15, 2005, which is our first quarter beginning November 1, 2005. We routinely use share-based payment arrangements as compensation for our employees. During fiscal 2003, 2004 and 2005, had this rule been in effect, we would have recorded the non-cash expense of \$82,000, \$379,000 and \$341,000, respectively.

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PRIMEDEX HEALTH SYSTEMS, INC. AND AFFILIATES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS - CONTINUED

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### DETERMINING AMORTIZATION PERIOD FOR LEASEHOLD IMPROVEMENTS

In June 2005, the EITF issued EITF Issue No. 05-06, "Determining the Amortization Period for Leasehold Improvements Purchased after Lease Inception or Acquired in a Business Combination" ("EITF 05-06"). EITF 05-06 provides that the amortization period for leasehold improvements acquired in a business combination or purchased after the inception of a lease be the shorter of (a) the useful life of the assets or (b) a term that includes required lease periods and renewals that are reasonably assured upon the acquisition or the purchase. The provision of EITF 05-06 are effective on a prospective basis for leasehold improvements purchased or acquired beginning July 1, 2005. The adoption of EITF 05-06 during the three months ended October 31, 2005 did not have a material affect on the Company's consolidated financial statements.

### EXCHANGES OF NONMONETARY ASSETS

In December 2004, the FASB issued FASB Statement No. 153, "Exchanges of Nonmonetary Assets - An Amendment of APB Opinion No. 29." The amendments made by Statement 153 are based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. Further, the amendments eliminate the narrow exception for nonmonetary exchanges of similar productive assets and replace it with a broader exception for exchanges of nonmonetary assets that do not have "commercial substance." The provisions in Statement 153 are effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Adoption of this standard is not expected to have a material impact on the consolidated financial statements.

### DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION

In September 2004, the Emerging Issues Task Force (EITF) reached a consensus on EITF Issue No. 04-10, "Applying Paragraph 19 of FAS 131 in Determining Whether to Aggregate Operating Segments That Do Not Meet the Quantitative Thresholds." The consensus states that operating segments that do not meet the quantitative thresholds can be aggregated only if aggregation is consistent with the objective and basic principles of SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," the segments have similar economic characteristics, and the segments share a majority of the aggregation criteria (a)-(e) listed in paragraph 17 of SFAS 131. The consensus was ratified by the FASB at their October 13, 2004 meeting. The effective date of the consensus in this Issue has been postponed indefinitely at the November 17-18 EITF meeting. The Company does not anticipate a material impact on the financial statements from the adoption of this consensus.

### DETERMINING WHETHER TO REPORT DISCONTINUED OPERATIONS

In November 2004, the Emerging Issues Task Force (EITF) reached a consensus on EITF Issue No. 03-13, "Applying the Conditions in Paragraph 42 of FASB Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," in Determining Whether to Report Discontinued Operations. The consensus provides guidance in determining: (a) which cash flows should be taken into consideration when assessing whether the cash flows of the disposal component have been or will be eliminated from the ongoing operations of the entity, (b) the types of involvement ongoing between the disposal component and the entity disposing of the component that constitute continuing involvement in the operations of the disposal component, and (c) the appropriate (re)assessment period for purposes of assessing whether the criteria in paragraph 42 have been met. The consensus was ratified by the FASB at their November 30, 2004 meeting and should be applied to a component of an enterprise that is either disposed of or classified as held for sale in fiscal periods beginning after December 15, 2004. The Company does not anticipate a material impact on the financial statements from the adoption of this consensus.

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## PRIMEDEX HEALTH SYSTEMS, INC. AND AFFILIATES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 3 - ACQUISITIONS, SALES AND DIVESTITURES

#### SALE OF JOINT VENTURE INTEREST - DISCONTINUED OPERATION

Effective March 31, 2003, we sold our 50% share of Westchester Imaging Group, or Westchester, to our joint venture partner for \$3.0 million. As part of the transaction, we acquired 100% of the accounts receivable generated through March 31, 2003 for \$1.3 million and reimbursed Westchester \$0.3 million, which represented 50% of the remaining liabilities, resulting in net cash proceeds of approximately \$1.4 million. We recognized a gain on the transaction of approximately \$2.9 million in fiscal 2003. Westchester's results from fiscal 2003 were as follows:

|                    | 2003(1)     |
|--------------------|-------------|
|                    | -----       |
| Net revenue        | \$2,230,000 |
| Operating expenses | 1,703,000   |
| Net income         | 255,000     |

(1) Represents operations through March 31, 2003

#### FACILITY OPENINGS

In January 2004, we entered into a new building lease for approximately 3,963 square feet of space in Murrietta, California, near Temecula. The center opened in December 2004 and offers MRI, CT, PET, nuclear medicine and x-ray services. The equipment was financed by GE. During fiscal 2004, we had used existing lines of credit for the payment of approximately \$840,000 in leasehold improvements for Murietta.

In July 2003, we entered into a new building lease for approximately 3,533 square feet of space in Westlake, California, near Thousand Oaks. The center opened in March 2005 and offers MRI, mammography, ultrasound and x-ray services. During fiscal 2005, we used existing lines of credit for the payment of approximately \$873,000 in leasehold improvements for the new facility.

In December 2002, we opened an imaging center in Rancho Bernardo, California. Prior to its opening, in late November 2001, we entered into a new building lease arrangement for 9,557 square feet in Rancho Bernardo in anticipation of opening the new multi-modality imaging center. The center was 75%-owned by us and 25%-owned by two physicians who invested \$250,000. Effective July 31, 2004, we purchased the 25% minority interest from the two physicians for \$200,000 that consisted of an \$80,000 down payment and monthly payments of \$10,000 due from September 2004 to August 2005. All payments were made during fiscal 2005. There was no goodwill recorded in the transaction.

In addition, during fiscal 2003, upon entering into new capitation arrangements, we opened two facilities adjacent to our Burbank and Santa Clarita facilities to provide X-ray services. In fiscal 2004, we opened an additional three satellite facilities servicing our Northridge, Rancho Cucamonga and Thousand Oaks centers.

#### FACILITY CLOSURES

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In early fiscal 2004, we first downsized and later closed our San Diego facility. The center's location was no longer productive and business could be sent to our new facility in Rancho Bernardo. The equipment was moved to other locations and our leasehold improvements were written off. During the years ended October 31, 2003 and 2004, the center generated net revenue of \$1,067,000 and \$49,000, respectively. During the year ended October 31, 2004, the center incurred a net loss of \$122,000, and during the year ended October 31, 2003, the center generated net income of \$33,000.

In addition, during fiscal 2004, we closed two satellite facilities servicing our Antelope Valley and Lancaster regions.

In July 2003, we closed our La Habra facility. The center's location was no longer a productive asset in our network and business could be sent to our facilities in Orange County. The equipment was moved to other locations or returned to the vendor and its leasehold improvements were written off. During the year ended October 31, 2003, the center generated net revenue of \$368,000 and incurred a net loss of \$155,000.

In addition, during fiscal 2003, we closed three satellite facilities servicing our Long Beach region and one satellite facility servicing our Riverside region.

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### PRIMEDEX HEALTH SYSTEMS, INC. AND AFFILIATES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### NOTE 3 - ACQUISITIONS, SALES AND DIVESTITURES - CONTINUED

Due to low volume, RadNet Heartcheck Management, Inc., one of our subsidiaries, ceased doing business in early fiscal 2003. We wrote-off a receivable related to Heartcheck of approximately \$0.2 million during fiscal 2003.

At various times, we may open or close small x-ray facilities acquired primarily to service larger capitation arrangements over a specific geographic region. Over time, patient volume from these contracts may vary, or we may end the arrangement, resulting in the subsequent closures of these smaller satellite facilities.

#### NOTE 4 - PROPERTY AND EQUIPMENT

Property and equipment and accumulated depreciation and amortization as of October 31, 2004 and 2005 are:

|   | 2004          | 2005          |
|---|---------------|---------------|
|   | -----         | -----         |
| Buildings                                 | \$ 600,000    | \$ 600,000    |
| Medical equipment                         | 22,069,000    | 21,956,000    |
| Office equipment, furniture and fixtures  | 7,171,000     | 7,587,000     |
| Leasehold improvements                    | 26,243,000    | 28,313,000    |
| Equipment under capital lease             | 93,289,000    | 96,438,000    |
|   | -----         | -----         |
|   | 149,372,000   | 154,894,000   |
| Accumulated depreciation and amortization | (72,039,000)  | (86,787,000)  |
|   | -----         | -----         |
|   | \$ 77,333,000 | \$ 68,107,000 |
|   | =====         | =====         |

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Depreciation and amortization expense on property and equipment for the years ended October 31, 2003, 2004 and 2005 was approximately \$16,756,000, \$17,494,000 and \$16,866,000, respectively. Accumulated amortization for equipment under capital leases as of October 31, 2004 and 2005 was approximately \$41,747,000 and \$52,243,000, respectively. Amortization expense for equipment under capital leases for the years ended October 31 2003, 2004, and 2005 included above, was approximately, \$10,507,000, \$11,550,000, and \$10,494,000, respectively.

### NOTE 5 - GOODWILL

Goodwill is recorded at cost of \$29,144,000 less accumulated amortization of \$6,045,000 for the years ended October 31, 2004 and 2005. Fully amortized goodwill at the Company's Tustin location, with both cost and accumulated amortization of \$220,000, was written off in October 2004.

Upon the adoption of SFAS No. 142, we discontinued amortization of goodwill effective November 1, 2001. Thus, for the three years ended October 31, 2003, 2004 and 2005, no adjustment to amortization expense is necessary when comparing net income and earnings per share.

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### PRIMEDEX HEALTH SYSTEMS, INC. AND AFFILIATES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED EXPENSES

|                                 | 2004          | 2005          |
|---------------------------------|---------------|---------------|
|                                 | -----         | -----         |
| Accounts payable                | \$ 7,882,000  | \$ 9,001,000  |
| Accrued expenses                | 8,415,000     | 7,371,000     |
| Accrued payroll and vacation    | 3,758,000     | 4,226,000     |
| Accrued professional fees       | 1,045,000     | 693,000       |
| Accrued loss on legal judgments | 205,000       | --            |
| Accrued patient service payable | 1,876,000     | 1,209,000     |
|                                 | -----         | -----         |
|                                 | 23,181,000    | 22,500,000    |
| Less long-term portion          | (329,000)     | (31,000)      |
|                                 | -----         | -----         |
|                                 | \$ 22,852,000 | \$ 22,469,000 |
|                                 | =====         | =====         |

Accrued professional fees consist of outside professional agreements, which are paid out of net cash collections. The long-term portion relates to the accounts receivable classified as long-term. Accrued patient service payable relates to one contract that prepays us for future diagnostic exams to be performed for which they receive a discount.

