

SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q/A

Quarterly report pursuant to sections 13 or 15(d) [amend]

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FILER

DIGIRAD CORP

CIK: **707388** | IRS No.: **330145723** | State of Incorpor.: **DE** | Fiscal Year End: **1231**
Type: **10-Q/A** | Act: **34** | File No.: **000-50789** | Film No.: **04968394**
SIC: **3845** Electromedical & electrotherapeutic apparatus

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549**

FORM 10-Q/A

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2004**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM _____ TO _____**

Commission file number: 000-50789

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

Delaware
(State or other jurisdiction of incorporation or organization)

33-0145723
(IRS Employer Identification No)

13950 Stowe Drive
Poway, California 92064
(Address of principal executive offices)

(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 No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of July 31, 2004, the registrant had 18,011,316 shares of Common Stock (\$0.0001 par value) outstanding.

Explanatory Note

This Amendment No. 1 is being filed to include Exhibits 3.1 and 3.2 which were unintentionally omitted by the financial printer from the original filing. No other changes were made to this filing.

DIGIRAD CORPORATION
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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Digirad Corporation
Consolidated Balance Sheets

	June 30, 2004	December 31, 2003
Assets	(Unaudited)	
Current assets:		
Cash and cash equivalents	\$60,394,364	\$ 7,681,407
Accounts receivable, net	10,589,908	12,195,031
Inventories, net	4,405,163	3,709,321
Other current assets	982,101	854,170
Total current assets	76,371,536	24,439,929
Property and equipment, net	11,141,698	10,087,030
Intangibles, net	514,674	511,832
Restricted cash	120,000	120,000
Total assets	<u>\$88,147,908</u>	<u>\$ 35,158,791</u>
Liabilities and stockholders' equity (deficit)		
Current liabilities:		
Accounts payable	\$4,525,581	\$ 3,036,209
Accrued compensation	2,119,839	1,893,336
Accrued warranty	1,268,535	1,051,242
Other accrued liabilities	4,190,275	2,647,741
Deferred revenue	2,036,744	1,514,488
Current portion of notes payable to stockholders	81,667	245,000
Current portion of debt	2,296,899	11,473,619
Total current liabilities	16,519,540	21,861,635
Deferred rent	273,175	-
Notes payable to stockholders, net of current portion	142,917	490,000
Long-term debt, net of current portion	3,246,570	4,232,071
Commitments and contingencies		
Redeemable convertible preferred stock, \$0.0001 par value: no shares and 46,023,000 shares authorized at June 30, 2004 and December 31, 2003, respectively; no shares and 43,555,313 shares issued and outstanding at June 30, 2004 (unaudited) and December 31, 2003, respectively	-	84,277,992
Stockholders' equity (deficit):		
Preferred stock, \$0.0001 par value: 10,000,000 and no shares authorized at June 30, 2004 and December 31, 2003, respectively; no shares issued and outstanding at June 30, 2004 and December 31, 2003, respectively	-	-
Common stock, \$0.0001 par value: 150,000,000 and		

53,000,000 shares authorized at June 30, 2004 and
December 31, 2003, respectively; 18,008,390 and 23,540
shares issued and outstanding at June 30, 2004 (unaudited)

and December 31, 2003, respectively	1,801	2
Additional paid-in capital	149,972,268	5,031,891
Deferred compensation	(1,503,696)	(554,375)
Accumulated deficit	<u>(80,504,667)</u>	<u>(80,180,425)</u>
Total stockholders' equity (deficit)	<u>67,965,706</u>	<u>(75,702,907)</u>
Total liabilities and stockholders' equity (deficit)	\$88,147,908	\$ 35,158,791
	<hr/>	<hr/>

See accompanying notes.

Digirad Corporation
Consolidated Statements of Operations
(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2004	2003	2004	2003
Revenues:				
DIS	\$ 11,294,909	\$ 8,763,586	\$ 21,701,887	\$ 16,266,512
Product	5,995,129	5,248,687	11,456,015	10,724,978
Total revenues	17,290,038	14,012,273	33,157,902	26,991,490
Cost of revenues:				
DIS	7,509,457	6,087,476	14,774,023	11,729,380
Product	3,983,966	4,131,203	7,623,306	7,972,146
Stock-based compensation	130,510	29,812	246,006	31,129
Total cost of revenues	11,623,933	10,248,491	22,643,335	19,732,655
Gross profit	5,666,105	3,763,782	10,514,567	7,258,835
Operating expenses:				
Research and development	684,916	595,728	1,325,067	1,175,002
Sales and marketing	1,859,427	1,435,895	3,639,832	2,982,426
General and administrative	2,497,690	1,983,060	4,643,160	3,834,387
Amortization and impairment of intangible assets	16,076	94,409	32,152	213,658
Stock-based compensation	249,980	29,651	437,272	30,359
Total operating expenses	5,308,089	4,138,743	10,077,483	8,235,832
Income (loss) from operations	358,016	(374,961)	437,084	(976,997)
Other income (expense):				
Interest income	33,886	9,091	41,793	20,034
Interest expense	(289,458)	(429,430)	(612,042)	(765,161)
Other	200	-	(29,742)	-
Total other income (expense)	(255,372)	(420,339)	(599,991)	(745,127)
Net income (loss)	102,644	(795,300)	(162,907)	(1,722,124)
Accretion of deferred issuance costs on preferred stock	(72,797)	(84,106)	(161,335)	(169,456)
Net income (loss) applicable to common stockholders	\$ 29,847	\$ (879,406)	\$ (324,242)	\$ (1,891,580)
Net income (loss) per common share:				
Basic (1)	\$ 0.01	\$ (63.08)	\$ (0.16)	\$ (137.67)
Diluted (1)	\$ 0.01	\$ (63.08)	\$ (0.16)	\$ (137.67)
Shares used in computing net income (loss) per share:				
Weighted average shares outstanding - Basic	4,002,598	13,942	2,017,564	13,740

Weighted average shares outstanding - Diluted

15,131,932

13,942

2,017,564

13,740

(1) As a result of the conversion of our preferred stock into 12.4 million shares of our common stock upon completion of our initial public offering in June 2004, there is a lack of comparability in the basic and diluted net income (loss) per share amounts for the periods presented above. Please refer to Note 8 for an unaudited pro forma basic and diluted net income (loss) per share calculation for the periods presented.

See accompanying notes.

Digirad Corporation
Consolidated Statements of Cash Flows
(Unaudited)

	Six months ended June 30,	
	2004	2003
Operating activities		
Net loss	\$ (162,907)	\$ (1,722,124)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation	1,467,211	1,377,959
Loss on disposal of assets	29,742	764
Amortization and impairment of intangibles	32,152	213,658
Stock-based compensation	683,278	61,488
Changes in operating assets and liabilities:		
Accounts receivable	1,605,123	(2,524,777)
Inventories	(695,842)	2,001,386
Other assets	(97,781)	13,318
Accounts payable	1,489,372	780,062
Accrued compensation	226,503	(158,439)
Accrued warranty and other accrued liabilities	2,033,002	(618,393)
Deferred revenue	522,256	(62,646)
Net cash provided by (used in) operating activities	7,132,109	(637,744)
Investing activities		
Purchases of property and equipment	(2,551,620)	(1,015,577)
Patents and other assets	(34,995)	(23,758)
Net cash used in investing activities	(2,586,615)	(1,039,335)
Financing activities		
Issuances of common stock, net of offering costs	58,840,100	837
Net borrowings (repayments) under lines of credit	(9,356,726)	1,146,266
Proceeds from capital lease financing	235,024	1,228,708
Repayment of obligations under capital leases	(1,040,519)	(913,958)
Repayment of notes payable to stockholders	(510,416)	-
Net cash provided by financing activities	48,167,463	1,461,853
Net increase (decrease) in cash and cash equivalents	52,712,957	(215,226)
Cash and cash equivalents at beginning of period	7,681,407	6,987,666
Cash and cash equivalents at end of period	\$ 60,394,364	\$ 6,772,440
Supplemental information:		
Cash paid during the period for interest	\$ 617,629	\$ 689,541

See accompanying notes.

Digirad Corporation

Notes to Consolidated Financial Statements (unaudited)

1. Organization and Basis of Presentation

Digirad Corporation (“Digirad”), a Delaware corporation, designs, develops, manufactures, markets, and services solid-state digital gamma cameras for use in nuclear medicine and provides, through two subsidiaries, Digirad Imaging Solutions, Inc. and Digirad Imaging Systems, Inc., collectively “DIS,” in-office services for physicians, offering certified personnel, required licensure, an imaging system and other support for the performance of nuclear imaging procedures under the supervision of our physician customers. DIS physician customers enter into annual contracts for imaging services delivered on a per-day basis.

We have prepared the accompanying unaudited consolidated financial statements in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and disclosures required by generally accepted accounting principles for complete financial statements. In the opinion of our management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Intercompany accounts have been eliminated in consolidation. Operating results for the three and six months ended June 30, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004. For further information see the financial statements and disclosures thereto for the year ended December 31, 2003 in our prospectus filed on June 9, 2004 and included in our Registration Statement filed pursuant to Rule 424(b) under the Securities Act of 1933, as amended, with the Securities and Exchange Commission on June 10, 2004.

2. Inventories

Inventories consist of the following:

	June 30, 2004	December 31, 2003
Raw materials	\$ 1,534,575	\$ 1,402,187
Work-in-progress	3,114,118	2,203,700
Finished goods	199,830	439,739
	4,848,523	4,045,626
Less reserves for excess and obsolete inventories	(443,360)	(336,305)
	<u>\$ 4,405,163</u>	<u>\$ 3,709,321</u>

3. Warranty

We provide a warranty on certain of our products and accrue the estimated cost at the time revenue is recorded. Warranty expense is charged to product cost of goods sold. Substantially all of the warranty periods are 12 months before customer-sponsored maintenance begins. Warranty reserves are established based on historical experience with failure rates and repair costs and the number of gamma cameras covered by warranty and are depleted as gamma cameras are repaired. The costs consist principally of materials, personnel, overhead and transportation. We review warranty reserves monthly and, if necessary, make adjustments.

The activities in our warranty reserve during the three months ended June 30, 2004 and 2003 are as follows:

	Balance at beginning of period	Charged to cost of revenues	Applied to liability	Balance at end of period
Three months ended June 30, 2004	\$ 1,176,537	\$ 474,000	\$ 382,002	\$ 1,268,535

Three months ended June 30, 2003

\$ 1,156,843

\$ 505,689

\$ 706,721

\$ 955,812

Digirad Corporation

Notes to Consolidated Financial Statements (unaudited)

4. Debt

The composition of our debt balance is as follows:

	June 30, 2004	December 31, 2003
Lines of credit	\$ —	\$ 9,356,727
Capital lease obligations	5,543,469	6,348,963
	5,543,469	15,705,690
Current portion of debt	(2,296,899)	(11,473,619)
Long-term debt, less current portion	\$ 3,246,570	\$ 4,232,071

Lines of Credit

In June 2004, we paid down both existing lines of credit to zero. We continue to have \$10,000,000 of available credit, subject to certain limitations. The available credit expires \$5,000,000 on October 15, 2004 and \$5,000,000 on December 31, 2004.

Notes Payable to Stockholders

On May 7, 2004, we agreed to accelerate payments due under certain notes payable to stockholders and to issue warrants to two of our stockholders and their designees following the consummation of our initial public offering. The warrants to purchase 47,618 shares of common stock were valued using the Black-Scholes option pricing model and the fair value of these warrants was \$355,000. The issuance of the warrants was directly attributable to completing our initial public offering and, therefore, is accounted for in stockholders' equity. We intend to enter into a similar agreement with an additional stockholder and its designees whereby we would issue warrants to purchase up to 23,809 shares of our common stock valued at approximately \$123,000.

5. Redeemable Convertible Preferred Stock and Stockholders' Equity

Redeemable convertible preferred stock

As part of the initial public offering completed in June 2004, all of our redeemable convertible preferred stock was converted into 12,444,271 shares of our common stock.

Reverse stock split

On April 30, 2004, our stockholders approved a 1-for-3.5 reverse stock split of our outstanding common stock. The accompanying consolidated financial statements give retroactive effect to the reverse stock split for all periods presented.

Initial Public Offering

In June 2004, we completed an initial public offering whereby we sold 5,500,000 shares of common stock at \$12 per share and received net proceeds of \$58.8 million (after underwriting discounts and commissions and estimated offering expenses).

2004 Stock Incentive Plan

Upon the effectiveness of the initial public offering, we adopted the 2004 Stock Incentive Plan and reserved 1,400,000 shares of common stock for issuance pursuant to the plan.

Digirad Corporation

Notes to Consolidated Financial Statements (unaudited)

6. Commitments and Contingencies

Compliance with Laws and Regulations

We are directly, or indirectly through our clients, subject to extensive regulation by both the federal government and the states and foreign countries in which we conduct business. The healthcare laws applicable to us are complex and are subject to variable interpretations. We have established a compliance program to help ensure that we will remain in compliance with the applicable healthcare laws and have instituted other safeguards intended to help prevent any violations of the laws and to remedy any situations that could give rise to violations.

In the first quarter of 2004, we discovered certain isolated arrangements entered into in good faith but that, upon review by our compliance personnel, raised some compliance concerns under these laws. In accordance with our compliance program, we took immediate remedial steps. While there have been no claims asserted against us, we cannot assure you that those remedial steps will insulate us from liability associated with these isolated arrangements. Although uncertain, if a claim were asserted and we were not to prevail, possible sanctions could have a material effect on our financial statements or our ability to conduct our operations.

Legal Matters

We may from time to time become involved in litigation relating to claims arising in the normal course of business, such as claims related to customer disputes, employment practices, product liability or patent infringement. Currently, we are not involved in any litigation which could have a material adverse impact on our financial statements.

7. Stock-Based Compensation

We have elected to follow Accounting Principles Board (“APB”) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations in accounting for our employee stock options as permitted by SFAS No. 123, *Accounting for Stock-Based Compensation*. Under APB 25, if the exercise price of our employee stock options is not less than the fair value of the underlying stock on the date of grant, no compensation expense is recognized. The following table illustrates the effect on net earnings and earnings per share as if we had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation:

	Three months ended June 30,		Six months ended June 30,	
	2004	2003	2004	2003
Net income (loss) per common share, as reported	\$ 29,847	\$ (879,406)	\$ (324,242)	\$ (1,891,580)
Add: total stock-based employee compensation included in reported net income (loss)	380,490	59,463	673,228	61,488
Less: total stock-based employee compensation determined under the fair value method for all awards	(435,921)	(62,239)	(766,021)	(77,681)
Pro forma net income (loss)	\$ (25,584)	\$ (882,182)	\$ (417,035)	\$ (1,907,773)
Net income (loss) per common share, as reported:				
Basic	\$ 0.01	\$ (63.08)	\$ (0.16)	\$ (137.67)
Diluted	\$ 0.01	\$ (63.08)	\$ (0.16)	\$ (137.67)
Net income (loss) per common share, pro forma:				
Basic	\$ (0.01)	\$ (63.28)	\$ (0.21)	\$ (138.85)
Diluted	\$ (0.01)	\$ (63.28)	\$ (0.21)	\$ (138.85)

The fair value of the options granted prior to the completion of our initial public offering were estimated at the date of grant using the minimum value pricing model. Upon completion of the initial public offering in June 2004, we began using the Black-Scholes model to estimate fair value. The estimated fair value of the options is amortized on an accelerated basis in accordance with FASB Interpretation (“FIN”) No. 28 over the vesting period.

Digirad Corporation

Notes to Consolidated Financial Statements (unaudited)

The following assumptions were utilized for the calculations during each period:

	Three months ended June 30,		Six months ended June 30,	
	2004	2003	2004	2003
Expected dividend yield	–	–	–	–
Risk-free interest rate	3.40%	3.00%	3.08%	3.00%
Expected volatility	–%	–%	–%	–%
Expected life (in years):	5.00	5.00	5.00	5.00

The above results are not likely to be representative of the effects of applying SFAS No.123 on reported net income or loss for future periods.

Stock-based compensation expense for stock options and warrants granted to non-employees is recorded at fair value as determined in accordance with SFAS No. 123, and EITF No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring or in Conjunction with Selling Goods or Services*. The fair value of the unvested options, warrants, and other equity instruments is periodically remeasured and the related expense is adjusted as necessary.

The composition of stock-based compensation is as follows:

	Three months ended June 30,		Six months ended June 30,	
	2004	2003	2004	2003
The composition of stock-based compensation is as follows:				
Cost of DIS revenue	\$ 65,863	\$ 3,080	\$ 126,293	\$ 4,362
Cost of product revenue	64,647	26,732	119,713	26,767
Research and development	45,721	311	73,220	464
Sales and marketing	44,097	1,787	88,796	2,104
General and administrative	160,162	27,553	275,256	27,791
	<u>\$ 380,490</u>	<u>\$ 59,463</u>	<u>\$ 683,278</u>	<u>\$ 61,488</u>

8. Net Income (Loss) Per Share

We calculated net income (loss) per share in accordance with SFAS No. 128, *Earnings Per Share*. Basic earnings per share (“EPS”) is calculated by dividing the net income or loss available to common stockholders by the weighted average number of common shares outstanding for the period, without consideration for common stock equivalents. Diluted EPS is computed by dividing the net income available to common stockholders by the weighted average number of common shares outstanding for the period and the weighted average number of dilutive common stock equivalents outstanding for the period determined using the treasury-stock method. For purposes of this calculation, common stock subject to repurchase by us, convertible preferred stock, options, and warrants are considered to be common stock equivalents and are only included in the calculation of diluted earnings per share when their effect is dilutive.

As mentioned above, upon the completion of our initial public offering, all of our previously outstanding preferred shares converted into 12.4 million shares of our common stock. As a result of the issuance of these common shares, there is a lack of comparability in both the basic

and diluted net income (loss) per share amounts for the periods presented. In order to provide a more relevant measure of our operating results, an unaudited pro forma net income (loss) per share calculation has been included. The shares used to compute unaudited pro forma basic and diluted net income (loss) per share include the assumed conversion of all outstanding shares of preferred stock into shares of common stock using the as- if converted method as of the beginning of each period presented or the date of issuance, if later.

Digirad Corporation

Notes to Consolidated Financial Statements
(unaudited)

Historical and pro forma basic and diluted net income (loss) per share were calculated as follows:

	Three months ended June 30,		Six months ended June 30,	
	2004	2003	2004	2003
Historical:				
Numerator:				
Net income (loss) applicable to common stockholders - diluted	\$ 102,644	\$ (795,300)	\$ (162,907)	\$ (1,722,124)
Accretion of deferred issuance costs on preferred stock	(72,797)	(84,106)	(161,335)	(169,456)
Net income (loss) applicable to common stockholders - basic	<u>\$ 29,847</u>	<u>\$ (879,406)</u>	<u>\$ (324,242)</u>	<u>\$ (1,891,580)</u>
Denominator:				
Weighted average common shares outstanding - basic	4,002,598	13,942	2,017,564	13,740
Effect of dilutive securities:				
Conversion of preferred stock	9,709,266	-	-	-
Options	1,397,374	-	-	-
Warrants	22,694	-	-	-
Weighted average common shares outstanding - diluted	<u>15,131,932</u>	<u>13,942</u>	<u>2,017,564</u>	<u>13,740</u>
Net income (loss) per common share:				
Basic	<u>\$ 0.01</u>	<u>\$ (63.08)</u>	<u>\$ (0.16)</u>	<u>\$ (137.67)</u>
Diluted	<u>\$ 0.01</u>	<u>\$ (63.08)</u>	<u>\$ (0.16)</u>	<u>\$ (137.67)</u>
Pro forma:				
Numerator:				
Net income (loss) applicable to common stockholders - basic and diluted	<u>\$ 102,644</u>	<u>\$ (795,300)</u>	<u>\$ (162,907)</u>	<u>\$ (1,722,124)</u>
Denominator:				
Weighted average common shares outstanding - basic	4,002,598	13,942	2,017,564	13,740
Pro forma adjustments to reflect weighted average effect of assumed conversion of preferred stock (unaudited)				
Pro forma weighted average common shares outstanding - basic	<u>9,709,266</u>	<u>12,444,271</u>	<u>11,076,769</u>	<u>12,444,271</u>
Weighted average common shares outstanding - diluted	<u>13,711,864</u>	<u>12,458,213</u>	<u>13,094,333</u>	<u>12,458,011</u>
Weighted average common shares outstanding - diluted	15,131,932	13,942	2,017,564	13,740
Pro forma adjustments to reflect weighted average effect of assumed conversion of preferred stock (unaudited)				
Pro forma weighted average common shares outstanding - diluted	<u>-</u>	<u>12,444,271</u>	<u>11,076,769</u>	<u>12,444,271</u>
Pro forma weighted average common shares outstanding - diluted	<u>15,131,932</u>	<u>12,458,213</u>	<u>13,094,333</u>	<u>12,458,011</u>
Pro forma net income (loss) per common share:				
Basic	<u>\$ 0.01</u>	<u>\$ (0.06)</u>	<u>\$ (0.01)</u>	<u>\$ (0.14)</u>
Diluted	<u>\$ 0.01</u>	<u>\$ (0.06)</u>	<u>\$ (0.01)</u>	<u>\$ (0.14)</u>

Digirad Corporation

Notes to Consolidated Financial Statements
(unaudited)

9. Segments

We have determined our reporting segments 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 operating income contributed by each segment. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies.

