DIGIRAD CORP
Form 10-Q
August 03, 2018

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 JUNE 30, 2018
o 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: 001-35947
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.)
1048 Industrial Court, Suwanee, GA	30024
(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 x No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o Yes No x
As of July 30, 2018 the registrant had 20,119,318 shares of Common Stock ($0.0001 par value) outstanding.

DIGIRAD CORPORATION
TABLE OF CONTENTS

Important Information Regarding Forward-Looking Statements

Portions of this Quarterly Report on Form 10-Q (including information incorporated by reference) include “forward-looking statements” based on our current beliefs, expectations, and projections regarding our business strategies, market potential, future financial performance, industry, and other matters. This includes, in particular, “Item 2 — Management’s Discussion and Analysis of Financial Condition and Results of Operations” of this Quarterly Report on Form 10-Q, as well as other portions of this Quarterly Report on Form 10-Q. The words “believe,” “expect,” “anticipate,” “project,” “could,” “would,” and similar expressions, among others, generally identify "forward-looking statements," which speak only as of the date the statements were made. The matters discussed in these forward-looking statements are subject to risks, uncertainties, and other factors that could cause our actual results to differ materially from those projected, anticipated, or implied in the forward-looking statements. The most significant of these risks, uncertainties, and other factors are described in “Item 1A — Risk Factors” of this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 filed with the Securities and Exchange Commission on February 28, 2018. Except to the limited extent required by applicable law, we undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
DIGIRAD CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
AND COMPREHENSIVE INCOME (LOSS)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands, except per share data)	2018	2017	2018	2017
Revenues:				
Services	$24,324	$23,742	$46,947	$46,799
Product and product-related	2,756	2,943	5,598	5,726
Total revenues	27,080	26,685	52,545	52,525
Cost of revenues:				
Services	20,023	19,105	39,284	37,688
Product and product-related	1,490	1,892	3,087	3,547
Total cost of revenues	21,513	20,997	42,371	41,235
Gross profit	5,567	5,688	10,174	11,290
Operating expenses:				
Marketing and sales	1,461	1,596	2,928	3,379
General and administrative	3,522	5,717	7,914	10,613
Amortization of intangible assets	356	373	713	747
Goodwill impairment	476	—	476	—
Total operating expenses	5,815	7,686	12,031	14,739
Loss from operations	(248)	(1,998)	(1,857)	(3,449)
Other expense:				
Other expense, net	(19)	—	(36)	—
Interest expense, net	(189)	(227)	(363)	(420)
Loss on extinguishment of debt	—	(709)	(43)	(709)
Total other expense	(208)	(936)	(442)	(1,129)
Loss before income taxes	(456)	(2,934)	(2,299)	(4,578)
Income tax benefit (expense)	106	88	561	(519)
Loss from continuing operations, net of tax	(350)	(2,846)	(1,738)	(5,097)
Income from discontinued operations, net of tax	—	74	5,494	249
Net (loss) income	$(350)	$(2,772)	$3,756	$(4,848)
Net (loss) income per share - basic and diluted				
Continuing operations	$(0.02)	$(0.14)	$(0.09)	$(0.26)
Discontinued operations	$—	$—	$0.27	$0.01
Net (loss) income per share - basic and diluted [(1)]	$(0.02)	$(0.14)	$0.19	$(0.24)
Dividends declared per common share	$0.055	$0.05	$0.11	$0.10

Net (loss) income	$(350)	$(2,772)	$3,756	$(4,848)
Other comprehensive (loss) income:				
Unrealized loss on available-for-sale securities	—	(69)	—	(31)
Reclassification of unrealized gains on available-for-sale securities to retained earnings	—	—	(17)	
Total other comprehensive loss	—	(69)	(17)	(31)
Comprehensive (loss) income	$(350)	$(2,841)	$3,739	$(4,879)

(1) Earnings per share may not add due to rounding.

See accompanying notes to the unaudited condensed consolidated financial statements.

4

DIGIRAD CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

(in thousands, except share data)	June 30, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$1,410	$ 1,877
Securities available-for-sale	96	97
Accounts receivable, net	12,581	15,887
Inventories, net	5,992	5,501
Restricted cash	243	242
Other current assets	2,174	1,972
Total current assets	22,496	25,576
Property and equipment, net	25,664	28,365
Intangible assets, net	7,116	7,830
Goodwill	1,916	2,392
Restricted cash	101	101
Non-current assets held for sale	—	1,736
Other assets	582	703
Total assets	$57,875	$ 66,703
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$5,313	$ 5,207
Accrued compensation	4,122	5,507
Accrued warranty	157	204
Deferred revenue	1,646	2,302
Current liabilities held for sale	—	835
Other current liabilities	2,342	2,915
Total current liabilities	13,580	16,970
Long-term debt	12,500	19,500
Deferred tax liabilities	372	254
Other liabilities	1,784	2,180
Total liabilities	28,236	38,904
Commitments and contingencies (Note 10)		
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; 20,119,318 and 20,060,311 shares issued and outstanding (net of treasury shares) at June 30, 2018 and December 31, 2017, respectively	2	2
Treasury stock, at cost; 2,588,484 shares at June 30, 2018 and December 31, 2017	(5,728)	(5,728)
Additional paid-in capital	146,247	148,163
Accumulated other comprehensive loss	(22)	(5)
Accumulated deficit	(110,860)	(114,633)
Total stockholders' equity	29,639	27,799

Total liabilities and stockholders’ equity	$57,875	$ 66,703

See accompanying notes to the unaudited condensed consolidated financial statements.

DIGIRAD CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(in thousands)	Six Months Ended June 30, 2018	2017
Operating activities		
Net income (loss)	$3,756	$(4,848)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation	3,842	4,011
Amortization of intangible assets	727	1,156
Provision for bad debt	82	24
Stock-based compensation	371	559
Amortization of loan fees	21	153
Loss on extinguishment of debt	43	709
Gain on disposal of discontinued operation	(6,261)	—
Gain on sale of assets	(238)	(70)
Goodwill impairment	476	—
Deferred income taxes	120	676
Other, net	36	(159)
Changes in operating assets and liabilities:		
Accounts receivable	3,219	827
Inventories	(463)	157
Other assets	339	(84)
Accounts payable	(73)	(860)
Accrued compensation	(1,385)	978
Deferred revenue	(844)	(301)
Other liabilities	(727)	566
Net cash provided by operating activities	3,041	3,494
Investing activities		
Purchases of property and equipment	(919)	(782)
Proceeds from sale of discontinued operations	6,844	—
Proceeds from sale of property and equipment	325	167
Purchases of securities available-for-sale	(14)	(17)
Maturities of securities available-for-sale	—	917
Net cash provided by investing activities	6,236	285
Financing activities		
Proceeds from long term borrowings	18,125	29,353
Repayments of long term debt	(25,125)	(33,838)
Loan issuance costs and extinguishment costs	(7)	(110)
Dividends paid	(2,212)	(1,993)
Taxes paid related to net share settlement of equity awards	(74)	(192)
Cash paid for contingent consideration for acquisitions	—	(27)
Repayment of obligations under capital leases	(450)	(411)
Net cash used in financing activities	(9,743)	(7,218)
Net decrease in cash, cash equivalents and restricted cash	(466)	(3,439)
Cash, cash equivalents and restricted cash at beginning of period	2,220	5,679

Cash, cash equivalents and restricted cash at end of period	$1,754	$2,240
Non-Cash Investing Activities		
Assets acquired by entering into capital leases	$16	$1,844

See accompanying notes to the unaudited condensed consolidated financial statements.

DIGIRAD CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
Note 1. Basis of Presentation
Basis of Presentation
The unaudited condensed consolidated financial statements included in this Form 10-Q have been prepared in accordance with the U.S. Securities and Exchange Commission ("SEC") instructions for Quarterly Reports on Form 10-Q. Accordingly, the condensed consolidated financial statements are unaudited and do not contain all the information required by U.S. generally accepted accounting principles ("GAAP") to be included in a full set of financial statements. The unaudited condensed consolidated balance sheet at December 31, 2017 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by GAAP for a complete set of financial statements. The audited consolidated financial statements for our fiscal year ended December 31, 2017, filed with the SEC on Form 10-K on February 28, 2018, include a summary of our significant accounting policies and should be read in conjunction with this Form 10-Q. In the opinion of management, all material adjustments necessary to present fairly the results of operations, cash flows, and balance sheets for such periods have been included in this Form 10-Q. All such adjustments are of a normal recurring nature. The results of operations for interim periods are not necessarily indicative of the results of operations for the entire year.
As discussed in Note 2, the results of our Medical Device Sales and Services ("MDSS") reportable segment are presented as discontinued operations and, as such, are excluded from both continuing operations and segment results for all periods presented.
Use of Estimates
Preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses. By their nature, estimates are subject to an inherent degree of uncertainty. Actual results could differ from management’s estimates.
New Accounting Pronouncements
Recently Adopted Accounting Standards
In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, which requires amounts generally described as restricted cash and restricted cash equivalents be included with cash and cash equivalents when reconciling the total beginning and ending amounts for the periods shown on the statement of cash flows. The pronouncement is effective for fiscal years beginning after December 15, 2017, and for interim periods within those periods, using a retrospective transition method to each period presented. We adopted ASU 2016-18 effective January 1, 2018 which resulted in an increase of $3.0 million in net cash flows used in financing activities that was previously reported for the six months ended June 30, 2017.
In January 2016, the FASB issued ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, which amended the existing accounting standards for the accounting for financial instruments. The amendments require equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income. The new standard is effective prospectively for fiscal years beginning after December 15, 2017. We adopted ASU 2016-01 on January 1, 2018. As a result of the adoption, we recorded an increase to retained earnings of $17 thousand to recognize the unrealized gains previously recorded within accumulated other comprehensive income. Subsequent changes in the fair value of our marketable securities will be recorded to other expense, net. See Note 8 for further details.
In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606) that outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers which supersedes current revenue recognition guidance, including most industry-specific guidance. The guidance provides that an entity recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This guidance also requires additional disclosure about the nature, amount, timing, and uncertainty of revenue and cash flows arising