#### NOTE 7 - NOTES PAYABLE, LONG-TERM DEBT, LINE OF CREDIT AND CAPITAL LEASES

Notes payable, long-term debt, line of credit and capital lease obligations at October 31, 2004 and 2005 consist of the following:

|  | 2004  | 2005  |
|--|-------|-------|
|  | ----- | ----- |



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|   |               |               |
|---|---------------|---------------|
| Revolving lines of credit   | \$ 14,011,000 | \$ 13,341,000 |
| Notes payable at interest rates ranging from 8.8% to 13.5%, due through 2009, collateralized by medical equipment                               | 72,320,000    | 71,940,000    |
| Obligations under capital leases at interest rates ranging from 9.1% to 13.0%, due through 2010, collateralized by medical and office equipment | 67,399,000    | 62,753,000    |
|   | -----         | -----         |
|   | 153,730,000   | 148,034,000   |
| Less: discount on notes payable   | (2,707,000)   | (1,773,000)   |
| Less: current portion   | (29,638,000)  | (142,132,000) |
|   | -----         | -----         |
|   | \$121,385,000 | \$ 4,129,000  |
|   | =====         | =====         |

The current portion of notes payable, long-term debt and capital lease obligations increased in fiscal 2005 due to the reclassification of approximately \$109 million in notes and capital lease obligations as current liabilities that are expected to be refinanced. We are subject to financial covenants under our current debt agreements. We believe that we may be unable to continue to be in compliance with our existing financial covenants during fiscal 2006. As such, the associated debt has been classified as a current liability. We expect to refinance these obligations presented as current liabilities in the second quarter of fiscal 2006. On January 31, 2006, we executed a commitment letter with an institutional lender to which such lender provided us with a commitment, subject to final documentation and legal due diligence, for a \$160 million senior secured credit facility to be used to refinance all of our existing indebtedness (except for \$16.1 million of outstanding subordinated debentures and \$6.1 million of capital lease obligations). The commitment provides for a \$15 million five-year revolving credit facility, an \$85 million term loan due in five years and \$60 million second lien term loan due in six years. The loans are subject to acceleration on February 28, 2008, unless we have made arrangements to discharge or extend our outstanding subordinated debentures by that date. The loans are essentially payable interest only monthly at varying rates that are yet to be finalized but will be based upon market conditions. Finalization of the credit facility is subject to customary conditions, including legal due diligence and final documentation that is scheduled for completion on or about March 7, 2006.

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PRIMEDEX HEALTH SYSTEMS, INC. AND AFFILIATES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7 - NOTES PAYABLE, LONG-TERM DEBT, LINE OF CREDIT AND CAPITAL LEASES  
(CONTINUED)

BRMG and Wells Fargo Foothill were parties to a credit facility under which BRMG could borrow the lesser of 85% of the net collectible value of eligible accounts receivable plus one month of average capitation receipts for the prior six months, two times the trailing month cash collections, or \$20,000,000. Eligible accounts receivable excluded those accounts older than 150 days from invoice date and were net of customary reserves. In addition, Wells Fargo Foothill set up a term loan where they could advance up to the lesser of

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\$3,000,000 or 80% of the liquidation value of the equipment value servicing the loan. Under this term loan, we borrowed \$880,000 in February 2005 to acquire medical equipment. The five-year term loan had interest only payments through February 28, 2005 with the first quarterly principal payments due on April 1, 2005. Access to additional funds under the term loan expired soon after the February 2005 draw.

Under the \$20,000,000 revolving loan, an overadvance subline was available not to exceed \$2,000,000, or one month of the average capitation receipts for the prior six months, until June 30, 2005. From July 1 to September 30, 2005, the overadvance subline was available not to exceed \$1,500,000, or one month of the average capitation receipts for the prior six months. Beginning October 1, 2005, the maximum overadvance could not exceed the lesser of \$1,000,000 or one month of the average capitation receipts for the prior six months. Also under the revolving loan, we were entitled to request that Wells Fargo Foothill issue guarantees of payment in an aggregate amount not to exceed \$5,000,000 at any one time outstanding.

Advances outstanding under the revolving loan bore interest at the base rate plus 1.5%, or the LIBOR rate plus 3.0%. Advances under the overadvance subline and term loan bore interest at the base rate plus 4.75%. Letter of credit fees bore interest of 3.0% per annum times the undrawn amount of all outstanding lines of credit. The base rate refers to the rate of interest announced within Wells Fargo Bank at its principal office in San Francisco as its prime rate. The line was collateralized by substantially all of our accounts receivable and requires us to meet certain financial covenants including minimum levels of EBITDA, fixed charge coverage ratios and maximum senior debt/EBITDA ratios as well as limitations on annual capital expenditures.

Effective September 14, 2005, we established a new \$20 million working capital revolving credit facility with Bridge Healthcare Finance, or Bridge, a specialty lender in the healthcare industry. Upon the establishment of this credit facility, we borrowed \$15.5 million that was used to pay off the entire balance of our existing credit facility with Wells Fargo Foothill. Upon repayment, the existing credit facility with Wells Fargo Foothill was terminated. Additionally, Bridge provided us approximately \$0.8 million in the form of a term loan, which we used to pay the balance of a term loan owed to Wells Fargo Foothill.

Under the Bridge revolving credit facility, we may borrow the lesser of 85% of the net collectible value of eligible accounts receivable plus one month capitation receipts for the preceding month, or \$20,000,000. An overadvance subline is available not to exceed \$2,000,000, so long as after giving effect to the overadvance subline, the revolver usage does not exceed \$20,000,000. Eligible accounts receivable shall exclude those accounts older than 150 days from invoice date and will be net of customary reserves. Dr. Berger has agreed to personally guaranty the repayment of any monies under the overadvance subline. Advances under the revolving loan bear interest at the base rate plus 3.25%. The base rate refers to the prime rate publicly announced by La Salle Bank National Association, in effect from time to time. The term loan bears interest at the annual rate of 12.50%.

The revolving credit facility is collateralized by substantially all of our accounts receivable and requires us to meet certain financial covenants including minimum levels of EBITDA, fixed charge coverage ratios and maximum senior debt/EBITDA ratios. The term loan is collateralized by specific imaging equipment used by us at certain of our locations. As part of the Bridge financing, our financial covenants were revised with our creditors, including GE, US Bank and Post Advisory Group.

We also had a line of credit with an affiliate of DVI. At October 31, 2004, we had \$3.4 million outstanding under this line. Interest on the

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outstanding balance was payable monthly at our lender's prime rate plus 1.0%. Future borrowings under this line of credit were no longer available and the balance was being paid down by collections on historical accounts receivable and variable monthly installment payments in the future. Effective November 30, 2004, we issued \$4.0 million in principal amount of notes to Post Advisory Group, LLC ("Post"), a Los Angeles-based investment advisor, and Post purchased the DVI affiliate's line of credit facility with the residual funds utilized by us as working capital.

Bridge's prime rate on October 31, 2005 was 6.75%. As of October 31, 2005 the total funds available for borrowing under the line was approximately \$4.6 million. For fiscal 2004 and 2005, the weighted average interest rates on short-term borrowings were 7.1% and 8.6%, respectively.

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### PRIMEDEX HEALTH SYSTEMS, INC. AND AFFILIATES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### NOTE 7 - NOTES PAYABLE, LONG-TERM DEBT, LINE OF CREDIT AND CAPITAL LEASES (CONTINUED)

Annual principal maturities of notes payable and long-term obligations exclusive of capital leases for future years ending October 31 are:

|            | Principal due at<br>Maturity<br>----- | Discount on<br>Notes Payable<br>----- | Net<br>Principal<br>----- |
|------------|---------------------------------------|---------------------------------------|---------------------------|
| 2006       | \$71,941,000                          | \$ 1,774,000                          | \$70,167,000              |
| Thereafter | --                                    | --                                    | --                        |
|            | -----                                 | -----                                 | -----                     |
|            | \$71,941,000                          | \$ 1,774,000                          | \$70,167,000              |
|            | =====                                 | =====                                 | =====                     |

We lease equipment under capital lease arrangements. Future minimum lease payments under capital leases for future years ending October 31 are:

|   |               |
|---|---------------|
| 2006  | \$ 69,288,000 |
| 2007  | 1,713,000     |
| 2008  | 1,429,000     |
| 2009  | 1,353,000     |
| 2010  | 227,000       |
| Thereafter                                  | --            |
|   | -----         |
| Total minimum payments                      | 74,010,000    |
| Amount representing interest                | (11,257,000)  |
|   | -----         |
| Present value of net minimum lease payments | 62,753,000    |
| Current portion                             | (58,624,000)  |
|   | -----         |
| Long-term portion                           | \$ 4,129,000  |
|   | =====         |

#### NOTE 8 - SUBORDINATED DEBENTURES

In June 1993, our registration for a total of \$25,875,000 of 10% Series A convertible subordinated debentures due June 2003 was declared effective by the

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Securities and Exchange Commission. The net proceeds to us were approximately \$23,000,000. Costs of \$3,000,000 associated with the original offering were fully amortized over ten years. The debentures were convertible into shares of common stock at any time before maturity into \$1,000 principal amounts at a conversion price of \$12.00 per share after June 1999.

Amortization expense of the offering costs for the years ended October 31, 2003, 2004 and 2005 was \$110,000, \$-0- and \$-0-, respectively. Interest expense for the years ended October 31, 2003, 2004 and 2005 was approximately \$1,708,000, \$1,862,000 and \$1,857,000, respectively. Bondholders converted \$73,000 face value of debentures into 6,079 shares of common stock in July 2003. There were no conversions during the years ended October 31, 2004 and 2005. During the years ended October 31, 2003, 2004 and 2005, we repurchased debentures with face amounts of \$3,000, \$68,000 and \$-0-, for \$3,000, \$60,000 and \$-0-, respectively, resulting in gains on early extinguishments of \$-0-, \$8,000 and \$-0-, respectively.

In October 2003, we successfully consummated a "pre-packaged" Chapter 11 plan of reorganization with the United States Bankruptcy Court, Central District of California, in order to modify the terms of our convertible subordinated debentures by extending the maturity to June 30, 2008, increasing the annual interest rate from 10.0% to 11.5%, reducing the conversion price from \$12.00 to \$2.50 and restricting its ability to redeem the debentures prior to July 1, 2005. The plan of reorganization did not affect any of our operations or obligations, other than the subordinated debentures.

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### PRIMEDEX HEALTH SYSTEMS, INC. AND AFFILIATES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### NOTE 9 - INCOME TAXES

Income taxes have been recorded under SFAS No. 109, "Accounting for Income Taxes." Deferred income taxes reflect the net tax effects of temporary differences between carrying amounts of assets and liabilities for financial and income tax reporting purposes and operating loss carryforwards. We did not incur any federal or state income taxes in 2003, 2004 or 2005.

