DIGIRAD CORP
Form 10-Q
November 01, 2012

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

FORM 10-Q

(Mark One)

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2012
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM TO

Commission file number: 000-50789

Digirad Corporation
(Exact name of registrant as specified in its charter)

Delaware	33-0145723
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
13950 Stowe Drive, Poway, CA	92064
(Address of Principal Executive Offices)	(Zip Code)

(858) 726-1600
(Registrant’s Telephone Number, Including Area Code)

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

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

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

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

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

As of October 22, 2012, the registrant had 20,218,089 shares of Common Stock ($0.0001 par value) outstanding.

DIGIRAD CORPORATION
TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
DIGIRAD CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)

	September 30, 2012 (Unaudited)	December 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	$18,343	$24,039
Securities available-for-sale	8,826	6,413
Accounts receivable, net	6,864	6,320
Inventories, net	6,573	6,178
Other current assets	722	855
Restricted cash	244	194
Total current assets	41,572	43,999
Property and equipment, net	5,148	5,367
Intangible assets, net	293	477
Goodwill	184	184
Total assets	$47,197	$50,027
Liabilities and stockholders' equity		
Accounts payable	$1,906	$1,330
Accrued compensation	2,736	2,291
Accrued warranty	226	297
Deferred revenue	1,748	2,099
Other accrued liabilities	2,263	2,397
Total current liabilities	8,879	8,414
Deferred rent	164	126
Total liabilities	9,043	8,540
Commitments and contingencies (Note 9)		
Stockholders' equity:		
Preferred stock, $0.0001 par value: 10,000,000 shares authorized; no shares issued or outstanding	—	—
Common stock, $0.0001 par value: 80,000,000 shares authorized; 19,102,037 and 18,901,160 shares issued and outstanding (net of treasury shares) at September 30, 2012 and December 31, 2011, respectively	2	2
Treasury stock, at cost; 1,073,641 and 582,825 shares at September 30, 2012 and December 31, 2011, respectively	(2,087)	(1,058)
Additional paid-in capital	156,472	155,704
Accumulated other comprehensive income	26	33
Accumulated deficit	(116,259)	(113,194)
Total stockholders' equity	38,154	41,487
Total liabilities and stockholders' equity	$47,197	$50,027

See accompanying notes to unaudited condensed consolidated financial statements.

DIGIRAD CORPORATION
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenues:				
DIS	$8,856	$9,293	$27,522	$28,839
Product	2,961	4,146	9,975	13,024
Total revenues	11,817	13,439	37,497	41,863
Cost of revenues:				
DIS	6,880	7,048	20,765	22,582
Product	1,808	2,241	6,250	7,617
Total cost of revenues	8,688	9,289	27,015	30,199
Gross profit	3,129	4,150	10,482	11,664
Operating expenses:				
Research and development	1,055	702	2,998	2,124
Marketing and sales	1,348	1,575	4,735	4,616
General and administrative	1,744	1,848	5,820	5,818
Amortization of intangible assets	49	77	184	253
Restructuring gain	—	—	—	(164)
Total operating expenses	4,196	4,202	13,737	12,647
Loss from operations	(1,067)	(52)	(3,255)	(983)
Other income (expense):				
Interest income	28	105	82	385
Interest expense	(2)	—	(3)	(20)
Other income	135	46	111	103
Total other income	161	151	190	468
Net Income (loss)	$(906)	$99	$(3,065)	$(515)
Net income (loss) per common share – basic and diluted	$(0.05)	$0.01	$(0.16)	$(0.03)
Weighted average shares outstanding – basic	19,263	19,086	19,273	19,005
Weighted average shares outstanding – diluted	19,263	19,714	19,273	19,005
Other comprehensive income (loss):				
Unrealized gain (loss) on marketable securities	32	(137)	26	(338)
Total other comprehensive income (loss)	32	(137)	26	(338)
Comprehensive loss	$(874)	$(38)	$(3,039)	$(853)

See accompanying notes to unaudited condensed consolidated financial statements.

DIGIRAD CORPORATION
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Nine Months Ended September 30,	
	2012	2011
Operating activities		
Net loss	$(3,065)	$(515)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation	1,466	2,223
Amortization of intangible assets	184	253
Provision for bad debt	(17)	(6)
Stock-based compensation	471	612
Gain on disposal of assets	(48)	(99)
Amortization of premiums on investments (accretion of discounts), on securities available-for-sale	103	(68)
Changes in operating assets and liabilities:		
Accounts receivable	(527)	436
Inventories	(777)	(736)
Other assets	133	(19)
Accounts payable	576	(206)
Accrued compensation	445	815
Deferred revenue	(351)	(516)
Other accrued liabilities	(167)	(140)
Restricted cash	(50)	—
Net cash provided by (used in) operating activities	(1,624)	2,034
Investing activities		
Purchases of property and equipment	(880)	(594)
Proceeds from sale of property and equipment	63	156
Purchases of securities available-for-sale	(4,887)	(13,113)
Sales and maturities of securities available-for-sale	2,365	1,250
Net cash used in investing activities	(3,339)	(12,301)
Financing activities		
Issuances of common stock	296	111
Repurchases of common stock	(1,029)	—
Repayment of obligations under capital leases	—	(45)
Net cash provided by (used in) financing activities	(733)	66
Net decrease in cash and cash equivalents	(5,696)	(10,201)
Cash and cash equivalents at beginning of period	24,039	20,459
Cash and cash equivalents at end of period	$18,343	$10,258

See accompanying notes to unaudited condensed consolidated financial statements.

DIGIRAD CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Note 1. The Company
Digirad Corporation (“Digirad”), a Delaware corporation, is a leading developer and manufacturer of medical diagnostic imaging systems including solid-state gamma cameras for nuclear cardiology and general nuclear medicine applications. Digirad is also one of the largest national providers of in-office nuclear cardiology imaging and ultrasound services to physician practices, hospitals and imaging centers through its Digirad Imaging Solutions (“DIS”) division. Digirad has two reportable segments, DIS and Product which are collectively referred to herein as the “Company.” The accompanying condensed consolidated financial statements include the operations of both segments. Intercompany accounts and transactions are accounted for at cost and have been eliminated in consolidation. Substantially all of the Company’s revenue arises from sales activity in the United States. Through DIS, the Company provides in-office imaging services to physicians, offering certified personnel, required licensure, an imaging system and other support and supplies for the performance of nuclear and ultrasound imaging procedures under the supervision of its physician customers. DIS physician customers enter into annual contracts for imaging services generally delivered on a per-day basis. The Company’s Product segment sells solid-state gamma cameras for nuclear cardiology and general nuclear medicine applications and provides camera service and maintenance.
Note 2. Basis of Presentation and Significant Accounting Policies
Basis of Presentation
The Company has prepared the accompanying unaudited condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and disclosures required by generally accepted accounting principles for complete financial statements. In the opinion of the Company’s management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine months ended September 30, 2012 are not necessarily indicative of the results that may be expected for the entire year. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011 filed with the Securities and Exchange Commission on February 17, 2012.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and disclosures made in the accompanying notes to the condensed consolidated financial statements. The Company’s significant estimates include the valuation of goodwill, the valuation of long-lived assets, the reserve for doubtful accounts, revenue and billing adjustments, excess and obsolete inventories, warranty costs, the valuation allowance for deferred tax assets, and the assumptions used in estimating the fair value-based measurement of stock options. Actual results could differ from those estimates.
Revenue Recognition
The Company derives revenue primarily from providing in-office services to support the performance of cardiac diagnostic imaging procedures and from selling and servicing solid-state digital gamma cameras. The Company recognizes revenue in accordance with the authoritative guidance for revenue recognition when all of the following four criteria are met: (i) a contract or sales arrangement exists; (ii) products have been shipped and title has transferred or services have been rendered; (iii) the price of the products or services is fixed or determinable; and (iv) collectability is reasonably assured. The timing of revenue recognition is based upon factors such as passage of title and risk of loss, the need for installation, and customer acceptance. These factors are based on the specific terms of each contract or sales arrangement.
DIS revenue is derived from the service of personnel and equipment for in-office nuclear and ultrasound imaging procedures. Revenue related to imaging services is recognized at the time services are performed and collection is

reasonably assured. DIS services are generally billed on a per-day basis under annual contracts, which specify the number of days of service to be provided, or on a flat rate month-to-month basis.

Product revenues are generated from the sales of gamma cameras and follow-on maintenance service contracts. The Company generally recognizes revenue upon delivery to customers. The Company provides installation and training for camera sales in the United States. Installation and training is generally performed shortly after delivery and represents a cost which the Company accrues at the time revenue is recognized. Neither service is essential to the functionality of the product. Maintenance services are sold beyond the term of the warranty, which is generally one year from the date of purchase. Revenue from these contracts is deferred and recognized ratably over the service period and is included in Product sales.