from customer contracts, including significant judgments and changes in judgments, and assets recognized from costs incurred to obtain or fulfill a contract. We adopted Topic 606 as of January 1, 2018 using the modified retrospective transition method. Under the modified retrospective method, the Company would recognize the cumulative effect of initially applying the standard as an adjustment to opening retained earnings at the date of initial application; however, we did not have any material adjustments as of the date of the adoption. The comparative periods have not been restated and continue to be reported under the accounting standards in effect for those periods. See Note 3 for expanded revenue disclosures and updates to our revenue recognition policy.

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, which simplifies the subsequent measurement of goodwill by removing the second step of the two-step impairment test. The amendment requires an entity to perform its annual, or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An impairment charge should be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. The amendment should be applied on a prospective basis. The pronouncement is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. We early adopted ASU 2017-04 effective April 1, 2018 in conjunction with the interim impairment test of goodwill performed during the quarter. See Note 7 for additional information on or interim goodwill impairment test performed.

New Accounting Standards To Be Adopted

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which amended the existing accounting standards for the accounting for leases. The amendments are based on the principle that assets and liabilities arising from leases should be recognized within the financial statements. The Company is required to adopt the amendments beginning in 2019. Early adoption is permitted. The amendments must be applied using a modified retrospective transition approach and the FASB decided not to permit a full retrospective transition approach. We currently expect that most of our operating lease commitments will be subject to the update and recognized as operating lease liabilities and right-of-use assets upon adoption. However, we are currently evaluating the effect that implementation of this update will have upon adoption on our consolidated financial position and results of operations.

Note 2. Discontinued Operations

On February 1, 2018, the Company completed the sale of its customer contracts relating to our MDSS post-warranty service business to Philips North America LLC ("Philips") pursuant to an Asset Purchase Agreement, dated as of December 22, 2017 for $8.0 million. The total cash proceeds were adjusted for deferred revenue liabilities assigned to Philips at the closing date, as well as $0.5 million of proceeds held in escrow, subject to claims for breaches of general representation and warranties. The escrow amount was recorded in other current assets as of June 30, 2018 and is expected to be released to the Company during the fourth quarter of 2018.

Prior to the contemplation of the transaction entered into above, on September 28, 2017, we received notification from Philips that our distribution agreement to sell Philips imaging systems on a commission basis would be terminated, effective December 31, 2017. As a result, our product sales activities within our MDSS reportable segment were also discontinued effective in the first quarter of 2018.

The Company deemed the disposition of our MDSS reportable segment in the first quarter of 2018 to represent a strategic shift that will have a major effect on our operations and financial results, in accordance with the provisions of FASB authoritative guidance on the presentation of financial statements, we have classified the results of our MDSS segment as discontinued operations in our condensed consolidated statement of operations for all periods presented. Additionally, the related assets and liabilities associated with the discontinued operations were reclassified as held for sale in our condensed consolidated balance sheet.

The Company has allocated a portion of interest expense to discontinued operations since the proceeds received from the sale were required to be used to pay down outstanding borrowings under our revolving credit facility with Comerica Bank, a Texas banking association ("Comerica"). The allocation was based on the ratio of proceeds received in the sale to total borrowings for the period. In addition, certain general and administrative costs related to corporate and shared service functions previously allocated to the MDSS reportable segment are not included in discontinued operations.

The following table presents financial results of the MDSS business:

(in thousands)	Three Months Ended June 30, 2018 (1)	Three Months Ended June 30, 2017	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
Total revenues	$165	$3,101	$789	$6,341
Total cost of revenues	30	1,756	546	3,491
Gross profit	135	1,345	243	2,850
Operating expenses:				
Marketing and sales	—	673	85	1,290
General and administrative	—	220	172	428
Amortization of intangible assets	—	205	13	409
Gain on sale of discontinued operations	—	—	(6,261)	—
Total operating expenses	—	1,098	(5,991)	2,127
Income from operations	135	247	6,234	723
Interest expense	—	(76)	(26)	(198)
Income from discontinuing operations before income taxes	135	171	6,208	525
Income tax expense	(135)	(97)	(714)	(276)
Income from discontinuing operations, net of tax	$—	$74	$5,494	$249

(1) Income from operations for the three months ended June 30, 2018 primarily relates to the sale of inventory used in our former MDSS service business.

The following table summarizes the major classes of assets and liabilities of discontinued operations that were included in the Company's balance sheet:

(in thousands)	June 30, 2018	December 31, 2017
Carrying amounts of assets included as part of discontinued operations:		
Intangible assets, net	$ —	$ 637
Goodwill	—	1,099
Total assets classified as held for sale in the condensed consolidated balance sheet	$ —	$ 1,736
Carrying amounts of liabilities included as part of discontinued operations:		
Deferred revenue	$ —	$ 835
Total liabilities classified as held for sale in the condensed consolidated balance sheet	$ —	$ 835

The following table presents supplemental cash flow information of discontinued operations:

(in thousands)	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
Operating activities:		
Depreciation	$2	$18
Amortization of intangible assets	$13	$409
Gain on sale of discontinued operations	$(6,261)	$—
Stock-based compensation	$(1)	$11
Investing activities:		
Proceeds from the sale of discontinued operations	$6,844	$—
Purchases of property, plant and equipment	$—	$—

9

Note 3. Revenue

Product and Product-Related Revenues and Services Revenue

Product and product-related revenue are generated from the sale of gamma cameras and post-warranty maintenance service contracts within our Diagnostic Imaging reportable segment.

Services revenue are generated from providing diagnostic imaging and cardiac monitoring services to customers within our Diagnostic Services and Mobile Healthcare reportable segments. Services revenue also includes lease income generated from interim rentals of imaging systems to our customers.

Revenue Recognition

Revenue is recognized upon transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. Taxes collected from customers, which are subsequently remitted to governmental authorities, are excluded from revenue.

The majority of our contracts have a single performance obligation as we provide a series of distinct services that are substantially the same and are transferred with the same pattern to the customer. For contracts with multiple performance obligations, we allocate the total transaction price to each performance obligation using our best estimate of the standalone selling price of each distinct good or service in the contract. We use an observable price to determine the stand-alone selling price for separate performance obligations or a cost plus margin approach when one is not available.

Our products are generally not sold with a right of return and the Company does not provide significant credits or incentives, which may be required for as variable consideration when estimating the amount of revenue to be recognized.

Disaggregation of Revenue

The following table presents our revenues disaggregated by major source:

	Three Months Ended June 30, 2018			
(in thousands)	Diagnostic Services	Diagnostic Imaging	Mobile Healthcare	Total
Major Goods/Service Lines				
Mobile Imaging and Cardiac Monitoring	$13,075	$ —	$ 8,554	$21,629
Camera	—	913	—	913
Camera Support	—	1,809	—	1,809
Revenue from Contracts with Customers	13,075	2,722	8,554	24,351
Lease Income	192	34	2,503	2,729
Total Revenues	$13,267	$ 2,756	$ 11,057	$27,080
Timing of Revenue Recognition				
Services and goods transferred over time	$12,123	$ 1,630	$ 10,986	$24,739
Services and goods transferred at a point in time	1,144	1,126	71	2,341
Total Revenues	$13,267	$ 2,756	$ 11,057	$27,080

(in thousands)	Six Months Ended June 30, 2018			
	Diagnostic Services	Diagnostic Imaging	Mobile Healthcare	Total
Major Goods/Service Lines				
Mobile Imaging and Cardiac Monitoring	$24,973	$ —	$ 16,633	$41,606
Camera	—	1,983	—	1,983
Camera Support	—	3,553	—	3,553
Revenue from Contracts with Customers	24,973	5,536	16,633	47,142
Lease Income	319	62	5,022	5,403
Total Revenues	$25,292	$ 5,598	$ 21,655	$52,545
Timing of Revenue Recognition				
Services and goods transferred over time	$23,087	$ 3,350	$ 21,477	$47,914
Services and goods transferred at a point in time	2,205	2,248	178	4,631
Total Revenues	$25,292	$ 5,598	$ 21,655	$52,545

Nature of Goods and Services

Mobile Imaging and Cardiac Monitoring

Within our Diagnostic Services and Mobile Healthcare reportable segments, our sales are derived from providing services and materials to our customers, primarily physician practices and hospitals, that allow them to perform diagnostic imaging services at their site. We typically bundle our services in providing staffing, our imaging systems, licensing, radiopharmaceuticals, and supplies depending on our customers' needs. Our contracts with customers are typically entered into annually and are billed on a fixed rate per-day or per-scan basis, depending on terms of the contract. For the majority of these contracts, the Company has the right to invoice the customer in an amount that directly corresponds with the value to the customer of the Company's performance to date. The Company uses the practical expedient to recognize revenue corresponding with amounts we have the right to invoice for services performed.