Reconciliation between the effective tax rate and the statutory tax rates for the years ended October 31, 2003, 2004 and 2005 are as follows:

|   | 2003    | 2004    | 2005    |
|---|---------|---------|---------|
|   | ----    | ----    | ----    |
| Federal tax                                 | (34.0)% | (34.0)% | (34.0)% |
| State franchise tax, net of federal benefit | (5.8)   | 2.2     | (5.8)   |
| Change in valuation allowance               | 39.8    | 90.0    | 39.8    |
|   | -----   | -----   | -----   |
| Income tax expense                          | --%     | 58.2%   | --%     |
|   | =====   | =====   | =====   |

At October 31, 2004 and 2005, our deferred tax assets and liabilities were comprised of the following items:

|   | 2004           | 2005           |
|---|----------------|----------------|
|   | -----          | -----          |
| DEFERRED TAX ASSETS AND LIABILITIES, noncurrent |                |                |
| Fixed and intangible assets                     | \$(10,435,000) | \$(10,726,000) |
| Other   | 632,000        | 794,000        |

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|                                  |              |              |
|----------------------------------|--------------|--------------|
| Net operating loss carryforwards | 57,259,000   | 57,239,000   |
|                                  | -----        | -----        |
|                                  | 47,456,000   | 47,307,000   |
| Valuation allowance              | (47,456,000) | (47,307,000) |
|                                  | -----        | -----        |
|                                  | \$ --        | \$ --        |
|                                  | =====        | =====        |

As of October 31, 2005, we had federal and state net operating loss carryforwards of approximately \$161,319,000 and \$41,224,000, respectively, which expire at various intervals from the years 2006 to 2025. As of October 31, 2005, \$4,100,000 of federal net operating loss carryforwards expired unused. As of October 31, 2005, \$18,046,000 of our federal net operating loss carryforwards acquired during 1998 in connection with the acquisition of Diagnostic Imaging Services, Inc. were subject to limitations related to their utilization under Section 382 of the Internal Revenue Code, however, the annual limitation amount has not been determined. Future ownership changes as determined under Section 382 of the Internal Revenue Code could further limit the utilization of net operating loss carryforwards. Realization of deferred tax assets is dependent upon future earnings, if any, the timing and amount of which are uncertain. Accordingly, the net deferred tax assets have been fully offset by a valuation allowance.

For the next five years, and thereafter, federal net operating loss carryforwards expire as follows:

| Year Ended | Total Net<br>Operating Loss<br>Carryforward | Subject to<br>Limitation |
|------------|---|--------------------------|
| -----      | -----                                       | -----                    |
| 2006       | \$ 3,439,000                                | \$ 3,439,000             |
| 2007       | 1,226,000                                   | 1,226,000                |
| 2008       | 22,533,000                                  | 2,295,000                |
| 2009       | 16,421,000                                  | 2,513,000                |
| 2010       | 18,563,000                                  | 5,337,000                |
| Thereafter | 99,137,000                                  | 3,236,000                |
|            | -----                                       | -----                    |
|            | \$161,319,000                               | \$ 18,046,000            |
|            | =====                                       | =====                    |

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PRIMEDEX HEALTH SYSTEMS, INC. AND AFFILIATES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 10 - CAPITAL STRUCTURE AND CAPITAL TRANSACTIONS

PREFERRED STOCK

We have authorized the issuance of 10,000,000 shares of preferred stock with a par value of \$0.01 per share. There were no preferred shares issued or outstanding at October 31, 2003, 2004 or 2005. Shares may be issued in one or more series. During the year ended October 31, 2001, we issued 5,542,018 preferred shares in settlement of certain debt obligations and subsequently retired the stock by restructuring existing notes payable and combining the preferred stock balance due of approximately \$5,542,000 plus accrued interest of approximately \$235,000. In conjunction with this refinancing, we issued

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five-year warrants to purchase 1,000,000 shares of common stock at an exercise price of \$1.00 per share.

### STOCK OPTION INCENTIVE PLANS

We have two long-term incentive stock option plans. The 1992 plan has not issued options since the inception of the new 2000 plan. The 2000 plan reserves 2,000,000 shares of common stock. Options granted under the plan are intended to qualify as incentive stock options under existing tax regulations. In addition, we have issued non-qualified stock options from time to time in connection with acquisitions and for other purposes and have also issued stock under the plan. Employee stock options generally vest over three years and expire five to ten years from date of grant. As of October 31, 2005, approximately 637,000, or 93%, of the outstanding stock options are fully vested.

We have issued warrants under various types of arrangements to employees, in conjunction with debt financing and in exchange for outside services. All warrants are issued with an exercise price equal to the fair market value of the underlying common stock on the date of issuance. Generally, the warrants expire five years from the date of grant. The terms of vesting are determined by the board of directors at issuance. Warrants issued to employees typically vest over three years.

The following table summarizes the activity for each of the three years ended October 31, 2005:

|                           | Outstanding Warrants |                | Outstanding Options |                      |
|---------------------------|----------------------|----------------|---------------------|----------------------|
|                           | Shares               | Price Range    | Number              | Exercise Price Range |
| Balance, October 31, 2002 | 7,462,135            | \$ 0.38 - 1.61 | 1,181,917           | \$ 0.40 - 1.67       |
| Granted                   | 750,000              | 0.19 - 0.41    | --                  | ---                  |
| Exercised                 | --                   | ---            | (95,000)            | 0.30                 |
| Canceled or expired       | (130,000)            | 0.75 - 0.79    | (28,000)            | 0.46 - 1.67          |
| Balance, October 31, 2003 | 8,082,135            | \$ 0.19 - 1.61 | 1,058,917           | \$ 0.40 - 1.67       |
| Granted                   | 4,325,000            | 0.30 - 0.70    | 150,000             | 0.46                 |
| Exercised                 | --                   | ---            | --                  | ---                  |
| Canceled or expired       | (402,365)            | 0.41 - 0.80    | (7,500)             | 0.46 - 1.67          |
| Balance, October 31, 2004 | 12,004,770           | \$ 0.19 - 1.61 | 1,201,417           | \$ 0.40 - 1.67       |
| Granted                   | 900,000              | 0.30 - 0.40    | --                  | ---                  |
| Exercised                 | (300,000)            | 0.19           | --                  | ---                  |
| Canceled or expired       | (600,000)            | 0.35 - 0.70    | (514,250)           | 0.40 - 1.67          |
| Balance, October 31, 2005 | 12,004,770           | \$ 0.30 - 1.61 | 687,167             | \$ 0.40 - 1.67       |

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PRIMEDEX HEALTH SYSTEMS, INC. AND AFFILIATES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 10 - CAPITAL STRUCTURE AND CAPITAL TRANSACTIONS (CONTINUED)

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Options under the plans are issued at the fair market value of the common stock on the date issued. The following summarizes information about employee stock options and warrants outstanding at October 31, 2005:

| Outstanding Options      |                    |   |                                 |
|--------------------------|--------------------|---|---------------------------------|
| Range of exercise prices | Number outstanding | Weighted average remaining contractual life | Weighted average exercise price |
| \$ 0.40 - \$ 0.75        | 669,167            | 4.89 years                                  | \$ 0.48                         |
| \$ 0.76 - \$ 1.70        | 18,000             | 1.33 years                                  | \$ 1.67                         |
|                          | 687,167            | 4.87 years                                  | \$ 0.51                         |
|                          | 687,167            |   |                                 |
| Outstanding Warrants     |                    |   |                                 |
| Range of exercise prices | Number outstanding | Weighted average remaining contractual life | Weighted average exercise price |
| \$ 0.30 - \$ 0.75        | 9,312,115          | 2.12 years                                  | \$ 0.47                         |
| \$ 0.76 - \$ 1.70        | 2,692,655          | 0.81 years                                  | \$ 1.06                         |
|                          | 12,004,770         | 1.82 years                                  | \$ 0.60                         |
|                          | 12,004,770         |   |                                 |

### CAPITAL TRANSACTIONS

On February 17, 2004, we filed a certificate of merger with the Delaware Secretary of State to acquire the balance of our 91%-owned subsidiary, DIS, that we did not previously own. Pursuant to the terms of the merger, we are obligated to pay each stockholder of DIS, other than Primedex, \$0.05 per share or approximately \$60,000 in the aggregate. We believe the price per share represents the value of the minority interest. Stockholders had the right to contest the price by exercising their appraisal rights at any time through March 15, 2004. During the year ended October 31, 2004, we paid \$35,000 to acquire 648,366 shares of DIS common stock and recorded the purchases as goodwill.

On December 19, 2003, we issued a \$1.0 million convertible subordinated note payable at a stated rate of 11% per annum with interest payable quarterly. As additional consideration for the financing, we issued a warrant for the purchase of 500,000 shares at an exercise price of \$0.50 per share and an expiration date of December 19, 2010. We have allocated \$0.1 million to the value of the warrants and believe the value of the conversion feature is nominal.

During the year ended October 31, 2003, one individual exercised his options to purchase 95,000 shares of common stock at \$0.30 per share, or \$28,500. During the year ended October 31, 2005, one individual exercised his options to purchase 300,000 shares of common stock at \$0.19 per share, or \$57,000.

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### PRIMEDEX HEALTH SYSTEMS, INC. AND AFFILIATES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### NOTE 11 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company estimates the fair value of financial instruments as of October 31, follows:

|   | 2004               |               | 2005               |               |
|---|--------------------|---------------|--------------------|---------------|
|   | Carrying<br>Amount | Fair<br>Value | Carrying<br>Amount | Fair<br>Value |
| Accounts receivable, current                | \$20,029,000       | \$20,029,000  | \$22,319,000       | \$22,319,000  |
| Accounts receivable, long term              | 1,868,000          | 1,868,000     | 1,267,000          | 1,267,000     |
| Debt maturing within one year               | 20,796,000         | 20,796,000    | 83,508,000         | 83,508,000    |
| Long-term debt                              | 62,828,000         | 59,364,000    | --                 | --            |
| Notes payable to related parties, long-term | 2,119,000          | 2,258,000     | 3,533,000          | 2,654,000     |
| Subordinated debentures                     | 16,147,000         | 17,983,000    | 16,147,000         | 16,882,000    |

In assessing the fair value of these financial instruments, we had used a variety of methods and assumptions, which were based on estimates of market conditions and risks existing at that time. For certain instruments, including cash and cash equivalents, cash overdraft, accounts receivable and current and short-term debt, it was assumed that the carrying amount approximated fair value for the majority of these instruments because of their short maturities. The fair value of the long-term amounts for notes payable to related parties and debt is based on current rates at which the Company could borrow funds with similar remaining maturities. The fair value of the subordinated debentures is the estimated value of debentures available to repurchase at current market rates over the bond term including an estimated interest payment stream.

#### NOTE 12 - RELATED PARTY TRANSACTIONS

The amount due to related parties at October 31, 2005 consisted of notes payable, with interest at 6.58%, due to an officer and employee of ours for the purchase of DIS common stock in 1996 of \$940,000 and \$61,000, respectively, and a note payable of \$2,532,000, with interest at 6.58%, due to another officer of ours for loans made by him to us. During the year ended October 31, 2005, the note payable due the employee was reduced by \$43,000 and applied to the purchase of his stock options exercised in the same period (see "Capital Transactions"). In addition, during the year ended October 31, 2005, an officer loaned the Company an additional \$1,370,000 (included above).

The amount due to related parties at October 31, 2004 consisted of notes payable, with interest at 6.58%, due to an officer and employee of ours for the purchase of DIS common stock in 1996 of \$940,000 and \$105,000, respectively, and a note payable of \$1,074,000, with interest at 6.58%, due to another officer of ours for loans made by him to us.