Share-Based Compensation

The Company accounts for share-based awards exchanged for services in accordance with the authoritative guidance for share-based payments. Under this guidance, share-based compensation expense is measured at the grant date, based on the estimated fair value-based measurement of the award, and is recognized as expense, net of estimated forfeitures, over the requisite service period.

Total share-based compensation expense related to all of the Company’s share-based awards for the three and nine months ended September 30, 2012 and 2011 was allocated in the condensed consolidated statements of comprehensive loss as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Cost of revenues:				
DIS	$2	$3	$5	$11
Product	20	23	62	76
Research and development	20	20	59	63
Marketing and sales	34	22	100	87
General and administrative	68	121	245	375
Share-based compensation expense	$144	$189	$471	$612

New Accounting Pronouncements

In June and December 2011, the Financial Accounting Standards Board (FASB) issued guidance on the presentation of comprehensive income. This guidance eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The Company adopted this guidance beginning on January 1, 2012. The adoption did not have a material effect on the Company's financial condition or results of operations, and only resulted in a change to financial statement presentation.

On May 12, 2011 the FASB issued Accounting Standards Update (ASU) No. 2011-04, “Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs" (ASU 2011-04). This update amends Accounting Standards Codification (ASC) Topic 820, “Fair Value Measurement and Disclosure.” ASU 2011-04 clarifies the application of certain existing fair value measurement guidance and expands the disclosures for fair value measurements that are estimated using significant unobservable (Level 3) inputs. ASU 2011-04 is effective for annual and interim reporting periods beginning on or after December 15, 2011. The Company adopted this guidance beginning on January 1, 2012. The adoption of this guidance did not have a material effect on the Company's financial condition or results of operations.

Note 3. Basic and Diluted Net Income (Loss) Per Share

Basic earnings per share (EPS) is calculated by dividing net income or loss by the weighted average number of common shares and vested restricted stock units outstanding. Diluted EPS is computed by dividing net income or loss by the weighted average number of common shares and vested restricted stock units outstanding and the weighted average number of dilutive common stock equivalents, including stock options and non-vested restricted stock units under the treasury stock method. Common stock equivalents are only included in the diluted earnings per share calculation when their effect is dilutive.

The following table sets forth the computation of basic and diluted net income (loss) per share (in thousands, except per share data).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Numerator:				
Net income (loss)	$(906)	$99	$(3,065)	$(515)
Denominator:				
Weighted average shares outstanding - basic	19,263	19,086	19,273	19,005
Dilutive potential common stock outstanding :				
Stock options	—	577	—	—
Restricted stock units	—	51	—	—
Weighted average shares outstanding - diluted	19,263	19,714	19,273	19,005
Net income (loss) per common share - basic and diluted	$(0.05)	$0.01	$(0.16)	$(0.03)

The following weighted average outstanding common stock equivalents were not included in the calculation of diluted net income (loss) per share because their effect was anti-dilutive (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Stock options	331	577	412	571
Restricted stock units	22	51	24	63
Total	353	628	436	634

Note 4. Supplementary Balance Sheet Information (in thousands):

	September 30, 2012	December 31, 2011
Inventories, net:		
Raw materials	$2,694	$2,899
Work-in-process	2,545	2,665
Finished goods	2,750	2,207
	7,989	7,771
Less reserve for excess and obsolete inventories	(1,416)	(1,593)
	$6,573	$6,178
Property and equipment, net:		
Machinery and equipment	$22,566	$21,684
Computer hardware and software	2,817	2,712
Leasehold improvements	857	813
	26,240	25,209
Accumulated depreciation	(21,092)	(19,842)
	$5,148	$5,367
Intangible assets, net:		
Customer relationships	$2,600	$2,600
Covenants not to compete	300	300
Patents	141	141
	3,041	3,041
Accumulated amortization of customer relationships	(2,356)	(2,201)
Accumulated amortization of covenants not to compete	(300)	(280)
Accumulated amortization of patents	(92)	(83)
	$293	$477
Other accrued liabilities:		
Sales and property taxes payable	$401	$473
Radiopharmaceuticals and consumable medical supplies	572	243
Professional fees	314	293
Outside services and consulting	310	836
Facilities and related costs	139	129
Travel expenses	100	110
Other accrued liabilities	427	313
	$2,263	$2,397

Note 5. Fair Value of Financial Instruments

The authoritative guidance for fair value measurements defines fair value for accounting purposes, establishes a framework for measuring fair value and provides disclosure requirements regarding fair value measurements. The guidance defines fair value as an exit price, which is the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date. The degree of judgment utilized in measuring the fair value of assets and liabilities generally correlates to the level of pricing observability. Assets and liabilities with readily available, actively quoted prices or for which fair value can be measured from actively quoted prices in active markets generally have more pricing observability and require less judgment in measuring fair value. Conversely, assets and liabilities that are rarely traded or not quoted have less pricing observability and are generally measured at fair value using valuation models that require more judgment. These valuation techniques involve some level of management estimation and judgment, the degree of which is dependent on the price transparency of the asset, liability or market and the nature of the asset or liability.

9

The Company has categorized its assets and liabilities measured at fair value into a three-level hierarchy in accordance with the authoritative guidance for fair value measurements. Assets and liabilities presented at fair value in the Company's condensed consolidated balance sheets are generally categorized as follows:

Level 1:	Quoted prices in active markets for identical assets or liabilities.
Level 2:	Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
Level 3:	Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Such assets and liabilities may have values determined using pricing models, discounted cash flow methodologies, or similar techniques, and include instruments for which the determination of fair value requires significant management judgment or estimation.

As required by the authoritative guidance for fair value measurements, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Management's assessment of the significance of a particular input to the fair value measurement requires judgment, which may affect the valuation of assets and liabilities and their placement within the fair value hierarchy levels. The following table sets forth by level within the fair value hierarchy the Company’s assets that were recorded at fair value as of September 30, 2012 and December 31, 2011 (in thousands).

	Fair Value as of September 30, 2012			
	Level 1	Level 2	Level 3	Total
Assets:				
Corporate debt securities	$—	$8,826	$—	$8,826

	Fair Value as of December 31, 2011			
	Level 1	Level 2	Level 3	Total
Assets:				
Corporate debt securities	$—	$6,413	$—	$6,413

The fair value of the Company's high quality investment grade corporate debt securities is determined using proprietary valuation models and analytical tools. These valuation models and analytical tools use market pricing or prices for similar instruments that are both objective and publicly available, including matrix pricing or reported trades, benchmark yields, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids and/or offers. The Company did not reclassify any investments between levels in the fair value hierarchy during the three and nine months ended September 30, 2012.

Securities Available for Sale

Securities available-for-sale consist of investment grade corporate debt securities. The Company classifies all securities as available-for-sale and as current assets, as the sale of such securities may be required prior to maturity to implement management strategies. These securities are carried at fair value, with the unrealized gains and losses reported as a component of other comprehensive income (loss) in stockholders' equity until realized. Realized gains and losses from the sale of available-for-sale securities, if any, are determined on a specific identification basis. A decline in the market value of any available-for-sale security below cost that is determined to be other than temporary will result in an impairment charge to earnings and a new cost basis for the security is established. No such impairment charges were recorded for any period presented. It is more likely than not that the Company will be required to sell its investments before recovery of their amortized costs. As of September 30, 2012 and December 31, 2011, none of the Company’s investments have been in an unrealized loss position for more than 12 months. Premiums and discounts are amortized or accreted over the life of the related security as an adjustment to yield using the straight-line method and included in interest income. Interest income is recognized when earned. Realized gains and losses on investments in securities are included in other income (expense) within the condensed consolidated statements of comprehensive loss. The realized gains and losses on these sales were minimal for the three and nine months ending September 30, 2012 and 2011.

The following table sets forth the composition of securities available-for-sale as of September 30, 2012 and

10

December 31, 2011 (in thousands):

As of September 30, 2012	Maturity in Years	Amortized Cost	Unrealized Gains	Losses	Fair Value
Corporate debt securities	3 or less	$ 8,800	$29	$(3)	$8,826

As of December 31, 2011	Maturity in Years	Amortized Cost	Unrealized Gains	Losses	Fair Value
Corporate debt securities	2 or less	$ 6,380	$33	$—	$6,413

Note 6. Warranty

The Company generally provides a 12 month warranty on its gamma cameras. The Company accrues the estimated cost of this warranty at the time revenue is recorded and charges warranty expense to Product cost of revenues. Warranty reserves are established based on historical experience with failure rates and repair costs and the number of systems covered by warranty. Warranty reserves are depleted as gamma cameras are repaired. The costs consist principally of materials, personnel, overhead and transportation. The Company reviews warranty reserves quarterly and, if necessary, makes adjustments.