Diagnostic Services also offers remote cardiac event monitoring services. These services include provision of a monitor, remote monitoring by registered nurses, and 24 hours a day, 7 days a week monitoring support for our patients and physician customers. We provide our services under contracts with our customers that typically allow for direct billing to Medicare, Medicaid, or third-party private payors once the monitoring cycle is complete. Typically, our contracts can be canceled at any time, and are generally used to define billing responsibilities amongst the parties. Our cardiac event monitoring services are provided primarily through an independent diagnostic testing facility model which allows us to bill Medicare, Medicaid, or a third-party healthcare insurer directly for services provided. We also receive reimbursement directly from patients through co-pays and self-pay arrangements. Billings for services reimbursed by third party payors, including Medicare, are recorded as revenue net of contractual allowances. Contractual allowances are estimated based on historical collections by Current Procedural Terminology (CPT) code for specific payors, or class of payors. Adjustments to the estimated receipts, based on final settlement with the third-party payors, are recorded upon settlement.

Camera

Within our Diagnostic Imaging segment, camera revenues are generated from the sale of internally developed solid-state gamma camera imaging systems. We recognize revenue upon transfer of control to the customer, which is generally upon delivery and acceptance. We also provide installation services and training on cameras we sell, primarily in the United States. Installation and initial training is generally performed shortly after delivery. The Company recognizes revenues for installation and training over time as the customer receives and consumes benefits provided as the Company performs the installation services.

Our sale of imaging systems includes a one-year warranty which we account for as an assurance-type warranty. The expected costs associated with our standard warranties and field service actions continue to be recognized as expense when cameras are sold. Maintenance service contracts sold beyond the term of our standard warranties are accounted for as a service-type warranty and revenue is deferred and recognized ratably over the period of the obligation.

Camera Support

Within our Diagnostic Imaging segment, camera support revenue is derived from the sale of separately-priced extended maintenance contracts to camera owners, training, and paid service arrangements when a customer does not have an extended warranty and parts that are sold by the service department. Our separately priced service contracts range from 12 to 48 months. Service contracts are usually billed at the beginning of the contract period or at periodic intervals (e.g. monthly or quarterly) and revenue is recognized ratably over the term of the agreement.

Services and training revenues are recognized in the period the services and training are performed. Revenue for sales of parts are recognized when the parts are delivered to the customer and control is transferred.

Lease Income

Within primarily our Mobile Healthcare segment, we also generate income from interim rentals of our imaging systems to customers that are in the midst of new construction or refurbishing their current facilities. Rental contracts are structured as either a weekly or monthly payment arrangement and are accounted for as operating leases. Revenues are recognized on a straight-line basis over the term of the rental.

Deferred Revenues

We record deferred revenues when cash payments are received or due in advance of our performance, including amounts which are refundable. We have determined our contracts do not include a significant financing component. The majority of our deferred revenue relates to payments received on camera support post-warranty service contracts which are billed at the beginning of the annual contract period or at periodic intervals (e.g. monthly or quarterly).

At December 31, 2017, the Company deferred revenues balance was $2.4 million, of which $0.9 million and $1.8 million of this was recognized as revenue during the three and six months ended June 30, 2018. As of June 30, 2018, deferred revenue was $1.7 million. The decrease of $0.7 million was mainly due to the timing of when customer payments are received in relation to the service contract period.

The Company has elected to use the practical expedient under ASC 606 to exclude disclosures of unsatisfied remaining performance obligations for (i) contracts having an original expected length of one year or less or (ii) contracts which the practical expedient has been applied to recognize revenue at the amount to which it has a right to invoice.

Contract Costs

We recognize an asset for the incremental costs of obtaining a contract with a customer if we expect the benefit of those costs to be longer than one year. The Company applies a practical expedient to expense costs as incurred for costs to obtain a contract when the amortization period would have been one year or less. These costs mainly include the Company's internal sales commissions; under the terms of these programs these are generally earned and the costs are recognized at the time the revenue is recognized.

Note 4. Basic and Diluted Net Income (Loss) Per Share

For the six months ended June 30, 2018 and 2017, basic net income (loss) per common share is computed by dividing net income (loss) by the weighted average number of common shares and vested restricted stock units outstanding during the period. Diluted net income per common share is calculated to give effect to all dilutive securities, if applicable, using the treasury stock method. In periods for which there is a net loss, diluted loss per common share is equal to basic loss per common share, since the effect of including any common stock equivalents would be antidilutive.

The following table sets forth the reconciliation of shares used to compute basic and diluted net income (loss) per share for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
(shares in thousands)	2018	2017	2018	2017
Numerator:				
Loss from continuing operations	$(350)	$(2,846)	$(1,738)	$(5,097)
Income from discontinued operations	—	74	5,494	249
Net income (loss)	$(350)	$(2,772)	$3,756	$(4,848)
Denominator:				
Weighted average shares outstanding - basic	20,119	19,979	20,106	19,957
Dilutive potential common stock outstanding:				
Stock options	—	—	—	—
Restricted stock units	—	—	—	—
Weighted average shares outstanding - diluted	20,119	19,979	20,106	19,957
Income (loss) per common share - basic				
Continuing operations	$(0.02)	$(0.14)	$(0.09)	$(0.26)
Discontinued operations	$—	$—	$0.27	$0.01
Net income (loss) per common share - basic (1)	$(0.02)	$(0.14)	$0.19	$(0.24)
Income (loss) per common share - diluted				
Continuing operations	$(0.02)	$(0.14)	$(0.09)	$(0.26)
Discontinued operations	$—	$—	$0.27	$0.01
Net income (loss) per common share - diluted (1)	$(0.02)	$(0.14)	$0.19	$(0.24)

(1) Earnings per share may not add due to rounding.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
(shares in thousands)	2018	2017	2018	2017
Stock options	360	287	258	301
Restricted stock units	234	84	171	74
Total	594	371	429	375

Note 5. Inventories

The components of inventories are as follows:

(in thousands)	June 30, 2018	December 31, 2017
Inventories:		
Raw materials	$2,687	$ 2,331
Work-in-process	2,014	2,094
Finished goods	1,659	1,529
Total inventories	6,360	5,954
Less reserve for excess and obsolete inventories	(368)	(453)
Total inventories, net	$5,992	$ 5,501

Note 6. Property and Equipment

Property and equipment consists of the following:

(in thousands)	June 30, 2018	December 31, 2017
Property and equipment:		
Land	$1,170	$ 1,170
Buildings and leasehold improvements	2,946	2,946
Machinery and equipment	55,786	55,152
Computer hardware and software	4,661	4,615
Total property and equipment	64,563	63,883
Less accumulated depreciation	(38,899)	(35,518)
Total property and equipment, net	$25,664	$ 28,365

Note 7. Goodwill

The value of our goodwill is primarily derived from the acquisition of MD Office Solutions ("MD Office") in 2015, Telerhythmics, LLC ("Telerhythmics") in 2014, and substantially all of the assets of Ultrascan, Inc. ("Ultrascan") in 2007. During the six months ended June 30, 2018, reporting units that carried goodwill balances included Digirad Imaging Solutions and Telerhythmics. The combined Digirad Imaging Solutions and Telerhythmics reporting units make up the Diagnostic Services reportable segment.

Changes in the carrying amount of goodwill from December 31, 2017 to June 30, 2018, by reportable segment, are as follows:

(in thousands)	Diagnostic Services	Total
Balance at December 31, 2017	$ 2,392	$2,392
Impairment of Telerhythmics	(476)	(476)
Balance at June 30, 2018	$ 1,916	$1,916

The Company tests goodwill for impairment annually during the fourth quarter of each year at the reporting unit level and on an interim basis if events or substantive changes in circumstances indicate that the carrying amount of a reporting unit may exceed its fair value.

During the second quarter of 2018, the Company's ongoing and continuous efforts to explore strategic alternatives across the entire business in order to maximize shareholder value triggered an interim impairment test during the quarter. As a result of additional market data and information that became available in connection with these efforts, the Company concluded that the carrying value of its Telerhythmics reporting unit was in excess of fair value and recorded a goodwill impairment charge of $0.5 million during the three months ended June 30, 2018. The remaining goodwill balance within this reporting unit as of June 30, 2018 was $0.2 million.

Note 8. Financial Instruments

Assets and Liabilities Measured at Fair Value on a Recurring Basis.

The following table presents information about our financial assets that are measured at fair value on a recurring basis, and indicates the fair value hierarchy of the valuation techniques we utilize to determine such fair value at June 30, 2018 and December 31, 2017.