	<u>Three months ended June 30,</u>		<u>Six months ended June 30,</u>	
	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>
Gross profit by segment:				
DIS	\$ 3,719,588	\$ 2,673,030	\$ 6,801,570	\$ 4,532,770
Product	1,946,517	1,090,752	3,712,997	2,726,065
Consolidated gross profit	<u>\$ 5,666,105</u>	<u>\$ 3,763,782</u>	<u>\$ 10,514,567</u>	<u>\$ 7,258,835</u>
Income (loss) from operations by segment:				
DIS	\$ 942,615	\$ 559,127	\$ 1,453,313	\$ 301,737
Product	(584,599)	(934,088)	(1,016,229)	(1,278,734)
Consolidated income (loss) from operations	<u>\$ 358,016</u>	<u>\$ (374,961)</u>	<u>\$ 437,084</u>	<u>\$ (976,997)</u>
Depreciation, amortization and impairment of intangible assets by segment:				
DIS	\$ 532,222	\$ 525,406	\$ 1,032,763	\$ 1,058,989
Product	231,259	261,206	466,600	532,628
Consolidated depreciation and amortization	<u>\$ 763,481</u>	<u>\$ 786,612</u>	<u>\$ 1,499,363</u>	<u>\$ 1,591,617</u>
Identifiable assets by segment:				
DIS	\$ 16,560,477	\$ 17,006,928	\$ 16,560,477	\$ 17,006,928
Product	71,587,431	15,854,112	71,587,431	15,854,112
Consolidated assets	<u>\$ 88,147,908</u>	<u>\$ 32,861,040</u>	<u>\$ 88,147,908</u>	<u>\$ 32,861,040</u>

Foreign sales have not been significant for any period presented.

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

Forward-Looking Statements May Prove Inaccurate

The following discussion and analysis should be read in conjunction with our financial statements and notes thereto included in this report on Form 10-Q and the audited financial statements and notes thereto as of and for the year ended December 31, 2003 included in our Prospectus filed pursuant to Rule 424(b) under the Securities Act of 1933, as amended, with the Securities and Exchange Commission on June 10, 2004. Operating results are not necessarily indicative of results that may occur in future periods.

This report includes various forward-looking statements that are subject to risks and uncertainties, many of which are beyond our control. Our actual results could differ materially from those anticipated in these forward looking statements as a result of various factors, including those set forth below under the caption "Risk Factors." Forward-looking statements discuss matters that are not historical facts. Forward-looking statements include, but are not limited to, discussions regarding our operating strategy, growth strategy, acquisition strategy, cost savings initiatives, industry, economic conditions, financial condition, liquidity and capital resources and results of operations. In this report, for example, we make forward-looking statements regarding our expectations about the rate of revenue growth in specific business segments and the reasons for that growth and our profitability. Such statements include, but are not limited to, statements preceded by, followed by or that otherwise include the words "believes," "expects," "anticipates," "intends," "estimates," "projects," "can," "could," "may," "will," "would," or similar expressions. For those statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. You should not unduly rely on these forward-looking statements, which speak only as of the date on which they were made. They give our expectations regarding the future but are not guarantees. We undertake no obligation to update publicly or revise any forward-looking statements, whether as a result of new information, future events or otherwise, unless required by law.

Overview

We are a leader in the development, manufacture and distribution of solid-state medical imaging products and services. We were the first company to develop and commercialize a solid-state medical gamma camera for the detection of cardiovascular disease and other medical conditions. Our high performance imaging systems are mobile and provide enhanced operability and reliability and improved patient comfort and utilization when compared to traditional vacuum tube cameras. The cameras and accompanying equipment fit easily into spaces as small as seven feet by eight feet and facilitate the delivery of nuclear medicine procedures directly in a physician's office, an outpatient hospital setting or within multiple departments of a hospital.

Our revenues are divided between two primary operating segments: our DIS business and product sales. DIS collectively refers to our wholly-owned subsidiaries, Digirad Imaging Solutions, Inc. and Digirad Imaging Systems, Inc. Through DIS, we offer FlexImaging, our mobile and comprehensive leasing service for physicians who wish to perform nuclear cardiology and nuclear medicine procedures in their offices, but do not have the patient volume, capital or personnel to justify purchasing an imaging system. DIS is currently provided in 18 states and the District of Columbia. Physicians enter into annual contracts for imaging services delivered on a per-day basis. Our annual lease contracts typically provide for one day of service per week. Our product revenue results primarily from selling solid-state gamma cameras, custom designed chairs and accessories, such as printers, viewing workstations and connectivity, and revenue from our maintenance contracts. We sell our imaging systems to physician practices, outpatient clinics and hospitals primarily in the United States, although we have sold a small number of imaging systems internationally.

Given the recurring contractual revenue stream from our DIS business and our strategy to continue to expand the number of areas where we offer DIS services, we expect DIS revenue to continue to grow at a higher rate than product revenue and to continue to represent the majority of our consolidated revenues. We attribute the overall growth of our business to geographical expansion, increased market penetration, awareness and acceptance of our services and products, and the shift in the delivery of nuclear cardiology imaging procedures from hospitals to physician offices. We believe that the increase in demand for our services and products is driven by the desire of cardiologists to control their patients' diagnosis and treatment and to capture revenue for services that would otherwise be performed by a hospital or imaging center. The mobile feature of our technology also provides us with a significant advantage in the delivery of nuclear cardiology imaging services.

In April 2004, we completed the transition of our product manufacturing and headquarters operations from several separate facilities to a single facility in Poway, California. We believe that this consolidation will streamline our operations and improve efficiencies.

We experience some seasonality in our DIS business as a result of holidays, inclement weather and summer slowdowns principally relating to vacations. Historically, these variables have had the most impact on our third quarter operating results. As of June 30, 2004, our accumulated deficit was \$80.5 million. We believe that we will achieve our first full year of profitability in 2004, and intend to continue to enhance profitability through increased volume and improved margins, although we may incur losses in any given quarter. We also currently purchase some components from sole source providers but are either qualifying or seeking second source providers in an effort to limit our reliance on these suppliers.

Results Of Operations

The following table sets forth our results from operations, expressed as percentages of revenues for the three and six months ended June 30, 2004 and 2003:

	Three months ended June 30,		Six months ended June 30,	
	2004	2003	2004	2003
Revenues:				
DIS	65.3%	62.5%	65.5%	60.3%
Product	34.7	37.5	34.5	39.7
Total revenues	100.0	100.0	100.0	100.0
Cost of revenues:				
DIS	43.4	43.4	44.6	43.5
Product	23.0	29.5	23.0	29.5
Stock-based compensation	0.8	0.2	0.7	0.1
Total cost of revenues	67.2	73.1	68.3	73.1
Gross profit	32.8	26.9	31.7	26.9
Operating expenses:				
Research and development	4.0	4.3	4.0	4.4
Sales and marketing	10.8	10.2	11.0	11.0
General and administrative	14.4	14.2	14.0	14.2
Amortization and impairment of intangible assets	0.1	0.7	0.1	0.8
Stock-based compensation	1.4	0.2	1.3	0.1
Total operating expenses	30.7	29.6	30.4	30.5
Income (loss) from operations	2.1	(2.7)	1.3	(3.6)
Other income (expense)	(1.5)	(3.0)	1.8	(2.7)
Accretion of deferred issuance costs on preferred stock	(0.4)	(0.6)	(0.5)	(0.6)
Net income (loss) applicable to common stockholders	0.2%	(6.3)%	(1.0)%	(6.9)%

Comparison of Three Months Ended June 30, 2004 and 2003

Revenues

Consolidated. Consolidated revenues increased to \$17.3 million for the three months ended June 30, 2004 from \$14.0 million for the three months ended June 30, 2003, which represents an increase of \$3.3 million, or 23.4%, primarily as a result of increased demand for our DIS imaging services. We believe that this increased demand was principally a result of increased customer awareness and acceptance of our products and services. DIS and product revenue accounted for 65% and 35%, respectively, of total revenues for the three months ended June 30, 2004, compared to 63% and 37%, respectively, for the three months ended June 30, 2003. We expect DIS revenue to continue to grow at a higher rate than product revenue and to continue to represent a larger percentage of consolidated revenue.

DIS. Our DIS revenue increased to \$11.3 million for the three months ended June 30, 2004 from \$8.8 million for the three months ended June 30, 2003, which represented an increase of \$2.5 million, or 28.9%. The increase in DIS revenue resulted from an increase in the number of DIS service days to 2,965 for the three months ended June 30, 2004 from 2,501 for the three months ended June 30, 2003, which was primarily attributable to an increase in the number of physicians entering into our DIS services contracts and growth of existing accounts. Our DIS business operated 63 imaging systems as of June 30, 2004 as compared to 51 as of June 30, 2003. We anticipate that our DIS revenue will increase as we expand into new markets and continue to penetrate existing markets. Such growth will fluctuate, however, based on seasonality stemming from physician vacations, holidays and inclement weather.

Product. Our product revenue increased to \$6.0 million for the three months ended June 30, 2004 from \$5.2 million for the three months ended June 30, 2003, which represented an increase of \$0.7 million, or 14.2%. The increase in product revenues resulted from an

increase in camera and accessories revenue as well as increased service contract revenues. We have experienced pricing pressures on our dual head gamma cameras and, while we expect this pricing pressure to continue, we also anticipate demand will continue to increase, potentially offsetting the effects of these pricing pressures.

Gross Profit

Consolidated. Consolidated gross profit increased to \$5.7 million for the three months ended June 30, 2004 from \$3.8 million for the three months ended June 30, 2003, which represents an increase of \$1.9 million, or 50.5%. Consolidated gross profit as a percentage of revenue increased to 32.8% for the three months ended June 30, 2004 from 26.9% for the three months ended June 30, 2003, primarily as a result of an increase in revenue, lower DIS imaging service costs and reductions in gamma camera production costs and per unit warranty costs.

DIS. Cost of DIS revenue consists primarily of labor, radiopharmaceuticals, equipment depreciation and other costs associated with the provision of services. Cost of DIS revenue increased to \$7.5 million for the three months ended June 30, 2004 from \$6.1 million for the three months ended June 30, 2003, which represents an increase of \$1.4 million, or 23.4%, primarily as a result of an increase in our direct headcount and consumables used in performing imaging services, which are primarily radiopharmaceuticals. Our clinical headcount relating to our DIS business increased to 155 employees at June 30, 2004 from 120 employees at June 30, 2003. DIS gross profit increased to \$3.8 million for the three months ended June 30, 2004 from \$2.7 million for the three months ended June 30, 2003, which represents an increase of \$1.1 million, or 41.5%, as a result of increased volumes and reductions in the per unit cost of labor and radiopharmaceuticals used in providing our imaging services. DIS gross profit as a percentage of revenue increased to 33.5% for the three months ended June 30, 2004 from 30.5% for the three months ended June 30, 2003.

Product. Cost of goods sold primarily consists of materials, labor and overhead costs associated with the manufacturing and warranty of our products. Warranty costs are charged to cost of goods sold in the period our cameras are sold and are based on our historical experience with failure rates and repair costs. Warranty reserves are reviewed monthly and if necessary, warranty expense is adjusted. Cost of goods sold decreased to \$4.0 million for the three months ended June 30, 2004 from \$4.1 million for the three months ended June 30, 2003, which represents a decrease of \$0.1 million, or 3.6%. Product gross profit increased to \$2.0 million for the three months ended June 30, 2004 from \$1.1 million for the three months ended June 30, 2003, which represents an increase of \$0.9 million, or 80.0%, primarily as a result of the decrease in cost of goods sold and reduced costs per unit resulting from lower warranty costs, increased manufacturing volumes, fewer and lower-cost materials and more efficient manufacturing processes used to build our third-generation camera heads introduced in July 2003. Product gross profit as a percentage of revenue increased to 33.5 % for the three months ended June 30, 2004 from 21.3% for the three months ended June 30, 2003.

Operating Expenses

Research and Development. Research and development expenses consist primarily of costs associated with the design, development, testing, and enhancement of our products. The primary costs are salaries and fringe benefits, consulting fees, facilities and overhead charges and nonrecurring engineering costs, such as tooling and other one-time costs associated with manufacturing. Research and development expenses increased to \$0.7 million for the three months ended June 30, 2004 from \$0.6 million for the three months ended June 30, 2003, which represents an increase of \$0.1 million, or 15.0%. This increase was primarily attributable to increased employee headcount to develop new products. For the three months ended June 30, 2004, research and development expenses were 4.0% of total revenue, compared to 4.3% for the three months ended June 30, 2003. In the future, we expect to continue to invest between approximately 10% and 12% of product revenue on research and development as we seek to continue to improve our existing technology and innovate.

Sales and Marketing. Sales and marketing expenses consist primarily of salaries, commissions, bonuses, recruiting costs, travel, marketing and collateral materials and tradeshow costs. Sales and marketing expenses increased to \$1.9 million for the three months ended June 30, 2004, from \$1.4 million for the three months ended June 30, 2003, which represents an increase of \$0.4 million, or 29.5%. This increase was primarily attributable to an increase in the number of sales and marketing personnel and expansion of our marketing efforts. For the three months ended June 30, 2004, sales and marketing expenses were 10.8% of total revenue, compared to 10.2% for the three months ended June 30, 2003. We expect to increase our sales and marketing efforts, as we expand the locations in which we expect to perform DIS services and focus on increasing market awareness of our products and offerings.

General and Administrative. General and administrative expenses consist primarily of salaries and other related costs for finance and accounting, human resources and other personnel, as well as legal and other professional fees and insurance. General and administrative expenses increased to \$2.5 million for the three months ended June 30, 2004 from \$2.0 million for the three months ended June 30, 2003,

which represents an increase of \$0.5 million, or 26.0%. Increases in headcount and recruiting costs, and insurance, legal fees and other costs primarily related to our IPO and operating as a newly public company, and DIS billing and collection fees, all contributed to increased general and administrative expenses. At the end of June 30, 2004, general and administrative expenses amounted to 14.4% of total revenue compared to 14.2% at the end of June 30, 2003. As a result of our initial public offering, we will be required to incur additional general and administrative costs to meet various public reporting and compliance requirements.

Stock-Based Compensation Charges. Deferred compensation for stock options granted to employees has been determined as the difference between the exercise price and the fair value of our common stock on the date of grant. Options or awards issued to non-employees are recorded at their fair value in accordance with SFAS No. 123 and periodically remeasured in accordance with EITF 96-18 and recognized over the respective service or vesting period. These amounts are initially recorded as a component of stockholders' equity and are amortized, on an accelerated basis, as a non-cash charge to cost of revenues and operations over the vesting period of the options. In connection with the grant of stock options to employees, we recorded amortization of stock-based compensation of \$0.4 million and \$0.1 million for the three months ended June 30, 2004 and 2003, respectively.

Other Income (Expense)

Interest expense decreased to \$0.3 million for the three months ended June 30, 2004 from \$0.4 million for the three months ended June 30, 2003, which represents a decrease of \$0.1 million, or 32.6%. The reduction is a result of a decrease in the variable interest rates on two accounts receivable credit lines and a reduction on capital leases.

Net Income (Loss)

Net income increased to \$0.1 million for the three months ended June 30, 2004 from a net loss of \$0.8 million for the three months ended June 30, 2003, as a result of the factors described above.

Comparison of Six Months Ended June 30, 2004 and 2003

Revenues

Consolidated. Consolidated revenues increased to \$33.2 million for the six months ended June 30, 2004 from \$27.0 million for the six months ended June 30, 2003, which represents an increase of \$6.2 million, or 22.8%, primarily as a result of increased demand for our DIS imaging services. We believe that this increased demand was principally a result of increased customer awareness and acceptance of our products and services. DIS and product revenue accounted for 66% and 34%, respectively, of total revenues for the six months ended June 30, 2004, compared to 60% and 40%, respectively, for the six months ended June 30, 2003. We expect DIS revenue to continue to grow at a higher rate than product revenue and to continue to represent a larger percentage of consolidated revenue.

DIS. Our DIS revenue increased to \$21.7 million for the six months ended June 30, 2004 from \$16.3 million for the six months ended June 30, 2003, which represents an increase of \$5.4 million, or 33.4%. The increase in DIS revenue resulted from an increase in the number of DIS service days to 5,699 for the six months ended June 30, 2004 from 4,511 for the three months ended June 30, 2003, which was primarily attributable to an increase in the number of physicians entering into our DIS services contracts, growth of existing accounts and the deployment of additional mobile imaging systems. Our DIS business operated 63 imaging systems as of June 30, 2004 as compared to 51 as of June 30, 2003.

Product. Our product revenue increased to \$11.5 million for the six months ended June 30, 2004 from \$10.7 million for the six months ended June 30, 2003, which represents an increase of \$0.7 million, or 6.8%. The increase in product revenues resulted from an increase in camera and accessories revenue as well as increased service contract revenues.

Gross Profit

Consolidated. Consolidated gross profit increased to \$10.5 million for the six months ended June 30, 2004 from \$7.3 million for the six months ended June 30, 2003, which represents an increase of \$3.3 million, or 44.9%. Consolidated gross profit as a percentage of revenue increased to 31.7% for the six months ended June 30, 2004 from 26.9% for the six months ended June 30, 2003, primarily as a result of an increase in revenue, lower DIS imaging service costs and reductions in gamma camera production costs and per unit warranty cost s.

DIS. Cost of DIS revenue increased to \$14.8 million for the six months ended June 30, 2004 from \$11.7 million for the six months ended June 30, 2003, which represents an increase of \$3.0 million, or 26.0%, primarily as a result of our increased direct headcount and consumables used in performing imaging services, which are primarily radiopharmaceuticals. Our clinical headcount relating to our DIS business increased to 155 employees at June 30, 2004 from 120 employees at June 30, 2003. DIS gross profit increased to \$6.9 million for the

six months ended June 30, 2004 from \$4.5 million for the six months ended June 30, 2003, which represents an increase of \$2.4 million, or 52.7%, as a result of increased volumes and reductions in the per unit cost of labor and radiopharmaceuticals used in providing our imaging services. DIS gross profit as a percentage of revenue increased to 31.9% for the six months ended June 30, 2004 from 27.9% for the six months ended June 30, 2003.