#### NOTE 13 - COMMITMENTS AND CONTINGENCIES

**LEASES** - We lease various operating facilities and certain medical equipment under operating leases with renewal options expiring through 2029. Certain leases contain renewal options from two to ten years and escalation based primarily on the consumer price index. The schedule below assumes we take



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advantage of all lease renewal options. Minimum annual payments under noncancellable operating leases for future years ending October 31 are as follows:

|            | Facilities   | Equipment | Total        |
|------------|--------------|-----------|--------------|
|            | -----        | -----     | -----        |
| 2005       | \$ 7,672,000 | 25,000    | 7,697,000    |
| 2006       | 6,971,000    | 5,000     | 6,976,000    |
| 2007       | 6,928,000    | 5,000     | 6,933,000    |
| 2008       | 6,792,000    | 3,000     | 6,795,000    |
| 2009       | 6,834,000    | --        | 6,834,000    |
| Thereafter | 58,907,000   | --        | 58,907,000   |
|            | -----        | -----     | -----        |
|            | \$94,104,000 | \$ 38,000 | \$94,142,000 |

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PRIMEDEX HEALTH SYSTEMS, INC. AND AFFILIATES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 13 - COMMITMENTS AND CONTINGENCIES - CONTINUED

Total rent expense, including equipment rentals, for the years ended October 31, 2003, 2004 and 2005 amounted to approximately \$9,375,000, \$7,804,000 and \$7,919,000, respectively. Effective November 1, 2003, we converted operating leases with an affiliate of GE into capital leases by amending the lease agreements to include \$1.00 buyouts. The total converted equipment cost and capitalized lease obligation is \$6,206,000. Included in equipment rental expense for the year ended October 31, 2003 was GE rental expenses of approximately \$1,765,000.

Salaries and consulting agreements - We have a variety of arrangements for the payment of professional and employment services. The agreements provide for the payment of professional fees to physicians under various arrangements, including a percentage of revenue collected from 15.0% to 21.0%, fixed amounts per periods and combinations thereof.

We also have employment agreements with officers, key employees and through BRMG, physicians, at annual compensation rates ranging from \$50,000 to \$390,000 and for periods extending up to five years through October 2010. Total commitments under the agreements are approximately \$16,677,000 for fiscal 2006. The majority of the contracts are for one year.

PURCHASE COMMITMENT

On December 18, 2003, we entered into a three-year purchase agreement with an imaging film provider whereby we must purchase \$7,500,000 of film at a rate of approximately \$2,500,000 annually over the term of the agreement.

EQUIPMENT SERVICE CONTRACT

On March 1, 2000, we entered into an equipment maintenance service contract through October 2005, extended through October 2009, with GE Medical Systems to provide maintenance and repair on the majority of its medical equipment for a fee based upon a percentage of net revenues, subject to certain minimum aggregate net revenue requirements. Net revenue is reduced by the provision for bad debt, mobile PET revenue and other professional reading service revenue to obtain adjusted net revenue. The fiscal 2005 annual service

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fee was the higher of 3.50% of our adjusted net revenue, or \$4,970,000. The fiscal 2006 annual service rate will be the higher of 3.62% of our adjusted net revenue, or \$5,393,800. For the fiscal years 2007, 2008 and 2009, the annual service fee will be the higher of 3.62% of our adjusted net revenue, or \$5,430,000. We believe this framework of basing service costs on usage is an effective and unique method for controlling our overall costs on a facility-by-facility basis. We have met or exceeded the minimum required revenue for each of the last three fiscal years. As of October 31, 2005, we owe GE Medical Systems \$3,222,000 for past services under the arrangement since fiscal 2002. GE has made arrangements for interest-free payments that will continue to reduce this liability during fiscal 2006. The liability is classified as "Accounts Payable and Accrued Expenses-current" on the financial statements.

### LITIGATION

In the ordinary course of business from time to time we become involved in certain legal proceedings, the majority of which are covered by insurance. Management is not aware of any pending material legal proceedings outside of the ordinary course of business.

### NOTE 14 - EMPLOYEE BENEFIT PLAN

We adopted a profit-sharing/savings plan pursuant to Section 401(k) of the Internal Revenue Code that covers substantially all non-professional employees. Eligible employees may contribute on a tax-deferred basis a percentage of compensation, up to the maximum allowable under tax law. Employee contributions vest immediately. The plan does not require a matching contribution by us. There was no expense for the years ended October 31, 2003, 2004 or 2005.

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### PRIMEDEX HEALTH SYSTEMS, INC. AND AFFILIATES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 15 - MALPRACTICE INSURANCE

We and our affiliated physicians are insured by Fairway Physicians Insurance Company. Fairway provides claims-based malpractice insurance coverage that covers only asserted malpractice claims within policy limits. Management does not believe there are material uninsured malpractice costs at October 31, 2005.

We recorded a \$300,000 noncurrent asset for the cost basis of our investment in the common stock we hold in Fairway Physicians Insurance Company, the risk retention group that holds our malpractice policy.

### NOTE 16 - SUBSEQUENT EVENTS

On January 31, 2006, we executed a commitment letter with an institutional lender to which such lender provided us with a commitment, subject to final documentation and legal due diligence, for a \$160 million senior secured credit facility to be used to refinance all of our existing indebtedness (except for \$16.1 million of outstanding subordinated debentures and \$6.1 million of capital lease obligations). The commitment provides for a \$15 million five-year revolving credit facility, an \$85 million term loan due in five years and \$60 million second lien term loan due in six years. The loans are subject to acceleration on February 28, 2008, unless we have made arrangements to discharge or extend our outstanding subordinated debentures by that date. The loans are essentially payable interest only monthly at varying rates that are yet to be

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finalized but will be based upon market conditions. Finalization of the credit facility is subject to customary conditions, including legal due diligence and final documentation that is scheduled for completion on or about March 7, 2006.

On November 7, 2005, we issued to one of our key employees five-year options exercisable at a price of \$0.50 per share, which was the public market closing price for our common stock on the transaction date, to purchase 15,000 shares of our common stock. The options become exercisable, or vest, in equal installments over three years with the first 5,000 options becoming exercisable on November 7, 2005.

On December 19, 2003, we issued a \$1.0 million convertible subordinated note payable to Galt Financial, Ltd., at a stated rate of 11% per annum with interest payable quarterly. The note payable is convertible at the holder's option anytime after January 1, 2006 at \$0.50 per share. As additional consideration for the financing we issued a warrant for the purchase of 500,000 shares at an exercise price of \$.50 per share. We allocated \$0.1 million to the value of the warrants and believe the value of the conversion feature is nominal. In November 2005, the right to convert was waived and the warrant for the purchase of 500,000 shares of common stock was terminated in exchange for the issuance of a five-year warrant to purchase 300,000 shares of our common stock at a price of \$0.50 per share, the public market price on the date the warrant, with the underlying note being extended to July 1, 2006. We allocated an additional \$0.1 million to the value of the new warrants.

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### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON SUPPLEMENTAL SCHEDULE

To the Stockholders and Board of Directors of  
Primedex Health Systems, Inc.

Our report on the consolidated financial statements of Primedex Health Systems, Inc. and its affiliates, as of October 31, 2004 and 2005 and for each of the years in the three-year period ended October 31, 2005, is included on page F-1 of this Form 10-K. In connection with our audits of such consolidated financial statements, which were conducted for purposes of forming an opinion on the basic consolidated financial statements taken as a whole, we have also audited the related accompanying financial statements Schedule II -- Valuation and Qualifying Accounts for the years ended October 31, 2005, 2004, and 2003. In our opinion, the financial statement schedule referred to above, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information required to be included therein.

/s/ Moss Adams LLP

Los Angeles, California

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February 13, 2006

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PRIMEDEX HEALTH SYSTEMS, INC. AND AFFILIATES  
SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

|   | Balance at<br>Beginning<br>of Year | Additions<br>-----<br>Charged Against<br>Income | Deductions<br>from<br>Reserves (a) | Balance at<br>End of Year |
|---|------------------------------------|---|------------------------------------|---------------------------|
|   | -----                              | -----   | -----                              | -----                     |
| Year ended October 31, 2005:                          |                                    |   |                                    |                           |
| Accounts receivable-contractual allowances-current    | \$ 52,961,000                      | \$278,523,000                                   | \$276,115,000                      | \$ 55,369,000             |
|   | =====                              | =====   | =====                              | =====                     |
| Accounts receivable-bad debt allowances-current       | \$ 678,000                         | \$ 4,664,000                                    | \$ 4,415,000                       | \$ 927,000                |
|   | =====                              | =====   | =====                              | =====                     |
| Accounts receivable-contractual allowances-noncurrent | \$ 4,939,000                       | \$ 15,805,000                                   | \$ 17,602,000                      | \$ 3,142,000              |
|   | =====                              | =====   | =====                              | =====                     |
| Accounts receivable-bad debt allowances-noncurrent    | \$ 63,000                          | \$ 265,000                                      | \$ 275,000                         | \$ 53,000                 |
|   | =====                              | =====   | =====                              | =====                     |
| Year ended October 31, 2004:                          |                                    |   |                                    |                           |
| Accounts receivable-contractual allowances-current    | \$ 54,650,000                      | \$279,414,000                                   | \$281,103,000                      | \$ 52,961,000             |
|   | =====                              | =====   | =====                              | =====                     |
| Accounts receivable-bad debt allowances-current       | \$ 955,000                         | \$ 3,577,000                                    | \$ 3,854,000                       | \$ 678,000                |
|   | =====                              | =====   | =====                              | =====                     |
| Accounts receivable-contractual allowances-noncurrent | \$ 4,361,000                       | \$ 26,056,000                                   | \$ 25,478,000                      | \$ 4,939,000              |
|   | =====                              | =====   | =====                              | =====                     |
| Accounts receivable-bad debt allowances-noncurrent    | \$ 76,000                          | \$ 334,000                                      | \$ 347,000                         | \$ 63,000                 |
|   | =====                              | =====   | =====                              | =====                     |
| Year ended October 31, 2003:                          |                                    |   |                                    |                           |
| Accounts receivable-contractual allowances-current    | \$ 53,158,000                      | \$261,594,000                                   | \$260,102,000                      | \$ 54,650,000             |
|   | =====                              | =====   | =====                              | =====                     |
| Accounts receivable-bad debt allowances-current       | \$ 1,593,000                       | \$ 4,578,000                                    | \$ 5,216,000                       | \$ 955,000                |
|   | =====                              | =====   | =====                              | =====                     |
| Accounts receivable-contractual allowances-noncurrent | \$ 4,271,000                       | \$ 20,875,000                                   | \$ 20,785,000                      | \$ 4,361,000              |
|   | =====                              | =====   | =====                              | =====                     |
| Accounts receivable-bad debt allowances-noncurrent    | \$ 128,000                         | \$ 366,000                                      | \$ 418,000                         | \$ 76,000                 |
|   | =====                              | =====   | =====                              | =====                     |

(a) Deductions include sales and divestitures

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND  
-----  
FINANCIAL DISCLOSURE  
-----

Inapplicable.