	Fair Value as of June 30, 2018			
(in thousands)	Level 1	Level 2	Level 3	Total
Assets:				
Equity securities	$96	$ 89	$ —	$185
Total	$96	$ 89	$ —	$185

	Fair Value as of December 31, 2017			
(in thousands)	Level 1	Level 2	Level 3	Total
Assets:				
Equity securities	$97	$ 111	$ —	$208
Total	$97	$ 111	$ —	$208

We did not reclassify any investments between levels in the fair value hierarchy during the six months ended June 30, 2018.

The investment in equity securities consists of common stock of publicly traded companies. The fair value of these securities is based on the closing prices observed on June 30, 2018.

Securities Available-for-Sale

As of June 30, 2018, securities available-for-sale consist of investments in equity securities that are publicly traded. These investments include shares held in Birner Dental Management Services ("Birner Dental"), a publicly traded company whose board of directors include a current Director of the Company. We classify a portion of equity securities as available-for-sale and as current assets, as the sale of such securities may be required prior to maturity to execute management strategies. One of our equity securities, Perma-Fix Medical S.A. ("Perma-Fix Medical"), is classified as an other asset (non-current), as the investment is strategic in nature and our current intent is to hold the investment over a several year period. Securities available-for-sale are carried at fair value, with the unrealized gains and losses presented within 'other expense, net' on our condensed consolidated statement of operations. As of December 31, 2017, the accumulated unrealized gains on these investments was $17 thousand, which was reclassified from accumulated other comprehensive income into beginning retained earnings upon adoption of ASU 2016-01.

The following table sets forth the composition of securities available-for-sale as of June 30, 2018 and December 31, 2017 (in thousands).

As of June 30, 2018	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Equity securities	$221	$—	$(36)	$ 185
	$221	$—	$(36)	$ 185

As of December 31, 2017	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Equity securities	$191	$17	$—	$ 208
	$191	$17	$—	$ 208

Note 9. Debt

A summary of long-term debt is as follows:

	June 30, 2018		December 31, 2017	
(in thousands)	Amount	Weighted-Average Interest Rate	Amount	Weighted-Average Interest Rate
Long-term debt:				
Revolving Credit Facility	$12,500	4.44%	$19,500	3.90%
Total borrowings	$12,500		$19,500	

On June 21, 2017, the Company entered into a Revolving Credit Agreement (the “Comerica Credit Agreement”) with Comerica. The Comerica Credit Agreement provides for a five-year revolving credit facility with a maximum credit amount of $25.0 million maturing in June 2022, upon which a balloon payment on the balance is due. Under the Comerica Credit Facility, the Company can request the issuance of letters of credit in an aggregate amount not to exceed $1.0 million at any one time. In connection with the sale of our post-warranty service customer contracts to Philips, the Company entered into an Amendment No. 1 to the Comerica Credit Agreement, dated January 30, 2018 (the "Amendment"). The Amendment to the Comerica Credit Agreement reduced the revolving credit commitment from $25.0 million to $20.0 million. As of June 30, 2018, our borrowing availability under the Comerica Credit Agreement was $7.4 million.

In connection with the Amendment, during the six months ended June 30, 2018, less than $0.1 million of unamortized loan fees were written off in proportion to the decrease in our borrowing capacity. As of June 30, 2018, the unamortized loan fees were $0.2 million, which are being amortized on a straight-line basis to interest expense over the five-year term.

At the Company’s option, the Comerica Credit Facility will bear interest at either (i) the LIBOR Rate, as defined in the Comerica Credit Agreement, plus a margin of 2.35%; or (ii) the PRR-based Rate, plus a margin of 0.5%. As further defined in the Comerica Credit Agreement, the "PRR-based Rate" means the greatest of (a) the Prime Rate in effect on such day (as defined in the Comerica Credit Agreement) plus 0.5%, or (b) the daily adjusting LIBOR Rate plus 2.50%. In addition to interest on outstanding borrowings under the Comerica Credit Facility, the revolving credit note bears an unused line fee of 0.25%, which is presented as interest expense. As of June 30, 2018, we had outstanding borrowings under the Comerica Credit Agreement of $12.5 million at a weighted average interest rate of 4.44%.

The Comerica Credit Agreement contains certain representations, warranties, events of default, as well as certain affirmative and negative covenants customary for credit agreements of this type. These covenants include restrictions on borrowings, investments and divestitures, as well as limitations on the Company’s ability to make certain restricted payments. The Comerica Credit Agreement requires us to comply with certain financial covenants, including a Fixed Charge Coverage Ratio and a Funded Debt to Adjusted EBITDA Ratio (each as defined in the Comerica Credit Agreement). The Fixed Charge Coverage Ratio is calculated based on the ratio of (a) Adjusted EBITDA, less (i) cash income taxes paid for such period, less (ii), FCCR Capital Expenditures (as defined in the Comerica Credit Agreement) made during such period, less (iii) payments, repurchases or redemptions of stock made during such period, less (iv) Distributions and Purchases (each as defined in the Comerica Credit Agreement) made during such period, to (b) (i) the Current Maturities of Long Term Debt (each as defined in the Comerica Credit Agreement) as of the last day of such period plus (ii) interest paid during such period. The Fixed Charge Coverage ratio is measured on a quarterly basis as of the most recent fiscal quarter end. Under the Comerica Credit Agreement, we must maintain a fixed charge ratio of at least 1.25 to 1.00 for each trailing twelve-month period as of the end of each fiscal quarter. The funded debt to Adjusted EBITDA ratio (as defined in the Comerica Credit Agreement) must be not more than 2.25 to 1.00 measured at each fiscal quarter.

Upon the occurrence and during the continuation of an event of default under the Comerica Credit Agreement, Comerica may, among other things, declare the loans and all other obligations under the Comerica Credit Agreement immediately due and payable and increase the interest rate at which loans and obligations under the Comerica Credit Agreement bear interest. Pursuant to a separate Security Agreement dated June 21, 2017, between the Company, its subsidiaries and Comerica Bank, the Comerica Credit Facility is secured by a first-priority security interest in substantially all of the assets (excluding real estate) of the Company and its subsidiaries and a pledge of all shares and membership interests of the Company’s subsidiaries.

At June 30, 2018, the Company was in compliance with all covenants.

Note 10. Commitments and Contingencies

In addition to commitments and obligations in the ordinary 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 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. We are not able to predict the timing or outcome of these matters.

Note 11. Income Taxes

We provide for income taxes under the asset and liability method. This approach requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of differences between the tax basis of assets or liabilities and their carrying amounts in the financial statements. We provide a valuation allowance for deferred tax assets if it is more likely than not that these items will expire before we are able to realize their benefit. We calculate the valuation allowance in accordance with the authoritative guidance relating to income taxes, which requires an assessment of both positive and negative evidence regarding the realizability of these deferred tax assets, when measuring the need for a valuation allowance. Significant judgment is required in determining any valuation allowance against deferred tax assets. As of December 31, 2017, as a result of a three-year cumulative loss and recent events, such as the unanticipated termination of the Philips distribution agreement and its effect on our near term forecasted income, we concluded that a full valuation allowance was necessary to offset our deferred tax assets. We intend to maintain a valuation allowance until sufficient positive evidence exists to support its reversal.

Intraperiod tax allocation rules require us to allocate our provision for income taxes between continuing operations and other categories of comprehensive income, such as discontinued operations. In periods in which we have a year-to-date pre-tax loss from continuing operations and pre-tax income in other categories of comprehensive income, such as discontinued operations, we must consider that income in determining the amount of tax benefit that results from a loss in continuing operations and that shall be allocated to continuing operations. For the six months ended June 30, 2018, we recorded income of $5.5 million, net of tax, in discontinued operations related to our MDSS reportable segment and a loss of $1.7 million, net of tax, in continuing operations.

As a result of the intraperiod tax allocation rules, for the six months ended June 30, 2018, the Company recorded an income tax benefit of $0.6 million within continuing operations and $0.7 million of income tax expense within discontinued operations. For the six months ended June 30, 2017, the Company recorded an income tax expense of $0.5 million and $0.3 million within continuing operations and discontinued operations, respectively.

For the six months ended June 30, 2018, the Company expects to utilize $1.1 million of net operating losses associated with projected taxable income in discontinued operations mainly attributable to the gain on the sale of our MDSS post-warranty service contract business. The utilization of net operating losses in 2018 results in a reduction in our deferred tax asset balance, with a corresponding reduction in our valuation allowance, due to our full valuation allowance position discussed above.

As of June 30, 2018, we had unrecognized tax benefits of approximately $3.9 million related to uncertain tax positions. Included in the unrecognized tax benefits were $3.5 million of tax benefits that, if recognized, would reduce our annual effective tax rate, subject to the valuation allowance.

We file income tax returns in the US and in various state jurisdictions with varying statutes of limitations. We are no longer subject to income tax examination by tax authorities for years prior to 2013; however, our net operating loss and research credit carryovers arising prior to that year are subject to adjustment. It is our policy to recognize interest expense and penalties related to uncertain income tax matters as a component of income tax expense.

Note 12. Segments

Our reporting segments have been determined based on the nature of the products and/or services offered to customers or the nature of their function in the organization. We evaluate performance based on the gross profit and operating income (loss) excluding litigation reserve expense, goodwill impairment, and transaction and integration costs. The Company does not identify or allocate its assets by operating segments.