Product. Cost of goods sold decreased to \$7.6 million for the six months ended June 30, 2004 from \$8.0 million for the six months ended June 30, 2003, which represents a decrease of \$0.3, or 4.4%. Product gross profit increased to \$3.8 million for the six months ended June 30, 2004 from \$2.8 million for the six months ended June 30, 2003, which represents an increase of \$1.1 million, or 39.2%, primarily as a result of the decrease in cost of goods sold and reduced costs per unit resulting from lower warranty costs, increased manufacturing volumes, fewer and lower-cost materials and more efficient manufacturing processes used to build our third-generation camera heads introduced in July 2003. Product gross profit as a percentage of revenue increased to 33.5% for the six months ended June 30, 2004 from 25.7% for the six months ended June 30, 2003.

Operating Expenses

Research and Development. Research and development expenses increased to \$1.3 million for the six months ended June 30, 2004 from \$1.2 million for the six months ended June 30, 2003, which represents an increase of \$0.2 million, or 12.8%. This increase was primarily attributable to increased employee headcount to develop new products. For the six months ended June 30, 2004, research and development expenses were 4.0% of total revenue, compared to 4.4% for the six months ended June 30, 2003.

Sales and Marketing. Sales and marketing expenses increased to \$3.6 million for the six months ended June 30, 2004, from \$3.0 million for the six months ended June 30, 2003, which represents an increase of \$0.7 million, or 22.0%. This increase was primarily attributable to an increase in the number of sales and marketing personnel and expansion of our marketing efforts. Sales and marketing expenses were 11.0% of total revenue for both of the six month periods ended June 30, 2004 and 2003.

General and Administrative. General and administrative expenses increased to \$4.6 million for the six months ended June 30, 2004 from \$3.8 million for the six months ended June 30, 2003, which represents an increase of \$0.8 million, or 21.1%. Increases in headcount and recruiting costs, and insurance, legal fees and other costs primarily related to our IPO and operating as a newly public company, and DIS billing and collection fees, all contributed to increased general and administrative expenses. At the end of June 30, 2004, general and administrative expenses amounted to 14.0% of total revenue compared to 14.2% at the end of June 30, 2003.

Stock-Based Compensation Charges. In connection with the grant of stock options to employees, we recorded as amortization of stock-based compensation of \$0.7 million and \$0.1 million for the six months ended June 30, 2004 and 2003, respectively.

Other Income (Expense)

Interest expense decreased to \$0.6 million for the six months ended June 30, 2004 from \$0.8 million for the six months ended June 30, 2003, which represents a decrease of \$0.2 million, or 20.0%. The reduction is a result of a decrease in the variable interest rates on our two credit lines and a reduction of amounts outstanding under capital leases.

Net Loss

The net loss decreased to \$0.2 million for the six months ended June 30, 2004 from \$1.7 million for the six months ended June 30, 2003, as a result of the factors described above.

Liquidity and Capital Resources

We require capital principally for working capital, debt service and capital expenditures. Working capital is required principally to finance accounts receivable and inventory. Our working capital requirements vary from period to period depending on manufacturing volumes, the timing of deliveries and the payment cycles of our customers. Our capital expenditures consist primarily of DIS cameras and vans, computer hardware and software. We have historically funded our operations principally through private placements of equity securities. In June 2004, we completed our initial public offering and received net proceeds of \$58.8 million.

As of June 30, 2004, we had cash and cash equivalents totaling \$60.4 million. We currently invest our cash reserves in money market funds. We also have two separate credit facilities that provide up to \$10.0 million of borrowing capacity, subject to certain limitations.

Net cash provided by operations was approximately \$7.1 million for the six months ended June 30, 2004. Net cash provided by operating activities for the six months ended June 30, 2004 was primarily the result of a decrease in accounts receivable and increases in accounts payable and accrued liabilities, augmented by non-cash items such as depreciation and amortization of stock-based compensation. The decrease in accounts receivable reflects a reduction in our days sales outstanding. The increase in accounts payable reflects the growth of our business while the increase in accrued liabilities is primarily associated with the accrual of costs associated with our initial public offering.

Net cash used in investing activities amounted to approximately \$2.6 million for the six months ended June 30, 2004, and reflects capital expenditures primarily associated with our DIS operations.

Net cash provided by financing activities amounted to approximately \$48.2 million for the six months ended June 30, 2004. Proceeds from the initial public offering less amounts paid under credit line borrowings and capital lease obligations were primarily responsible for the net cash provided by financing activities in the six months ended June 30, 2004.

Based upon our current level of expenditures, we believe the proceeds from our initial public offering, together with cash flows from operating activities will be adequate to meet our anticipated cash requirements for working capital, debt service and capital expenditures for the next 12 months.

Critical Accounting Policies

The Securities and Exchange Commission defines critical accounting policies as those that are, in management's opinion, very important to the portrayal of our financial condition and results of operations and require our management's most difficult, subjective or complex judgments. In preparing our financial statements in accordance with generally accepted accounting principles in the United States, we must often make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, expenses and related disclosures at the date of the financial statements and during the reporting period. Some of those judgments can be subjective and complex. Consequently, actual results could differ from our estimates. The accounting policies that are most subject to important estimates or assumptions include those described below.

Revenue Recognition

We recognize revenue in accordance with Staff Accounting Bulletin No. 101 when each of the following four criteria are met:

1. A contract or sales arrangement exists;
2. Products have been shipped and title has transferred or services have been rendered;
3. The price of the products or services is fixed or determinable; and
4. Collectibility is reasonably assured.

For our product revenue, these criteria are usually met upon delivery. Our DIS revenue is recorded once the services and disposables are provided and consumed, which is normally on the day of the service. Reductions to product revenue are recorded to provide for payment adjustments and credit memos and historically have not been significant. Reductions to our DIS revenue are recorded to provide for payment adjustments and credit memos. In addition, we establish reserves against our DIS revenue to allow for uncollectible items relating to patient co-payments and contractual allowances and other adjustments, based on historical collection experience.

Reserves for Doubtful Accounts, Billing Adjustments and Contractual Allowances

Historically, the need to estimate reserves for accounts receivable has been limited to our DIS business. We provide reserves for billing adjustments, contractual allowances and doubtful accounts. DIS payment adjustments and credit memos are adjustments for billing errors that are normally adjusted within the first 90 days subsequent to the performance of service, with the majority occurring within the first 30 days. Reserves are provided as a percentage of DIS revenue based on historical experience rate. We primarily bill the physicians under contract directly, and in a minority of cases, we are reimbursed under government programs, Medicare or by private insurance companies. We provide reserves for contractual allowances for billings to Medicare and insurance companies based on our collection experience rates. We use a combination of factors in evaluating the collectibility of accounts receivable. Each account is reviewed on at least a quarterly basis and a percentage varying from zero to 100% for each account is established. We do not establish reserves for accounts with a history of payment without disputes. We generally reserve between 20% and 50% of the outstanding balance for accounts that are more than 180 days late and under dispute. We reserve 100% of the outstanding balance for accounts that we believe constitute a high risk of default based on factors such as level of dispute, payment history and our knowledge of a customer's inability to meet its obligations. We also consider bad debt write-off history. Our estimates of collectibility could be reduced by material amounts by changed circumstances, such as a higher number of defaults or material adverse changes in a payor's ability to meet its obligations.

Long-Lived Assets

We state property and equipment and purchased contracts at cost. We capitalize betterments, which extend the useful life of the equipment. We calculate depreciation on property and equipment and purchased contracts on the straight-line method over the estimated useful life (three to seven years for property and equipment and five years for purchased contracts) of the assets. We follow Financial Accounting Standards Board ("FASB") *Statement of Financial Accounting Standards ("SFAS") No. 144, Accounting for Impairment or Disposal of Long-Lived Assets*, which requires impairment losses to be recorded on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amount. If such assets are considered to be impaired, we measure the impairment to be recognized by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. Assets are examined for impairment annually or more frequently if events occur that may indicate potential asset impairment.

Inventory

We state inventories at the lower of cost (first-in, first-out) or market (net realizable value). Costs include material, labor and manufacturing overhead costs. Inventory expected to be converted into equipment to be used as imaging cameras in DIS is classified as property and equipment. We review our inventory monthly for excess or obsolete inventory levels. Except where firm orders are on-hand, we consider inventory quantities of sale products in excess of the last 12 months' demand as excess and reserve for them at levels between 20% and 50% of cost, depending on our knowledge and forecast for the product. We establish obsolescence reserves from 0% for active, high-demand products, to 100% for obsolete products. We review the reserve periodically and, if necessary, make adjustments. We rely on historical information to support our reserve and utilize management' s business judgment. Once the inventory is written down, we do not adjust the reserve balance until the inventory is sold.

Warranty

We provide a warranty on certain of our products and accrue the estimated cost at the time revenue is recorded. Historically, the warranty periods have ranged from up to 24 months. Since July 2002, substantially all of the warranty periods have been 12 months before customer-sponsored maintenance begins. Warranty reserves are established based on historical experience with failure rates and repair costs and the number of cameras covered by warranty. We review warranty reserves monthly and, if necessary, make adjustments.

New Accounting Pronouncements

In November 2002, the FASB issued FIN 45, *Guarantor' s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. This interpretation elaborates on the disclosures required in financial statements concerning obligations under certain guarantees. We adopted the disclosure requirements of this interpretation that were effective on December 31, 2002. The recognition provisions of the interpretation became effective in 2003 and are applicable only to guarantees issued or modified after December 31, 2002. We have not issued or modified any such guarantees and accordingly the interpretation did not have a material impact on our financial position, results of operations or cash flows.

In January 2003, the FASB issued FIN No. 46, *Consolidation of Variable Interest Entities*, an Interpretation of ARB No. 51. FIN No. 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. In December 2003, the FASB issued FIN No. 46R, a revision to FIN No. 46. FIN No. 46R provides a broad deferral of the latest date by which all public entities must apply FIN No. 46 to certain variable interest entities to the first reporting period ending after March 15, 2004. The adoption of FIN No. 46 or FIN No. 46R did not have a material impact upon our financial position, cash flows or results of operations.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is

effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 did not have a material effect on our consolidated financial statements.

Corporate Information

We have trademark registrations in the United States for 2020tc Imager[®], CardiusSST[®], Digirad[®], Digirad Logo[®], Digirad Imaging Solutions[®], FlexImaging[®] and SPECTour[®]. We have trademark applications pending in the United States for the following marks: Cardius[™], DigiServSM, DigiSpectSM, DigiTechSM and SolidiumSM. We have obtained and sought trademark protection for some of the above listed marks in the European Community and Japan.

Risk Factors

You should carefully consider the risks and uncertainties described below, together with all other information included in this quarterly report and in our other public filings, before making any investment decision regarding our stock. If any of the following risks actually occurs, our business, financial condition, results of operations and future prospectus would likely be materially and adversely affected. In that event, the market price of our stock could decline and you could lose all or part of your investment.

Risks Related to Our Business and Industry

If our imaging systems and DIS services are not accepted by physicians or hospitals, we may be unable to develop a sustainable, profitable business.

We expect that substantially all of our revenue in the foreseeable future will be derived from sales of our products in the nuclear imaging market and our leasing services offered through our wholly owned subsidiaries, Digirad Imaging Solutions, Inc. and Digirad Imaging Systems, Inc., which we refer to collectively as DIS. Our solid-state gamma cameras and DIS services represent a new approach in the nuclear imaging market. We began full commercial release of our imaging systems in March 2000 and established DIS in September 2000. Because of the recent commercial introduction of our nuclear imaging systems, we have limited product and brand recognition and our imaging systems have been used by a limited number of physicians and hospitals. Physicians and hospitals may generally be slow to adopt our products and leasing services for a number of reasons, including:

perceived liability risks generally associated with the use of new technologies for nuclear imaging;

availability of reimbursement from health care payors for procedures using our system;

lack of experience with our products and services;

costs associated with the purchase or lease of our products and services;

the presence of competing products sold by companies with longer operating histories, more recognizable names and more established distribution networks;

the introduction or existence of competing products and services or technologies that may be more effective, easier to use or that produce better images; and

physician and hospital perceptions of our imaging systems as compared to those of competitors.

Our success in the nuclear imaging market depends on whether physicians and hospitals view our imaging systems and DIS services as effective and economically beneficial. We believe that physicians and hospitals will not adopt our imaging systems or lease our DIS services unless they determine, based on experience and other factors, that our imaging systems and DIS services are an attractive alternative to vacuum tube imaging systems. We also believe that recommendations and support of our products and services by influential physicians and other health care providers are essential for market acceptance and adoption. We cannot assure you that physicians or hospitals will adopt or accept our imaging systems or DIS services. If physicians and hospitals do not adopt our imaging systems or DIS services, our operating results and business will be harmed.

We sell our imaging systems and provide our services in a highly competitive industry, and we often compete against large, well-established competitors that have significantly greater financial resources than we have.

The medical device industry, including the market for imaging systems and services, is highly competitive, subject to rapid change and significantly affected by new product introductions and market activities of other industry participants. Our primary competitors with respect to imaging systems include several large medical device manufacturers, including Philips Medical Systems, General Electric Healthcare, Siemens Medical Systems and Toshiba Medical Systems. All of these competitors offer a full line of imaging cameras for each diagnostic imaging technology, including x-ray, magnetic resonance imaging, computerized tomography, ultrasound and nuclear medicine. The existing imaging systems sold by our competitors have been in use for a longer time than our products and are more widely recognized and used by physicians and hospitals for nuclear imaging. Many of our competitors and potential competitors enjoy significant competitive advantages over us, including:

significantly greater name recognition and financial, technical and marketing resources;

established relationships with healthcare professionals, customers and third-party payors;

established distribution networks;

additional lines of products and the ability to offer rebates or bundle products to offer discounts or incentives; and

greater resources for product development, sales and marketing.

The competitive nature of the nuclear imaging industry has had an impact on the price of our gamma cameras. While we anticipate demand for our gamma cameras to continue to increase, we believe these pricing pressures will continue to impact our gamma camera product revenue and gross profit.

In providing comprehensive mobile nuclear imaging solutions, we generally compete against small businesses employing traditional vacuum tube cameras that must be transported in large vehicles and cannot be moved in and out of physician offices.

We are aware of certain major medical device companies that are attempting to develop solid-state cameras and we believe these efforts will continue. In addition, we are aware of a privately-held company, Gamma Medica, which is currently marketing a solid-state gamma camera for breast imaging. We do not believe that this camera can be used in a cardiac application. However, we cannot assure you that Gamma Medica will not attempt to modify its existing camera for use in the cardiac segment in the future, or develop another gamma camera for cardiac applications. Because of the size of the potential market, we anticipate that companies will dedicate significant resources to developing competing products and services. Current or future competitors may develop technologies and products that demonstrate better image quality, ease of use or mobility than our imaging systems. Our ability to compete successfully will depend on our ability to develop proprietary products that reach the market in a timely manner, receive adequate reimbursement and are less expensive than alternatives available for the same purpose. If we are unable to compete effectively against our existing and future competitors our sales will decline and our business will be harmed.

Changes in domestic and international legislation, regulation, or coverage and reimbursement policies of third-party payors may adversely impact our ability to market and sell our products and services.

Physicians and hospitals purchasing and using our products rely on adequate third-party payor coverage and reimbursement to maintain their operations. Changes in domestic and international legislation, regulation or coverage and reimbursement policies of third-party payors may adversely affect the demand for our existing and future products and services and may limit our ability to market and sell our products and services on a profitable basis. For example, on December 8, 2003, President Bush signed into law the Medicare Prescription Drug, Improvement and Modernization Act of 2003, or the Medicare Modernization Act, which contains a wide variety of changes that impact Medicare reimbursement to physicians and hospitals. We cannot predict what additional changes will be made to such legislation, regulation, or coverage and reimbursement policies, but we believe that future coverage and reimbursement may be subject to increased restrictions both in the United States and in international markets. Additionally, we cannot be certain that under prospective payment systems, or established fee schedule payment formulas, under which healthcare providers may be reimbursed a fixed amount based on the patient's condition or the type of procedure performed, the costs of our products and services will be justified and incorporated into the overall payment for the procedure. Third-party payors continue to act to contain or reduce healthcare costs through various means, including the movement to managed care systems where healthcare providers contract to provide comprehensive healthcare for a fixed fee per patient. These continued efforts to reduce healthcare costs may result in third-party payors refusing to reimburse patients or healthcare providers for our imaging services or allowing only specific providers to provide imaging services. As a result, sales of our gamma cameras would suffer and we may receive pressure from our customers to terminate or otherwise modify the lease arrangements for our DIS services. Under such circumstances, our business, financial condition and results of operations could be materially adversely affected.

Because our imaging systems and DIS services are not widely diversified, a decrease in sales of our products and leasing services could seriously harm our business.

Our current product and leasing service offerings consist primarily of our line of gamma cameras, including our Cardius-1, Cardius-2, 2020*tc* Imager and SPECTpak PLUS camera systems, each of which is used in the nuclear imaging market segment and all of which utilize the same solid-state technology. In addition, we offer a mobile imaging leasing service through DIS, which includes an imaging system, certified personnel, required licensure and other support for nuclear imaging procedures. As such, our line of products and services is not as diversified as those of some of our competitors. Consequently, if sales of our products or leasing services decline precipitously, our business would be seriously harmed, and it would likely be difficult for us to recover because we do not have the breadth of products or services that would enable us to sustain our business while seeking to develop new types of products or services or other markets for our existing products and services. In addition, because our technical know-how and intellectual property have limited applications, we may be unable to leverage our technical know-how and intellectual property to diversify our products and services or to develop other products or sources of revenue outside of the nuclear imaging market.

Our imaging systems and DIS services may become obsolete, and we may not be able to timely develop new products, product enhancements or services that will be accepted by the market.

Our nuclear imaging system and DIS services may become obsolete or unmarketable if other products or services utilizing new technologies are introduced by our competitors or new industry standards emerge. We cannot assure you that we will be able to successfully develop or market new products and services, or enhancements to our existing products, or that our future products and enhancements will be accepted by our current or potential customers or the third-party payors who financially support many of the procedures performed with our products. Any of these circumstances may cause us to lose customers, disrupt our business operations and harm our product sales and services. To be successful, we will need to enhance our products or services and to design, develop and market new products that successfully respond to competitive developments, all of which may be expensive and time consuming.

The success of any new product offering or enhancement to an existing product will depend on several factors, including our ability to:

properly identify and anticipate physician and patient needs;

develop new products or enhancements in a timely manner;

obtain the necessary regulatory approvals or clearances for new products or product enhancements in a timely manner;

provide adequate training to users of our products;

price our products competitively;

obtain appropriate coverage and receive adequate reimbursement notifications and respond to them in a commercially viable way;

comply with changing or new regulatory requirements; and

develop an effective marketing, sales and distribution network.

If we do not develop and obtain regulatory approvals or clearances for new products, services or product enhancements in time to meet market demand, or if there is insufficient demand for these products, services or enhancements, our business, financial condition and results of operations will likely suffer. In addition, even if our customers acquire new products, services or product enhancements we may offer, the revenues from any such products, services or enhancements may not be sufficient to offset the significant costs associated with offering such products, services or enhancements to customers. In addition, any announcements of new products, services or enhancements may cause customers to decline or cancel their purchasing decisions in anticipation of such products, services or enhancements.

If we experience problems with the technologies used in our imaging systems or if delivery of our DIS services are delayed, public perception of us could be harmed and cause us to lose customers and revenue.

Our gamma cameras have only recently been introduced into the marketplace. Most of our cameras currently in use are less than three years old. We have experienced some reliability issues with a prior version of our detector heads. In July 2003, we began selling most of our gamma cameras with a new version of our detector heads which has shown increased reliability, although other reliability issues remain. In addition, as the period of use of our cameras increases, other significant defects may occur. If significant defects do arise with our gamma cameras, our reputation among physicians and hospitals could be damaged.

Additionally, physicians rely on our DIS services to provide nuclear imaging procedures to their patients on the dates and at the times they have requested. Many factors could prevent us from delivering our DIS services on a timely basis, including weather and the availability of staffing, transportation and necessary supplies. If we are unable to provide physicians or hospitals our DIS services in a timely and effective manner, our reputation among physicians and hospitals could be damaged.