The activities in the Company's warranty reserve for the three and nine months ended September 30, 2012, and 2011 are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Balance at beginning of period	$281	$403	$297	$378
Charges to Product cost of revenues	81	223	294	682
Applied to liability	(136)	(221)	(365)	(655)
Balance at end of period	$226	$405	$226	$405

Note 7. Segments

The Company's reporting segments have been determined based on the nature of the products, services offered to customers and the nature of their function in the organization. The Company evaluates performance based on the operating income contributed by each segment. Segment results are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Gross profit by segment:				
DIS	$1,976	$2,245	$6,757	$6,257
Product	1,153	1,905	3,725	5,407
Condensed consolidated gross profit	$3,129	$4,150	$10,482	$11,664
Income (loss) from operations by segment:				
DIS	$12	$43	$227	$(266)
Product	(1,079)	(95)	(3,482)	(717)
Condensed consolidated loss from operations	$(1,067)	$(52)	$(3,255)	$(983)
Depreciation and amortization of tangible and intangible assets by segment:				
DIS	$440	$527	$1,414	$2,219
Product	84	95	236	257
Condensed consolidated depreciation and amortization	$524	$622	$1,650	$2,476

	As of September 30, 2012	As of December 31, 2011
Identifiable assets by segment:		
DIS	$11,436	$12,789
Product	35,761	37,238
Condensed Consolidated assets	$47,197	$50,027

Note 8. Income Taxes

As of December 31, 2011, the Company had unrecognized tax benefits of approximately $1.6 million. Included in the unrecognized tax benefits of $1.6 million at December 31, 2011 was $1.4 million of tax benefits that, if recognized, would reduce the Company’s annual effective tax rate, subject to the valuation allowance. During the quarter ended September 30, 2012, the Company recorded a $0.1 million tax benefit due to the lapsing of the statute of limitation relating to a previously unrecognized uncertain tax position. The Company does not expect its unrecognized tax benefits to change significantly over the next 12 months.

The Company files income tax returns in the U.S. and in various state jurisdictions with varying statutes of limitations. The Company is no longer subject to income tax examination by tax authorities for years prior to 2007; however, its net operating loss and research credit carry-forwards arising prior to that year are subject to adjustment. The Company’s policy is to recognize interest expense and penalties related to income tax matters as a component of income tax expense.

Note 9. Commitments and Contingencies

Outstanding Letter of Credit

The Company has an outstanding letter of credit of $0.2 million to secure the Company’s performance under an insurance agreement.

Legal Matters

In the normal course of business, the Company has been, and will likely continue to be, subject to litigation or administrative proceedings incidental to its business, such as claims related to customer disputes, employment practices, wage and hour disputes, product liability, professional liability, commercial disputes, licensure restrictions or denials, and warranty or patent infringement. Responding to litigation or administrative proceedings, regardless of whether they have merit, can be expensive and disruptive to normal business operations. As litigation and the administrative proceedings are inherently uncertain, the Company cannot predict the outcome of such matters. While the ultimate outcome of litigation is always uncertain, the Company does not believe that any currently known matters will have a material adverse effect on its business or financial results.

Note 10. Stock Buyback Program

Stock Repurchase Program

On September 18, 2012, the Company amended its stock buyback program, originally adopted in February 2009, to permit an additional $2 million of the Company's issued and outstanding common shares to be repurchased. As amended, the stock buyback program permits the Company to purchase an aggregate of $4 million of its common stock. The timing of stock repurchases and the number of shares of common stock to be repurchased are in compliance with Rule 10b-18 under the Securities Exchange Act of 1934. The timing and extent of the repurchase depends upon market conditions, applicable legal and contractual requirements, and other factors. During the three and nine months ended September 30, 2012, the Company repurchased 218,759 and 490,816 shares respectively of its common stock under the buyback program. Cumulatively through September 30, 2012 the Company has repurchased 1,073,641 shares of its common stock at a cost of $2.09 million at a weighted average price of $1.92 per share under the stock repurchase program.

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with our financial statements and notes thereto included in this report on Form 10-Q, and the audited financial statements and notes as of and for the year ended December 31, 2011 included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 17, 2012. Operating results are not necessarily indicative of results that may occur in future periods.

This report contains various forward-looking statements regarding our business, financial condition, results of operations and future plans and projects. Forward-looking statements discuss matters that are not historical facts and can be identified by the use of words such as “believes,” “expects,” “anticipates,” “estimates,” “can,” “could,” “may,” “will,” “ “might,” or similar expressions. In this report, for example, we make forward-looking statements regarding, among other things, our expectations about the rate of revenue growth in specific business segments and the reasons for that growth and our profitability, our expectations regarding an increase in sales, strategic traction and marketing and sales spending, uncertainties relating to our ability to compete, uncertainties relating to our ability to increase our market share, changes in coverage and reimbursement policies of the Center for Medicare and Medicaid Services along with third-party payers and the effect on our ability to sell our products and services, our ability to timely develop new products or services that will be accepted by the market, competition from alternative imaging modalities, declining average selling prices for our Product offerings, supplies of radiopharmaceuticals, and the profitability of our business.

Although these forward-looking statements reflect our good faith judgment, such statements can only be based upon facts and factors currently known to us. Forward-looking statements are inherently subject to risks and uncertainties, many of which are beyond our control. As a result, our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth below under the caption “Risk Factors.” For these statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. You should not unduly rely on these forward-looking statements, which speak only as of the date on which they were made. They give our expectations regarding the future, but are not guarantees. We undertake no obligation to update publicly or revise any forward-looking statements, whether as a result of new information, future events or otherwise, unless required by law.

Overview

We are a leading developer and manufacturer of medical diagnostic imaging systems including solid-state gamma cameras for nuclear cardiology and general nuclear medicine applications. We also are one of the largest national providers of in-office nuclear cardiology imaging and ultrasound services to physician practices, hospitals and imaging centers through our Digirad Imaging Solutions (“DIS”) business segment. We designed and commercialized the first solid-state nuclear gamma camera for the detection of cardiovascular disease and other medical conditions. Our imaging systems are sold in both portable and fixed configurations, and provide enhanced operability, improved patient comfort and, in the case of our triple-headed Cardius® 3 XPO and Cardius® X-ACT system, shorter image acquisition time when compared to traditional vacuum tube cameras or our single or dual headed cameras. Our nuclear cameras fit easily into floor spaces as small as seven feet by eight feet and facilitate the delivery of nuclear medicine procedures in a physician’s office, an outpatient hospital setting or within multiple departments of a hospital.

Our Business Segments

We generate revenues within two primary operating segments: our DIS segment (our personnel and equipment service business) and our Product segment (the manufacture and sales of our medical diagnostic camera business and associated maintenance services).

Our DIS Segment. Through DIS, we offer a convenient and economically efficient imaging services program as an alternative to purchasing a gamma camera or ultrasound equipment or outsourcing the procedures to another physician or imaging center. For physicians who wish to perform nuclear imaging, echocardiography, vascular or general ultrasound tests, or any combination of these procedures in their offices, we provide the ability for them to engage our services, which includes the use of our imaging system, qualified personnel, and related items required to perform imaging in their own offices and bill Medicare, Medicaid or one of the third-party healthcare insurers directly for those services. These services are also used by large and small hospitals, multi-practice physician groups, and imaging centers. The flexibility of our products and our DIS service allows physicians to ensure continuity of care and convenience for their patients and allows them to retain revenue from procedures they would otherwise refer to imaging centers and hospitals. DIS services are primarily provided to cardiologists, internal medicine physicians, and family practice doctors who enter into annual contracts for a set number of days ranging from once per month to five times per week. We experience some seasonality in our DIS business related to vacations, holidays, and inclement weather. Most of the DIS business focuses on cardiac care with an increase in a combination of cardiac and general ultrasound imaging in recent months. Many of the physicians who use DIS services are reliant on reimbursements from Medicare and third-party insurers where there has been downward pressure and uncertainty due to factors outside the physicians' control. The uncertainty created by the 2010 healthcare reform laws, Congress' continued deferred action on the Sustainable Growth Rate reimbursement factor (which is part of the Relative Value Unit calculation of reimbursements for all medical codes) and other legislation has also impacted our business. These changes may require further modifications to our business model in order for our physician customers and us to maintain a viable economic model.

Our Product Segment. Our Product revenue results primarily from selling solid-state gamma cameras and camera maintenance contracts. We sell our imaging systems to physician offices, hospitals and imaging centers primarily in the United States, although we have sold a small number of imaging systems internationally. The central component of our nuclear camera is the detector and it ultimately determines the overall clinical quality of the image our camera produces. Our nuclear cameras feature detectors based on advanced proprietary solid-state technology developed by us. Solid-state systems have a number of benefits over conventional photomultiplier tube-based camera designs typically offered by our competitors. Our solid-state technology systems are typically lighter and considerably more compact than most traditional nuclear systems, making them far easier and less costly to build, as well as very reliable. Our solid-state technology provides us with the capability to market and manufacture a diverse family of high-performance dedicated cardiac and general-purpose cameras that offer a number of economic, service and performance benefits over traditional PMT-based camera systems. We recently introduced our first general imaging camera called the ergo ™, which is targeted to hospital customers. Prior to that, we introduced a new product called the Cardius ® X-ACT camera, which is a rapid cardiac SPECT/VCT imager. The Cardius ® X-ACT camera is also positioned more toward the hospital and larger cardiology practices.