During the first quarter of 2018, we have classified the results of our MDSS segment as discontinued operations in our condensed consolidated statement of operations for all periods presented. Accordingly, segment results have been recast for all periods presented to reflect MDSS as discontinued operations. As costs of shared service functions previously allocated to MDSS are not allocable to discontinued operations, prior period corporate costs have been reallocated amongst the continuing reportable segments. Segment information is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands)	2018	2017	2018	2017
Revenue by segment:				
Diagnostic Services	$13,267	$12,559	$25,292	$24,761
Diagnostic Imaging	2,756	2,943	5,598	5,726
Mobile Healthcare	11,057	11,183	21,655	22,038
Condensed consolidated revenue	$27,080	$26,685	$52,545	$52,525
Gross profit by segment:				
Diagnostic Services	$2,969	$2,730	$5,216	$5,566
Diagnostic Imaging	1,266	1,051	2,511	2,179
Mobile Healthcare	1,332	1,907	2,447	3,545
Condensed consolidated gross profit	$5,567	$5,688	$10,174	$11,290
Income (loss) from continuing operations by segment:				
Diagnostic Services	$804	$139	$514	$155
Diagnostic Imaging	(132)	(471)	(336)	(908)
Mobile Healthcare	(444)	(327)	(1,559)	(1,357)
Segment income (loss) from continuing operations	$228	$(659)	$(1,381)	$(2,110)
Goodwill impairment (1)	(476)	—	(476)	—
Litigation reserve (2)	—	(1,339)	—	(1,339)
Condensed consolidated loss from continuing operations	$(248)	$(1,998)	$(1,857)	$(3,449)

(1) See Note 7 for further information.

(2) Reflects legal settlement reserve for wage and hour litigation.

Note 13. Subsequent Events

On August 2, 2018, the Company announced a cash dividend of $0.055 per share payable on August 30, 2018 to shareholders of record on August 16, 2018.

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

This management’s discussion and analysis of financial condition and results of operations (“MD&A”), contains forward-looking statements that involve risks and uncertainties. Please see “Important Information Regarding Forward-Looking Statements” for a discussion of the uncertainties, risks, and assumptions that may cause our actual results to differ materially from those discussed in the forward-looking statements. This discussion should be read in conjunction with our unaudited condensed consolidated financial statements and related notes thereto and the other disclosures contained elsewhere in this Quarterly Report on Form 10-Q, and the audited consolidated financial statements and related notes thereto for the fiscal year ended December 31, 2017, which were included in our Form 10-K, filed with the SEC on February 28, 2018.

The results of operations for the periods reflected herein are not necessarily indicative of results that may be expected for future periods.

Overview

Digirad delivers convenient, effective, and efficient healthcare solutions on an as needed, when needed, and where needed basis. Digirad's diverse portfolio of mobile healthcare solutions and diagnostic imaging equipment and services, provides hospitals, physician practices, and imaging centers throughout the United States with technology and services necessary to provide exceptional patient care in the rapidly changing healthcare environment.

Strategy

Our main strategic focus is to grow our business into an integrated healthcare services company that addresses the rapidly changing healthcare environment. We believe that there are many opportunities to provide outsourced and mobile healthcare services and solutions in the current healthcare environment. We believe this strategy will be accomplished by:

1. Focused organic growth from our core businesses;
2. Introducing new service offerings through our existing businesses or through acquisition; and
3. Acquiring similar or complementary healthcare service companies.

We continue to explore strategic alternatives to improve the market position and profitability of our product offerings in the marketplace, generate additional liquidity and enhance our valuation. We may pursue our goals during the next twelve months through organic growth and through strategic alternatives. Some of these alternatives have included, and could continue to include, selective acquisitions of business segments or entire businesses, divestitures of assets or divisions, or a restructuring of our company. We have also provided, and may from time to time in the future provide, information to interested parties relating to the foregoing.

Business Segments

As of June 30, 2018, we operate the Company in three reportable segments:

1. Diagnostic Services
2. Mobile Healthcare
3. Diagnostic Imaging

Diagnostic Services. Through Diagnostic Services, we offer a convenient and economically efficient imaging and monitoring services program as an alternative to purchasing 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, we provide imaging systems, qualified personnel, radiopharmaceuticals, licensing services, and the logistics required to perform imaging in their own offices, and thereby the ability to bill Medicare, Medicaid, or third-party healthcare insurers directly for those services, which are primarily cardiac in nature. We provide imaging services primarily to cardiologists, internal medicine physicians, and family practice doctors who typically enter annual contracts for a set number of days ranging from once per month to five times per week.

Diagnostic Services also offers remote cardiac event monitoring services through our Telerhythmics business. These services include provision of a monitor, remote monitoring by registered nurses, and 24 hours a day, 7 days a week monitoring support for our patients and physician customers. We offer modalities of mobile cardiac telemetry ("MCT"), mobile cardiac event monitoring, holter monitoring, and pacemaker analysis. These services offer flexibility and convenience to our customers who do not have to incur the costs of staffing, equipment, and logistics to monitor patients as part of their standard of care. Our cardiac event monitoring services are provided primarily through an independent diagnostic testing facility model that allows us to bill Medicare, Medicaid, or third-party healthcare insurers directly for our services, and is the only business at Digirad that bills Medicare, Medicaid, and private insurance directly.

Mobile Healthcare. Through Mobile Healthcare, we provide contract diagnostic imaging, including computerized tomography ("CT"), magnetic resonance imaging ("MRI"), positron emission tomography ("PET"), PET/CT, and nuclear medicine and healthcare expertise to hospitals, integrated delivery networks ("IDNs"), and federal institutions on a long-term contract basis, as well as interim (short-term) services to institutions that are in transition. These services are provided primarily when there is a cost, access, and efficiency component of providing the services directly rather than owning and operating the related services and equipment directly by our customers.
Diagnostic Imaging. Through Diagnostic Imaging, we sell our internally developed solid-state gamma cameras and camera maintenance contracts. Our cameras include nuclear cardiac imaging systems, as well as general purpose nuclear imaging systems. We sell our imaging systems to physician offices and hospitals primarily in the United States, although we have sold a small number of imaging systems internationally.

Discontinued Operations

Medical Device Sales and Service. Prior to January 1, 2018, through Medical Device Sales and Service ("MDSS"), we provided: (a) contract sales services and (b) warranty and post-warranty services, under our contract with Philips Healthcare ("Philips"), within a defined region in the upper Midwest region of the United States. Under the contract sales services, we primarily sold Philips branded imaging and patient monitoring systems, including CT, MRI, PET, PET/CT systems, ultrasound and patient and monitoring systems, and received a commission on these sales. For our equipment contract sales services, we did not take title to the underlying equipment; it is delivered directly to the end user by Philips. Under our warranty and post-warranty services, we provided warranty and post-warranty services on certain Philips equipment within this territory related to equipment we sold or other equipment sold in the territory.
On September 28, 2017, we received a notice of termination (the "Termination Notice") from Philips that the Consolidated Agreement, dated April 1, 2014, as amended on June 9, 2015, between Philips and DMS Health Technologies ("DMS"), and the Remote Inside Sales Services Agreement dated March 23, 2016 (collectively, the "Philips Agreements"), were terminated upon the close of business on December 31, 2017 (“Termination Date”). The impact of the Termination Notice was to (a) end our contract sales services relationship with Philips as of December 31, 2017, effectively ending revenue associated with these services, and (b) end our relationship and support under our warranty and post-warranty services in the upper Midwest territory with Philips. However, the Philips Termination did not impact our ability to continue to service our existing contracts and allowed us opportunities to enter into new service contracts with customers outside the territory we were previously constrained to.
Based on the Philips Termination, we carefully considered the opportunity to run the post-warranty service business outside the relationship with Philips, but determined that ultimately due to pricing challenges and logistics, the best economic decision was to sell the business to Philips. Therefore, on December 22, 2017, we entered into an Asset Purchase Agreement (the “Philips Purchase Agreement”) with Philips to sell all of our MDSS customer contracts relating to the post-warranty service business for $8.0 million (the “Philips Transaction”). The Philips Transaction is subject to certain post-closing adjustments. In connection with entering into the Philips Purchase Agreement, we entered into an agreement with Philips pursuant to which we continued to provide installation and warranty services pursuant to an existing Service Agreement until January 31, 2018. On February 1, 2018, the Philips Transaction was closed. Following the closing, the Company's MDSS reportable segment ceased to exist. As a result, the MDSS reportable segment is reported as discontinued operations in these unaudited condensed consolidated financial statements and related notes thereto.

Critical Accounting Policies and Estimates

In preparing our financial statements, we make estimates, assumptions and judgments that can have a significant impact on our revenue and net income or loss, as well as on the value of certain assets and liabilities on our balance sheet. We believe that the estimates, assumptions, and judgments involved in the accounting policies described in Management’s Discussion and Analysis of Financial Condition and Results of Operations in Item 7 of our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 have the greatest potential impact on our financial statements, so we consider them to be our critical accounting policies and estimates. Except as discussed below, we believe there were no other significant changes in those critical accounting policies and estimates during the six months ended June 30, 2018.