The performance and reliability of our products and services are critical to our reputation and to our ability to achieve market acceptance of those products and services. Widespread or other failures of our cameras and other products to consistently meet the expectations of purchasers or customers that use our DIS services could adversely affect our reputation, our ability to provide our DIS services, our relations with current customers and our business operations. Such failures could also reduce the attractiveness of our products and services to potential customers. Equipment failures could result from any number of causes, including equipment aging, ordinary wear and tear due to regular transportation and relocation, failure to perform routine maintenance and latent hardware or software defects of which we are unaware. Such failures, whether actual or perceived, could adversely affect our business even if we correct the underlying problems.

Our manufacturing operations are highly dependent upon third-party suppliers, making us vulnerable to supply problems and price fluctuations, which could harm our business.

We rely on a limited number of third parties to manufacture and supply certain of the key components of our products. While many of the components used in our products are available from multiple sources, we obtain some components from single sources. For example, key components of the detector heads and the acquisition and control software utilized in our gamma cameras are manufactured or supplied by a single source. To be successful, our contract manufacturers and suppliers must provide us with the components of our systems in requisite quantities, in compliance with regulatory requirements, in accordance with agreed-upon specifications, at acceptable cost and on a timely basis. Segami Corporation, or Segami, has developed image acquisition and processing software for our camera under a non-exclusive license agreement. In the event that Segami attempts to terminate the license agreement, refuses to extend the term of the license or seeks to impose unreasonable pricing or terms, we would have to find an alternative software system to use in our gamma camera. Our reliance on these outside suppliers subjects us to a number of risks that could harm our business, including:

suppliers may make errors in manufacturing components that could adversely affect the efficacy or safety of our products or cause delays in shipment of our products;

we may not be able to obtain adequate supply in a timely manner or on commercially reasonable terms;

we may have difficulty locating and qualifying alternative suppliers for our components;

once we identify alternative suppliers, we could experience significant delays in production due to the need to evaluate and test the products delivered by alternative suppliers and to obtain regulatory qualification for them;

we are not a major customer of many of our suppliers, and these suppliers may therefore give other customers' needs higher priority than ours;

we use some suppliers that are small, privately-held companies, and these suppliers could encounter financial or other difficulties that could cause them to modify or discontinue their operations at any time;

our suppliers manufacture products for a range of customers, and fluctuations in demand for the products those suppliers manufacture for others may affect their ability to deliver components to us in a timely manner; and

our suppliers may encounter financial hardships unrelated to our demand for components, which could inhibit their ability to fulfill our orders and meet our requirements.

Any interruption or delay in the supply of components or materials, or our inability to obtain components or materials from alternate sources at acceptable prices in a timely manner, could impair our ability to meet the demand of our customers and cause them to cancel orders or switch to competitive procedures. These events could harm our business and operating results.

We have limited marketing, sales and distribution capabilities, and our efforts in those areas are dependent in part on third parties.

We began commercial production and shipped our first imaging products in 2000, and therefore have limited experience in marketing, selling and distributing our products and services. Additionally, while we have a direct sales team focused on domestic marketing, sales and

distribution, we also use four independent distributors in the United States and two independent, international sales distributors to market, sell and distribute our products and services. As a result, we are dependent in part upon the marketing, sales and distribution efforts of our third-party distributors. To date, one of our domestic third-party distributors is permitted to market, sell and distribute competing imaging services and products. Additionally, one of our domestic third-party distributors, as well as one of our international distributors, is generally permitted to market, sell and distribute competing imaging products that are used or refurbished and meet specified age requirements. Our other international distributor is prohibited from promoting or distributing any other gamma camera product, but is not prohibited from offering competing services.

Our future revenue growth will depend in large part on our success in maintaining and expanding our marketing, sales and distribution channels, which will likely be an expensive and time-consuming process. We are highly dependent upon the efforts of our sales force and third-party distributors to increase our revenue. We face intense competition for qualified sales employees and may be unable to hire, train, manage and retain such personnel, which could adversely affect our ability to maintain and expand our marketing, sales and distribution network, which would negatively affect our ability to compete effectively as a distributor of nuclear imaging devices. Additionally, even if we are able to expand our sales force and enter into agreements with additional third-party distributors on commercially reasonable terms, they may not commit the necessary resources to effectively market, sell and distribute our products and services domestically and internationally. If we are unable to maintain and expand our direct and third-party marketing, sales and distribution networks, we may be unable to sell enough of our products and imaging services for our business to be profitable and our financial condition and results of operations will likely suffer accordingly.

We are subject to the financial risks associated with providing services through our DIS business.

There are numerous risks associated with any leasing arrangement, including the possibility that physicians may fail to make the required payments under the terms and provisions of their lease commitments. Our DIS business is also affected by the ability of physicians to pay us, which in turn may be affected by general economic and business conditions and the availability of reimbursement for the physicians. Such circumstances could adversely affect our business and financial condition.

If we are unable to expand our DIS business, our business could be materially harmed.

We plan to grow our DIS business by expanding into several new states, adding new hub locations in states in which we currently operate and increasing hub utilization by adding physician customers and routes. As we undertake this expansion, we will need to hire, train and retain qualified personnel. We cannot assure you that physicians or hospitals in these new markets will accept our imaging products or services. Our expansion into additional domestic markets is subject to inherent risk, including the burden of complying with applicable state regulations, including but not limited to regulations concerning the use, storage, handling and disposal of radioactive materials, the difficulties in obtaining the necessary radioactive licensures and difficulties in staffing and managing operations. Furthermore, physician self-referral laws currently in effect in the State of New York do not allow the conduct of our DIS business as it is currently structured or at all, and we may find the laws of other states in which we do not currently operate to require us to change the structure of our DIS business to operate in such states.

A loss of key executives or failure to attract qualified managers, engineers and imaging technologists could limit our growth and adversely affect our business.

Our success is dependent on the efforts of our key technical, sales and managerial personnel and our ability to retain them. The loss of any one or more of these individuals could place a significant strain on our remaining management team and we may have difficulty replacing any of these individuals. Furthermore, our future growth will depend in part upon our ability to identify, hire and retain additional key personnel, including nuclear imaging technologists, paramedics, nurses, radiation safety officers, engineers, management, sales personnel and other highly skilled personnel. Hiring qualified management and technical personnel will be difficult due to the limited number of qualified candidates. Competition for these types of employees, particularly nuclear imaging technologists and engineers, is intense in the medical imaging field. Given the competition for such qualified personnel, we cannot assure you that we will be able to continue to attract, hire and retain the personnel necessary to maintain and develop our business. Failure to attract, hire and retain key personnel could have an adverse effect on our business, financial condition and results of operations. We do not have any employment agreements with, or key person insurance on, any of our employees.

If we choose to acquire new or complementary businesses, products or technologies instead of developing them ourselves, we may be unable to complete those acquisitions or to successfully integrate them in a cost-effective and non-disruptive manner.

Our success depends on our ability to continually enhance and broaden our product and service offerings in response to changing customer demands, competitive pressures and technologies. While we have no current plans or commitments regarding any acquisitions of new or complementary businesses, products or technologies, we may in the future choose to pursue such acquisitions instead of developing those businesses, products or technologies ourselves. We cannot assure you, however, that we would be able to successfully complete any acquisition we choose to pursue, or that we would be able to successfully integrate any acquired business, product or technology into our

company in a cost-effective and non-disruptive manner. Furthermore, there is no certainty that we would be able to attract, hire or retain key employees associated with any acquired businesses, products or technologies.

Integrating any acquired businesses, products or technologies could be expensive and time consuming, disrupt our ongoing business and divert the attention and resources of our management. If we are unable to integrate any acquired businesses, products or technologies effectively, our business will likely suffer. Additionally, any amortization of assets or charges resulting from the costs of acquisitions could harm our business and operating results.

We will face additional risks as we expand into international markets.

We have sales distributors for our imaging systems in Canada and Russia and are beginning to build an international sales organization. As we expand internationally, we will need to hire, train and retain qualified personnel in countries where language, cultural or regulatory impediments may exist. We cannot assure you that distributors, physicians or other involved parties in foreign markets will accept our nuclear imaging products, services and business practices. Our international operations will be subject to inherent risks, including:

- costs of localizing product and service offerings for foreign markets;
- difficulties in staffing and managing foreign operations;
- reduced protection for intellectual property rights in some countries;
- difficulties and delays in enforcing agreements and in collecting receivables through the legal systems of foreign countries;
- fluctuating currency exchange rates;
- the possibility that foreign countries may impose additional withholding taxes or otherwise tax our foreign income, impose tariffs or adopt other restrictions on foreign trade;
- changes in political, regulatory, or economic conditions in a country or region;
- our ability to obtain U.S. export licenses and other required export or import licenses or approvals;
- burdens of complying with a wide variety of foreign laws, regulations specific to the delivery of and payment for healthcare services, regulations and licensing requirements relating to the use, storage, handling and disposal of radioactive materials, labor practices; and
- conforming our business model to operate under government-run healthcare systems.

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

Our manufacturing operations and executive offices are located at a single facility in Poway, California, near known fire areas and earthquake fault zones. This facility is located a short distance from the recent wildfires that destroyed many homes and businesses in San Diego County, California. We have taken precautions to safeguard our facilities, including insurance and health and safety protocols. However, any future natural disaster, such as a fire or an earthquake, could cause substantial delays in our operations, damage to or destroy our manufacturing equipment or inventory, and cause us to incur additional expenses. A disaster could significantly harm our business and results of operations. The insurance we maintain against fires and other natural disasters may not be adequate to cover our losses in any particular case.

Additionally, electrical power is vital to our operations and we rely on a continuous power supply to conduct our business. California has experienced significant electrical power shortages and price volatility in recent years, and such shortages and price volatility may occur in the future. In the event of an acute power shortage, the California system operator has on some occasions implemented, and may in the future implement, rolling blackouts throughout California. If our energy costs substantially increase or blackouts interrupt our power supply frequently or for more than a few days, we may have to reduce or temporarily discontinue our normal operations. In addition, the cost of our research and development efforts may increase because of the disruption to our operations. Any such reduction or disruption of our operations at our facilities could harm our business.

We are exposed to risks relating to product liability, product recalls, property damage and personal injury for which insurance coverage is expensive, limited and potentially inadequate, and our business may be impacted by increased insurance costs.

Our operations entail a number of risks, including risks relating to product liability claims, product recalls, property damage and personal injury. We currently maintain insurance that we believe is adequate with respect to the nature of the risks insured against, including product liability insurance, professional liability insurance, automobile insurance, property insurance, workers compensation insurance and general liability insurance. In many cases such insurance is expensive and difficult to obtain, and no assurance can be given that we will be able to maintain our current insurance or that we will be able to obtain or maintain comparable or additional insurance in the future on reasonable terms, if at all. Additionally, we may be negatively affected by increased costs of insurance, including workers compensation insurance. For example, in October 2003, the Governor of California signed a bill which will take effect in January 2006, which will require California businesses with 50 or more employees either to pay at least 80% of the premiums for a basic individual health insurance package for each of its employees and their families, or to pay a fee into a state pool for the purchase of health insurance for uninsured, low income workers.

Risks Related to Our Financial Results and Need for Financing

We have incurred significant and recurring operating losses since our inception in 1985 and we expect to incur increased operating expenses in the near term.

We have incurred significant net losses since our inception in November 1985 and as of June 30, 2004, we had an accumulated deficit of \$80.5 million. We expect to incur increased operating expenses in the near term as we, among other things:

expand our manufacturing operations and DIS business;

increase marketing, sales and distribution of our current products; and

conduct research and development to develop next-generation products and to enhance our existing products.

As a result of these activities, we may not be able to maintain profitability. If our revenue grows more slowly than anticipated, or if our operating expenses exceed our expectations, our ability to achieve our development and expansion goals would be adversely affected.

Our quarterly financial results are difficult to predict and are likely to fluctuate significantly from period to period because our business prospects are uncertain and due to the seasonality of our DIS leasing services business.

Our revenue and results of operations at any given time will be primarily based on the following factors, many of which we cannot control:

physician, healthcare provider and patient acceptance of our products and services;

demand and pricing of our products and services;

success and timing of new product offerings, acquisitions, licenses or other significant events by us or our competitors;

our ability to establish and maintain a productive manufacturing, marketing, sales and distribution force;

the ability of our suppliers to timely provide us with an adequate supply of necessary components;

timing and magnitude of our expenditures;

our ability to reduce our expenses, including our debt service obligations, quickly enough to respond to any declines in revenue;

regulatory approvals and legislative changes affecting the products we may offer or those of our competitors;

the effect of competing technological and market developments;

our addition or termination of research programs or funding support;

levels of third-party reimbursement for our products and services;

interruption in the manufacturing or distribution of our products and services; and

changes in our ability to obtain FDA approval or clearance for our products.

Furthermore, we have experienced seasonality in the leasing services offered by DIS. While our physicians are obligated to pay us for all lease days to which they have committed, our contracts permit some flexibility in scheduling when services are to be performed. This accounts for some of the seasonality of our DIS revenues. For example, our daily services have typically declined from our second fiscal quarter to our third fiscal quarter due to summer holidays and vacation schedules. We have also experienced declining daily services in December due to holidays and in our first quarter due to weather conditions in certain parts of the United States. We cannot predict with certainty the degree to which seasonal circumstances such as the summer slowdown, winter holiday variations and weather conditions may make our revenue unpredictable or lead to fluctuations in our quarterly operating results in the future.

In addition, due to the way that customers in our target markets acquire our products, a large percentage of our orders of gamma cameras is booked during the last month of each quarterly accounting period. As such, a delivery delay of only a few days may significantly impact our quarter-to-quarter comparisons.

For these reasons, we believe that quarterly sales and operating results may vary significantly in the future and that period-to-period comparisons of our results of operations are not necessarily meaningful and should not be relied upon as indicators of future performance. We cannot assure you that our sales will increase or be sustained in future periods. Accordingly, we may experience significant, unanticipated quarterly losses. Because of these and other factors, our operating results in one or more future quarters may fail to meet the expectations of securities analysts or investors, which could cause our stock price to decline significantly.

Our reliance on a limited number of customers may cause our sales to be volatile.

We currently have a small number of customers, whom we typically bill after the delivery of our products and imaging services. If orders for our gamma cameras were to be cancelled, or our leasing service customers stopped using us or do not renew their lease agreements with us, our business would be adversely affected. Furthermore, in view of our small customer base, our failure to gain additional customers, the loss of any current customers or a significant reduction in the level of leasing services provided to any one customer could disrupt our business, harm our reputation and adversely affect our sales.

The sales cycle for our gamma cameras is typically lengthy, which may result in significant fluctuations in our revenue.

Our sales efforts for our gamma cameras are dependent on the capital expenditures budgets of the physicians and hospitals to which we market. Often physicians and hospitals require a significant amount of lead time to plan for a major acquisition such as the purchase of our imaging systems. We may spend substantial time, effort and expense long before we actually consummate an order of our cameras and with no assurance that we will ultimately be successful in achieving any such orders. As a result, we may experience significant fluctuations in our revenues. Furthermore, evaluating and predicting our future sales and operating performance is difficult and may not be as accurate as it could be if we had shorter sales cycles.

Our future capital needs are uncertain and we may need to raise additional funds in the future, and such funds may not be available on acceptable terms, if at all.

Although we believe that our current cash and cash equivalents will be sufficient to meet our projected operating requirements for the foreseeable future, our capital requirements will depend on many factors, including:

the revenue generated by sales of our products and services;

the costs associated with expanding our manufacturing, marketing, sales and distribution efforts;

the rate of progress and cost of our research and development activities;

the costs of obtaining and maintaining FDA and other regulatory clearance of our products and products in development;

the costs of obtaining and maintaining radioactive materials licenses and radiation safety procedures;

the effects of competing technological and market developments;

the number and timing of acquisitions and other strategic transactions; and

the costs associated with our expansion, if any.

As a result of these factors, we may need to raise additional funds, and we cannot be certain that such funds will be available to us on acceptable terms, if at all. Furthermore, if we issue equity or debt securities to raise additional funds, our existing stockholders may experience dilution and the new equity or debt securities may have rights, preferences and privileges senior to those of our existing stockholders. In addition, if we raise additional funds through collaboration, licensing or other similar arrangements, it may be necessary to relinquish potentially valuable rights to our future products or proprietary technologies, or grant licenses on terms that are not favorable to us. If we cannot raise funds on acceptable terms, we may not be able to expand our operations, develop new products, take advantage of future opportunities or respond to competitive pressures or unanticipated customer requirements.

Risks Related to Government Regulation

We must be licensed to handle and use hazardous materials and may be liable for contamination or other harm caused by hazardous materials that we use.

We use hazardous and radioactive materials in our research and development and manufacturing processes, as well as in the provision of our imaging services. We are subject to federal, state and local regulations governing use, storage, handling and disposal of these materials and waste products. We are currently licensed to handle such materials in all states in which we operate, but there can be no assurances that we will be able to retain those licenses in the future. In addition, we must become licensed in all states in which we plan to expand. Obtaining those additional licenses is an expensive and time consuming process, and in some cases we may not be able to obtain those licenses at all.

Although we believe that our procedures for use, handling, storing and disposing of these materials comply with legally prescribed standards, we cannot completely eliminate the risk of contamination or injury resulting from hazardous materials and we may incur liability as a result of any such contamination or injury. In the event of an accident, we could be held liable for damages or penalized with fines, and the liability could exceed our resources and any applicable insurance.

We have also incurred and may continue to incur expenses related to compliance with environmental laws. Such future expenses or liability could have a significant negative impact on our business, financial condition and results of operations. Further, we cannot assure you that the cost of complying with these laws and regulations will not materially increase in the future.

Compliance with extensive product regulations could be expensive and time consuming, and any failure to comply with those regulations could harm our ability to sell and market our products and imaging services.

U.S. and foreign regulatory agencies, including the FDA, govern the testing, marketing and registration of new medical devices or modifications to medical devices, in addition to regulating manufacturing practices, reporting, labeling and recordkeeping procedures. The regulatory process makes it longer, harder and more costly to bring our products to market, and we cannot assure you that any of our future products will be approved. All of our planned services, products and manufacturing activities, as well as the manufacturing activities of third-party medical device manufacturers who supply components to us, are subject to these regulations. Generally, we and our third-party manufacturers are or will be required to:

undergo rigorous inspections by domestic and international agencies;

obtain the prior approval of those agencies before we can market and sell our medical device products; and

satisfy content and format requirements for all of our sales and promotional materials.

Compliance with the regulations of those agencies may delay or prevent us from introducing new or improved products, which could in turn affect our ability to achieve or maintain profitability. We may be subject to sanctions, including monetary fines and criminal penalties, the temporary or permanent suspension of operations, product recalls and marketing restrictions, if we fail to comply with the laws and regulations applicable to our business. Our third-party component manufacturers may also be subject to the same sanctions and, as a result, may be unable to supply components for our products. Any failure to retain governmental approvals that we currently hold or obtain additional similar approvals could prevent us from successfully marketing our products and technology and could harm our operating results.

Furthermore, changes in the applicable governmental regulations could prevent further commercialization of our products and technologies and could harm our business.

Even if regulatory approval or clearance of a product is granted, regulatory agencies could impose limitations on uses for which the product may be labeled and promoted. Further, for a marketed product, its manufacturer and manufacturing facilities are subject to periodic review and inspection. Later discovery of problems with a product, manufacturer or facility may result in restrictions on the product, manufacturer or facility, including withdrawal of the product from the market or other enforcement actions.

Our products are subject to reporting requirements and recalls even after receiving FDA clearance or approval, which could harm our reputation, business and financial results.

We are subject to medical device reporting regulations that require us to report to the FDA or similar governmental bodies in other countries if our products cause or contribute to a death or serious injury or malfunction in a way that would be reasonably likely to contribute to death or serious injury if the malfunction were to recur. In addition, the FDA and similar governmental bodies in other countries have the authority to require the recall of our products in the event of material deficiencies or defects in design or manufacture. A government mandated or voluntary recall by us could occur as a result of component failures, manufacturing errors or design defects, including defects in labeling. Any recall would divert management attention and financial resources and harm our reputation with customers. A recall involving our product could harm the reputation of the product and our company and would be particularly harmful to our business and financial results.