Our Market

The target market for our products and services includes cardiologists, internal medicine physicians, family practice physicians, imaging centers and hospitals in the United States that perform or could perform nuclear cardiac, general nuclear and ultrasound procedures. We provide imaging services through DIS to more than 1,100 physicians and physician groups, and have sold over 700 cameras through our Product segment. More than half of our DIS nuclear and ultrasound imaging customers are internal medicine physicians or other primary care practitioners, and the remainder are primarily cardiologists. Our market has been negatively affected by lower physician reimbursements from the Center for Medicare and Medicaid Services (CMS) and third party providers for the codes under which our physician customers bill for our services, pricing pressures, decreases in radiopharmaceutical isotope supplies and continuing efforts by some third party payers to reduce health care expenditures by requiring physicians to obtain specific accreditations or certifications. We have been addressing and will continue to address these market pressures by introducing new products, modifying our DIS business model, and assisting our physician customers in complying with new regulations and requirements.

Trends and Drivers

The medical device industry, including the market for nuclear and ultrasound imaging systems and services, is highly competitive. Our business continues to be affected by many factors, including healthcare reimbursement rates for cardiac imaging procedures, competition from alternative imaging modalities such as positron emission tomography (PET) and computed tomography (CT) angiography, competition from other small owner-operated mobile nuclear imaging providers, declining average selling prices for our product offerings and general uncertainty in the healthcare marketplace. We continue to experience significant market changes due to the fluctuations in reimbursement rates and the uncertainty of healthcare legislation. We also continue to experience a low demand for our cameras, partially due to very limited hospital and physician group capital budgets and the general low economic recovery rate. We expect most of these trends to continue in the foreseeable future.

In our DIS segment, our physician customers continue to experience significant uncertainty in reimbursements from CMS and third party providers for the codes under which our physician customers bill for our services. This uncertainty has caused some of our physician customers to sell their practices to a hospital and others to reduce the volume of our service. As a result, we are continuing to modify our offering and pricing for our services upon contract renewal. The uncertainty over the enactment of future legislation that may impact reimbursement rates continues to linger and cause concern with our physician customers. We continue to consider modification to our business model in order to adapt to environmental and regulatory changes in our dynamic healthcare marketplace.

In our Product segment, we continue to build on past Product segment achievements by introducing new single photon emission computed tomography, or SPECT, products targeted specifically at the larger physician practices and hospital marketplace. The most widely used imaging acquisition technology utilizing gamma cameras is single SPECT, and all of our current cardiac gamma cameras employ SPECT methodology. Although the National Electrical Manufactures Association has reported that the dedicated cardiac nuclear market has declined by approximately 70 percent since 2005, according to industry sources (despite the improving image quality and increasing utilization rates of competing modalities such as CT, PET, and MRI, and diagnostic procedures such as CT angiography), SPECT procedures performed with gamma cameras will continue to be used for a substantial number of cardiac-specific imaging procedures. We believe continued utilization will be driven by patients having easier access to nuclear medicine services at physicians' offices, lower purchase and maintenance costs, a smaller physical footprint, and easier service logistics of gamma cameras. In an emerging trend in cardiology, SPECT technologies are being integrated with other imaging modalities to form hybrid imaging modalities, such as SPECT/CT, resulting in improved clinical quality and diagnostic certainty. We are also seeking other market opportunities to expand the use of our technology. We believe that our product mix will begin to reflect more ergo general purpose portable imaging system sales as we penetrate the hospital marketplace. Although the hospital sales cycles tend to be longer than the in-office market sales cycles, we have already sold and installed several ergo imaging systems into leading U.S. hospitals and expect that trend to continue.

Nine Months of 2012 Financial Highlights

Our consolidated revenues were $37.5 million for the nine months ended September 30, 2012, which represented a decrease of $4.4 million, or 10.4%, compared to the prior year period. DIS revenue decreased $1.3 million, or 4.6%, primarily due to a reduction in the number of days we scanned for our physician customers. The number of scan days was reduced due to a consolidation in the number of scan days by our physician customers in response to reimbursement uncertainty, in addition to other business factors such as physician pre-certification requirements, making it more difficult for our physician customers to utilize our services. Product revenues for the nine months ended September 30, 2012 decreased by $3.0 million, or 23.4%, compared to the prior year period, primarily due to a fewer number of new cameras sold to hospitals and cardiology practices. The increase in gross profit of our DIS segment was primarily attributable to lower radiopharmaceutical costs and improvement in operational performance, primarily associated with the management of labor and equipment resources. The decrease in gross profit of our Product segment was primarily attributable to lower camera sales and product mix.

We realized a net loss of $3.1 million for the nine months ended September 30, 2012, compared to a net loss of $0.5 million for the same nine month period in 2011. This was primarily the result of our decreased revenues coupled with our increased investment in market research and development with a focus on new innovative products.

Our DIS business currently operates in 19 states. For the nine months ended September 30, 2012, DIS operated 62 nuclear gamma cameras and 66 ultrasound imaging systems, compared to 64 nuclear gamma cameras and 67 ultrasound imaging systems during the same period in the prior year. We seek to improve our overall profitability through more efficient utilization of our fleet of gamma cameras and ultrasound equipment. We measure efficiency by tracking system utilization, which is measured based on the percentage of days that our nuclear gamma cameras and ultrasound equipment are used to deliver services to customers out of the total number of days that they are available to deliver such services. System utilization decreased to 55.2% for the nine months ended September 30, 2012, compared to 57.2% during the same period in the prior year, primarily due to fewer scan days as discussed above.

Results of Operations

The following table sets forth our results from operations expressed as percentages of revenues for the three and nine months ended September 30, 2012 and 2011 (dollars in thousands):

	Three Months Ended September 30,				Change from Prior Year	
	2012	Percent of 2012 Revenues	2011	Percent of 2011 Revenues	Dollars	Percent
Revenues:						
DIS	$8,856	74.9 %	$9,293	69.1 %	$(437)	(4.7)%
Product	2,961	25.1 %	4,146	30.9 %	(1,185)	(28.6)%
Total revenues	11,817	100 %	13,439	100 %	(1,622)	(12.1)%
Total cost of revenues	8,688	73.5 %	9,289	69.1 %	(601)	(6.5)%
Gross profit	3,129	26.5 %	4,150	30.9 %	(1,021)	(24.6)%
Operating expenses:						
Research and development	1,055	8.9 %	702	5.2 %	353	50.3 %
Marketing and sales	1,348	11.4 %	1,575	11.7 %	(227)	(14.4)%
General and administrative	1,744	14.8 %	1,848	13.8 %	(104)	(5.6)%
Amortization of intangible assets	49	0.4 %	77	0.6 %	(28)	(36.4)%
Total operating expenses	4,196	35.5 %	4,202	31.3 %	(6)	(0.1)%
Loss from operations	(1,067)	(9.0)%	(52)	(0.4)%	(1,015)	1,951.9 %
Total other income	161	1.4 %	151	1.1 %	10	6.6 %
Net income (loss)	$(906)	(7.7)%	$99	0.7 %	$(1,005)	(1,015.2)%

	Nine Months Ended September 30,				Change from Prior Year	
	2012	Percent of 2012 Revenues	2011	Percent of 2011 Revenues	Dollars	Percent
Revenues:						
DIS	$27,522	73.4 %	$28,839	68.9 %	$(1,317)	(4.6)%
Product	9,975	26.6 %	13,024	31.1 %	(3,049)	(23.4)%
Total revenues	37,497	100 %	41,863	100 %	(4,366)	(10.4)%
Total cost of revenues	27,015	72.0 %	30,199	72.1 %	(3,184)	(10.5)%
Gross profit	10,482	28.0 %	11,664	27.9 %	(1,182)	(10.1)%
Operating expenses:						
Research and development	2,998	8.0 %	2,124	5.1 %	874	41.1 %
Marketing and sales	4,735	12.6 %	4,616	11.0 %	119	2.6 %
General and administrative	5,820	15.5 %	5,818	13.9 %	2	— %
Amortization of intangible assets	184	0.5 %	253	0.6 %	(69)	(27.3)%
Restructuring gain	—	— %	(164)	(0.4)%	164	(100.0)%
Total operating expenses	13,737	36.6 %	12,647	30.2 %	1,090	8.6 %
Loss from operations	(3,255)	(8.7)%	(983)	(2.3)%	(2,272)	231.1 %
Total other income	190	0.5 %	468	1.1 %	(278)	(59.4)%
Net loss	$(3,065)	(8.2)%	$(515)	(1.2)%	$(2,550)	495.1 %

16

Comparison of Three Months Ended September 30, 2012 and 2011

Revenues

Consolidated. Consolidated revenue was $11.8 million for the three months ended September 30, 2012, a decrease of $1.6 million, or 12.1%, compared to the prior year quarter, primarily as a result of a decrease in the number of camera sales in our Product business segment along with a lower number of imaging days in our DIS business. DIS revenue accounted for 74.9% of total revenues for 2012, compared to 69.1% for the prior year quarter. We expect our DIS revenue to continue to represent the larger percentage of our consolidated revenue.