Revenue Recognition

Revenue is recognized upon transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. Taxes collected from customers, which are subsequently remitted to governmental authorities, are excluded from revenue.

The majority of our contracts have a single performance obligation as we provide a series of distinct services that are substantially the same and are transferred with the same pattern to the customer. For contracts with multiple performance obligations, we allocate the total transaction price to each performance obligation using our best estimate of the standalone selling price of each distinct good or service in the contract. We use an observable price to determine the stand-alone selling price for separate performance obligations or a cost plus margin approach when one is not available.

Our products are generally not sold with a right of return and the Company does not provide significant credits or incentives, which may be required to be accounted for as variable consideration when estimating the amount of revenue to be recognized.

Refer to Note 3 to the unaudited condensed consolidated financial statements for further updates to the Company's revenue recognition policy under the new revenue standard.

Results of Operations

Comparison of the Three Months Ended June 30, 2018 and 2017

The following table summarizes our results for the three months ended June 30, 2018 and 2017:

	Three Months Ended June 30,					
		Percent		Percent	Change from	
	2018	of 2018	2017	of 2017	Prior Year	
(in thousands)		Revenues		Revenues	Dollars	Percent
Total revenues	$27,080	100.0 %	$26,685	100.0 %	$395	1.5 %
Total cost of revenues	21,513	79.4 %	20,997	78.7 %	516	2.5 %
Gross profit	5,567	20.6 %	5,688	21.3 %	(121)	(2.1)%
Total operating expenses	5,815	21.5 %	7,686	28.8 %	(1,871)	(24.3)%
Loss from operations	(248)	(0.9)%	(1,998)	(7.5)%	1,750	(87.6)%
Total other expense	(208)	(0.8)%	(936)	(3.5)%	728	(77.8)%
Loss before income taxes	(456)	(1.7)%	(2,934)	(11.0)%	2,478	(84.5)%
Income tax benefit	106	0.4 %	88	0.3 %	18	20.5 %
Net loss from continuing operations	(350)	(1.3)%	(2,846)	(10.7)%	2,496	(87.7)%
Income from discontinued operations, net of tax	—	— %	74	0.3 %	(74)	(100.0)%
Net (loss) income	$(350)	(1.3)%	$(2,772)	(10.4)%	$2,422	(87.4)%

In the context of results of operations discussions, the reportable segments Diagnostic Services and Mobile Healthcare are considered “Services,” and Diagnostic Imaging is considered “Product and Product-Related.” The Company's former MDSS reportable segment is reported as discontinued operations in our condensed consolidated financial statements and discussion within results operations for all periods presented.

Revenues

Services Revenue

Services revenue by segment is summarized as follows:

	Three Months Ended June 30,			
(in thousands)	2018	2017	Change	% Change
Diagnostic Services	$13,267	$12,559	$ 708	5.6 %
Mobile Healthcare	11,057	11,183	(126)	(1.1)%
Total Services Revenue	$24,324	$23,742	$ 582	2.5 %

Diagnostic Services revenue increased $0.7 million, or 5.6%, compared to the prior year quarter, primarily due to a higher volume of imaging days ran and an increase in the average mobile imaging rate per day, partially offset by a $0.1 million decrease in revenue from our Telerhythmics business due to lower enrollments.

Mobile Healthcare revenue decreased $0.1 million, or 1.1%, compared to the prior year quarter, primarily due to lower mobile imaging revenue of $0.3 million resulting from higher cancellations and lower supplies and accessories revenue of $0.1 million, partially offset by an increase in interim rentals of $0.3 million. The utilization of our interim rentals can vary in each period based on customers that are in the midst of new construction or refurbishing their current facilities.

Product and Product-Related Revenue

Product and product-related revenue by segment is summarized as follows:

	Three Months Ended June 30,			
(in thousands)	2018	2017	Change	% Change
Diagnostic Imaging	$2,756	$2,943	$(187)	(6.4)%

Diagnostic Imaging revenue decreased $0.2 million, or 6.4%, compared to the prior year quarter, primarily due to a decrease in the number of cameras sold, partially offset by a more favorable product mix and an increase in camera support time and material activities, which are variable in nature and based on customer needs.

Gross Profit

Services Gross Profit

Services gross profit and gross margin is summarized as follows:

	Three Months Ended June 30,		
(in thousands)	2018	2017	% Change
Services gross profit	$4,301	$4,637	(7.2)%
Services gross margin	17.7 %	19.5 %	

Diagnostic Services gross profit increased $0.2 million, or 8.8%, to $3.0 million in the current year quarter compared to $2.7 million in the prior year quarter, and the gross margin percentage was 22.4% in the current year quarter compared to 21.7% in the prior year quarter. The increase in gross margin percentage was mainly due to higher sales volume.

Mobile Healthcare gross profit decreased $0.6 million, or 30.2%, to $1.3 million in the current year quarter compared to $1.9 million in the prior year quarter, and gross margin percentage was 12.0% in the current year quarter compared to 17.1% in the prior year quarter. The decrease in gross margin percentage was primarily due to lower sales volume and higher equipment repair costs of $0.4 million and higher employee related costs of $0.1 million, partially offset by higher margins on interim rentals compared to the prior year period.

Product and Product-Related Gross Profit

Product and product-related gross profit and margin is summarized as follows:

	Three Months Ended June 30,		
(in thousands)	2018	2017	% Change
Product and product-related gross profit	$1,266	$1,051	20.5 %
Product and product-related gross margin	45.9 %	35.7 %	

Diagnostic Imaging gross profit increased $0.2 million, or 20.5%, to $1.3 million in the current year quarter compared to $1.1 million in the prior year quarter, and the gross margin percentage was 45.9% in the current year quarter compared to 35.7% in the prior year quarter. The increase in gross margin percentage was primarily due to a more favorable product mix, lower service part costs and lower product royalty fees.

Operating Expenses

Operating expenses are summarized as follows:

	Three Months Ended June 30,				Percent of Revenues	
(in thousands)	2018	2017	Change Dollars	Percent	2018	2017
Marketing and sales	$1,461	$1,596	$(135)	(8.5)%	5.4 %	6.0 %
General and administrative	3,522	5,717	(2,195)	(38.4)%	13.0%	21.4%
Amortization of intangible assets	356	373	(17)	(4.6)%	1.3 %	1.4 %
Goodwill impairment	476	—	476	100.0 %	1.8 %	— %
Total operating expenses	$5,815	$7,686	$(1,871)	(24.3)%	21.5%	28.8%

Marketing and sales expenses decreased $0.1 million, or 8.5%, compared to the prior year quarter, primarily attributable to lower headcount and variable compensation.

General and administrative expenses decreased $2.2 million, or 38.4%, compared to the prior year quarter, primarily attributable to lower litigation-related costs of $1.5 million primarily from the settlement of a wage and hour lawsuit in the prior year, lower employee related costs of $0.4 million, and higher gains on equipment sales of $0.2 million.

Goodwill non-cash impairment charges of $0.5 million were recognized during the three months ended June 30, 2018 related to our Telerhythmics business. See Note 7 to the unaudited condensed consolidated financial statements for further information.

Total Other Expense

Total other expense is summarized as follows:

	Three Months Ended June 30,	
(in thousands)	2018	2017
Other expense, net	$(19)	$—
Interest expense, net	(189)	(227)
Loss on extinguishment of debt	—	(709)
Total other expense	$(208)	$(936)

Interest expense, net, for the three months ended June 30, 2018 and 2017 is predominantly comprised of cash interest costs and related amortization of deferred issuance costs on our debt. A portion of interest costs has been allocated to discontinued operations for the three months ended June 30, 2017 since the proceeds received in the sale were required to be used to reduce our borrowings under our revolving credit facility with Comerica Bank, a Texas banking association ("Comerica").

Loss on extinguishment of debt for the three months ended June 30, 2017 is primarily related to the write-off of unamortized deferred financing costs related to the termination of the Wells Fargo Credit Agreement on June 21, 2017.

Income Tax Benefit

Income tax benefit was $0.1 million for the three months ended June 30, 2018 and 2017. The income tax benefit primarily related to the utilization of tax losses from continuing operations against discontinued operations gains in accordance with the intraperiod allocation rules. See Note 11 to the unaudited condensed consolidated financial statements for further information related to the Company's income taxes.

Income from Discontinued Operations

As described in Note 2 of the unaudited condensed consolidated financial statements, the results of our MDSS reportable segment have been reported as discontinued operations for all periods presented. See Note 2 for additional information regarding discontinued operations.