If we fail to obtain, or are significantly delayed in obtaining, FDA clearances or approvals for future products or product enhancements, or if we fail to comply with FDA's Quality System Regulation, our ability to commercially market and distribute our products will suffer.

Our products are subject to rigorous regulation by the FDA, and numerous other federal, state and foreign governmental authorities. In the U.S., the FDA regulates virtually all aspects of a medical device's testing, manufacture, safety, labeling, storage, recordkeeping, reporting, promotion and distribution. Our failure to comply with those regulations could lead to the imposition of administrative or judicial sanctions, including injunctions, suspensions or the loss of regulatory approvals, product recalls, termination of distribution, or product seizures. In the most egregious cases, criminal sanctions or closure of our manufacturing facilities are possible. The process of obtaining regulatory approvals to market a medical device, particularly from the FDA, can be costly and time consuming, and there can be no assurance that such approvals will be granted on a timely basis, if at all. In particular unless exempt, the FDA permits commercial distribution of a new medical device only after the device has received 510(k) clearance or is the subject of an approved Premarket Approval Application, or PMA. The FDA will clear marketing of a medical device through the 510(k) process if it is demonstrated that the new product is substantially equivalent to other 510(k)-cleared products. The PMA approval process is more costly, lengthy and uncertain than the 510(k) clearance process, and must be supported by extensive data, including data from preclinical studies and human clinical trials. Because we cannot assure you that any new products we develop, or any product enhancements, will be subject to the shorter 510(k) clearance process, significant delays in the introduction of any new products or product enhancements may occur. While we have not been required to obtain PMA approval for any of our products, there is no assurance that the FDA will not require a new product or product enhancement go through the lengthy and expensive PMA approval process. Further, pursuant to FDA regulations, we can only market our products for approved uses. If our products are used for purposes other than those approved by the FDA, the FDA could object to such off-label uses.

Our manufacturing processes and those of our third-party manufacturers are required to comply with the FDA's Quality System Regulation, which covers the design, testing, production processes, controls, quality assurance, labeling, packaging, storage and shipping of our devices. In addition, we must engage in extensive recordkeeping and reporting and must make available our manufacturing facility and records for periodic unscheduled inspections by federal, state and foreign agencies, including the FDA. Our or our third-party manufacturers' failure to pass a Quality System Regulation inspection or to comply with these and other applicable regulatory requirements could result in disruption of our operations and manufacturing delays, and a failure to take adequate corrective action could result in, among other things, withdrawal of our medical device clearances, seizure or recall of our devices, or other civil or criminal enforcement actions.

Foreign governmental authorities that regulate the manufacture and sale of medical devices have become increasingly stringent and, to the extent we now or in the future market and sell our products in foreign countries, we may be subject to rigorous regulation by those foreign governmental authorities. In such circumstances, we would rely significantly on our foreign independent distributors to comply with the varying regulations, and any failures on their part could result in restrictions on the sale of our products in foreign countries.

Modifications to our products may require new 510(k) clearances or premarket approvals, or may require us to cease marketing or recall the modified products until clearances are obtained.

Any modification to a 510(k)-cleared device that could significantly affect its safety or effectiveness, or that would constitute a major change in its intended use, design, or manufacture, requires a new 510(k) clearance or, possibly, approval of a PMA. The FDA requires every manufacturer to make this determination in the first instance, but the FDA may review any manufacturer's decision. The FDA may not agree

with our decisions regarding whether new clearances or approvals are necessary. If the FDA requires us to seek 510(k) clearance or PMA for modification of a previously cleared product for which we have concluded that new clearances or approvals are unnecessary, we may be required to cease marketing or to recall the modified product until we obtain clearance or approval, and we may be subject to significant regulatory fines or penalties. Further, our products could be subject to recall if the FDA determines, for any reason, that our products are not safe or effective. Any recall or FDA requirement that we seek additional approvals or clearances could result in delays, fines, costs associated with modification of a product, loss of revenue and potential operating restrictions imposed by the FDA.

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

We are directly or indirectly through our clients, subject to extensive regulation by both the federal government and the states and foreign countries in which we conduct our business. The laws that directly or indirectly affect our ability to operate our business include, but are not limited to, the following:

the federal Medicare and Medicaid Anti-Kickback Law, which prohibits persons from knowingly and willfully soliciting, offering, receiving or providing remuneration, directly or indirectly, in cash or in kind, to induce either the referral of an individual, or furnishing or arranging for a good or service, for which payment may be made under federal healthcare programs such as the Medicare and Medicaid Programs;

other Medicare laws and regulations that prescribe the requirements for coverage and payment for services performed by us and our DIS customers, including the amount of such payment;

the federal False Claims Act, which imposes civil and criminal liability on individuals and entities who submit, or cause to be submitted, false or fraudulent claims for payment to the government;

the federal Health Insurance Portability and Accountability Act of 1996, or HIPAA, which prohibits executing a scheme to defraud any healthcare benefit program, including private payors and, further, requires us to comply with standards regarding the privacy and security of individually identifiable health information and conduct certain electronic transactions using standardized code sets. In addition, regulations have been issued under HIPAA that will require us to comply with additional security regulations by April 2005 and to adopt unique health identifiers for use in filing and processing healthcare claims and other transactions by May 2007;

the federal False Statements Statute, which prohibits knowingly and willfully falsifying, concealing or covering up a material fact or making any materially false statement in connection with the delivery of or payment for healthcare benefits, items or services;

the federal physician self-referral prohibition, commonly known as the Stark Law, which, in the absence of a statutory or regulatory exception, prohibits the referral of Medicare patients by a physician to an entity for the provision of certain designated healthcare services, if the physician or a member of the physician's immediate family has a direct or indirect financial relationship, including an ownership interest in, or a compensation arrangement with, the entity and also prohibits that entity from submitting a bill to a federal payor for services rendered pursuant to a prohibited referral;

the federal Food, Drug and Cosmetic Act, which regulates the manufacture, labeling, marketing, distribution and sale of prescription drugs and medical devices;

state and foreign law equivalents of the foregoing;

federal and state radioactive materials laws, which govern the procurement, use, transfer and storage of radioactive materials;

state food and drug laws, pharmacy acts and state pharmacy board regulations, which govern the sale, distribution, use, administration and prescribing of prescription drugs;

state laws that prohibit the practice of medicine by non-physicians and fee-splitting arrangements between physicians and non-physicians, as well as state law equivalents to the federal Medicare and Medicaid Anti-Kickback Law and the Stark Law, which may not be limited to government reimbursed items or services; and

federal laws and regulations that permit physicians to bill and receive payment for certain diagnostic tests under the Medicare Physician Fee Schedule only if certain conditions are satisfied, including the requirement that the physician personally perform, or adequately supervise the performance of, the test using equipment they own or lease, and that prohibit physicians from marking up the cost of tests they “purchase,” rather than perform or supervise, for Medicare patients.

We implemented a compliance program in 2002 to help assure that we remain in compliance with these laws. Like most companies with active and effective compliance programs, we occasionally discover compliance concerns. For example, we have discovered certain isolated arrangements that we entered into in good faith but that, upon review by our compliance personnel, raised some compliance concerns under these laws. In accordance with our compliance program, we took immediate remedial steps. We cannot assure you that these remedial steps will insulate us from liability associated with these isolated arrangements.

If our past or present operations are found to be in violation of any of the laws described above or the other governmental regulations to which we or our customers are subject, we may be subject to the applicable penalty associated with the violation, including civil and criminal penalties, damages, fines, exclusion from the Medicare and Medicaid programs and the curtailment or restructuring of our operations. Similarly, if our customers are found non-compliant with applicable laws, they may be subject to sanctions, which could also have a negative impact on us. In addition, if we are required to obtain permits or licensure under these laws that we do not already possess, we may become subject to substantial additional regulation or incur significant expense. Any penalties, damages, fines, curtailment or restructuring of our operations would adversely affect our ability to operate our business and our financial results. The risk of our being found in violation of these laws is increased by the fact that many of them have not been fully interpreted by the regulatory authorities or the courts, and their provisions are open to a variety of interpretations, and additional legal or regulatory change. Any action against us for violation of these laws, even if we successfully defend against it, could cause us to incur significant legal expenses, divert our management's attention from the operation of our business and damage our reputation.

Legislative or regulatory reform of the healthcare system may affect our ability to sell our products profitably.

In both the United States and certain other foreign jurisdictions, there have been a number of legislative and regulatory proposals to change the healthcare system in ways that could impact our ability to sell our products and services profitably. In the United States, federal and state lawmakers regularly propose and, at times, enact new legislation establishing significant changes in the healthcare system. Recently, President Bush signed into law the Medicare Modernization Act, which contains a wide variety of reforms that impact Medicare reimbursements to hospitals and physicians including changes to Medicare payment methodologies for radiopharmaceuticals and other drugs dispensed by hospital outpatient departments and for drugs dispensed by physician offices and independent diagnostic testing facilities. These changes reduced payment amounts for some of the drugs used in conjunction with our imaging procedures, although the physician fee schedule payment rates applicable to nuclear cardiology increased slightly. Downward changes to Medicare reimbursement rates may adversely impact reimbursement to customers or potential customers that use or could use our cameras and services. We cannot predict the full impact that this new legislation will have nor whether new federal legislation will be enacted in the future. The potential for adoption of healthcare reform proposals on a state-by-state basis could require us to develop state-specific marketing and sales approaches. In addition, we may experience pricing pressures in connection with the sale of our products and services due to additional legislative proposals or healthcare reform initiatives. Our results of operations and our business could therefore be adversely affected by future healthcare reforms.

The impact of regulatory changes could have a negative impact on camera sales to and leases with hospitals desiring to use our cameras and services in their outpatient facilities.

In order for hospitals to receive certain payments for their outpatient facilities as hospital outpatient services, including services that utilize our products, these services must be furnished in a "provider-based" organization or facility or be covered services furnished "under arrangement" with the hospital. Failure to meet these requirements may result in reduced payments to the hospitals for their services. The Medicare program has published and revised rules establishing criteria for classifying a facility as "provider-based" or a service as furnished "under arrangement." These rules require an analysis of the facts and circumstances surrounding the delivery by a hospital of a particular service, and hospitals that use our products or DIS services in their outpatient facilities will need to determine if they meet the applicable "provider-based" or "under arrangement" requirements. Hospitals that cannot obtain sufficient payments for these services may not purchase a camera from us or enter into arrangements with us for provision of services.

The application of state certificate of need regulations could harm our business and financial results.

Some states currently require, or may require in the future, a certificate of need or similar regulatory approval prior to the acquisition of high-cost capital items, including diagnostic imaging systems, or provision of diagnostic imaging services by us or our clients. In many cases, a limited number of these certificates are available in a given state. If we or our clients are unable to obtain the applicable certificate or

approval or additional certificates or approvals necessary to expand our operations, these regulations may limit or preclude our operations in the relevant jurisdictions.

If we fail to comply with various licensure, or certification standards, we may be subject to loss of licensure or certification, which would adversely affect our operations.

All of the states in which we operate require that the imaging technicians that operate our cameras be licensed or certified. Obtaining such licenses may take significant time as we expand into additional states. Any lapse in the licensure or certification of our technicians could increase our costs and adversely affect our operations and financial results. Further, we are currently enrolled by Medicare contractors, or “carriers,” as an independent diagnostic testing facility in nine states where we are or were operating under our “mixed bill” model, and enrollment is essential for us to receive payment for healthcare services directly from Medicare. We are phasing out our “mixed bill” operations and, as of August 1, 2004, derive less than one percent of our DIS revenues from such operations.

In the healthcare industry, various types of organizations are accredited to facilitate meeting certain Medicare certification requirements, expedite third-party payment and fulfill state licensure requirements. Some managed care providers prefer to contract with accredited organizations. Thus far, we have not found it necessary to seek or obtain accreditation from any established accreditation agency. If it becomes necessary for us to do so in the future in order to satisfy the requirements of third-party payors or regulatory agencies, there can be no assurances that we will be able to obtain or continuously maintain this accreditation.

Audits or denials of our claims, or claims submitted by our DIS customers, by government agencies or contractors could reduce our revenues or profits and expose us to claims.

Under our “mixed bill” model, we submit claims directly to and receive payments directly from the Medicare program. Therefore, we are subject to extensive government regulation, including requirements for maintaining certain documentation to support our claims. Government agencies and Medicare contractors also may conduct inspections or surveys of our facilities, payment reviews and other audits of our claims and operations. For example, as part of a national audit conducted pursuant to the 2003 work plan, the Office of the Inspector General of the U.S. Department of Health and Human Services, or the OIG, conducted a review of one of our independent diagnostic testing facilities in early 2003 to review the appropriateness of Medicare payments received. This audit was concluded without any action being taken by the OIG. While we believe this audit will have no impact on us, we cannot assure you that the OIG may not take some follow-up action. We may be subject to investigations, payment reviews and audits and cannot assure you that such scrutiny will not result in material delays in payment, as well as material recoupments or denials, which could reduce our revenue or profits. Our DIS customers also submit claims to Medicare and other third-party payors, are subject to the same types of regulation and scrutiny, and may experience the same types of problems. This could adversely affect our ability to market our leases and services and to maintain existing contracts.

Risks Related to Our Intellectual Property and Potential Litigation

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

Our success depends significantly on our ability to protect our proprietary rights to the technologies used in our products. We rely on patent protection, as well as a combination of copyright, trade secret and trademark laws, and nondisclosure, confidentiality and other contractual restrictions to protect our proprietary technology. However, these legal means afford only limited protection and may not adequately protect our rights or permit us to gain or keep any competitive advantage. Our pending U.S. and foreign patent applications, which include claims to material aspects of our products and procedures that are not currently protected by issued patents, may not issue as patents in a form that will be advantageous to us. Any patents we have obtained or do obtain may be challenged by re-examination or otherwise invalidated or eventually found unenforceable. Both the patent application process and the process of managing patent disputes can be time consuming and expensive. Competitors may attempt to challenge or invalidate our patents, or may be able to design alternative techniques or devices that avoid infringement of our patents, or develop products with functionalities that are comparable to ours. Although we have taken steps to protect our intellectual property and proprietary technology, including entering into confidentiality agreements and intellectual property assignment agreements with our employees, consultants, advisors and corporate partners, such agreements may not be enforceable or may not provide meaningful protection for our trade secrets or other proprietary information in the event of unauthorized use or disclosure or other breaches of the agreements. Furthermore, the laws of some foreign countries may not protect our intellectual property rights to the same extent as do the laws of the United States.

In the event a competitor infringes upon our patent or other intellectual property rights, litigation to enforce our intellectual property rights or to defend our patents against challenge, even if successful, could be expensive and time consuming and could require significant time and attention from our management. We may not have sufficient resources to enforce our intellectual property rights or to defend our patents against challenges from others.

We have entered into a royalty-bearing license for one U.S. patent with a third-party for use in nuclear imaging, which license is co-exclusive with the U.S. government. In July 2004, we settled our dispute concerning this license and retain the license co-exclusively at more favorable licensing terms.

The medical device industry is characterized by patent litigation and we could become subject to litigation that could be costly, result in the diversion of our management's time and efforts, and require us to pay damages.

The medical device industry is characterized by extensive litigation and administrative proceedings over patent and other intellectual property rights. Whether a product infringes a patent involves complex legal and factual issues, the determination of which is often uncertain. Our competitors may assert that our products, their components or the methods we employ in the use of our products are covered by U.S. or foreign patents held by them. In addition, they may claim that their patents have priority over ours because their patents were filed or invented earlier. Because patent applications can take many years to issue, there may be applications now pending of which we are unaware, which may later result in issued patents that our products may infringe. There could also be existing patents that one or more components of our products may be infringing of which we are unaware. As the number of participants in our industry increases, the possibility of patent infringement claims against us also increases.

Any litigation or claims against us may cause us to incur substantial costs, could place a significant strain on our financial resources, divert the attention of our management from our core business and harm our reputation. If the relevant patents were upheld as valid and enforceable and we were found to be inadvertently infringing, we could be required to pay substantial damages and/or royalties and could be prevented from selling our products unless we could obtain a license or were able to redesign our system to avoid infringement. Any such license may not be available on reasonable terms, if at all. If we fail to obtain any required licenses or make any necessary changes to our products or technologies, we may be unable to commercialize one or more of our products.

We rely significantly on a license agreement with Segami Corporation for the imaging acquisition and processing software for our digital gamma camera, and the loss of the license could result in delivery delays, loss of customers and loss of revenue.

Segami Corporation, or Segami, has developed image acquisition and processing software for our camera under a non-exclusive license agreement. In the event that Segami attempts to terminate the license agreement, refuses to extend the term of the license or seeks to impose unreasonable pricing or terms, we would have to find an alternative software system to use in our gamma camera. To our knowledge, there are a limited number of companies that would be able to develop and implement a software system similar to what we use in our gamma camera. As a result, in the event that we were unable to continue to use the software under the license from Segami, we could have delays in the production of our gamma camera as we attempted to find a substitute software provider. Furthermore, we cannot guarantee that alternative software providers would be able to meet our requirements or that their software would be available to us at favorable prices, if at all. To the extent we were unable to find an alternative source for the software, we may have to develop our own software system. We cannot guarantee that we could internally develop such a software system or that such efforts would not divert resources away from the development of other features of our camera. As a result, locating an alternative software system or developing our own software system could interrupt the manufacture and delivery of our products for an extended period of time and may cause the loss of customers and revenue.

We may be subject to damages resulting from claims that we, or our employees, have wrongfully used or disclosed alleged trade secrets of their former employers.

Many of our employees were previously employed at other medical device companies, including our competitors or potential competitors. Although no claims against us are currently pending, we may be subject to claims that we or our employees have inadvertently or otherwise used or disclosed trade secrets or other proprietary information of their former employers. Litigation may be necessary to defend against these claims. Even if we are successful in defending against these claims, litigation could result in substantial costs and be a distraction to management. If we fail in defending such claims, in addition to paying money damages, we may lose valuable intellectual property rights or personnel. A loss of key research personnel or their work product could hinder or preclude our ability to commercialize our products, which could severely harm our business.

If we become subject to product liability or warranty claims, we may experience reduced demand for our products or be required to pay damages that exceed our insurance coverage.

The sale and support of our products entails the risk of product liability or warranty claims, such as those based on claims that the failure of one of our products resulted in a misdiagnosis, among other issues. The medical device industry has been subject to significant products liability litigation. We may incur significant liability in the event of any such litigation, regardless of the merit of the action. Although we

maintain product liability insurance, we cannot be sure that this coverage is adequate or that it will continue to be available on acceptable terms, if at all. We also may face warranty exposure, which could adversely affect our operating results. Any unforeseen warranty exposure or insufficient insurance could harm our business, financial condition and results of operations. Finally, even a meritless or unsuccessful product liability claim could harm our reputation in the industry, lead to significant legal fees and could result in the diversion of management's attention from managing our business.

We may be subject to lawsuits and actions brought by our employees.

We may from time to time be subject to employment claims or disputes. In June 2004, we settled allegations by one former and three present employees claiming that they were due overtime pay because of an alleged misclassification of their positions as non-exempt rather than exempt employees. However, we cannot assure you that we may not be subject to other lawsuits and actions brought by our employees or that we would be successful defending against such actions. Any employment claims could significantly divert our management's time and attention and could materially affect our business.

Risks Related to the Securities Markets and Ownership of Our Common Stock

There has been no prior public market for our common stock and an active trading market may not develop

Prior to our initial public offering, there had been no public market for our stock. An active trading market for our common stock may not develop in the future or, if it is developed, may not be sustained. An inactive market may impair your ability to sell your shares at the time you wish to sell them or at a price that you consider reasonable. Furthermore, an inactive market may impair our ability to raise capital by selling shares and may impair our ability to acquire other businesses, products and technologies by using our shares as consideration.