DIS. Our DIS revenue was $8.9 million for the three months ended September 30, 2012, a decrease of $0.4 million, or 4.7%, compared to the prior year quarter. The decrease resulted from a reduction in the number of days our physician customers utilized our imaging services.

Product. Our Product revenue was $3.0 million for the three months ended September 30, 2012, a decrease of $1.2 million, or 28.6%, compared to the prior year quarter. The decrease in revenue resulted mainly from selling a fewer number of new gamma cameras as compared to the prior year quarter.

Cost of Revenue and Gross Profit

Consolidated. Consolidated gross profit was $3.1 million for the three months ended September 30, 2012, a decrease of $1.0 million, or 24.6%, compared to the prior year quarter. The decrease in consolidated gross profit is primarily the result of lower camera sales, fewer imaging days, increase in labor costs and partially offset by lower radiopharmaceutical costs. Consolidated gross profit as a percentage of revenue decreased to 26.5% for the three months ended September 30, 2012 from 30.9% for the prior year quarter.

DIS. Cost of DIS revenue primarily consists of labor, radiopharmaceuticals, equipment depreciation, and other costs associated with the providing our services. Cost of DIS revenue was $6.9 million for the three months ended September 30, 2012, a decrease of $0.2 million, or 2.4%, compared to the prior year quarter. The decrease in cost of DIS revenue is primarily a result of decreased revenues and lower radiopharmaceutical costs. DIS gross profit was $2.0 million for the three months ended September 30, 2012, a decrease of $0.3 million, or 12.0%, from a gross profit of $2.2 million for the prior year quarter. DIS gross profit as a percentage of DIS revenue decreased to 22.3% for the three months ended September 30, 2012 from 24.2% for the prior year quarter. The reduction in gross profit was primarily attributable to an increase in labor cost offset by lower radiopharmaceutical costs.

Product. Cost of Product revenue primarily consists of materials, labor and overhead costs associated with the manufacturing, warranty and service contracts associated with our products. Cost of Product revenue was $1.8 million for the three months ended September 30, 2012, a decrease of $0.4 million , or 19.3%, compared to the prior year quarter. Product gross profit was $1.2 million for the three months ended September 30, 2012, a decrease of $0.8 million, or 39.5%, compared to the prior year period. Product gross profit as a percentage of Product revenue was 38.9% for the three months ended September 30, 2012, compared to 45.9% for the prior year quarter due to changes in product mix and lower camera sales.

Operating Expenses

Research and Development. Research and development expenses are the costs associated with the design, development and expansion of our existing technology and consist of salaries, development material costs, facility and overhead costs, consulting fees, and non-recurring engineering costs. We continue to invest in research and development with a focus on innovation as we seek to improve our existing technology. Research and development expenses were $1.1 million for the three months ended September 30, 2012, an increase of $0.4 million from the prior year quarter mainly due to initiatives to explore and develop new products and technologies. Research and development expenses were 35.6% of Product revenue for the three months ended September 30, 2012, compared to 16.9% in the prior year quarter, mainly due to a decrease in Product revenue of $1.2 million and the aforementioned exploration of new initiatives. We plan to continue investing in our technology platform to penetrate new and existing market segments and attract new customers.

Marketing and Sales. Marketing and sales expenses consist primarily of salaries, commissions, bonuses, recruiting costs, travel, marketing and collateral materials and trade show costs. Marketing and sales expenses were $1.3 million for the three months ended September 30, 2012, a decrease of $0.2 million, or 14.4%, compared to the prior year quarter, primarily as a result of lower personnel related costs and marketing support costs. Marketing and sales expenses as a percentage of total revenues were 11.4% and 11.7% for the three months ended September 30, 2012 and 2011, respectively.

General and Administrative. General and administrative expenses consist primarily of salaries and other related costs for accounting, human resources, information technology and executive personnel, legal related costs, professional fees, outside services, insurance, and costs related to our board of directors. General and administrative expenses were $1.7 million for the three months ended September 30, 2012, a decrease of $0.1 million, or 5.6%, compared to the prior year quarter. This decrease is primarily the result of lower payroll related costs. General and administrative expenses were 14.8% of total revenue for the three months ended September 30, 2012 compared to 13.8% for the prior year quarter.

Comparison of Nine Months Ended September 30, 2012 and 2011

Revenues
Consolidated. Consolidated revenue was $37.5 million for nine months ended September 30, 2012, a decrease of $4.4 million, or 10.4%, compared to the prior year, primarily as a result of a decrease in revenue from our Product segment from lower camera sales, coupled with a decline in DIS segment revenue due to fewer days of service. DIS revenue accounted for 73.4% of total revenues for 2012, compared to 68.9% for the prior year. We expect DIS revenue to continue to represent the larger percentage of our consolidated revenue.

DIS. Our DIS revenue was $27.5 million for the nine months ended September 30, 2012, a decrease of $1.3 million, or 4.6%, compared to the prior year. The decrease resulted from a reduction in the number of days our physician customers utilized our imaging services.

Product. Our Product revenue was $10.0 million for the nine months ended September 30, 2012, a decrease of $3.0 million, or 23.4%, compared to the prior year. The decrease in revenue was primarily due to lower camera sales and product mix.

Cost of Revenue and Gross Profit
Consolidated. Consolidated gross profit was $10.5 million for the nine months ended September 30, 2012, a decrease of $1.2 million, or 10.1%, compared to the prior year. The decrease in consolidated gross profit is primarily the result of fewer camera sales and a change in product mix, partially offset by improving gross margins in DIS due to lower radiophamaceutical costs during the nine months ended September 30, 2012. Consolidated gross profit as a percentage of revenue increased to 28.0% for the nine months ended September 30, 2012 from 27.9% for the prior year.

DIS. Cost of DIS revenue was $20.8 million for the nine months ended September 30, 2012, a decrease of $1.8 million, or 8.0%, compared to the prior year. The decrease in cost of DIS revenue was primarily a result of decreased expenses from fewer nuclear days and lower radiophamaceutical. DIS gross profit was $6.8 million for the nine months ended September 30, 2012, which represents an increase of $0.5 million, or 8.0%, from a gross profit of $6.3 million for the prior year. DIS gross profit as a percentage of DIS revenue increased to 24.6% for the nine months ended September 30, 2012 from 21.7% for the prior year due to improvement in operational performance primarily associated with the management of labor and equipment resources.

Product. Cost of revenues for the Product segment was $6.3 million for the nine months ended September 30, 2012, a decrease of $1.4 million, or 17.9%, compared to the prior year. The decrease in cost of Product revenue is primarily a result of lower camera sales. Product gross profit was $3.7 million for the nine months ended September 30, 2012, a decrease of $1.7 million, or 31.1%, compared to the prior year period. Product gross profit as a percentage of Product revenue decreased to 37.3% for the nine months ended September 30, 2012 compared to 41.5% for the prior year, primarily due to changes in product mix.

Operating Expenses

Research and Development. Research and development expenses were $3.0 million for the nine months ended September 30, 2012, an increase of $0.9 million, or 41.1%, compared to the prior year mainly due to initiatives to explore and develop new products and technologies. Research and development expenses were 30.1% of Product revenue for the nine months ended September 30, 2012 compared to 16.3% in the prior year. We plan to continue investing in our technology platform to penetrate new and existing market segments, support new product introductions and attract new customers.

Marketing and Sales. Marketing and sales expenses were $4.7 million for the nine months ended September 30, 2012, an increase of $0.1 million, or 2.6%, compared to the prior year, primarily as a result of exploring new markets that will allow us to diversify our current customer base. Marketing and sales expenses as a percentage of total revenues were 12.6%,

18

compared to, 11.0% for the nine months ended September 30, 2012 and 2011, respectively.

General and Administrative. General and administrative expenses were $5.8 million for the nine months ended September 30, 2012, the same amount compared to the prior year. General and administrative expenses were 15.5% of total revenue for the nine months ended September 30, 2012, compared to 13.9% for the prior year.

Restructuring Gain. In 2009, we financed a note receivable related to certain assets that we sold as part of our restructuring efforts. We fully reserved the note at that time. The buyer subsequently paid the note in full and we recognized a $0.2 million gain on the transaction in the first quarter of 2011.

Liquidity and Capital Resources

We require working capital principally to finance accounts receivable, inventory and for capital expenditures. Our working capital requirements vary from period to period depending on several factors, including our manufacturing volumes, the timing of our deliveries and the payment cycles of our customers. Our capital expenditures primarily relate to purchases of ultrasound equipment, manufacturing equipment and computer hardware and software to support our people and our customers.