Comparison of the Six Months Ended June 30, 2018 and 2017

The following table summarizes our results for the six months ended June 30, 2018 and 2017:

	Six Months Ended June 30,					
(in thousands)	2018	Percent of 2018 Revenues	2017	Percent of 2017 Revenues	Change from Prior Year Dollars	Percent
Total revenues	$52,545	100.0 %	$52,525	100.0 %	$20	— %
Total cost of revenues	42,371	80.6 %	41,235	78.5 %	1,136	2.8 %
Gross profit	10,174	19.4 %	11,290	21.5 %	(1,116)	(9.9)%
Total operating expenses	12,031	22.9 %	14,739	28.1 %	(2,708)	(18.4)%
Loss from operations	(1,857)	(3.5)%	(3,449)	(6.6)%	1,592	(46.2)%
Total other expense	(442)	(0.8)%	(1,129)	(2.1)%	687	(60.9)%
Loss before income taxes	(2,299)	(4.4)%	(4,578)	(8.7)%	2,279	(49.8)%
Income tax benefit (expense)	561	1.1 %	(519)	(1.0)%	1,080	(208.1)%
Net loss from continuing operations	(1,738)	(3.3)%	(5,097)	(9.7)%	3,359	(65.9)%
Income from discontinued operations, net of tax	5,494	10.5 %	249	0.5 %	5,245	2,106.4 %
Net income (loss)	$3,756	7.1 %	$(4,848)	(9.2)%	$8,604	(177.5)%

Revenues

Services Revenue

Services revenue by segment is summarized as follows:

	Six Months Ended June 30,			
(in thousands)	2018	2017	Change	% Change
Diagnostic Services	$25,292	$24,761	$ 531	2.1 %
Mobile Healthcare	21,655	22,038	(383)	(1.7)%
Total Services Revenue	$46,947	$46,799	$ 148	0.3 %

Diagnostic Services revenue increased $0.5 million, or 2.1%, compared to the prior year period, primarily due to a higher volume of imaging days ran and an increase in the average mobile imaging rate per day, partially offset by a $0.3 million decrease in revenue from our Telerhythmics business due to lower enrollments.

Mobile Healthcare revenue decreased $0.4 million, or 1.7%, compared to the prior year period, primarily due to lower mobile imaging revenue of $1.0 million resulting from higher cancellations which were in part impacted by severe weather conditions during the first quarter of 2018, lower supplies and accessories revenue of $0.2 million, partially offset by an increase in interim rentals of $0.8 million. The utilization of our interim rentals can vary in each period based on customers that are in the midst of new construction or refurbishing their current facilities.

Product and Product-Related Revenue

Product and product-related revenue by segment is summarized as follows:

	Six Months Ended June 30,			
(in thousands)	2018	2017	Change	% Change
Diagnostic Imaging	$5,598	$5,726	$(128)	(2.2)%

Diagnostic Imaging revenue decreased $0.1 million, or 2.2%, compared to the prior year period, due a decrease in camera revenue of $0.3 million primarily from a lower volume of cameras sold, partially offset by an increase in camera support time and material activities, which are variable in nature and based on customer needs.

Gross Profit

Services Gross Profit

Services gross profit and gross margin is summarized as follows:

	Six Months Ended June 30,		
(in thousands)	2018	2017	% Change
Services gross profit	$7,663	$9,111	(15.9)%
Services gross margin	16.3 %	19.5 %	

Diagnostic Services gross profit decreased $0.4 million, or 6.3%, to $5.2 million in the current year period compared to $5.6 million in the prior year period, and the gross margin percentage was 20.6% in the current year period compared to 22.5% in the prior year period. The decrease in gross margin percentage was mainly due to higher employee related costs compared to the prior year period.

Mobile Healthcare gross profit decreased $1.1 million, or 31.0%, to $2.4 million in the current year period compared to $3.5 million in the prior year period, and gross margin percentage was 11.3% in the current year period compared to 16.1% in the prior year period. The decrease in gross margin percentage was primarily due to an unfavorable mix of services provided, as well as increase of $0.6 million in repair and maintenance costs and $0.4 million in employee related costs.

Product and Product-Related Gross Profit

Product and product-related gross profit and margin is summarized as follows:

	Six Months Ended June 30,		
(in thousands)	2018	2017	% Change
Product and product-related gross profit	$2,511	$2,179	15.2 %
Product and product-related gross margin	44.9 %	38.1 %	

Diagnostic Imaging gross profit increased $0.3 million, or 15.2%, to $2.5 million in the current year period compared to $2.2 million in the prior year period, and the gross margin percentage was 44.9% in the current year period compared to 38.1% in the prior year period. The increase in gross margin percentage was primarily due to a more favorable product mix, lower service part costs and lower product royalty fees.

Operating Expenses

Operating expenses are summarized as follows:

	Six Months Ended June 30,				Percent of Revenues	
(in thousands)	2018	2017	Change Dollars	Percent	2018	2017
Marketing and sales	$2,928	$3,379	$(451)	(13.3)%	5.6 %	6.4 %
General and administrative	7,914	10,613	(2,699)	(25.4)%	15.1%	20.2%
Amortization of intangible assets	713	747	(34)	(4.6)%	1.4 %	1.4 %
Goodwill impairment	476	—	476	100.0 %	0.9 %	— %
Total operating expenses	$12,031	$14,739	$(2,708)	(18.4)%	22.9%	28.1%

Marketing and sales expenses decreased $0.5 million, or 13.3%, compared to the prior year period, primarily attributable to lower headcount and variable compensation.

General and administrative expenses decreased $2.7 million, or 25.4%, compared to the prior year quarter, primarily attributable to lower litigation-related costs of $1.6 million primarily from the settlement of a wage and hour lawsuit in the prior year, lower employee related costs of $0.6 million, and higher gains on equipment and vehicle sales of $0.3 million.

Goodwill non-cash impairment charges of $0.5 million were recognized during the three months ended June 30, 2018 related to our Telerhythmics business. See Note 7 to the unaudited condensed consolidated financial statements for further information.

Total Other Expense

Total other expense is summarized as follows:

(in thousands)	Six Months Ended June 30, 2018	2017
Other expense, net	$(36)	$—
Interest expense, net	(363)	(420)
Loss on extinguishment of debt	(43)	(709)
Total other expense	$(442)	$(1,129)

Interest expense, net, for the six months ended June 30, 2018 and 2017 is predominantly comprised of cash interest costs and related amortization of deferred issuance costs on our debt. A portion of interest costs has been allocated to discontinued operations in both periods since the proceeds received in the sale were required to be used to reduce our borrowings under our revolving credit facility with Comerica Bank, a Texas banking association ("Comerica").

Loss on extinguishment of debt for the six months ended June 30, 2017 is primarily related to the write-off of unamortized deferred financing costs related to the termination of the Wells Fargo Credit Agreement on June 21, 2017.

Income Tax Benefit (Expense)

During the six months ended June 30, 2018, an income tax benefit of $0.6 million was recorded in continuing operations in accordance with the intraperiod allocation rules as a result of income generated from the gain on the sale of one of our business segments recorded in discontinued operations. During the six months ended June 30, 2017, income tax expense of $0.5 million was recorded in continuing operations, primarily due to an increase in our valuation allowance associated with changes in our income projections, which limited our ability to utilize net operating losses during the year. In the fourth quarter of 2017, a full valuation allowance was established against our deferred tax assets due to a recent history of losses and uncertainties regarding our ability to utilize our net operating losses before expiration. See Note 11 to the unaudited condensed consolidated financial statements for further information related to the Company's income taxes.

Income from Discontinued Operations

As described in Note 2 of the unaudited condensed consolidated financial statements, the results of our MDSS reportable segment have been reported as discontinued operations for all periods presented. During the six months ended June 30, 2018, discontinued operations includes a $6.3 million gain on the sale of our MDSS post-warranty service contracts to Philips which closed on February 1, 2018. See Note 2 for additional information regarding discontinued operations.

Liquidity and Capital Resources

We generated $3.0 million of positive cash flow from operations during the six months ended June 30, 2018. Cash flows from operations primarily represent inflows from net income (adjusted for depreciation, amortization, and other non-cash items), as well as the net effect of changes in working capital. Cash flows from investing activities primarily represent our investment in capital equipment required to maintain and grow our business, as well as acquisitions and dispositions. Cash flows from financing activities primarily represent net proceeds from borrowings and receipt of cash related to the exercise of stock options, offset by outflows related to dividend payments and repayments of long-term borrowings.

Our principal sources of liquidity are our existing cash and cash equivalents, cash generated from operations, and availability on our revolving line of credit from our Comerica Credit Agreement. As of June 30, 2018, we had $1.4 million of cash and cash equivalents, as well as $7.4 million available under our revolving line of credit.

We require capital principally for capital expenditures, acquisition activity, dividend payments, and to finance accounts receivable and inventory. Our working capital requirements vary from period to period depending on inventory requirements, the timing of deliveries, and the payment cycles of our customers. Our capital expenditures consist primarily of medical imaging and diagnostic devices utilized in the provision of our services, as well as vehicles and information technology hardware and software. 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 at least the next 12 months.

Sources and Uses of Cash

The following table shows cash flow information for the six months ended June 30, 2018 and 2017:

	Six Months Ended June 30,	
(in thousands)	2018	2017
Net cash provided by operating activities	$3,041	$3,494
Net cash provided by investing activities	$6,236	$285
Net cash used in financing activities	$(9,743)	$(7,218)

Operating Activities

Net cash provided by operating activities was $3.0 million for the six months ended June 30, 2018 compared to $3.5 million in the prior year period. The decrease of $0.5 million was primarily due to unfavorable changes in working capital of $1.2 million compared to the prior year period; partially offset by higher net income adjusted for non-cash adjusted items of $0.8 million.