ITEM 9A. CONTROLS AND PROCEDURES  
-----

As of the end of the period covered by this report, we performed an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)). Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures are not effective in alerting them prior to the end of a reporting period to all material information required to be included in our periodic filings with the SEC because we identified the following material weakness in the design of internal controls over financial reporting. We concluded that we had insufficient personnel resources and technical accounting expertise within the accounting function to resolve the following non-routine accounting matters: the recording of non-typical cost-based investments and unusual debt-related transactions and the appropriate analysis of the amortization lives of leasehold improvements in accordance with generally accepted accounting principles. The incorrect accounting for the foregoing was sufficient to lead management to conclude that a material weakness in the design of internal controls over the accounting for non-routine transactions existed at October 31, 2005.

We are in the process of remediating this weakness. Subsequent to October 31, 2005, we determined to change the design of our internal controls over non-routine accounting matters by the identification of an outside resource at a recognized professional services company that we can consult with on non-routine transactions or the employment of qualified accounting personnel to deal with this issue together with the utilization of other senior corporate accounting staff, who are responsible for reviewing all non-routine matters and preparing formal reports on their conclusions, and conducting quarterly reviews and discussions of all non-routine accounting matters with our independent public accountants. We believe we will substantially address the identified weakness through the change in the design of our internal controls, and subject to confirmation of the effectiveness of our implementation of these remediation measures, anticipate that the material weakness should be remediated prior to the end of fiscal 2006. We are continuing to evaluate additional controls and procedures that we can implement and may add additional accounting personnel during fiscal 2006 to enhance our technical accounting resources. We do not anticipate that the cost of this remediation effort will be material to our financial statements. We experienced no impact on our financial statements for the year ended October 31, 2005.

The above identified material weakness in internal control was determined by management during our year-end audit to be a material change in our internal

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control over financial reporting during the quarter ended October 31, 2005.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system will be met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events.

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### PART III

#### ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The following table sets forth certain information with respect to each of our directors and executive officers as of January 25, 2006:

| Name                       | Age | Director or<br>Officer Since | Position  |
|----------------------------|-----|------------------------------|---|
| ----                       | --- | -----                        | -----   |
| Howard G. Berger, M.D. (1) | 61  | 1992                         | President, Treasurer, Chief Executive Officer and Director      |
| Norman R. Hames            | 49  | 1996                         | Vice President, Secretary, Chief Operating Officer and Director |
| John V. Crues, III, M.D.   | 56  | 2000                         | Vice President and Director                                     |
| David L. Swartz (2)        | 61  | 2004                         | Director  |
| Lawrence L. Levitt (2)     | 62  | 2005                         | Director  |
| Jeffrey L. Linden          | 63  | 2001                         | Vice President and General Counsel                              |
| Mark D. Stolper            | 34  | 2004                         | Chief Financial Officer   |

(1) Member of the Compensation Committee

(2) Member of the Audit and Compensation Committee

The following is a brief description of the business experience of each director and executive officer during the past five years.

Howard G. Berger, M.D. has served as President and Chief Executive Officer of our company and its predecessor entities since 1987. Dr. Berger is also the president of the entities that own BRMG. Dr. Berger has over 25 years of experience in the development and management of healthcare businesses. He began his career in medicine at the University of Illinois Medical School, is Board Certified in Nuclear Medicine and trained in an Internal Medicine residency, as well as in a masters program in medical physics in the University of California system.

Norman R. Hames has served as our Chief Operating Officer since 1996. Applying his 20 years of experience in the industry, Mr. Hames oversees all aspects of facility operations. His management team, comprised of regional

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directors, managers and sales managers, are responsible for responding to all of the day-to-day concerns of our facilities, patients, payors and referring physicians. Prior to joining our company, Mr. Hames was President and Chief Executive Officer of his own company, Diagnostic Imaging Services, Inc. (which we have acquired), which owned and operated 14 multi-modality imaging facilities throughout Southern California. Mr. Hames gained his initial experience in operating imaging centers for American Medical International, or AMI, and was responsible for the development of AMI's single and multi-modality imaging centers.

John V. Crues, III, M.D. is a world-renowned radiologist. Dr. Crues plays a significant role as a musculoskeletal specialist for many of our patients as well as a resource for physicians providing services at our facilities. Dr. Crues received his M.D. at Harvard University, completed his internship at the University of Southern California in Internal Medicine, and completed a residency at Cedars-Sinai in Internal Medicine and Radiology. Dr. Crues has authored numerous publications while continuing to actively participate in radiological societies such as the Radiological Society of North America, American College of Radiology, California Radiological Society, International Society for Magnetic Resonance Medicine and the International Skeletal Society.

David L. Swartz is a C.P.A. with thirty-five years of experience providing accounting and advisory services to clients. Since 1993, Mr. Swartz has been the managing partner of Good, Swartz, Brown & Berns. Prior to this, Mr. Swartz served as managing partner and was on the national Board of Directors of a 50 office international accounting firm. Mr. Swartz is also a former CFO of a publicly held shopping center and development company.

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Lawrence L. Levitt is a C.P.A. and has since 1987 been the president and chief financial officer of Canyon Management Company, a company which manages a privately held investment fund. Mr. Levitt is also a director of River Downs Management Company, operator of a thoroughbred racetrack in Ohio.

Jeffrey L. Linden joined us in 2001 as our Vice President and General Counsel. He is also associated with Cohen & Lord, a professional corporation, outside general counsel to us. Prior to joining us, Mr. Linden had been engaged in the private practice of law. He has lectured before numerous organizations on various topics, including the California State Bar, American Society of Therapeutic Radiation Oncologists, California Radiological Association, and National Radiology Business Managers Association.

Mark D. Stolper had diverse experiences in investment banking, private equity, venture capital investing and operations prior to joining us. Mr. Stolper began his career as a member of the corporate finance group at Dillon, Read and Co., Inc., executing mergers and acquisitions, public and private financings and private equity investments with Saratoga Partners LLP, an affiliated principal investment group of Dillon Read. After Dillon Read, Mr. Stolper joined Archon Capital Partners, backed by the Milken Family and NewsCorp, which made private equity investments in media and entertainment companies. Mr. Stolper received his operating experience with Eastman Kodak, where he was responsible for business development for Kodak's Entertainment Imaging subsidiary (\$1.5 billion in sales). Mr. Stolper was also co-founder of Broadstream Capital Partners, a Los Angeles-based investment banking firm focused on advising middle market companies engaged in financing and merger and acquisition transactions.

None of the directors serves as a director of any other corporation with

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a class of securities registered pursuant to Section 12 of the Exchange Act or subject to the requirements of Section 15(d) of the Exchange Act. There are no family relationships among any of the officers and directors. Furthermore, none of the events described in Item 401(f) of Regulation S-K involve a director or officer during the past five years.

The officers are elected annually and serve at the discretion of the Board of Directors. There are no family relationships among any of the officers and directors. During the fiscal year ended October 31, 2005, the Board of Directors held two meetings in which all directors were present, except that Dr. Crues was absent from one meeting, and took board action by unanimous written consent on six occasions. All directors participated in all such actions.

### AUDIT AND COMPENSATION COMMITTEES

The Audit Committee reviews the results and scope of the audit and other services provided by our independent auditors, and the Compensation Committee determines salaries and incentive compensation for our employees and consultants.

David Swartz is designated our "audit committee financial expert" under Item 401(h) of Regulation S-K under the Securities Act. Mr. Swartz is "independent" as that term is used in Item 7(d)(3)(iv) of Schedule 14A under the Exchange Act.

### DIRECTOR COMPENSATION

Independent directors receive compensation of \$25,000 per year and an annual warrant to purchase 50,000 shares of our common stock.

### COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

During fiscal 2005, all executive compensation was determined by the then members of our Board of Directors, Howard G. Berger, M.D., Norman R. Hames, John V. Crues, III, M.D. Lawrence L. Levitt and David L. Swartz. In addition, no individual who served as an executive officer of our company during fiscal 2005, served during fiscal 2005, on the board of directors or compensation committee of another entity where an executive officer of the other entity also served on our Board of Directors.

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### SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires our directors and officers and persons who own more than 10% of a registered class of our equity securities to file reports of ownership and changes in ownership with the SEC. Directors and officers and greater than 10% stockholders are required by SEC regulation to furnish us with copies of the reports they file. Based solely on the review of the copies of such reports and written representations from certain persons that certain reports were not required to be filed by such persons, we believe that all our directors, officers and greater than 10% beneficial owners complied with all filing requirements applicable to them with respect to transactions for the period November 1, 2004 through October 31, 2005.

### CODE OF ETHICS FOR SENIOR FINANCIAL OFFICERS

Our Board of Directors has adopted a Code of Ethics for Senior Financial Officers. A copy of the Code of Ethics is available on our website at



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www.radnetonline.com.

## ITEM 11. EXECUTIVE COMPENSATION

The following table sets forth information concerning the annual, long-term and all other compensation for services rendered in all capacities to us and our subsidiaries for the years ended October 31, 2005, 2004 and 2003, of (i) the person who served as our chief executive officer during the year ended October 31, 2005, and (ii) our three most highly compensated executive officers (other than the chief executive officer) serving as executive officers at October 31, 2005 ("Other Executive Officers"), and whose aggregate cash compensation exceeded \$100,000 for the year ended October 31, 2005. We collectively refer to them as the "Named Executive Officers":

SUMMARY COMPENSATION TABLE

| Name and Principal Position  | Year Ended | Annual Compensation |                        | Other Annual Comp. (\$) (1) | Long-Term                             |       |
|--|------------|---------------------|------------------------|-----------------------------|---------------------------------------|-------|
|  |            | 10/31               | Salary (\$) Bonus (\$) |                             | Securities Underlying Options (#) (7) | Res A |
| Howard G. Berger, M.D.,<br>Chief Executive Officer                           | 2005       | \$200,000           | (2) --                 | --                          | --                                    | --    |
|  | 2004       | \$225,000           | (2) --                 | --                          | --                                    | --    |
|  | 2003       | \$328,846           | (2) --                 | --                          | --                                    | --    |
| Norman R. Hames,<br>Vice President, Secretary<br>and Chief Operating Officer | 2005       | \$220,000           | --                     | --                          | 3,000,000                             |       |
|  | 2004       | \$229,000           | --                     | --                          | 3,000,000                             |       |
|  | 2003       | \$225,000           | --                     | --                          | 3,000,000                             |       |
| John V. Crues, III, M.D.,<br>Vice President                                  | 2005       | \$440,000           | (3) --                 | --                          | 1,000,000                             |       |
|  | 2004       | \$370,000           | (4) --                 | --                          | 1,000,000                             |       |
|  | 2003       | \$363,000           | (5) --                 | --                          | 500,000                               |       |
| Jeffrey L. Linden,<br>Vice President and<br>General Counsel                  | 2005       | \$350,000           | (6) --                 | --                          | 1,275,000                             |       |
|  | 2004       | \$350,000           | (6) --                 | --                          | 1,574,910                             |       |
|  | 2003       | \$303,015           | (6) --                 | --                          | 1,572,275                             |       |

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- (1) The dollar value of perquisites and other personal benefits, if any, for each of the Named Executive Officers was less than \$50,000 or 10% of salary and bonus, the reporting thresholds established by the SEC.
- (2) Includes \$300,000, \$225,000 and \$200,000 received from BRMG (see "Employment Agreements") in 2003, 2004 and 2005, respectively. Dr. Berger voluntarily reduced compensation payable by us in 2003, 2004 and 2005 to assist with our liquidity.
- (3) Received from BRMG.
- (4) Includes \$185,000 received from BRMG.
- (5) Includes \$200,000 received from BRMG.