As of September 30, 2012, we had cash, cash equivalents and securities available-for-sale of $27.2 million. We currently invest our cash reserves in money market accounts and corporate debt securities. Based upon our current level of expenditures, we believe our current working capital, together with cash flows from operating activities, will be more than adequate to meet our anticipated cash requirements for working capital and capital expenditures for at least the next 12 months.

Cash Flows

The following table shows cash flow information for the nine months ended September 30, 2012 and 2011 (in thousands):

	Nine Months Ended September 30,	
	2012	2011
Net cash provided by (used in) operating activities	$(1,624)	$2,034
Net cash used in investing activities	(3,339)	(12,301)
Net cash provided by (used in) financing activities	(733)	66

Operating Activities

Net cash used in operating activities increased $3.7 million for the nine months ended September 30, 2012 compared to the prior year period. This was primarily attributable to our greater net loss and increase in inventory and accounts receivables, partially offset by an increase in accounts payable.

Investing Activities

Net cash used in investing activities decreased $9.0 million for the nine months ended September 30, 2012 compared to the prior year period. This decrease was primarily attributable to decreased purchases and increased sales and maturities of securities available-for-sale during the nine months ended September 30, 2012.

Financing Activities

Net cash used in financing activities increased by $0.8 million for the nine months ended September 30, 2012 compared to the prior year period. This increase is attributable to our repurchase of $1.0 million of our common stock under the stock repurchase plan, partially offset by cash received from the issuance of stock of $0.3 million during the nine months ended September 30, 2012.

Off-Balance Sheet Arrangements

As part of our ongoing business, we do not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, or SPEs, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of September 30, 2012, we were not involved in any unconsolidated SPE transactions.

Contractual Obligations

There have been no material changes outside of the ordinary course of business in our outstanding contractual obligations from those disclosed within “Management's Discussion and Analysis of Financial Condition and Results of Operations,” as contained in our Annual Report on Form 10-K filed by the Company with the SEC on February 17, 2012 and as amended on April 27, 2012.

Critical Accounting Policies

Management’s discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements which are prepared in accordance with accounting principles that are generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities, and related disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. We continually evaluate our estimates and judgments, the most critical of which are those related to revenue recognition and inventory valuation. We base our estimates and judgments on historical experience and other factors that we believe to be reasonable under the circumstances. Materially different results can occur as circumstances change and additional information becomes known. Our accounting policies are the same as those described in the critical accounting policies in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 17, 2012.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to market risk due to changes in interest rates relates primarily to the increase or decrease in the value of debt securities in our investment portfolio. Our risk associated with fluctuating interest rates is limited to our investments in interest rate sensitive financial instruments. Under our current policies, we do not use interest rate derivative instruments to manage exposure to interest rate changes. We attempt to increase the safety and preservation of our invested principal funds by limiting default risk, market risk and reinvestment risk. We mitigate default risk by investing in investment grade securities. A 100 basis point adverse move in interest rates along the entire interest rate yield curve would not materially affect the fair value of our interest sensitive financial instruments. Changes in interest rates over time will increase or decrease our interest income.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

We maintain disclosure controls and procedures and internal controls that are designed to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures and internal controls, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable, and not absolute, assurance of achieving the desired control objectives. In reaching a reasonable level of assurance, management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures and internal controls.

As required by the Securities and Exchange Commission Rule 13a-15(e) and Rule 15d-15(e), we carried out an evaluation, under the supervision of and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting during the third quarter of 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In the normal course of business, we have been, and will likely continue to be, subject to litigation or administrative proceedings incidental to our business, such as claims related to customer disputes, employment practices, wage and hour disputes, product liability, professional liability, commercial and contract disputes, licensure restrictions or denials, and warranty or patent infringement. Responding to litigation or administrative proceedings, regardless of whether they have merit, can be expensive and disruptive to normal business operations. As litigation and the administrative proceedings are inherently uncertain, we cannot predict the outcome of such matters. While the ultimate outcome of litigation is always uncertain, we do not believe that any currently known matters will have a material adverse effect on our business or financial results.

ITEM 1A. RISK FACTORS

There have been no material changes to the Risk Factors described under "Part I – Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2011 filed with the Securities and Exchange Commission on February 17, 2012, other than:

- removal of the risk factor entitled "Failure to retain qualified technologists could limit our growth and adversely affect our business;"
- changes to the risk factor below entitled "Our manufacturing operations are highly dependent upon the availability of certain third-party suppliers, thereby making us vulnerable to supply problems that could harm our business," which has been updated to reflect recent developments with one of our sole suppliers of a key component of our gamma cameras; and
- addition of the risk factor entitled "Health care policy changes, including U.S. health care reform legislation signed in 2010, may have a material adverse effect on us."

Risks Related to Our Business and Industry

Our revenues may decline further due to reductions in Medicare reimbursement rates.

The success of our business is largely dependent upon our medical professional customers' ability to provide diagnostic imaging care to their patients in an economically sustainable manner, either through the purchase of our imaging systems or using our services, or both. Our customers are directly impacted by changes (decreases and increases) in governmental and private payor reimbursements for diagnostic imaging. Although we are not directly impacted by changes in reimbursements, we make every effort to act as business partners with our physician customers, e.g., in 2010, we proactively adjusted the fair market value of our imaging services rate down due to the dramatic reimbursement declines that our customers faced from the Centers for Medicare & Medicaid Services. Although Medicare/Medicaid reimbursement for the imaging modalities that we offer increased slightly in 2011 in the physician office setting, this occurred only after significant declines in ultrasound and nuclear reimbursements. Reimbursements remain a source of concern for our customers and downward pressure on reimbursements cause greater pricing pressure on our lease services and influences the buying decisions of our individual physician Product customers. Although the gap is closing, hospital reimbursements remain higher than in-office reimbursements. Our newer Product business segment's imaging systems are targeted to serve the hospital market. Only a small portion of our DIS business segment operates in the hospital market.

Further reductions in reimbursements could significantly impact the viability of in-office imaging performed by independent physicians. The uncertainty surrounding this issue and the historical decline in reimbursements has resulted in cancellations of imaging days in our imaging services business and the delay of purchase and service decisions by our existing and prospective customers in our Product business segment. Additional declines in Medicare/Medicaid reimbursement for our relevant diagnostic imaging modalities are possible due to many factors, including but not limited to the threatened implementation of the federal sustainable growth factor (SGR). The SGR is part of the relative value unit (RVU), a formula that was enacted by Congress as part of the Balanced Budget Act of 1997 to control the cost of the Medicare program. It applies to all health services paid for by Medicare, not just diagnostic imaging. The application of the SGR has been delayed by Congress for many years and most recently. If Congress allows the SGR to go into effect in 2012, all Medicare codes could incur a reimbursement reduction of approximately 27%. Congressional leadership has continually stated that they will address this issue; however, to date this has not been done. There is no assurance that the issue will be timely or favorably resolved, and if not favorably resolved, it could have a material adverse impact on our business.

Our revenues may decline further due to changes in diagnostic imaging regulations and use of third parties by private payors to drive down imaging volumes.

Nuclear medicine is a "designated health service" under the federal physician self-referral prohibition law known as the "Stark Law," which states that a physician may not refer designated health services to an entity with which the physician or an immediate family member has a financial relationship, unless a statutory exception applies. Our business model and service agreements are structured to enable our physician customers to meet the statutory in-office ancillary services (IOAS) exception to the Stark Law allowing them to perform nuclear diagnostic imaging services on their patients in the convenience of their own office. From time-to-time, the Centers for Medicare and Medicaid Services and Congress have proposed to modify the IOAS to further limit or eliminate this exception. Various lobbying organizations are pushing for, and the Medicare Payment Advisory Commission (MedPAC) is actively discussing, limiting the availability of the IOAS exception in order to reduce federal healthcare costs. The outcome of these efforts and discussions is uncertain at this time; however, the limitation or elimination of the IOAS exception could significantly impact our DIS business segment as currently structured.

Our customers who perform imaging services in their office also experience the continuing efforts by some private insurance companies to reduce healthcare expenditures by hiring radiology benefit managers to help them manage and limit imaging. The federal government has also set aside monies in the 2009 recession recovery acts to hire radiology benefit managers to provide image management services to Medicare/Medicaid and MedPAC has recommended and the Centers for Medicare & Medicaid Services has proposed legislation requiring Medicare physicians who engage in a relatively high volume of medical imaging be required to obtain pre-authorization through a radiology benefit manager. A radiology benefit manager is an unregulated entity that performs various functions for private payors and managed care organizations. Radiology benefit manager activities can include pre-authorization for imaging procedures, setting and enforcing standards approving which contracted physicians can perform the services, such as requiring even the most experienced and highly qualified cardiologists to obtain additional board certifications or interfering with the financial decision of the private practitioner by requiring them to own their own imaging system and not allowing them to lease the system. The radiology benefit managers often do not provide written documentation of their decisions or an appeals process, leaving leasing physicians unable to challenge their decisions with the carrier or the state insurance department. Some efforts are being made to address certain radiology benefit manager issues, for example, the New York State Attorney General recently entered into a settlement requiring a radiology benefit manager (based and operating in New York State) to buy out its owners in the state who own imaging centers because it created a conflict of interest in their decisions to deny authorization for competing physicians to provide imaging services; and, New York is requiring the radiology benefit manager to establish an appeals process. However, unregulated radiology benefit manager activities have and could continue to adversely affect our physician customers' ability to receive reimbursement, therefore impacting our customers' decision to utilize our DIS imaging services.