Investing Activities

Net cash provided by investing activities was $6.2 million for the six months ended June 30, 2018 compared to $0.3 million in the prior year period. The increase of $6.0 million in cash provided by investing activities compared to the prior year period was primarily attributable to $6.8 million of proceeds received from the sale of our MDSS service contract business to Philips during the first quarter of 2018, partially offset by a decrease of $0.9 million in cash provided by maturities of available-for-sale securities.

Financing Activities

Net cash used in financing activities was $9.7 million for the six months ended June 30, 2018 compared to $7.2 million in the prior year period. The increase of $2.5 million was primarily due to an increase in net principal repayments of $2.5 million as the proceeds from the sale of our MDSS service contract business were used to pay down outstanding borrowings on our revolving credit facility.

Comerica Revolving Credit Facility

On June 21, 2017, the Company entered into a Revolving Credit Agreement (the “Comerica Credit Agreement”) with Comerica. The Comerica Credit Agreement provides for a five-year revolving credit facility with a maximum credit amount of $25.0 million maturing in June 2022, upon which a balloon payment on the balance is due.

In connection with the sale of our post-warranty service customer contracts to Philips, the Company entered into an Amendment No. 1 to the Comerica Credit Agreement, dated January 30, 2018 (the "Amendment"). The Amendment to the Comerica Credit Agreement reduced the revolving credit commitment from $25.0 million to $20.0 million and modified the definitions of "Adjusted EBITDA," "FCCR Capital Expenditures" and "Revolving Credit Commitment" as used under the Comerica Credit Agreement. The net cash proceeds received during the quarter of $6.8 million were used to pay down existing borrowings under the Comerica Credit Facility. As of June 30, 2018, outstanding borrowings under the Comerica Credit Agreement of $12.5 million with additional borrowing availability of $7.4 million.

At the Company’s option, the Comerica Credit Facility will bear interest at either (i) the LIBOR Rate, as defined in the Comerica Credit Agreement, plus a margin of 2.35%; or (ii) the PRR-based Rate, plus a margin of 0.5%. As further defined in the Comerica Credit Agreement, the "PRR-based Rate" means the greatest of (a) the Prime Rate in effect on such day (as defined in the Comerica Credit Agreement) plus 0.5%, or (b) the daily adjusting LIBOR Rate plus 2.50%. In addition to interest on outstanding borrowings under the Comerica Credit Facility, the revolving credit note bears an unused line fee of 0.25%, which is presented as interest expense. As of June 30, 2018, the weighted average interest rate on outstanding borrowings was 4.44%.

Restrictive Covenants

The Comerica Credit Agreement contains certain representations, warranties, events of default, as well as certain affirmative and negative covenants customary for credit agreements of this type. These covenants include restrictions on borrowings, investments and divestitures, as well as limitations on the Company's ability to make certain restricted payments. These restrictions do not prevent or prohibit the payment of dividends by the Company consistent with past practice. The Comerica Credit Agreement requires us to comply with certain financial covenants, including a Fixed Charge Coverage Ratio and a Funded Debt to Adjusted EBITDA Ratio (each as defined in the Comerica Credit Agreement). The Fixed Charge Coverage Ratio is calculated based on the ratio of (a) Adjusted EBITDA, less (i) cash income taxes paid for such period, less (ii), FCCR Capital Expenditures (as defined in the Comerica Credit Agreement) made during such period, less (iii) payments, repurchases or redemptions of stock made during such period, less (iv) Distributions and Purchases (each as defined in the Comerica Credit Agreement) made during such period, to (b) (i) the Current Maturities of Long Term Debt (each as defined in the Comerica Credit Agreement) as of the last day of such period plus (ii) interest paid during such period. The Fixed Charge Coverage ratio is measured on a quarterly basis as of the most recent fiscal quarter end. Under the Comerica Credit Agreement we must maintain a fixed charge ratio of at least 1.25 to 1.00 for each trailing twelve-month period as of the end of each fiscal quarter. The funded debt to Adjusted EBITDA ratio (as defined in the Comerica Credit Agreement) must be not more than 2.25 to 1.00 measured at each fiscal quarter.

The Company's ability to comply to these and other provisions under the Comerica Credit Agreement is dependent on its future performance, which is subject to many factors, some of which are beyond our control. Although the Company is currently in compliance with its debt covenants, its declining performance has resulted in fixed charge ratios closer to the minimum ratios required under the credit agreement. As a result, the Company may be required to reduce or eliminate its quarterly cash dividend to maintain future compliance with our financial covenants, in which failure to comply may result in an event of default thereunder.

Upon the occurrence and during the continuation of an event of default under the Comerica Credit Agreement, Comerica may, among other things, declare the loans and all other obligations under the Comerica Credit Agreement immediately due and payable and increase the interest rate at which loans and obligations under the Comerica Credit Agreement bear interest. Pursuant to a separate Security Agreement dated June 21, 2017, between the Company, its subsidiaries and Comerica Bank, the Comerica Credit Facility is secured by a first-priority security interest in substantially all of the assets (excluding real estate) of the Company and its subsidiaries and a pledge of all shares and membership interests of the Company's subsidiaries.

At June 30, 2018, the Company was in compliance with all covenants.

Off-Balance Sheet Arrangements

As of June 30, 2018, we did not have any off-balance sheet arrangements.

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 with the SEC on February 28, 2018.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There were no material changes in market risk exposures that affect the quantitative and qualitative disclosures presented in our Form 10-K for the year ended December 31, 2017.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Securities and Exchange Commission Act of 1934 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 for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, we recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by Securities and Exchange Commission Rule 13a-15(e) and 15d-15(e), we carried out an evaluation, under the supervision 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 that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of June 30, 2018.

Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives as specified above. Management does not expect, however, that our disclosure controls and procedures will prevent or detect all errors and fraud. Any control system, no matter how well designed and operated, is based upon certain assumptions and can provide only reasonable, not absolute, assurance that its objectives will be met. Further, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected.

Changes in Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rules 13a-15 or 15d-15 under the Securities Exchange Act of 1934 that occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

See Note 10 to the unaudited condensed consolidated financial statements for a summary of legal proceedings.

ITEM 1A. RISK FACTORS

In evaluating us and our common stock, we urge you to carefully consider the risks and other information in this Quarterly Report on Form 10-Q, as well as the risk factors disclosed in Item 1A to Part I of our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, which we filed with the SEC on February 28, 2018. The risks and uncertainties described in “Item 1A - Risk Factors” of our Annual Report on Form 10-K have not materially changed, with the exception of the item noted below. Any of the risks discussed in this Quarterly Report on Form 10-Q or any of the risks disclosed in Item 1A to Part I of our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, as well as additional risks and uncertainties not currently known to us or that we currently deem immaterial, could materially and adversely affect our results of operations or financial condition.

The Comerica Credit Agreement governing our indebtedness contains restrictive covenants that will restrict our operational flexibility and require that we maintain specified financial ratios. If we cannot comply with these covenants, we may be in default under the Comerica Credit Agreement.

The Comerica Credit Agreement governing our indebtedness contains restrictions and limitations on our ability to engage in activities that may be in our long-term best interests. The Comerica Credit Agreement contains affirmative and negative covenants that limit and restrict, among other things, our ability to:

- incur additional debt;
- sell assets;
- incur liens or other encumbrances;
- make certain restricted payments and investments;
- acquire other businesses; and
- merge or consolidate.

Though the Comerica Credit Agreement does not limit our ability to pay dividends, if there was insufficient cash generation of our business to satisfy our required financial covenants, or if there is a default or event of default under the Comerica Credit Agreement that has occurred and is continuing, the Company may be required to reduce or eliminate its quarterly cash dividend until compliance with the financial covenants can be met.

The Comerica Credit Agreement contains a fixed charge coverage ratio covenant and a leverage ratio covenant. We may not have the ability to meet these and other covenants under the Comerica Credit Agreement depending on a number of factors including, without limitation, the performance of our business, capital allocation decisions made by the Company, or events beyond our control. Our failure to comply with our covenants and other obligations under the Credit Agreement may result in an event of default thereunder. A default, if not cured or waived, may permit acceleration of our indebtedness. If our indebtedness is accelerated, we cannot be certain that we will have sufficient funds available to pay the accelerated indebtedness (together with accrued interest and fees), or that we will have the ability to refinance the accelerated indebtedness on terms favorable to us or at all. This could have serious consequences to our financial condition, operating results, and business, and could cause us to become insolvent or enter bankruptcy proceedings, and shareholders may lose all or a portion of their investment because of the priority of the claims of our creditors on our assets.

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

None.

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	Certificate of Amendment of the Restated Certificate of Incorporation of Digirad Corporation (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed with the Commission on May 1, 2018).
10.1	2018 Incentive Plan (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on May 1, 2018).
31.1*	Certification of the Principal Executive and 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 the Principal Executive and Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase
101.LAB*	XBRL Taxonomy Extension Labels Linkbase
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase
101.DEF*	XBRL Taxonomy Extension Definition Linkbase

* 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.

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:	August 3, 2018	By:	/s/ MATTHEW G. MOLCHAN
			Matthew G. Molchan
			President, Chief Executive Officer, and Interim Chief Financial Officer
			(Principal Executive Officer and Principal Financial Officer)