Future sales of our common stock may cause our stock price to decline.

A small number of our current stockholders hold a substantial number of shares of our common stock that they will be able to sell in the public market in the near future. Sales by our current stockholders of a substantial number of shares, or the expectation that such sale may occur, could significantly reduce the market price of our common stock. Moreover, as of June 30, 2004, the holders of approximately 12,546,496 shares of common stock, including shares issued upon the exercise of certain of our warrants, will have rights, subject to some conditions, to require us to file registration statements to permit the resale of their shares in the public market or to include their shares in registration statements that we may file for ourselves or other stockholders. Although the holders of most of our outstanding capital stock have agreed with the underwriters of our initial public offering to be bound by a 180-day lock-up agreement that prohibits these holders from selling or transferring their stock, other than in specific circumstances, Merrill Lynch, Pierce, Fenner & Smith Incorporated and J.P. Morgan Securities Inc., at their discretion, can waive the restrictions of the lock-up agreement at an earlier time without prior notice or announcement and allow our stockholders to sell their shares of our common stock in the public market. If the restrictions of the lock-up agreement are waived, shares of our common stock will be available for sale into the market, subject only to applicable securities rules and regulations, which may cause our stock price to decline.

We have also registered all common stock that we may issue under our 2004 Stock Incentive Plan and 2004 Non-Employee Director Stock Option Program. Accordingly, they can be freely sold in the public market upon issuance, subject to restrictions under the securities laws and the lock-up agreements described above. If any of these stockholders cause a large number of securities to be sold in the public market, the sales could reduce the trading price of our common stock. These sales also could impede our ability to raise future capital.

Our stock price may be volatile.

The market price for our common stock is likely to be volatile. In addition, the market price of our common stock may fluctuate significantly in response to a number of factors, most of which we cannot control, including:

volume and timing of orders for our products and services;

the introduction of new products, product enhancements, services or technologies by us or our competitors;

quarterly variations in our or our competitors' results of operations;

conditions or trends in the medical device industry and the imaging service industry;

disputes or other developments with respect to intellectual property rights;

our ability to develop, obtain regulatory clearance for, and market, new and enhanced products on a timely basis;

product liability claims or other litigation;

additions or departures of key personnel;

sales of large blocks of our common stock, including sales by our executive officers and directors;

changes in governmental regulations or in the status of our regulatory approvals or applications;

changes in the availability of third-party reimbursement in the United States or other countries;

changes in earnings estimates or recommendations by securities analysts; and

general market conditions and other factors, including factors unrelated to our operating performance or the operating performance of our competitors.

Anti-takeover provisions in our organizational documents and Delaware law may discourage or prevent a change in control, even if an acquisition would be beneficial to our stockholders, which could affect our stock price adversely and prevent attempts by our stockholders to replace or remove our current management.

Our restated certificate of incorporation and restated bylaws contain provisions that may delay or prevent a change in control, discourage bids at a premium over the market price of our common stock and adversely affect the market price of our common stock and the voting and other rights of the holders of our common stock. These provisions include:

prohibiting our stockholders from calling a special meeting of stockholders unless they hold not less than 20% of the total number of votes to be cast at such a meeting;

permitting the issuance of additional shares of our common stock or preferred stock without stockholder approval;

prohibiting our stockholders from making certain changes to our restated certificate of incorporation or restated bylaws except with 66²/₃% stockholder approval; and

requiring advance notice for raising matters of business or making nominations at stockholders' meetings.

We are also subject to provisions of the Delaware corporation law that, in general, prohibit any business combination with a beneficial owner of 15% or more of our common stock for five years unless the holder's acquisition of our stock was approved in advance by our board of directors. Although we believe these provisions collectively provide for an opportunity to receive higher bids by requiring potential acquirors to negotiate with our board of directors, they would apply even if the offer may be considered beneficial by some stockholders. In addition, these provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors, which is responsible for appointing the members of our management.

We may become involved in securities class action litigation that could divert management's attention and harm our business.

The stock market in general, and the Nasdaq National Market and the market for medical device companies in particular, has experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of the companies in those markets. In addition to our performance, these broad market and industry factors may materially harm the market price of our common stock, regardless of our operating performance. In the past, following periods of volatility in the market price of a particular company's securities, securities class action litigation has often been brought against that company. We may become involved in this type of litigation in the future. Litigation often is expensive and diverts management's attention and resources, which could materially harm our financial condition and results of operations.

If our officers, directors and principal stockholders choose to act together, they may be able to control our management and operations, acting in their best interests and not in the best interests of other stockholders.

Our officers, directors and holders of 5% or more of our outstanding common stock beneficially own the majority of our outstanding common stock. As a result, these stockholders, acting together, will be able to significantly influence all matters requiring approval by our stockholders, including the election of directors and the approval of mergers or other business combination transactions. The interests of this group of stockholders may not always coincide with our interests or the interests of other stockholders, and they may act in a manner that advances their best interests and not necessarily those of other stockholders. As a result of their actions or inactions our stock price may decline.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to market risk due to changes in interest rates relates primarily to the increase or decrease in the amount of interest income we can earn on our investment portfolio and on the increase or decrease in the amount of interest expense we must pay on our various outstanding debt instruments. Our risk associated with fluctuating interest rates is limited, however, to certain of our long-term debt and capital lease obligations, all of which have interest rates that are closely tied to market rates, and our investments in interest rate sensitive financial instruments. Under our current policies, we do not use interest rate derivative instruments to manage exposure to interest rate changes. We attempt to increase the safety and preservation of our invested principal funds by limiting default risk, market risk and reinvestment risk. We mitigate default risk by investing in investment grade securities. A hypothetical 100 basis point adverse move in interest rates along the entire interest rate yield curve would not materially affect the fair value of our interest sensitive financial instruments. Changes in interest rates over time will increase or decrease our interest income and interest expense.

ITEM 4. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports pursuant to the Securities Exchange Act of 1934, as amended, 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, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by Rule 13a-15(b) of the Securities Exchange of 1934, as amended, 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 quarter covered by this report. Based on the foregoing, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

There has been no change in our internal controls over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

PART II. OTHER INFORMATION

ITEM 2. CHANGES IN SECURITIES, USE OF PROCEEDS AND ISSUER PURCHASES OF EQUITY SECURITIES.

(c) During the quarter ended June 30, 2004, we issued and sold the following unregistered securities:

On April 22, 2004, we granted options to purchase 62,000 shares of common stock to employees, directors and consultants under our 1998 Stock Option/Stock Issuance Plan at an exercise price of \$6.51 per share. During such period of time, 39,150 shares of common stock were purchased pursuant to the exercise of stock options for cash consideration with an aggregate exercise price of \$19,184. The offers, sales and issuances of the options and common stock were deemed to be exempt from registration under the Securities Act of 1933, as amended, in reliance on Rule 701 because the transactions were under compensatory benefit plans and contracts relating to compensation as provided under Rule 701. The recipients of such options and common stock were our employees, directors or bona fide consultants and received the securities under our 1998 Stock Option/Stock Issuance Plan. Appropriate legends were affixed to the share certificates issued in such transactions, and each of these recipients had adequate access, through employment or other relationships, to information about us.

On June 16, 2004, we issued warrants to purchase 47,618 shares of our common stock to six of our stockholders in connection with the repayment of principal outstanding under notes payable held by two of the stockholders. Such warrants have an exercise price equal to \$12.00 per share and expire if not exercised on or before June 16, 2008. The offers, sales and issuances of the warrants were deemed to be exempt from registration under the Securities Act in reliance on Section 4(2) of the Securities Act because the issuance of warrants to the recipients did not involve a public offering. The recipients of the warrants represented their intention to acquire the securities for investment only and not with a view to or for sale in connection with any distribution thereof and appropriate legends were affixed to warrants issued in such transaction. Each of the recipients of the warrants were accredited or sophisticated persons and had adequate access, through employment, business or other relationships, to information about us.

(d) We effected the initial public offering of our common stock pursuant to a Registration Statement on Form S-1 (File No. 333-113760) that was declared effective by the Securities and Exchange Commission on June 9, 2004. On June 15, 2004, 5,500,000 shares of common stock were sold on our behalf at an initial public offering price of \$12.00 per share, for an aggregate offering price of \$66.0 million, which offering was managed by Merrill Lynch, Pierce, Fenner & Smith Incorporated, J.P. Morgan Securities Inc., Banc of America Securities LLC and William Blair & Company, L.L.C. Following the sale of the 5,500,000 shares, the offering terminated.

We paid to the underwriters underwriting discounts and commissions totaling approximately \$4.6 million in connection with the offering. In addition, we estimate that we incurred additional expenses of approximately \$2.6 million in connection with the offering, which when added to the underwriting discounts and commissions paid by us, amounts to total estimated expenses of approximately \$7.2 million. Thus, the net offering proceeds to us, after deducting underwriting discounts and commissions and estimated offering expenses, were approximately \$58.8 million. No offering expenses were paid directly or indirectly to any of our directors or officers (or their associates) or persons owning ten percent or more of any class of our equity securities or to any other affiliates.

We expect to use a majority of the net proceeds from our initial public offering to manufacture and market our gamma cameras, build our sales and marketing capabilities, expand our business and repay outstanding lines of credit and notes payable. As of June 30, 2004, we had repaid the approximately \$9.7 million that was outstanding under our lines of credit and notes payable from the net proceeds, none of which was paid directly or indirectly to any of our directors or officers (or their associates) or persons owning ten percent or more of any class of our equity securities or to any other affiliates.

To a lesser extent, we anticipate using the remaining net proceeds of the offering:

for further research and development relating to our existing products and new product opportunities and to finance regulatory approval activities; and

for general corporate purposes.

In addition, we may use a portion of the net proceeds from our initial public offering to acquire products, technologies or businesses that are complementary to our own, but we currently have no commitments or agreements relating to any of these types of transactions.

We cannot specify with certainty all of the particular uses for the net proceeds to be received upon the completion of our initial public offering. The amount and timing of our expenditures will depend on several factors, including the amount of revenue generated from our operations, the progress of our commercialization efforts, and the amount of cash used in our operations. Accordingly, our management will have broad discretion in the application of the net proceeds.

Pending the uses described above, we plan to invest the net proceeds from our initial public offering in short- and medium-term, interest-bearing obligations, investment-grade instruments, certificates of deposit or direct or guaranteed obligations of the U.S. government.

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

Other than the authorized capital stock numbers set forth in our amended and restated certificate of incorporation referenced below, the following share numbers referenced in this Item 4 do not reflect a 1-for-3.5 reverse split of our common stock effected on June 2, 2004.

April 30, 2004 Written Consent Action

Effective as of April 30, 2004, our stockholders acted by written consent action pursuant to Section 228 of the Delaware General Corporation Law to approve the following matters:

the filing of an amendment to our amended and restated certificate of incorporation to effect a 1-for-3.5 reverse split of our common stock;

the filing of an amended and restated certificate of incorporation, effective upon the closing of our initial public offering, to provide for, among other things, authorized capital stock of 150,000,000 shares of common stock and 10,000,000 shares of undesignated preferred stock;

the restatement of our bylaws, effective upon the closing of our initial public offering;

the adoption of our 2004 Stock Incentive Plan, effective upon the closing of our initial public offering;

the adoption of our 2004 Non-Employee Director Option Program, effective upon the closing of our initial public offering; and

the approval of a form of indemnification agreement by and between us and each of our directors and officers.

Stockholders holding an aggregate of 32,120,664 shares approved each of the above matters and stockholders holding approximately 11,638,149 shares did not vote with respect to such matters.

May 17, 2004 Annual Meeting of Stockholders

On May 17, 2004, we held an annual meeting of stockholders to approve the following matters:

the election of seven directors to our board of directors to serve until the next annual meeting of stockholders; and

the ratification of the appointment of Ernst & Young LLP as our independent public accountants for the fiscal year ending December 31, 2004.

At the time of the meeting of the stockholders, which was held prior to the completion of our initial public offering, the amendment and restatement of our certificate of incorporation and the conversion of all outstanding shares of our preferred stock to common stock, holders of our Series G preferred stock were entitled to elect two members of our board directors, holders of our Series H preferred stock were entitled to elect three members of our board of directors and holders of our preferred stock and common stock, voting together as a single class, were entitled to elect the remaining members of the board.

At the annual meeting of stockholders, the following directors were elected to our board of directors by holders of our Series G preferred stock, Series H preferred stock and common stock and preferred stock, voting together as a single class, respectively, according to the votes listed below:

Series G preferred stock:

<u>Nominee</u>	<u>For</u>	<u>Withheld</u>	<u>Abstaining</u>
Robert M. Jaffe	21,597,152	1,079,262	-0-
Timothy J. Wollaeger	22,753,650	87	-0-

Series H preferred stock:

<u>Nominee</u>	<u>For</u>	<u>Withheld</u>	<u>Abstaining</u>
Douglas Reed	8,960,646	87	-0-

Common Stock and Preferred Stock:

<u>Nominee</u>	<u>For</u>	<u>Withheld</u>	<u>Abstaining</u>
David M. Sheehan	31,730,102	87	-0-
R. King Nelson	31,730,102	87	-0-
Kenneth E. Olson	31,730,102	87	-0-
Raymond V. Dittamore	31,730,102	87	-0-

Mr. Jaffe submitted his resignation on May 14, 2004, to be effective immediately prior to the effectiveness of our initial public offering.

With respect to the ratification of the appointment of Ernst & Young LLP as our independent public accountants for the fiscal year ending December 31, 2004, holders of shares of our common stock and preferred stock, voting together as a single class, voted as follows:

<u>For</u>	<u>Withheld</u>	<u>Abstaining</u>
30,650,937	1,079,250	2

May 21, 2004 Written Consent Action

Effective as of May 21, 2004, holders of shares of our Series H preferred stock acted by written consent action pursuant to Section 228 of the Delaware General Corporation Law to acknowledge and agree that the sale by us of our common stock in a bona fide, firm commitment underwritten public offering registered under the Securities Act, which resulted in (i) aggregate gross offering proceeds of at least \$25,000,000 and (ii) a public offering price which valued us (immediately prior to such offering) at \$169,000,000 or more, would constitute a “Qualifying Public Offering” under our amended and restated certificate of incorporation.

Holders of an aggregate of 9,911,621 shares of Series H preferred stock approved the foregoing matter and holders of approximately 2,650,085 shares of Series H preferred stock did not vote with respect to such matter.

May 21, 2004 Written Consent Action

Effective as of May 21, 2004, our stockholders acted by written consent action pursuant to Section 228 of the Delaware General Corporation Law to approve the following matters:

the amendment of provisions of our restated bylaws to be in effect following the completion of our initial public offering pertaining to the calling of special meetings of stockholders; and

the approval of a correction to our 2004 Non-Employee Director Option Program to be in effect upon the closing of our initial public offering regarding the number of options to be received by our non-employee directors hereunder.

Stockholders holding an aggregate of 30,458,137 shares approved each of the above matters and stockholders holding approximately 13,300,676 shares did not vote with respect to such matters.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

Exhibit Number	Description
3.1	Restated Certificate of Incorporation
3.2	Restated Bylaws
4.1(1)	Form of Specimen Stock Certificate
4.2(1)	Amended and Restated Investors' Rights Agreement by and among Digirad Corporation and the investors listed on the schedule attached thereto, dated April 23, 2002, as amended.
10.1†	Amendment to License Agreement by and between Digirad Corporation and the Regents of the University of California, dated July 26, 2004.
10.2(1)	Loan Agreement by and between Digirad Corporation and Clinton L. Lingren, dated September 1, 1993, as amended.
10.3(1)	Loan Agreement by and between Digirad Corporation and Jack F. Butler, dated September 1, 1993, as amended.
10.4 #	2004 Stock Incentive Plan.
10.5(1) #	2004 Non-Employee Director Option Program.
10.6	Form of Warrant to purchase shares of Common Stock by and among Digirad Corporation and the investors listed on the schedule thereto.
31.1	Certification of Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) promulgated pursuant to the Securities Exchange Act of 1934, as amended.
31.2	Certification of Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) promulgated pursuant to the Securities Exchange Act of 1934, as amended.
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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

† Application has been made to the Securities and Exchange Commission to seek confidential treatment of certain provisions. Omitted material for which confidential treatment has been requested has been filed separately with the Securities and Exchange Commission.

Indicates management contract or compensatory plan.

(b) Reports on Form 8-K

There were no current reports on Form 8-K filed by Digirad Corporation during the quarter ended June 30, 2004.

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 11, 2004

By: /s/ David M. Sheehan

David M. Sheehan
President and Chief Executive Officer
(Principal Executive Officer)

Date: August 11, 2004

By: /s/ Todd P. Clyde

Todd P. Clyde
Chief Financial Officer
(Principal Financial and Accounting Officer)

INDEX TO EXHIBITS

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Indicates management contract or compensatory plan.

RESTATED
CERTIFICATE OF INCORPORATION
OF
DIGIRAD CORPORATION

Digirad Corporation, a corporation organized and existing under the General Corporation Law of the State of Delaware (the "Corporation") DOES HEREBY CERTIFY:

FIRST: The original Certificate of Incorporation of the Corporation was filed with the Secretary of State of Delaware on January 2, 1997.

SECOND: The Restated Certificate of Incorporation of Digirad Corporation in the form attached hereto as EXHIBIT A has been duly adopted in accordance with the provisions of Sections 245 and 242 of the General Corporation Law of the State of Delaware by the directors and stockholders of the Corporation.

THIRD: The Restated Certificate of Incorporation so adopted reads in full as set forth in EXHIBIT A attached hereto and is hereby incorporated herein by this reference.

The undersigned has caused this Certificate to be signed this 15th day of June, 2004, and hereby certifies that the facts stated here are true.

By /s/ VERA P. PARDEE

Vera P. Pardee
Vice President, General Counsel and Secretary

EXHIBIT A

ARTICLE I

The name of this corporation is DIGIRAD CORPORATION (the "Corporation").

ARTICLE II

The address of the Corporation's registered office in the State of Delaware is 30 Old Rudnick Lane, City of Dover, County of Kent, 19901, and the name of the registered agent of the Corporation in the State of Delaware at such address is CorpAmerica, Inc.

ARTICLE III

The purpose of the Corporation is to engage in any lawful act or activity for which a corporation may now or hereafter be organized under the Delaware General Corporation Law.

ARTICLE IV

(A) CLASSES OF STOCK. The Corporation is authorized to issue two classes of stock, denominated "Common Stock" and "Preferred Stock." The Common Stock shall have a par value of \$0.0001 per share and the Preferred Stock shall have a par value of \$0.0001 per share. The total number of shares of Common Stock which the Corporation is authorized to issue is One Hundred Fifty Million (150,000,000), and the total number of shares of Preferred Stock which the Corporation is authorized to issue is Ten Million (10,000,000), which shares of Preferred Stock shall be undesignated as to series.

(B) ISSUANCE OF PREFERRED STOCK. The Preferred Stock may be issued from time to time in one or more series. The Board of Directors of the Corporation (the "Board") is hereby authorized, by filing one or more certificates pursuant to the Delaware General Corporation Law (each, a "Preferred Stock Designation"), to fix or alter from time to time the designations, powers, preferences and rights of each such series of Preferred Stock and the qualifications, limitations or restrictions thereof, including without limitation the dividend rights, dividend rate, conversion rights, voting rights, rights and terms of redemption (including sinking fund provisions), redemption price or prices, and the liquidation preferences of any wholly-unissued series of Preferred Stock, and to establish from time to time the number of shares constituting any such series and the designation thereof, or any of them; and to increase or decrease the number of shares of any series subsequent to the issuance of shares of that series, but not below the number of shares of such series then outstanding. In case the number of shares of any series shall be decreased in accordance with the foregoing sentence, the shares constituting such decrease shall resume the status that they had prior to the adoption of the resolution originally fixing the number of shares of such series.

(C) RIGHTS, PREFERENCES, PRIVILEGES AND RESTRICTIONS OF COMMON STOCK.