Our manufacturing operations are highly dependent upon the availability of certain third-party suppliers, thereby making us vulnerable to supply problems that could harm our business.

We rely on a limited number of third parties to manufacture and supply certain key components of our products. Alternative sources of production and supply may not be readily available or may take several months to scale-up and develop effective production processes. If a disruption in the availability of parts or in the operations of our suppliers were to occur, such as with respect to components manufactured in Japan, our ability to build gamma cameras could be materially adversely affected. For this reason, we are developing backup plans and investigating alternative procedures that are designed to prevent delays in production. If these plans are unsuccessful, delays in the production of our gamma cameras for an extended period of time could cause a loss of revenue and/or higher production costs, which could significantly harm our business and results of operations.

In late 2010, the sole supplier of a key component of our new ergo™ gamma camera ceased production of a critical component. We had a limited supply of that key component and worked hard with several suppliers, who subsequently successfully provided the component. We are working with our new suppliers to improve the yield, cost and efficiency of the key component, which efforts are expected to continue through 2012. The process to qualify a supplier for this key component is long, complex and costly. If the key component is not available when we need it, it could adversely impact our production capability and therefore negatively impact our financial condition. Furthermore, lower yields on the manufacturing of the key component that we do receive from our suppliers can have a negative impact on our financial condition through higher purchase price variances, which impact current period gross margins.

Our imaging operations are highly dependent upon the availability of certain radiopharmaceuticals, thereby making us vulnerable to supply problems and price fluctuations that could harm our business.

Our imaging service business involves the use of radiopharmaceuticals. There were significant disruptions in the international supply of these radiopharmaceuticals in 2010, which caused us to cancel services that would have otherwise been provided and this adversely affected our customers, as well as our financial condition in 2010. We believe we now have sufficient supply. The two major nuclear reactors supplying medical radiopharmaceuticals worldwide came back on-line at the end of 2010; however, there is no guarantee that the reactors will remain in good repair and our supplier will have continuing access to ample supply of our radiopharmaceutical product. If we are unable to obtain an adequate supply of the necessary radiopharmaceuticals, we may be unable to utilize our personnel and equipment through our in-office service operations, or the volume of our services could decline and our business may be adversely affected. Shortages can also cause price increases that may not be accounted for in third party reimbursement rates, thereby causing us to lose margin or require us to pass increases on to our physician customers. We have also engaged in a contractual dispute with our former radiopharmaceutical supplier. If we are unable to resolve the dispute in an amicable or cost effective manner, we may be required to pursue expensive and protracted litigation, which could have a material adverse impact on our financial statements.

Our business is not widely diversified.

Although we have a strategic initiative to expand our product line into general nuclear imaging with our ergo™ imaging system, which is primarily geared toward the hospital marketplace, historically, we have sold our products and imaging services and personnel primarily into the cardiac nuclear and ultrasound imaging private practice and in-office markets. We may not be able to leverage our assets and technology to diversify our products and services in order to generate revenue beyond the cardiac nuclear and ultrasound imaging private practice markets. If we are unable to diversify our product and service offerings, our financial condition may suffer.

We compete against businesses that have greater resources and different competitive strengths.

The market for cardiac nuclear imaging cameras is limited and has been decreasing. Some of our competitors have greater resources and a more diverse product offering than we do. Some of our competitors also enjoy significant advantages over us, including greater name recognition, greater financial and technical resources, established relationships with healthcare professionals, larger distribution networks, and greater resources for product development, as well as more extensive marketing and sales resources. Additionally, certain companies have developed portable cameras that directly compete with our product offerings. If we are unable to expand our current market share, our revenues and related financial condition could decline.

In addition, our imaging services customers may switch to other service providers. Our DIS imaging services segment competes against small local, owner operated or regional businesses, some of whom have the advantage of a lower cost structure, and against imaging centers that install nuclear gamma cameras and make them available to physicians in their geographic vicinity. If these competitors are able to win significant portions of our business, our sales could decline significantly. Our financial condition could be adversely affected under such circumstances.

Our quarterly and annual financial results are difficult to predict and are likely to fluctuate from period to period.

We have historically experienced seasonality in our imaging services business, and recent volatility due to the changing health care environment, the variable supply of radiopharmaceuticals, and the downturn in the U.S. economy. While our physicians are obligated to pay us for imaging days to which they have committed, our contracts permit some flexibility in scheduling when services are to be performed. We cannot predict with certainty the degree to which seasonal circumstances such as the summer slowdown, winter holiday vacations and weather conditions may affect the results of our operations. We have also experienced fluctuations in demand of our cardiac nuclear gamma cameras due to economic conditions, capital budget availability, or other financial or business reasons. In addition, due to the way that customers in our target markets acquire our products, a large percentage of our camera orders are booked during the last month of each quarterly accounting period. As such, a delivery delay of only a few days may significantly impact quarter-to-quarter comparisons of our results of operations. Moreover, the sales cycle in our Product segment for cameras is typically lengthy, particularly with our recent entry into the hospital market, which may cause us to experience significant revenue fluctuations. For these reasons, quarterly and annual sales and operating results may vary in the future. Therefore, period-to-period comparisons of our results of operations are not necessarily meaningful and should not be relied upon as indicators of future performance.

Our common stock is thinly traded and our option plan could affect the trading price of our common stock.

Our common stock is thinly traded and any significant sales of our common stock may cause volatility in our common stock price. We also have registered shares of common stock that we may issue under our employee benefit plans or from our treasury stock. Accordingly, these shares can be freely sold in the public market upon issuance, subject to restrictions under the securities laws. If any of these stockholders, or other selling stockholders, cause a large number of securities to be sold in the public market without a corresponding demand, the sales could reduce the trading price of our common stock. Although we are only aware of two single stockholders owning more than 5% or more of our stock and no one owning more than 15% or more of our stock, one or more stockholders holding a significant amount of our common stock might be able to significantly influence matters requiring approval by our stockholders, possibly including the election of directors and the approval of mergers or other business combination transactions.

We spend considerable time and money complying with federal and state laws, regulations and other rules, and if we are unable to comply with such laws, regulations and other rules, we could face substantial penalties.

We are directly, or indirectly through our physician customers, subject to extensive regulation by both the federal government and the states in which we conduct our business, including: the federal Medicare and Medicaid anti-kickback laws and other Medicare laws, regulations, rules, manual provisions, and policies that prescribe requirements for coverage and payment for services performed by us and our physician customers; the federal False Claims statutes; the federal Health

Insurance Portability and Accountability Act of 1996, or HIPAA, as amended in 2009 under the HITECH Act that places direct legal obligations and higher liability on us with respect to the security and handling of personal health information; the Stark Law; the federal Food, Drug and Cosmetic Act; federal and state radioactive materials laws; state food and drug and pharmacy laws and regulations; state laws that prohibit the practice of medicine by non-physicians and fee-splitting arrangements between physicians and non-physicians; state scope-of-practice laws; and federal rules prohibiting the mark-up of diagnostic tests to Medicare under certain circumstances. If our physician customers are unable or unwilling to comply with these statutes, regulations, rules, and policies, rates of our services and products could decline and our business could be harmed. Additionally, new government mandates will require us to provide a certain baseline of health benefits and premium contribution for our employees and their families or pay governmental penalties. Some of these costs are not tax deductible. We have opted to provide this coverage to our employee base in order to maintain retention of qualified medical technicians and other professionals rather than plan to pay penalties to the government. Either option will result in additional costs to us and could negatively impact our cash reserves.

We maintain a compliance program to identify and correct any compliance issues and remain in compliance with all applicable laws, to train employees, to audit and monitor our operations, and to achieve other compliance goals. Like most companies with compliance programs, we occasionally discover compliance concerns. In such cases, we take responsive action including corrective measures when necessary. There can be no assurance that our responsive actions will insulate us from liability associated with any detected compliance concerns.

If our past or present operations are found to be in violation of any of the laws, regulations, rules, or policies described above or the other laws or regulations to which we or our customers are subject, we may be subject to civil and criminal penalties, damages, fines, exclusion from federal or state health care programs, or the curtailment or restructuring of our operations. Similarly, if our physician customers are found to be non-compliant with applicable laws, they may be subject to sanctions which could have a negative impact on us. Any penalties, damages, fines, curtailment or restructuring of our operations could adversely affect our ability to operate our business and our financial results. Any action against us for violation of these laws, even if we successfully defend against it, could cause us to incur significant legal expenses, divert our management’s attention from the operation of our business, and damage our reputation.