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- (6) Mr. Linden voluntarily reduced compensation payable by us in 2003 to assist with our liquidity. Cohen & Lord, a professional corporation, a law firm with which Mr. Linden is associated, received \$365,695 in fees from us during the year ended October 31, 2005. Mr. Linden has specifically waived any interest in our fees paid to Cohen & Lord since becoming an officer.
- (7) Shares of our common stock.

STOCK OPTION GRANTS AND EXERCISES IN LAST FISCAL YEAR

In fiscal 2005, we granted options to John V. Crues, III, M.D. and to no other executive officer. The following table provides information about that option grant and projects potential realizable gains at hypothetical assumed annual compound rates of appreciation. Primedex had outstanding 12,691,937 options and warrants to purchase common stock as of October 31, 2005.

| NAME                     | NUMBER OF<br>SECURITIES<br>UNDERLYING<br>OPTIONS<br>GRANTED | PERCENT OF<br>TOTAL<br>OPTIONS<br>GRANTED TO<br>EMPLOYEES<br>IN FISCAL<br>YEAR | OPTION GRANT IN<br>2005 INDIVIDUAL<br>GRANTS |                    |
|--------------------------|---|--|--|--------------------|
|                          |   |  | EXERCISE<br>PRICE                            | EXPIRATION<br>DATE |
| John V. Crues, III, M.D. | 500,000   | 55.6%  | \$ 0.36                                      | 06/07/10           |

- (1) These values are solely the mathematical results of hypothetical assumed appreciation of the market value of the underlying shares at an annual rate of 5% and 10% over the full term of the options, less the exercise price. Actual gains, if any, will depend on future stock market performance of the underlying stock, market factors and conditions, and optionee's continued employment through the applicable vesting periods. We make no prediction as to the future value of these options or of the underlying stock, and these values are provided solely as examples required by the SEC rules.

AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR AND FISCAL YEAR END OPTION VALUES

There were no option exercises in the year ended October 31, 2005 by the Named Executive Officers except as follows:

| NAME              | SHARES<br>ACQUIRED<br>ON EXERCISE | VALUE<br>REALIZED (1) | NUMBER OF SECURITIES<br>UNDERLYING UNEXERCISED<br>OPTIONS AT FISCAL YEAR END |               | EXER |
|-------------------|-----------------------------------|-----------------------|--|---------------|------|
|                   |                                   |                       | EXERCISABLE  | UNEXERCISABLE |      |
| Jeffrey L. Linden | 300,000                           | \$ 63,000             | 1,275,000  | --            | \$   |

- (1) The value realized equals the fair market value of the common stock acquired on the date of exercise minus the exercise price.
- (2) Based on the closing price of the common stock of \$0.32 per share as of

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January 13, 2005, less the option exercise price.

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### EMPLOYMENT AGREEMENTS

BRMG entered into a Management Consulting Agreement with Howard G. Berger, M.D. as of January 1, 1994. The Agreement automatically renews annually unless either party delivers notice of non-renewal to the other party no less than 90 days prior to the scheduled termination date. Dr. Berger serves as the manager of BRMG and the chief executive for BRMG's partnerships, and receives compensation for his services from BRMG equal to \$300,000 per year. Dr. Berger's duties include the direction of day-to-day activities of BRMG, supervision of personnel, and the implementation of policies and plans appropriate to carry out the operational, financial and business objectives of BRMG. Under this agreement, if we terminate his employment for cause, he will be entitled to compensation equal to one year's base salary. If Dr. Berger terminates this agreement without cause, he is entitled to compensation accrued through the effective date of termination, and if his employment is terminated by BRMG without cause, BRMG shall pay to Dr. Berger an amount equal to the sum of (i) his base salary accrued through the effective date of termination; (ii) his base salary for the balance of the term, but not less than his base salary for five years; and (iii) an amount equal to the cost of all benefits he would receive for the balance of the term. Dr. Berger's employment shall not terminate in the event of a merger, consolidation, dissolution or other transaction whereby BRMG would not be the surviving entity of such transaction, and Dr. Berger holds the right to terminate this agreement upon 60 days notice in the event of any such transaction.

John V. Crues, III, M.D. entered into a renewable one-year employment agreement dated as of January 15, 1996 with each of us and BRMG which requires him to devote one-half of his time to each entity in exchange for annual combined remuneration currently of \$370,000. Dr. Crues' duties for us include information management systems for radiology practices, imaging facility network development and network marketing and management, utilization management, utilization review, all forms of provider and payor contracts and physician interaction. For BRMG, Dr. Crues' duties include diagnostic imaging, professional physician services, utilization management, utilization review, all forms of provider and payor contracts and physician interaction, some of which require a license to practice medicine.

On April 16, 2001, we entered into a five-year employment agreement with Jeffrey L. Linden for Mr. Linden to serve as vice president and general counsel. The agreement provides for annual compensation of \$350,000, together with the option to purchase 1,000,000 shares of our common stock at a price of \$0.43 per share (the closing price reported on the OTC Bulletin Board on the date the agreement was executed), exercisable throughout his employment, or by June 1, 2006 if Mr. Linden's employment is terminated. The agreement also extended Mr. Linden's ability to exercise 145,000 options previously held by him through May 31, 2006. Under this agreement, if we terminate Mr. Linden's employment for cause, he will be entitled to compensation equal to one year's base salary. If Mr. Linden terminates this agreement without cause, he is entitled to compensation accrued through the effective date of termination, and if his employment is terminated by us without cause, we shall pay Mr. Linden an amount equal to the sum of (i) his base salary accrued through the effective date of termination; (ii) his base salary for the balance of the term, but not less than his base salary for five years; and (iii) an amount equal to the cost of all benefits he would receive for the balance of the term. Mr. Linden's employment shall not terminate in the event of a merger, consolidation, dissolution or other transaction whereby we would not be the surviving entity of such

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transaction, and Mr. Linden holds the right to terminate this agreement upon 60 days notice in the event of any such transaction. If Mr. Linden's employment is terminated in connection with any such transaction he shall be entitled to the same compensation he would have received if we terminated his employment without cause.

On May 1, 2001, we entered into a three-year employment agreement with Norman R. Hames. Pursuant to the agreement Mr. Hames agreed to continue his employment with us as our vice president and chief operations officer. The agreement provides for Mr. Hames to receive annual compensation of \$225,000. Additionally, in consideration of his entry into the agreement Mr. Hames received the option to purchase 3,000,000 shares of our common stock at a price of \$0.55 per share (the closing price reported on the OTC Bulletin Board on the date the agreement was executed) exercisable throughout his employment, or by May 1, 2006 if Mr. Hames' employment is terminated. We also agreed to provide a cash bonus to Mr. Hames of \$0.20 for each share that he exercises under the options, up to a maximum of \$600,000. Under this agreement, if we terminate his employment for cause, he will be entitled to compensation equal to one year's base salary. If Mr. Hames terminates this agreement without cause, he is entitled to compensation accrued through the effective date of termination, and

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if his employment is terminated by us without cause, we shall pay Mr. Hames an amount equal to the sum of (i) his base salary accrued through the effective date of termination; (ii) his base salary for the balance of the term, but not less than his base salary for three years; and (iii) an amount equal to the cost of all benefits he would receive for the balance of the term. Mr. Hames' employment shall not terminate in the event of a merger, consolidation, dissolution or other transaction whereby we would not be the surviving entity of such transaction.

On July 30, 2004, we entered into a three year employment agreement with Mark Stolper for Mr. Stolper to serve as our chief financial officer. Mr. Stolper received a \$25,000 payment on entry into the agreement and receives annual compensation during the first twelve months of \$215,000 and thereafter \$250,000 per year. At the end of the first twelve months, Mr. Stolper receives a one time payment of \$10,000. In connection with his employment, Mr. Stolper received five-year warrants to purchase 650,000 shares of our common stock at \$0.30 per share (the closing price reported on the OTC Bulletin Board on the date the agreement was executed).

### STOCK INCENTIVE PLANS

We have two stock incentive plans: our 2000 Long-Term Incentive Plan and our Incentive Stock Option Plan.

We have reserved 2,000,000 shares of common stock for issuance under our 2000 Long-Term Incentive Plan, or the 2000 Plan. The material features of the 2000 Plan are as follows:

### ADMINISTRATION

The 2000 Plan is presently administered by our Board of Directors, but upon our locating non-employee directors who have the requisite qualifications will then be administered by a compensation committee appointed by the Board which will consist of two or more non-employee Directors. Subject to the terms of the 2000 Plan, the Board, and the compensation committee, if established, has full authority to administer the 2000 Plan in all respects, including: (i) selecting the individuals who are to receive awards under the 2000 Plan; (ii)

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determining the specific form of any award; and (iii) setting the specific terms and conditions of each award. Our senior legal and human resources representatives are also authorized to take ministerial actions as necessary to implement the 2000 Plan and awards issued under the 2000 Plan.

### ELIGIBILITY

Employees, directors and other individuals who provide services to us, our affiliates and subsidiaries who, in the opinion of the Board, or the compensation committee, if applicable, are in a position to make a significant contribution to our success or the success of our affiliates and subsidiaries are eligible for awards under the 2000 Plan.

### AMOUNT OF AWARDS

The value of shares or other awards to be granted to any recipient under the 2000 Plan are not presently determinable. However, the 2000 Plan restricts the number of shares and the value of awards not based on shares that may be granted to any individual during a calendar year or performance period. In order to facilitate our compliance with Section 162(m) of the Internal Revenue Code of 1986, as amended, or the Code, which deals with the deductibility of compensation for any of the chief executive officer and the four other most highly-paid executive officers, the 2000 Plan limits to 500,000 the number of shares for which options, stock appreciation rights or other stock awards may be granted to an individual in a calendar year and limits to \$1,000,000 the value of non-stock-based awards that may be paid to an individual with respect to a performance period. These restrictions were adopted by the Board of Directors as a means of complying with Code Section 162(m) and are not indicative of historical or contemplated awards made or to be made to any individual under the 2000 Plan.

### STOCK OPTIONS

The 2000 Plan authorizes the grant of options to purchase shares of common stock, including options to employees intended to qualify as incentive stock options within the meaning of Section 422 of the Code, as well as non-statutory options. The term of each option will not exceed ten years and each option will be exercisable at a price per share not less than 100% of the fair market value of a share of common stock on the date of the grant.

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Generally, optionees will pay the exercise price of an option in cash or by check, although the Board, and the compensation committee, if established, may permit other forms of payment including payment through the delivery of shares of common stock. Options granted under the 2000 Plan are generally not transferable, except at death or as gifts to certain Family Members, as defined in the 2000 Plan. At the time of grant or thereafter, the Board, and the compensation committee, if established, may determine the conditions under which stock options vest and remain exercisable.