1. DIVIDEND RIGHTS. Subject to the rights, preferences, privileges, restrictions and other matters pertaining to series of Preferred Stock that may from time to time in the future come into existence, the holders of the Common Stock shall be entitled to receive, when, as and if declared by the Board, out of any assets of the Corporation legally available therefor, such dividends as may be declared from time to time by the Board.

2. REDEMPTION. The Common Stock is not redeemable upon demand of any holder thereof or upon demand of the Corporation except as expressly provided by contract.

3. VOTING RIGHTS. Subject to the rights, preferences, privileges, restrictions and other matters pertaining to series of Preferred Stock that may from time to time in the future come into existence, the holder of each share of Common Stock shall have the right to one vote, and shall be entitled to notice of any stockholders' meeting in accordance with the Bylaws of the Corporation (the "Bylaws"), and shall be entitled to vote upon such matters and in such manner as may be provided by law. There shall be no cumulative voting.

ARTICLE V

(A) EXCULPATION. A director of the Corporation (each, a "Director" and collectively, the "Directors") shall not be personally liable to the Corporation or its stockholders for monetary damages for breach of fiduciary duty as a Director, except for liability (i) for any breach of the Director's duty of loyalty to the Corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under Section 174 of the Delaware General Corporation Law or (iv) for any transaction from which the Director derived any improper personal benefit. If the Delaware General Corporation Law is hereafter amended to further reduce or to authorize, with the approval of the Corporation's stockholders, further reductions in the liability of the Directors for breach of fiduciary duty, then a Director shall not be liable for any such breach to the fullest extent permitted by the Delaware General Corporation Law as so amended.

(B) INDEMNIFICATION. To the extent permitted by applicable law, the Corporation is also authorized to provide indemnification of (and advancement of expenses to) such agents (and any other persons to which Delaware law permits the Corporation to provide indemnification) through bylaw provisions, agreements with such agents or other persons, vote of stockholders or disinterested Directors or otherwise, in excess of the indemnification and advancement otherwise permitted by Section 145 of the Delaware General Corporation Law, subject only to limits created by applicable Delaware law (statutory or non-statutory), with respect to actions for breach of duty to the Corporation, its stockholders and others.

(C) EFFECT OF REPEAL OR MODIFICATION. Any repeal or modification of any of the foregoing provisions of this Article V shall be prospective and shall not adversely affect any right or protection of a Director, officer, agent or other person existing at the time of, or increase the liability of any Director with

respect to any acts or omissions of such Director occurring prior to, such repeal or modification.

ARTICLE VI

Elections of Directors need not be by written ballot except and to the extent provided in the Bylaws. A change in the Range (as defined in the Bylaws) may be effected only by affirmative vote of (i) at least sixty-six and two-thirds percent (66- 2/3%) of the Directors then in office or (ii) the holders of at least sixty-six and two-thirds percent (66- 2/3%) of the voting power of all the then-outstanding shares of capital stock entitled to vote. Subject to any limitations imposed by law, vacancies, including newly created directorships, only may be filled by affirmative vote of a majority of the Directors then in office, though less than a quorum, or by a sole remaining Director. Subject to any limitations imposed by law, the Board, or any individual Director, may be removed from office at any time only with cause by the affirmative vote of the holders of at least sixty-six and two-thirds percent (66- 2/3%) of the voting power of all the then-outstanding shares of capital stock entitled to vote generally in the election of Directors.

ARTICLE VII

No holder of shares of stock of the Corporation shall have any preemptive or other right, except as such rights are expressly provided by contract, to purchase or subscribe for or receive any shares of any class, or series thereof, of stock of the Corporation, whether now or hereafter authorized, or any warrants, options, bonds, debentures or other securities convertible into, exchangeable for or carrying any right to purchase any share of any class, or series thereof, of stock; but such additional shares of stock and such warrants, options, bonds, debentures or other securities convertible into, exchangeable for or carrying any right to purchase any shares of any class, or series thereof, of stock may be issued or disposed of by the Board to such persons, and on such terms and for such lawful consideration as in its discretion it shall deem advisable or as the Corporation shall have by contract agreed.

ARTICLE VIII

The Corporation is to have perpetual existence.

ARTICLE IX

The Corporation reserves the right to adopt, amend or repeal any provision contained in this Restated Certificate of Incorporation and/or any provision contained in any amendment to or restatement of this Restated Certificate of Incorporation, in the manner now or hereafter prescribed by statute, and all rights conferred on stockholders herein are granted subject to

this reservation; provided, however, that no amendment, alteration, change or repeal may be made to Article V, VI, IX, X or XI without the affirmative vote of the holders of at least sixty-six and two-thirds percent (66-2/3%) of the outstanding voting stock of the Corporation, voting together as a single class.

ARTICLE X

The Board may from time to time adopt, amend or repeal the Bylaws by the requisite affirmative vote of Directors as set forth in the Bylaws; provided, however, that the stockholders may adopt, amend or repeal any bylaw adopted by the Board by the requisite affirmative vote of stockholders as set forth in the Bylaws; and, provided further, that no amendment or supplement to the Bylaws adopted by the Board shall vary or conflict with any amendment or supplement thus adopted by the stockholders.

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ARTICLE XI

No action shall be taken by the stockholders of the Corporation except at an annual or special meeting of stockholders called in accordance with the Bylaws, and no action shall be taken by the stockholders by written consent. Special meetings of the stockholders shall be called only as provided in the Bylaws.

ARTICLE XII

Advance notice of stockholder nominations for the election of Directors and of business to be brought by stockholders before any meeting of the stockholders of the Corporation shall be given in the manner provided in the Bylaws.

ARTICLE XIII

Whenever a compromise or arrangement is proposed between the Corporation and its creditors or any class of them and/or between the Corporation and its stockholders or any class of them, any court of equitable jurisdiction within the State of Delaware may, on the application in a summary way of the Corporation or of any creditor or stockholder thereof, or on the application of any receiver or receivers appointed for the Corporation under the provisions of Section 291 of Title 8 of the Delaware Code or on the application of trustees in dissolution or of any receiver or receivers appointed for the Corporation under the provisions of Section 279 of Title 8 of the Delaware Code order a meeting of the creditors or class of creditors, and/or of the stockholders or class of stockholders of the Corporation, as the case may be, to be summoned in such manner as the said court directs. If a majority in number representing three-fourths in value of the creditors or class of creditors, and/or of the stockholders or class of stockholders of the Corporation, as the case may be, agree to any compromise or arrangement and to any reorganization of

the Corporation as a consequence of such compromise or arrangement, the said compromise or arrangement and the said reorganization shall, if sanctioned by the court to which the said application has been made, be binding on all the creditors or class of creditors, and/or on all the stockholders or class of stockholders, of the Corporation, as the case may be, and also on the Corporation.

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RESTATED BYLAWS
OF
DIGIRAD CORPORATION

ARTICLE I
OFFICES

Section 1. REGISTERED OFFICE. The registered office shall be in the City of Dover, County of Kent, State of Delaware.

Section 2. OTHER OFFICES. The corporation may also have offices at such other places both within and without the State of Delaware as the Board of Directors may from time to time determine or the business of the corporation may require.

ARTICLE II
MEETINGS OF STOCKHOLDERS

Section 1. PLACE OF MEETINGS; RULES OF CONDUCT. All meetings of the stockholders for the election of Directors shall be held in the City of San Diego, State of California, at such place as may be fixed from time to time by the Board of Directors, or at such other place either within or without the State of Delaware as shall be designated from time to time by the Board of Directors and stated in the notice of the meeting. Meetings of stockholders for any other purpose may be held at such time and place, within or without the State of Delaware, as shall be stated in the notice of the meeting or in a duly executed waiver of notice thereof. The Board of Directors or any officer of the corporation designated by the Board of Directors may adopt rules and regulations for the conduct of meetings of stockholders and may modify, repeal or replace such rules and regulations at any time.

Section 2. ANNUAL MEETING.

(a) The annual meeting of the stockholders of the corporation, for the purpose of election of Directors and for such other business as may lawfully come before it, shall be held on such date and at such time as may be designated from time to time by the Board of Directors.

(b) At an annual meeting of the stockholders, only such business shall be conducted as shall have been properly brought before the meeting. To be properly brought before an annual meeting, business must be: (A) specified in the notice of meeting (or any supplement thereto) given by or at

the direction of the Board of Directors, (B) otherwise properly brought before the meeting by or at the direction of the Board of Directors, or (C) otherwise properly brought before the meeting by a stockholder. For business to be properly brought before an annual meeting by a stockholder, the stockholder must have given timely notice thereof in writing to the Secretary of the corporation. To be timely, a stockholder's notice must be delivered to or mailed and received at the principal executive offices of the corporation by no later than the due date for stockholder proposals that is specified in the corporation's proxy

statement released to stockholders in connection with the previous year's annual meeting of stockholders, which date shall be not less than one hundred twenty (120) calendar days in advance of the date of such proxy statement; provided, however, that in the event that no annual meeting was held in the previous year or the date of the annual meeting has been changed by more than thirty (30) days from the date of the previous year's annual meeting, notice by the stockholder to be timely must be so received a reasonable time before the corporation begins to print and mail its proxy materials. A stockholder's notice to the Secretary shall set forth as to each matter the stockholder proposes to bring before the annual meeting: (i) a brief description of the business desired to be brought before the annual meeting and the reasons for conducting such business at the annual meeting, (ii) the name and address, as they appear on the corporation's books, of the stockholder proposing such business, (iii) the class and number of shares of the corporation which are beneficially owned by the stockholder, (iv) any material interest of the stockholder in such business and (v) any other information that is required to be provided by the stockholder pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended (the "1934 Act"), in such stockholder's capacity as a proponent to a stockholder proposal. In addition to the foregoing, in order to include information with respect to a stockholder proposal in the proxy statement and form of proxy for a stockholder's meeting, stockholders must provide notice as required by the regulations promulgated under the 1934 Act to the extent such regulations require notice that is different from the notice required above. Notwithstanding anything in these Bylaws to the contrary, no business shall be conducted at any annual meeting except in accordance with the procedures set forth in this paragraph (b) of this Section 2. The chairman of the annual meeting shall, if the facts warrant, determine and declare at the meeting that business was not properly brought before the meeting and in accordance with the provisions of this paragraph (b), and, if he or she should so determine, the chairman shall so declare at the meeting that any such business not properly brought before the meeting shall not be transacted.

(c) Only persons who are nominated in accordance with the procedures set forth in this paragraph (c) shall be eligible for election as Directors. Nominations of persons for election to the Board of Directors of the corporation may be made at a meeting of stockholders by or at the direction of the Board of Directors or by any stockholder of the corporation entitled to vote in the election of Directors at the meeting who complies with the notice

procedures set forth in this paragraph (c). Such nominations, other than those made by or at the direction of the Board of Directors, shall be made pursuant to timely notice in writing to the Secretary of the corporation in accordance with the provisions of paragraph (b) of this Section 2. Timely notice shall also be given of any stockholder's intention to cumulate votes in the election of Directors at a meeting if cumulative voting is available. Such stockholder's notice shall set forth (i) as to each person, if any, whom the stockholder proposes to nominate for election or re-election as a Director: (A) the name, age, business address and residence address of such person, (B) the principal occupation or employment of such person, (C) the class and number of shares of the corporation that are beneficially owned by such person, (D) a description of all arrangements or understandings between the stockholder and each nominee and any other person or persons (naming such person or persons) pursuant to which the nominations are to be made by the stockholder, and (E) any other information relating to such person that is required to be disclosed in solicitations of

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proxies for election of Directors, or is otherwise required, in each case pursuant to Regulation 14A under the 1934 Act (including without limitation such person's written consent to being named in the proxy statement, if any, as a nominee and to serving as a Director if elected); and (ii) as to such stockholder giving notice, the information required to be provided pursuant to subitems (ii), (iii) and (iv) of paragraph (b) of this Section 2 and, if cumulative voting is available to such stockholder, whether such stockholder intends to request cumulative voting in the election of Directors at the meeting. At the request of the Board of Directors, any person nominated by a stockholder for election as a Director shall furnish to the Secretary of the corporation that information required to be set forth in the stockholder's notice of nomination which pertains to the nominee. No person shall be eligible for election as a Director of the corporation unless nominated in accordance with the procedures set forth in this paragraph (c). The chairman of the meeting shall, if the facts warrant, determine and declare at the meeting that a nomination was not made in accordance with the procedures prescribed by these Bylaws, and if the chairman should so determine, he or she shall so declare at the meeting, and the defective nomination shall be disregarded.

Section 3. NOTICE OF ANNUAL MEETING. Written notice of the annual meeting stating the place, date and hour of the meeting shall be given to each stockholder entitled to vote at such meeting not less than ten (10) nor more than sixty (60) days before the date of the meeting.

Section 4. VOTING LIST. The officer who has charge of the stock ledger of the corporation shall prepare and make, or have prepared and made, at least ten (10) days before every meeting of stockholders, a complete list of the stockholders entitled to vote at the meeting, arranged in alphabetical order, and showing the address of each stockholder and the number of shares registered in the name of each stockholder. Such list shall be open to the examination of any stockholder, for any purpose germane to the meeting, during ordinary

business hours, for a period of at least ten (10) days prior to the meeting, either at a place within the city where the meeting is to be held, which place shall be specified in the notice of the meeting, or, if not so specified, at the place where the meeting is to be held. The list shall also be produced and kept at the time and place of the meeting during the whole time thereof, and may be inspected by any stockholder who is present.

Section 5. SPECIAL MEETINGS. Special meetings of the stockholders, for any purpose or purposes, unless otherwise prescribed by statute or by the Certificate of Incorporation, as amended from time to time (the "Certificate of Incorporation"), may only be called as provided in this Section 5 by the President, Chief Executive Officer or Chairman of the Board and shall also be called by the President or Secretary at the request in writing of a majority of the Board of Directors or the holders of not less than twenty percent (20%) of the outstanding capital stock of the corporation entitled to vote. Special meetings may not be called by any other person or persons. Such written request shall state the purpose or purposes of the proposed meeting. Upon receipt of such written request, the President or Secretary shall call a special meeting of stockholders to be held at the offices of the corporation at such date and time as the President or Secretary may fix, such meeting to be held not less than ten (10) nor more than sixty (60) days after the receipt of such written request.

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Section 6. NOTICE OF SPECIAL MEETING. Written notice of a special meeting stating the place, date and hour of the meeting and the purpose or purposes for which the meeting is called shall be given not less than ten (10) nor more than sixty (60) days before the date of the meeting, to each stockholder entitled to vote at such meeting.

Section 7. ACTION AT SPECIAL MEETING. Business transacted at any special meeting of stockholders shall be limited to the purposes stated in the notice.

Section 8. QUORUM AND ADJOURNMENTS.

(a) The holders of a majority of the stock issued and outstanding and entitled to vote thereat, present in person or represented by proxy, shall constitute a quorum at all meetings of the stockholders for the transaction of business except as otherwise provided by statute or by the Certificate of Incorporation. If, however, such quorum shall not be present or represented at any meeting of the stockholders, the stockholders entitled to vote thereat, present in person or represented by proxy, shall have the power to adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum shall be present or represented. At such adjourned meeting at which a quorum shall be present or represented, any business may be transacted which might have been transacted at the meeting as originally notified. If the adjournment is for more than thirty (30) days, or if after the adjournment a new record date is fixed for the adjourned meeting, a notice of

the adjourned meeting shall be given to each stockholder of record entitled to vote at the meeting.

(b) When a quorum is present at any meeting, in all matters other than the election of Directors, the vote of the holders of a majority of the stock having voting power present in person or represented by proxy shall decide any question brought before such meeting, unless the question is one upon which by express provision of statute or of the Certificate of Incorporation, a different vote is required, in which case such express provision shall govern and control the decision of such question. Directors shall be elected by a plurality of the votes of the stockholders present in person or represented by proxy at the meeting and entitled to vote on the election of Directors.

Section 9. VOTING RIGHTS. Unless otherwise provided in the Certificate of Incorporation, each stockholder shall at every meeting of the stockholders be entitled to one (1) vote in person or by proxy for each share of the capital stock having voting power held by such stockholder, but no proxy shall be voted on after three (3) years from its date, unless the proxy provides for a longer period.

Section 10. ACTION WITHOUT MEETING. No action shall be taken by the stockholders of the corporation except at an annual or special meeting of stockholders called in accordance with these Bylaws, and no action shall be taken by the stockholders by written consent.

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ARTICLE III
DIRECTORS

Section 1. NUMBER, TERM OF OFFICE AND QUALIFICATION. The number of Directors which shall constitute the whole Board shall not be less than five (5) nor more than nine (9) Directors (such range hereinafter referred to as the "Range"), and the exact number shall be fixed by resolution of the Board of Directors, with the number initially fixed at seven (7). The number of Directors may be increased or decreased only as set forth in the Certificate of Incorporation, or, in the event the Certificate of Incorporation is silent on such matters, in accordance with applicable statutory law. Each Director elected shall hold office until his or her successor is elected and qualified. Directors need not be stockholders.

Section 2. VACANCIES. Vacancies, including newly created directorships, may be filled only as set forth in the Certificate of Incorporation, or, in the event the Certificate of Incorporation is silent on such matters, in accordance with applicable statutory law. Each Director so chosen shall hold office until a successor is duly elected and shall qualify or until his or her earlier death, resignation or removal. If there are no Directors in office, then an election of Directors may be held in the manner provided by statute. If, at the time of

filling any vacancy, the Directors then in office shall constitute less than a majority of the whole Board (as constituted immediately prior to any such increase), the Court of Chancery may, upon application of any stockholder or stockholders holding at least ten percent (10%) of the total number of the shares at the time outstanding having the right to vote for such Directors, summarily order an election to be held to fill any such vacancies, or to replace the Directors chosen by the Directors then in office.

Section 3. POWERS. The business of the corporation shall be managed by or under the direction of its Board of Directors which may exercise all such powers of the corporation and do all such lawful acts and things as are not by statute or by the Certificate of Incorporation or by these Bylaws directed or required to be exercised or done by the stockholders.

Section 4. REGULAR AND SPECIAL MEETINGS. The Board of Directors of the corporation may hold meetings, both regular and special, either within or without the State of Delaware.

Section 5. ANNUAL MEETING. The annual meeting of the Board of Directors shall be held without notice immediately after, and at the same place as, the annual meeting of stockholders. In the event the annual meeting of the Board of Directors shall not be held immediately after, and at the same place as, the annual meeting of stockholders, the meeting may be held at such time and place as shall be specified in a notice given as hereinafter provided for special meetings of the Board of Directors.

Section 6. NOTICE OF REGULAR MEETINGS. Regular meetings of the Board of Directors may be held without notice at such time and at such place as shall from time to time be determined by the Board.

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Section 7. NOTICE OF SPECIAL MEETINGS. Special meetings of the Board may be called by the Chief Executive Officer or President on no less than forty-eight (48) hours notice to each Director either personally, or by telephone, mail, telegram, facsimile or electronic mail; special meetings shall be called by the Chief Executive Officer, President or Secretary in like manner and on like notice on the written request of two Directors unless the Board consists of only one Director, in which case special meetings shall be called by the Chief Executive Officer, President or Secretary in like manner and on like notice on the written request of the sole Director. A written waiver of notice, signed by the person entitled thereto, whether before or after the time of the meeting stated therein, shall be deemed equivalent to notice.

Section 8. QUORUM. At all meetings of the Board a majority of the Directors shall constitute a quorum for the transaction of business and the act of a majority of the Directors present at any meeting at which there is a quorum shall be the act of the Board of Directors, except as may be otherwise specifically provided by these Bylaws, by statute or by the Certificate of

Incorporation. If a quorum shall not be present at any meeting of the Board of Directors, the Directors present thereat may adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum shall be present.

Section 9. ACTION WITHOUT MEETING. Unless otherwise restricted by the Certificate of Incorporation, or these Bylaws, any action required or permitted to be taken at any meeting of the Board of Directors or of any committee thereof may be taken without a meeting, if all members of the Board or committee, as the case may be, consent thereto in writing, and the writing or writings are filed with the minutes of proceedings of the Board or committee.