Health care policy changes, including U.S. health care reform legislation signed in 2010, may have a material adverse effect on us.

In response to perceived increases in health care costs in recent years, there have been and continue to be proposals by the federal government, state governments, regulators, and third-party payers to control these costs and, more generally, to reform the U.S. health care system. Certain of these proposals could limit the prices we are able to charge for our products or the amounts of reimbursement available for our products and could limit the acceptance and availability of our products. The adoption of some or all of these proposals could have a material adverse effect on our financial position and results of operations.

In March 2010, President Obama signed into law the Patient Protection and Affordable Care Act and the Health Care and Education Affordability Reconciliation Act of 2010. The legislation imposes significant new taxes on medical device makers in the form of a 2.3% excise tax on all U.S. medical device sales beginning in 2013. Under the legislation, the total cost to the medical device industry is expected to be approximately $20 billion over ten years. This significant increase in the tax burden on our industry could have a material, negative impact on our results of operations and our cash flows. Other elements of this legislation, such as comparative effectiveness research, an independent payment advisory board, payment system reforms, including shared savings pilots, and other provisions, could meaningfully change the way health care is developed and delivered, and may materially impact numerous aspects of our business.

Our manufacturing operations and executive offices are located at a single facility that may be at risk from fire, earthquakes or other disasters.

Our manufacturing operations, research and development activities and executive offices are located in a single facility in Poway, California, near known fire areas and earthquake fault zones. Future natural disasters could cause substantial delays in our Product operations, damage to our manufacturing equipment, research and development efforts and inventory, and cause us to incur additional expenses. Although we have taken precautions to insure our facilities and continuing operations, as well as provide for offsite back-up of our information systems, this may not be adequate to cover our losses in any particular case. A disaster could significantly harm our business and results of operations.

The medical device industry is litigious, which could result in the diversion of our management's time and efforts, and require us to pay damages which may not be covered by our insurance.

Our operations entail risks of claims or litigation relating to product liability, radioactive contamination, patent infringement, trade secret disclosure, warranty claims, vendor disputes, product recalls, property damage, misdiagnosis, breach of contract, personal injury, and death. Any litigation or claims against us, or claims we bring against others, may cause us to incur substantial costs, could place a significant strain on our financial resources, divert the attention of our management from our core business and harm our reputation. We may incur significant liability in the event of any such litigation, regardless of the merit of the action. If we are unable to obtain insurance, or if our insurance is inadequate to cover claims, our cash reserves and other assets could be negatively impacted. Additionally, costs associated with maintaining our insurance could become prohibitively expensive, and our ability to become or remain profitable could be diminished.

Our ability to protect our intellectual property and proprietary technology through patents and other means is uncertain.

Our success depends, in part, on our ability to protect our proprietary rights to the technologies used in our products. Our pending United States patent applications, which include claims to material aspects of our products and procedures that are not currently protected by issued patents, may not issue as patents in a form that will be advantageous to us. Any patents we have obtained or do obtain may be challenged by re-examination or otherwise invalidated or eventually found unenforceable. Both the patent application process and the process of managing patent disputes can be time consuming and expensive. Competitors may attempt to challenge or invalidate our patents, or may be able to design alternative techniques or devices that avoid infringement of our patents, or develop products with functionalities that are comparable to ours. In the event a competitor infringes upon our patent or other intellectual property rights, litigation to enforce our intellectual property rights or to defend our patents against challenge, even if successful, could be expensive and time consuming and could require significant time and attention from our management. We may not have sufficient resources to enforce our intellectual property rights or to defend our patents against challenges from others.

Anti-takeover provisions in our organizational documents, our Stockholders Rights Plan and Delaware law may prevent or delay removal of current management or a change in control.

Our restated certificate of incorporation and restated bylaws contain provisions that may delay or prevent a change in control, discourage bids at a premium over the market price of our common stock, and adversely affect the market price of our common stock and the voting and other rights of the holders of our common stock. The rights issued pursuant to our Stockholder Rights Plan will become exercisable, subject to certain exceptions, the tenth day after a person or group announces acquisition of 20% or more of our common stock or announces commencement of a tender or exchange offer, the consummation of which would result in ownership by the person or group of 20% or more of our common stock. In addition, as a Delaware corporation, we are subject to Delaware law, including Section 203 of the Delaware General Corporation Law. In general, Section 203 prohibits a Delaware corporation from engaging in any business combination with any interested stockholder for a period of three years following the date that the stockholder became an interested stockholder unless certain specific requirements are met as set forth in Section 203. These provisions, alone or together, could have the effect of deterring or delaying changes in incumbent management, proxy contests or changes in control.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Sales of Unregistered Securities

None.

Issuer Purchases of Equity Securities

Issuer purchases of equity securities during the third quarter of fiscal 2012 were:

	Total Number of Shares Purchased During the Period	Average Price Paid Per Share for Period Presented	Total Cumulative Number of Shares Purchased	Maximum Dollar Value of Shares that May Yet Be Purchased

			as Part of Publicly Announced Plan (1)	Under the Plan
July 1, 2012 — July 31, 2012	—	$—	—	$—
August 1, 2012 — August 31, 2012	218,759	1.96	1,073,641	1,935,708
September 1, 2012 — September 30, 2012	—	—	—	—
As of September 30, 2012	218,759		1,073,641	$1,935,708

(1) On September 18, 2012, our board of directors amended our stock buyback program, originally adopted in February 2009, to permit an additional $2 million of its issued and outstanding common shares to be repurchased. As amended, the stock buyback program permits us to purchase an aggregate of $4 million of its common stock. The timing of stock repurchases and the number of shares of common stock to be repurchased are in compliance with Rule 10b-18

under the Securities Exchange Act of 1934. The timing and extent of the repurchase depends upon market conditions, applicable legal and contractual requirements, and other factors.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit Number	Description
3.1(1)	Restated Certificate of Incorporation.
3.2(2)	Restated Bylaws.
4.1(3)	Form of Specimen Stock Certificate.
4.2(4)	Amended and Restated Investors' Rights Agreement, by and among, Digirad Corporation and the investors listed on the schedule attached thereto, dated April 23, 2002, as amended.
10.5(5)	Letter Agreement.
10.27(6)#	Offer letter, dated August 21,2012, by and between the Company and Jeffry R. Keyes, Chief Financial Officer
31.1*	Certification of Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) promulgated pursuant to the Securities Exchange Act of 1934, as amended.
31.2*	Certification of Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) promulgated pursuant to the Securities Exchange Act of 1934, as amended.
32.1**	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2**	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101***	The following financial information from the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2012, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets, (ii) Condensed Consolidated Statements of Operations, (iii) Condensed Consolidated Statements of Cash Flows, and (iv) the Notes to Condensed Consolidated Financial Statements, tagged as blocks of text.

---

(1) This exhibit was previously filed as an exhibit to the Company's quarterly report on Form 10-Q originally filed with the Securities and Exchange Commission on August 11, 2004, as amended thereafter, and is incorporated herein by reference.

(2) The exhibit was previously filed as an exhibit to the Company's quarterly report on Form 8-K filed with the Securities and Exchange Commission on May 9, 2007, and is incorporated herein by reference.

(3) This exhibit was previously filed as an exhibit to the Registration Statement on Form S-1 (File No. 333-113760) originally filed with the Securities and Exchange Commission on March 19, 2004, as amended thereafter, and is incorporated herein by reference.

(4) This exhibit was previously filed as an exhibit to the Company's quarterly report on Form 10-Q filed with the Securities and Exchange Commission on November 2, 2004, and is incorporated herein by reference.

(5) The exhibit was previously filed as an exhibit to the company's current report on form 8-K on July 3, 2012, and is incorporated herein by reference.

(6) The exhibit was previously filed as an exhibit to the company's current report on form 8-K on September 6, 2012, and is incorporated herein by reference.

(#) Indicates management contract or compensation plan.

(*) Filed herewith.

(**) This certification is being furnished solely to accompany this quarterly report pursuant to 18 U.S.C. § 1350, and is not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not to be incorporated by reference into any filing of Digirad Corporation, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

(***) Users of this data are advised that pursuant to Rule 406T of Regulation S-T, this XBRL information is being furnished and not filed herewith for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and Sections 11 or 12 of the Securities Act of 1933, as amended, and is not to be incorporated by reference into any filing, or part of any registration statement or prospectus, of Digirad Corporation, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	DIGIRAD CORPORATION
Date: October 31, 2012	By: /s/ TODD P. CLYDE Todd P. Clyde President and Chief Executive Officer (Principal Executive Officer)
Date: October 31, 2012	By: /s/ JEFFRY R. KEYES Jeffry R. Keyes Chief Financial Officer (Principal Financial and Accounting Officer)

29