Unless otherwise determined by the Board, and the compensation committee, if established, unexercised options will terminate if the holder ceases for any reason to be associated with us, our affiliates or our subsidiaries. Options generally remain exercisable for a specified period following termination for reasons other than for Cause, as defined in the 2000 Plan, particularly in circumstances of death, Disability and Retirement, as defined in the 2000 Plan. In the event of a Change in Control or Covered Transaction, as defined in the Incentive 2000 Plan, of our company, options become immediately exercisable and/or are converted into options for securities of the surviving party as

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determined by the Board, and the compensation committee, if established.

### OTHER AWARDS

The Board, and the compensation committee, if established, may grant stock appreciation rights which pay, in cash or common stock, an amount generally equal to the difference between the fair market values of the common stock at the time of exercise of the right and at the time of grant of the right. In addition, the Board, and the compensation committee, if established, may grant awards of shares of common stock at a purchase price less than fair market value at the date of issuance, including zero. A recipient's right to retain these shares may be subject to conditions established by the Board, and the compensation committee, if established, if any, such as the performance of services for a specified period or the achievement of individual or company performance targets. The Board, and the compensation committee, if established, may also issue shares of common stock or authorize cash or other payments under the 2000 Plan in recognition of the achievement of certain performance objectives or in connection with annual bonus arrangements.

### PERFORMANCE CRITERIA

The Board, and the compensation committee, if established, may condition the exercisability, vesting or full enjoyment of an award on specified Performance Criteria. For purposes of Performance Awards, as defined in the 2000 Plan, that are intended to qualify for the performance-based compensation exception under Code Section 162(m), Performance Criteria means an objectively determinable measure of performance relating to any of the following as specified by the Board, and the compensation committee, if established, determined either on a consolidated basis or, as the context permits, on a divisional, subsidiary, line of business, project or geographical basis or in combinations thereof: (i) sales; revenue; assets; liabilities; costs; expenses; earnings before or after deduction for all or any portion of interest, taxes, depreciation, amortization or other items, whether or not on a continuing operations or an aggregate or per share basis; return on equity, investment, capital or assets; one or more operating ratios; borrowing levels, leverage ratios or credit rating; market share; capital expenditures; cash flow; working capital requirements; stock price; stockholder return; sales, contribution or gross margin, of particular products or services; particular operating or financial ratios; customer acquisition, expansion and retention; or any combination of the foregoing; or (ii) acquisitions and divestitures, in whole or in part; joint ventures and strategic alliances; spin-offs, split-ups and the like; reorganizations; recapitalizations, restructurings, financings of debt or equity and refinancings; transactions that would constitute a change of control; or any combination of the foregoing. Performance Criteria measures and targets determined by the Board, and the compensation committee, if established, need not be based upon an increase, a positive or improved result or avoidance of loss.

### AMENDMENTS

The Board, and the compensation committee, if established, may amend the 2000 Plan or any outstanding award for any purpose permitted by law, or may at any time terminate the 2000 Plan as to future grants of awards. The Board, and the compensation committee, if established, may not, however, increase the maximum number of shares of common stock issuable under the 2000 Plan or change the description of the individuals eligible to receive awards. In addition, no termination of or amendment to the 2000 Plan may adversely affect the rights of a participant with respect to any award previously granted under the 2000 Plan without the participant's consent, unless the compensation committee expressly reserves the right to do so in writing at the time the award is made. To the extent the Board, and the compensation committee, if established, desires the 2000 Plan to qualify under the Code, certain amendments may require stockholder

approval.

Our stockholders have adopted our Incentive Stock Option Plan, or the Incentive Plan. The Incentive Plan is designed to qualify as an "incentive stock option plan" under Section 422A of the Code. Under the Incentive Plan, options to purchase up to 1,600,000 shares of common stock were authorized for grant to key employees, including officers and directors. A committee of three directors appointed by the Board of Directors administers the Incentive Plan and designates the optionees, the number of shares subject to the options, and the terms and conditions of each option.

In May 1992, our Board of Directors authorized amendments to the Incentive Plan, subject to stockholder approval, increasing the number of shares reserved under the Incentive Plan to 2,000,000 shares of our common stock and amending the Incentive Plan in accordance with changes adopted in 1986 to the Code. These proposed amendments to the Incentive Plan were adopted by stockholders at the annual meeting of stockholders held on November 17, 1992.

Under the Incentive Plan, as amended, except for options granted to holders of 10% or more of our outstanding stock, the exercise price of an option must be at least 100% of the fair market value of the common stock on the effective date of grant. Options granted under the Incentive Plan to stockholders possessing more than 10% of our outstanding stock must be at an exercise price equal to not less than 110% of such fair market value. We are not issuing any additional options under the Incentive Plan because the Incentive Plan terminated in 2002. All options granted must be exercised within 10 years of date of grant. The aggregate fair market value of our common stock with respect to which options are exercisable for the first time by a grantee under the Incentive Plan during any calendar year may not exceed \$100,000. Options must be exercised by an optionee, if at all, within three months after the termination of such optionee's employment for any reason other than for cause, and within one year after termination of employment due to death or permanent disability, unless by its terms the option expires sooner.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND  
 -----  
 RELATED STOCKHOLDER MATTERS  
 -----

The following table sets forth certain information regarding the beneficial ownership of our common stock as of January 15, 2006, by (i) each holder known by us to beneficially own more than five percent of the outstanding common stock and (ii) each of our directors and executive officers. The percentages set forth in the table have been calculated on the basis of treating as outstanding, for purposes of computing the percentage ownership of a particular holder, all shares of our common stock outstanding at such date and all shares of common stock purchasable upon exercise of options and warrants owned by such holder which are exercisable at or within 60 days after such date.

| Name of Beneficial Owner<br>----- | SHARES OF COMMON<br>STOCK<br>BENEFICIALLY OWNED (1)<br>----- | PERCENT<br>OF<br>CLASS<br>----- |
|-----------------------------------|--|---------------------------------|
| Howard G. Berger, M.D.*           | 13,137,400 (2)   | 21.6%                           |
| John V. Crues, III, M.D.*         | 1,493,875 (3)  | 2.5%                            |
| Norman R. Hames*                  | 3,000,000 (4)  | 4.9%                            |

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|  |                |        |
|--|----------------|--------|
| David L. Swartz*   | 100,000 (5)    | -- (5) |
| Lawrence L. Levitt*  | 50,000 (6)     | -- (6) |
| Jeffrey L. Linden*   | 1,670,000 (7)  | 2.7%   |
| Mark D. Stolper*   | 708,800 (8)    | 1.2%   |
|  |                |        |
| All directors and executive officers<br>as a group (seven persons) | 20,160,075 (9) | 33.0%  |

\* The address of all of our officers and directors is c/o Primedex, 1510 Cotner Avenue, Los Angeles, California 90025.

(1) Subject to applicable community property statutes and except as otherwise noted, each holder named in the table has sole voting and investment power with respect to all shares of common stock shown as beneficially owned.

(2) Includes 122,400 shares issuable upon conversion of our outstanding convertible debentures convertible at \$2.50 per share. As a result of his stock ownership and his positions as president and a director of our company, Howard G. Berger, M.D. may be deemed to be a controlling person of our company.

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(3) Includes warrants for 1,000,000 shares exercisable between \$0.36 and \$0.46 per share.

(4) Represents warrants exercisable at \$0.55 per share.

(5) Represents warrants exercisable between \$0.40 and \$0.60 per share and is less than 1.0% of the class.

(6) Represents warrants exercisable at \$0.32 per share and is less than 1.0% of the class.

(7) Includes 1,275,000 options and warrants exercisable at prices between \$0.30 and \$0.47 per share.

(8) Represents warrants for 700,000 shares exercisable at prices between \$0.30 and \$0.60 per share.

(9) See the above footnotes. Includes 13,912,675 shares owned of record and 6,247,400 shares issuable upon exercise of presently exercisable options, warrants and convertible debentures.

### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

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Howard G. Berger, M.D. owns, indirectly, 99% of the equity interests in BRMG. BRMG provides all of the professional medical services at 42 of our facilities under a management agreement with us (and contracts with various other independent physicians and physician groups to provide all of the professional medical services at most of our other facilities). Under our management agreement with BRMG, which expires on January 1, 2014, BRMG pays us, as compensation for the use of our facilities and equipment and for our services, a percentage of the gross amounts collected for the professional services it renders. The percentage, which was 79% for fiscal 2005, is adjusted annually, if necessary, to ensure that the parties receive the fair value for the services they render. The annual revenue of BRMG from all sources closely approximates its expenses, including Dr. Berger's compensation, fees payable to



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us and amounts payable to third parties. In fiscal 2005, Dr. Berger received a salary of \$200,000 from BRMG. See "Business - Radiology Professionals."

Dr. Berger has guaranteed \$1,000,000 of our obligations to U.S. Bank.

On August 27, 2003, Dr. Berger advanced to us \$1,000,000 which we transferred to BRMG, which in turn used these funds to reduce outstanding borrowings under its credit facility. The advance bears interest at the same rate paid by BRMG to its lender under its working capital facility and is due on demand. During fiscal 2005, Dr. Berger advanced us an additional \$1,370,000 which we transferred to BRMG, which in turn used these funds to reduce outstanding borrowings under its credit facility. At October 31, 2005, \$2,531,560 was outstanding, including accrued interest at a rate of 6.58% per annum. Dr. Berger agreed to subordinate his loan to our obligation to Bridge Healthcare Finance, LLC under our revolving line of credit.

We maintain a \$5.0 million key-man life insurance policy on the life of Dr. Berger. We are the beneficiary under the policy.

Historically, BRMG has regularly advanced to us the funds that it drew under its working capital facility, which we used for our own working capital purposes. We repaid or offset these advances with periodic payments from BRMG to us under the management agreement. We guaranteed BRMG's obligations under this working capital facility. Because under current GAAP principles we are required to include BRMG as a consolidated entity in our consolidated financial statements, any borrowings or advances we have received from or made to BRMG are not reflected in our consolidated balance sheets.

On August 1, 1996, we acquired from Norman Hames (not then an officer or director of our company) all of his common stock and warrants to purchase shares of common stock of Diagnostic Imaging Services, Inc., a Delaware corporation, or DIS, which then represented 21.6% of the outstanding shares of that entity, in exchange for five year warrants to purchase 3,000,000 shares of our common stock at \$0.60 per share, as well as a 6.58% note having a principal balance at October 31, 2005 of \$940,185, payable interest only annually and due on June 30, 2005. The warrant expired unexercised. Pursuant to his May 1, 2001 employment agreement, we granted to him a new warrant, which expires on May 1, 2006, to purchase 3,000,000 shares at \$0.55 per share plus a bonus to purchase \$600,000 of shares at \$0.20 per share at the time he exercises the warrant.

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John V. Crues, III, M.D. agreed to continue his employment and leadership roles with us in consideration of our agreement in June 2005, to issue to him our five year warrant to purchase 500,000 shares of our common stock at an exercise price of \$0.36 per share (the price of our common stock on the date of the agreement in the public market in which it trades).

At October 31, 2005, we owed Jeffrey L. Linden \$61,151 in connection with our acquisition of his interest in DIS. The obligation accrues interest at the rate of 6.58% per annum and is due July 1, 2006. In the acquisition transaction, we issued to Mr. Linden warrants to purchase 197,365 shares of common stock at a price of \$0.60 per share expiring June 30, 2004. In connection with an agreement to extend our obligation to Mr. Linden, we issued to him warrants to purchase 300,000 shares of common stock at a price of \$0.19 per share that he exercised in June 2005. On July 30, 2004, we issued to Mr. Linden a five year warrant to purchase 200,000 shares of our common stock at an exercise price of \$0.30 per share in consideration of Mr. Linden's agreement to subordinate our obligation to him to our debt with our revolving line of credit.

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Cohen & Lord, a professional corporation, a law firm with which Mr. Linden is associated, received \$365,695 in fees from us during the year ended October 31, 2005. Mr. Linden has specifically waived any interest in our fees since becoming an officer of our company.

On July 30, 2004, we issued to Mark D. Stolper five-year warrants to purchase 650,000 shares of our common stock at \$0.30 per share in consideration of his entry into a three year employment agreement with us under which he became our chief financial officer and his assistance in refinancing our outstanding institutional debt. The warrant exercise price is the price of our common stock on the date of the agreement in the public market in which it trades.

### ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

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The following table presents information about fees that Moss Adams LLP charged us to audit our annual financial statements for 2005 and 2004, and fees billed for other services rendered by Moss Adams LLP during those years.

|                        | 2005      | 2004      |
|------------------------|-----------|-----------|
|                        | -----     | -----     |
| Audit Fees (1)         | \$227,000 | \$221,000 |
| Audit Related Fees (2) | 13,000    | 239,000   |
| Tax Fees (3)           | 92,000    | 104,000   |
|                        | -----     | -----     |
| Total                  | \$332,000 | \$564,000 |
|                        | =====     | =====     |

- (1) Audit Fees -- Audit fees billed to us by Moss Adams LLP for auditing our annual financial statements and reviewing the financial statements included in our Quarterly Reports on Form 10-Q.
- (2) Audit-Related Fees -- Audit-related fees billed to us by Moss Adams LLP include the audit of our 401(k) benefit plan and offering memorandum.
- (3) Tax Fees -- Tax fees billed to us by Moss Adams LLP include services provided to prepare federal, state, and local income and franchise tax returns for 2004, and related tax services and estimated tax payments for 2005.

### PRE-APPROVAL OF AUDIT AND NON-AUDIT SERVICES OF INDEPENDENT AUDITOR

The Audit Committee's policy is to pre-approve all audit and non-audit services provided by the independent auditors. These services may include audit services, audit-related services, tax services, and other services. Pre-approval is generally provided for up to 12 months from the date of pre-approval and any pre-approval is detailed as to the particular service or category of services. The Audit Committee may delegate pre-approval authority to one or more of its members when expedited services are necessary. The Audit Committee has determined that the provision of non-audit services by Moss Adams LLP is compatible with maintaining Moss Adams' independence.

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### ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) Financial Statements - The following financial statements are filed herewith:

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets

Consolidated Statements of Operations

Consolidated Statements of Stockholders' Deficit

Consolidated Statements of Cash Flows

Notes to Consolidated Financial Statements

Schedules - The Following financial statement schedules are filed herewith:

Report of Independent Registered Public Accounting Firm on Supplemental Schedule

Schedule II - Valuation and Qualifying Accounts

All other schedules are omitted because they are not applicable or the required information is shown in the consolidated financial statements or notes thereto.

(b) Exhibits - The following exhibits are filed herewith or incorporated by reference herein:

| EXHIBIT NO. | DESCRIPTION OF EXHIBIT   | INCORPORATED<br>REFERENCE T |
|-------------|--|-----------------------------|
| 3.1.1       | Certificate of Incorporation as amended  | (A)                         |
| 3.1.2       | November 17, 1992 amendment to the Certificate of Incorporation  | (A)                         |
| 3.1.3       | December 27, 2000 amendment to the Certificate of Incorporation  | (E)                         |
| 3.2         | By-laws  | (A)                         |
| 4.1         | Form of Common Stock Certificate   | (AA)                        |
| 4.2         | Form of Supplemental Indenture between Registrant and American Stock Transfer and Trust Company as Incorporated by Indenture Trustee with respect to the 11.5% Series A Convertible Subordinated Debentures due 2008 | (B)                         |
| 4.3         | Form of 11.5% Series A Convertible Subordinated Debenture Due 2008 [Included in Exhibit 4.2]   | (B)                         |
| 10.1        | Employment Agreement dated as of June 12, 1992 between RadNet and Howard G. Berger, M.D. and amendment to Agreement.   | (C) (I)                     |
| 10.6        | Securities Purchase Agreement dated March 22, 1996, between the Company and Diagnostic Imaging Services, Inc.  | (D)                         |
| 10.7        | Stockholders Agreement by and among the Company, Diagnostic Imaging Services, Inc. and Norman Hames  | (D)                         |
| 10.8        | Securities Purchase Agreement dated June 18, 1996 between the Company and Norman Hames   | (D)                         |

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|       |   |         |
|-------|---|---------|
| 10.10 | DVI Securities Purchase Agreement   | (E)     |
| 10.11 | General Electric Note Purchase Agreement  | (E)     |
| 10.12 | Securities Purchase Agreement between the Company and Howard G. Berger, M.D.  | (E)     |
| 10.13 | 2000 Long-Term Incentive Plan   | (F)     |
| 59    |   |         |
| 10.14 | Employment Agreement dated April 16, 2001, with Jeffrey L. Linden and amendment to agreement  | (G) (I) |
| 10.15 | Employment Agreement with Norman R. Hames dated May 1, 2001 and amendment to agreement  | (G) (I) |
| 10.16 | Amended and Restated Management Agreement with Beverly Radiology Medical Group III dated as of January 1, 2004                      | (H)     |
| 10.17 | Code of Financial Ethics  | (H)     |
| 10.18 | Incentive Stock Option Plan   | (H)     |
| 10.19 | DVI Agreement as amended  | (J)     |
| 10.20 | Master Amendment Agreement with General Electric Capital Corporation, General Electric Company and GE Healthcare Financial Services | (K)     |
| 10.21 | Amended, Restated and Consolidated Loan and Security Agreement with DVI Financial Services, Inc.                                    | (K)     |
| 10.22 | Amendment to Loan Documents re US Bank Portfolio Services   | (K)     |
| 10.23 | Credit Agreement with Wells Fargo Foothill, Inc.  | (K)     |
| 10.24 | Employment Agreement with Mark Stolper dated July 30, 2004  | (N)     |
| 10.25 | Second Amended and Restated Loan and Security Agreement with Post Advisory Group, LLC   | (L)     |
| 10.26 | Amended, Restated and Consolidated Loan and Security Agreement with Post Advisory Group, LLC  | (L)     |
| 10.27 | Fourth Amendment to Credit Agreement Substituting Bridge Healthcare Finance, LLC for Wells Fargo Foothill, Inc.                     | (M)     |
| 23    | Consent of Independent Public Accountants   | (O)     |
| 31.1  | CEO Certification pursuant to Section 302   | (O)     |
| 31.2  | CFO Certification pursuant to Section 302   | (O)     |
| 32.1  | CEO Certification pursuant to Section 906   | (O)     |
| 32.2  | CFO Certification pursuant to Section 906   | (O)     |

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(A) Incorporated by reference to exhibit filed with Registrant's Registration Statement on Form S-1 [File No. 33-51870].

(AA) Incorporated by reference to exhibit filed with Registrant's Registration Statement on Form S-3 [File 33-73150].

(B) Incorporated by reference to exhibit filed with Registrant's Registration Statement on Form T-3 [File No. 022-28703].

(C) Incorporated by reference to exhibit filed in an amendment to Form 8-K report for June 12, 1992.

(D) Incorporated by reference to exhibit filed with Form 10-K for the year ended October 31, 1996.

(E) Incorporated by reference to exhibit filed with the Form 10-K for the year ended October 31, 2000.

(F) Incorporated by reference to exhibit filed with the Form 10-Q for the quarter ended January 31, 2000.

(G) Incorporated by reference to exhibit filed with the Form 10-K for the year ended October 31, 2001.

(H) Incorporated by reference to exhibit filed with the Form 10-K for the year ended October 31, 2003.

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(I) Incorporated by reference to exhibit filed with the Form 10-Q for the quarter ended January 31, 2004.

(J) Incorporated by reference to exhibit filed with the Form 10-Q for the quarter ended April 30, 2004.

(K) Incorporated by reference to exhibit filed with the Form 8-K report for August 2, 2004.

(L) Incorporated by reference to exhibit filed with Form 8-K for November 29, 2004.

(M) Incorporated by reference to exhibit filed with Form 8-K for September 14, 2005.

(N) Incorporated by reference to exhibit filed with Form 10-K for October 31, 2004.

(O) Filed herewith.

| REGISTRANT'S PERCENTAGE<br>SUBSIDIARIES<br>----- | STATE OF<br>OWNERSHIP<br>----- | INCORPORATION<br>----- |
|--|--------------------------------|------------------------|
| RadNet Management, Inc.                          | 100%                           | California             |
| RadNet Managed Imaging Services, Inc.            | 100%                           | California             |
| Diagnostic Imaging Services, Inc.                | 100%                           | Delaware               |
| Primedex Corporation                             | 100%                           | California             |
| Radnet Management I, Inc.                        | 100%                           | California             |
| Radnet Management II, Inc.                       | 100%                           | California             |
| Radnet Sub, Inc.                                 | 100%                           | California             |

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SoCal MR Site Management, Inc.

100%

California

(c) Reports on Form 8-K

No reports on Form 8-K were filed during the quarter ended October 31, 2005 except that on September 14, 2005, we reported under Item 2.03 the replacement of our revolving line of credit accounts receivable facility, from Wells Fargo Foothill, Inc. to Bridge Healthcare Finance, LLC.

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SIGNATURES

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

PRIMEDEX HEALTH SYSTEMS, INC.

Date: September 28, 2006

/s/ HOWARD G. BERGER, M.D.

-----  
HOWARD G. BERGER, M.D., PRESIDENT

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

By /s/ HOWARD G. BERGER, M.D.

-----  
HOWARD G. BERGER, M.D., DIRECTOR

Date: September 28, 2006

By /s/ JOHN V. CRUES, III, M.D.

-----  
JOHN V. CRUES, III, M.D., DIRECTOR

Date: September 28, 2006

By /s/ NORMAN R. HAMES

-----  
NORMAN R. HAMES, DIRECTOR

Date: September 28, 2006

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By /s/ DAVID L. SWARTZ

-----  
DAVID L. SWARTZ, DIRECTOR

Date: September 28, 2006

By /s/ LAWRENCE L. LEVITT

-----  
LAWRENCE L. LEVITT, DIRECTOR

Date: September 28, 2006

By /s/ MARK D. STOLPER

-----  
MARK D. STOLPER, CHIEF FINANCIAL OFFICER  
(PRINCIPAL ACCOUNTING OFFICER)

Date: September 28, 2006