Section 10. MEETINGS BY TELEPHONE CONFERENCE CALLS. Unless otherwise restricted by the Certificate of Incorporation, or these Bylaws, members of the Board of Directors, or any committee designated by the Board of Directors, may participate in a meeting of the Board of Directors, or any committee, by means of conference telephone, video conference or similar communications equipment by means of which all persons participating in the meeting can hear each other, and such participation in a meeting shall constitute presence in person at the meeting.

Section 11. COMMITTEES. The Board of Directors may, by resolution passed by a majority of the whole Board, designate one or more committees, each committee to consist of one or more of the Directors of the corporation. The Board may designate one or more Directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee.

In the absence of disqualification of a member of a committee, the member or members thereof present at any meeting and not disqualified from voting, whether or not he, she or they constitute a quorum, may unanimously appoint another member of the Board of Directors to act at the meeting in the place of any such absent or disqualified member.

Any such committee, to the extent provided in the resolution of the Board of Directors, shall have and may exercise all the powers and authority of the Board of Directors in the management of the business and affairs of the corporation, and may authorize the seal of the corporation to be affixed to all papers which may require it; but no such committee shall have the power or authority in reference to amending the Certificate of Incorporation, adopting an agreement of merger or consolidation, recommending to the stockholders the sale, lease or exchange of all or substantially all of the corporation's property and assets, recommending to the stockholders a dissolution of the corporation or a revocation of a dissolution, or amending the Bylaws of the corporation; and, unless the resolution or the Certificate of Incorporation expressly so provides, no such committee shall have the power or authority to declare a dividend or to authorize the issuance of stock. Such committee or committees shall have such name or names as may be determined from time to time by resolution adopted by the Board of Directors.

Each committee shall keep regular minutes of its meetings and report the same to the Board of Directors when required.

Unless the Board of Directors otherwise provides, each committee designated by the Board of Directors may adopt, amend and repeal rules for the conduct of its business. In the absence of a provision adopted by the Board of Directors or a provision in the rules of such committee to the contrary, a majority of the entire authorized number of members of such committee shall constitute a quorum for the transaction of business by such committee, the vote of a majority of the members present at a meeting at the time of such vote if a quorum is then present shall be the act of such committee, and in other respects each committee shall conduct its business in the same manner as the Board of Directors conducts its business pursuant to Article III of these Bylaws.

Section 12. FEES AND COMPENSATION. Unless otherwise restricted by the Certificate of Incorporation or these Bylaws, the Board of Directors shall have the authority to fix the compensation of Directors. Without limiting the generality of the foregoing, the Directors may be paid their expenses, if any, of attendance at each meeting of the Board of Directors and may be paid a fixed sum for attendance at each meeting of the Board of Directors or a stated salary as Director. No such payment shall preclude any Director from serving the corporation in any other capacity and receiving compensation therefor. Members of special or standing committees may be allowed like compensation for attending committee meetings.

Section 13. REMOVAL. Subject to any limitations imposed by law or the Certificate of Incorporation, the Board of Directors, or any individual Director, may be removed from office at any time only with cause by the affirmative vote of the holders of at least two-thirds of the outstanding shares entitled to vote at an election of Directors.

ARTICLE IV NOTICES

Section 1. NOTICE. Whenever, under the provisions of statute or of the Certificate of Incorporation or of these Bylaws, notice is required to be given to any Director or stockholder, it shall not be construed to mean personal notice, but such notice may be given in writing, by mail, addressed to such Director or stockholder, at his, her or its address as it appears on the records of the corporation, with postage thereon prepaid, and such notice shall be deemed to be given at the time when the same shall be deposited in the United States mail. Notice to Directors may also be given personally, by telephone, including a voice messaging system or other system or technology designed to record and communicate messages, telegram, facsimile, electronic mail or other electronic means.

Section 2. WAIVER OF NOTICE. Whenever any notice is required to be given under the provisions of statute or of the Certificate of Incorporation or of these Bylaws, a waiver thereof in writing, signed by the person or persons entitled to said notice, whether before or after the time stated therein, shall be deemed equivalent thereto. Attendance of a person at a meeting shall constitute a waiver of notice of such meeting, except when the person attends a meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened.

ARTICLE V
OFFICERS

Section 1. ENUMERATION. The officers of the corporation shall be chosen by the Board of Directors and shall include a Chief Executive Officer, a Chief Financial Officer and a Secretary. The Board of Directors may elect from among its members a Chairman of the Board and a Vice Chairman of the Board. The Board of Directors may also choose a President, one or more Vice Presidents, one or more Assistant Secretaries and such other officers as the Board of Directors shall deem necessary. Any number of offices may be held by the same person, unless the Certificate of Incorporation or these Bylaws otherwise provide.

The compensation of all officers and agents of the corporation shall be fixed by the Board of Directors, and no officer shall be prevented from receiving such compensation by virtue of such officer also being a Director of the corporation.

Section 2. ELECTION OR APPOINTMENT. The Board of Directors at its first meeting after each annual meeting of stockholders shall choose a Chief Executive Officer, Chief Financial Officer and a Secretary and may choose a President, one or more Vice Presidents and one or more Assistant Secretaries. The Board of Directors may appoint such other officers and agents as it shall deem necessary who shall hold their offices for such terms and shall exercise such powers and perform such duties as shall be determined from time to time by the Board.

Section 3. TENURE, REMOVAL AND VACANCIES. Each officer of the corporation shall hold office until his or her successor is chosen and qualified, or until his or her earlier death, resignation or removal. Any officer elected or appointed by the Board of Directors may be removed at any time by the affirmative vote of a majority of the Board of Directors. Any vacancy occurring in any office of the corporation shall be filled by the Board of Directors.

Section 4. CHAIRMAN OF THE BOARD. The Chairman of the Board, if any, shall preside at all meetings of the Board of Directors at which he or she shall be present. The Chairman of the Board shall have and may exercise such powers as

are, from time to time, assigned by the Board and as may be provided by law.

Section 5. VICE CHAIRMAN OF THE BOARD. In the absence of the Chairman of the Board, the Vice Chairman of the Board, if any, shall preside at all meetings of the Board of Directors at which he or she shall be present. The Vice Chairman of the Board shall have and may exercise such powers as are, from time to time, assigned by the Board and as may be provided by law.

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Section 6. CHIEF EXECUTIVE OFFICER. The Chief Executive Officer of the corporation shall, subject to the control of the Board of Directors, have general supervision, direction and control of the business and the officers of the corporation. The Chief Executive Officer shall preside at all meetings of the stockholders (unless another officer is designated by the Board of Directors), and, in the absence or nonexistence of a Chairman of the Board or Vice Chairman of the Board, the Chief Executive Officer shall preside at all meetings of the Board of Directors. The Chief Executive Officer shall have the general powers and duties of management usually vested in the Chief Executive Officer of a corporation, including general supervision, direction and control of the business and supervision of other officers of the corporation, and shall have such other powers and duties as may be prescribed by the Board of Directors or these Bylaws.

The Chief Executive Officer shall, without limitation, have the authority to execute bonds, mortgages and other contracts requiring a seal, under the seal of the corporation, except where required or permitted by law to be otherwise signed and executed and except where the signing and execution thereof shall be expressly delegated by the Board of Directors to some other officer or agent of the corporation.

Section 7. PRESIDENT. Subject to such supervisory powers as may be given by these Bylaws or the Board of Directors to the Chairman of the Board or the Chief Executive Officer, if there be such officers, the President shall have general supervision, direction and control of the business and supervision of other officers of the corporation, and shall have such other powers and duties as may be prescribed by the Board of Directors or these Bylaws. In the event a Chief Executive Officer shall not be appointed, the President shall have the duties of such office.

Section 8. VICE PRESIDENTS. The Vice President, or if there shall be more than one, the Vice Presidents in the order determined by the Board of Directors, shall, in the absence or disability of the President, act with all of the powers and be subject to all the restrictions of the President. The Vice Presidents shall also perform such other duties and have such other powers as the Board of Directors, the Chief Executive Officer, the President or these Bylaws may, from time to time, prescribe.

Section 9. SECRETARY. Unless otherwise determined by the Board of

Directors, the Secretary shall attend all meetings of the Board of Directors, all meetings of the committees thereof and all meetings of the stockholders and record all the proceedings of the meetings in a book or books to be kept for that purpose. Under the Chief Executive Officer's or President's supervision, the Secretary (unless another officer is designated by the Board of Directors) shall give, or cause to be given, all notices required to be given by these Bylaws or by law; shall have such powers and perform such duties as the Board of Directors, the Chief Executive Officer, the President or these Bylaws may, from time to time, prescribe; and shall have custody of the seal of the corporation. The Secretary, or an Assistant Secretary, shall have authority to affix the seal of the corporation to any instrument requiring it and when so affixed, it may be attested by his or her signature or by the signature of such Assistant Secretary. The Board of Directors may give general authority to any other officer to affix the seal of the corporation and to attest the affixing by his or her signature.

Section 10. ASSISTANT SECRETARY. The Assistant Secretary, if any, or if there be more than one, the Assistant Secretaries in the order determined by the Board of Directors, shall, in the absence, disability or refusal to act of the Secretary, perform the duties and exercise the powers of the Secretary and shall perform such other duties and have such other powers as the Board of Directors, the Chief Executive Officer, the President, the Secretary or these Bylaws may, from time to time, prescribe.

Section 11. CHIEF FINANCIAL OFFICER. The Chief Financial Officer shall act as Treasurer and shall have the custody of the corporate funds and securities and shall keep full and accurate accounts of receipts and disbursements in books belonging to the corporation and shall deposit all moneys and other valuable effects in the name and to the credit of the corporation in such depositories as may be designated by the Board of Directors. The Chief Financial Officer may alternatively be designated by the title "Treasurer."

The Chief Financial Officer shall disburse the funds of the corporation as may be ordered by the Board of Directors, taking proper vouchers for such disbursements, and shall render to the Chief Executive Officer or, if there be no Chief Executive Officer, the President and the Board of Directors, at its regular meetings, or when the Board of Directors so requires, an account of all his or her transactions as Chief Financial Officer and of the financial condition of the corporation.

Section 12. OTHER OFFICERS, ASSISTANT OFFICERS AND AGENTS. Officers, assistant officers and agents, if any, other than those whose duties are provided for in these Bylaws, shall have such authority and perform such duties as may from time to time be prescribed by the Board of Directors, the Chief Executive Officer or the President.

Section 13. ABSENCE OR DISABILITY OF OFFICERS. In the case of the

absence or disability of any officer of the corporation and of any person hereby authorized to act in such officer's place during such officer's absence or disability, the Board of Directors may delegate the powers and duties of such officer to any officer or to any Director, or to any other person who it may select.

ARTICLE VI
CERTIFICATES OF STOCK

Section 1. CERTIFICATES OF STOCK. Every holder of stock in the corporation shall be entitled to have a certificate, signed by, or in the name of the corporation by, the Chairman or Vice Chairman of the Board of Directors, or the Chief Executive Officer or the President or a Vice President and the Chief Financial Officer or an Assistant Chief Financial Officer, or the Secretary or an Assistant Secretary of the corporation, certifying the number of shares owned by him or her in the corporation.

Certificates may be issued for partly paid shares and in such case upon the face or back of the certificates issued to represent any such partly paid shares, the total amount of the consideration to be paid therefor, and the amount paid thereon shall be specified.

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If the corporation shall be authorized to issue more than one class of stock or more than one series of any class, the powers, designations, preferences and relative, participating, optional or other special rights of each class of stock or series thereof and the qualifications, limitations or restrictions of such preferences and/or rights shall be set forth in full or summarized on the face or back of the certificate which the corporation shall issue to represent such class or series of stock, provided that, except as otherwise provided in Section 202 of the General Corporation Law of Delaware, in lieu of the foregoing requirements, there may be set forth on the face or back of the certificate which the corporation shall issue to represent such class or series of stock, a statement that the corporation will furnish without charge to each stockholder who so requests the powers, designations, preferences and relative, participating, optional or other special rights of each class of stock or series thereof and the qualifications, limitations or restrictions of such preferences and/or rights.

Section 2. EXECUTION OF CERTIFICATES. Any or all of the signatures on the certificate may be facsimile. In case any officer, transfer agent or registrar who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer, transfer agent or registrar before such certificate is issued, it may be issued by the corporation with the same effect as if he or she were such officer, transfer agent or registrar at the date of issue.

Section 3. LOST CERTIFICATES. The Board of Directors may direct a new certificate or certificates to be issued in place of any certificate or certificates theretofore issued by the corporation alleged to have been lost, stolen or destroyed, upon the making of an affidavit of that fact by the person claiming the certificate of stock to be lost, stolen or destroyed. When authorizing such issue of a new certificate or certificates, the Board of Directors may, in its discretion and as a condition precedent to the issuance thereof, require the owner of such lost, stolen or destroyed certificate or certificates, or the owner's legal representative, to advertise the same in such manner as it shall require and/or to give the corporation a bond in such sum as it may direct as indemnity against any claim that may be made against the corporation with respect to the certificate alleged to have been lost, stolen or destroyed.

Section 4. TRANSFER OF STOCK. Upon surrender to the corporation or the transfer agent of the corporation of a certificate for shares duly endorsed or accompanied by proper evidence of succession, assignation or authority to transfer, it shall be the duty of the corporation to issue a new certificate to the person entitled thereto, cancel the old certificate and record the transaction upon its books.

Section 5. FIXING RECORD DATE. In order that the corporation may determine the stockholders entitled to notice of or to vote at any meeting of stockholders or any adjournment thereof, or entitled to receive payment of any dividend or other distribution or allotment of any rights, or entitled to exercise any rights in respect of any change, conversion or exchange of stock or for the purpose of any other lawful action, the Board of Directors may fix, in advance, a record date, which shall not be more than sixty (60) nor less than ten (10) days before the date of such meeting, nor more than sixty (60) days prior to any other action. A determination of stockholders of record entitled to notice of or to vote at a meeting of stockholders shall apply to any adjournment of the meeting; provided, however, that the Board of Directors may fix a new record date for the adjourned meeting.

Section 6. REGISTERED STOCKHOLDERS. The corporation shall be entitled to recognize the exclusive right of a person registered on its books as the owner of shares to receive dividends, and to vote as such owner, and to hold liable for calls and assessments a person registered on its books as the owner of shares and shall not be bound to recognize any equitable or other claim to or interest in such share or shares on the part of any other person, whether or not it shall have express or other notice thereof, except as otherwise provided by the laws of Delaware.

ARTICLE VII
INDEMNIFICATION

Section 1. INDEMNIFICATION OF DIRECTORS AND EXECUTIVE OFFICERS. The corporation shall indemnify its Directors and executive officers to the fullest extent not prohibited by the Delaware General Corporation Law; provided, however, that the corporation may limit the extent of such indemnification by individual contracts with its Directors and executive officers; and, provided, further, that the corporation shall not be required to indemnify any Director or executive officer in connection with any proceeding (or part thereof) initiated by such person or any proceeding by such person against the corporation or its Directors, officers, employees or other agents unless (i) such indemnification is expressly required to be made by law, (ii) the proceeding was authorized by the Board of Directors of the corporation, or (iii) such indemnification is provided by the corporation, in its sole discretion, pursuant to the powers vested in the corporation under the Delaware General Corporation Law.

Section 2. INDEMNIFICATION OF OTHER OFFICERS, EMPLOYEES AND OTHER AGENTS. The corporation shall have power to indemnify its other officers, employees and other agents to the fullest extent permitted by the Delaware General Corporation Law.

Section 3. GOOD FAITH.

(a) For purposes of any determination under this Article VII, a Director or officer shall be deemed to have acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, to have had no reasonable cause to believe that his or her conduct was unlawful, if such Director's or officer's action is based on information, opinions, reports and statements, including financial statements and other financial data, in each case prepared or presented by:

(1) one or more officers or employees of the corporation whom the Director or executive officer believed to be reliable and competent in the matters presented;

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(2) counsel, independent accountants or other persons as to matters which the Director or executive officer believed to be within such person's professional competence; or

(3) with respect to a Director, a committee of the Board upon which such Director does not serve, as to matters within such committee's designated authority, which committee the Director believes to merit confidence; so long as, in each case, the Director or executive officer acts without knowledge that would cause such reliance to be unwarranted.

(b) The termination of any proceeding by judgment, order, settlement, conviction or upon a plea of nolo contendere or its equivalent shall

not, of itself, create a presumption that the person did not act in good faith and in a manner which such person reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal proceeding, that such person had reasonable cause to believe that his or her conduct was unlawful.

(c) The provisions of this Section 3 shall not be deemed to be exclusive or to limit in any way the circumstances in which a person may be deemed to have met the applicable standard of conduct set forth by the Delaware General Corporation Law.

Section 4. EXPENSES. To the extent permitted by law and subject to the terms and conditions of any individual contracts with its Directors and executive officers, the corporation shall advance, prior to the final disposition of any proceeding, promptly following request therefor, all expenses incurred by any Director or executive officer in connection with such proceeding upon receipt of an undertaking by or on behalf of such person to repay said amounts if it should be determined ultimately that such person is not entitled to be indemnified under this Article VII or otherwise.

Notwithstanding the foregoing, and subject to the terms and conditions of any individual contracts with its Directors and executive officers, no advance shall be made by the corporation if a determination is reasonably and promptly made (i) by the Board of Directors by a majority vote of a quorum consisting of Directors who were not parties to the proceeding, or (ii) if such quorum is not obtainable, or, even if obtainable, a quorum of disinterested Directors so directs, by independent legal counsel in a written opinion, that the facts known to the decision-making party at the time such determination is made demonstrate clearly and convincingly that such person acted in bad faith or in a manner that such person did not believe to be in or not opposed to the best interests of the corporation.

Section 5. ENFORCEMENT. Without the necessity of entering into an express contract, all rights to indemnification and advances to Directors and executive officers under this Article VII shall be deemed to be contractual rights and be effective to the same extent and as if provided for in a contract between the corporation and the Director or executive officer. Any right to indemnification or advances granted by this Article VII to a Director or executive officer shall be enforceable by or on behalf of the person holding such right in any court of competent jurisdiction if (i) the claim for

indemnification or advances is denied, in whole or in part, or (ii) no disposition of such claim is made within ninety (90) days of request therefor. The claimant in such enforcement action, if successful in whole or in part, shall be entitled to be paid also the expense of prosecuting his or her claim. The corporation shall be entitled to raise as a defense to any such action that the claimant has not met the standards of conduct that make it permissible under

the Delaware General Corporation Law for the corporation to indemnify the claimant for the amount claimed. Neither the failure of the corporation (including its Board of Directors, independent legal counsel or its stockholders) to have made a determination prior to the commencement of such action that indemnification of the claimant is proper in the circumstances because he or she has met the applicable standard of conduct set forth in the Delaware General Corporation Law, nor an actual determination by the corporation (including its Board of Directors, independent legal counsel or its stockholders) that the claimant has not met such applicable standard of conduct, shall be a defense to the action or create a presumption that the claimant has not met the applicable standard of conduct.

Section 6. NON-EXCLUSIVITY OF RIGHTS. The rights conferred on any person by this Article VII shall not be exclusive of any other right which such person may have or hereafter acquire under any statute, provision of the Certificate of Incorporation, Bylaws, agreement, vote of stockholders or disinterested Directors or otherwise, both as to action in such person's official capacity and as to action in another capacity while holding office. The corporation is specifically authorized to enter into individual contracts with any or all of its Directors, officers, employees or agents respecting indemnification and advances, to the fullest extent not prohibited by the Delaware General Corporation Law.

Section 7. SURVIVAL OF RIGHTS. The rights conferred on any person by this Article VII shall continue as to a person who has ceased to be a Director, officer, employee or other agent and shall inure to the benefit of the heirs, executors and administrators of such a person.

Section 8. INSURANCE. To the fullest extent permitted by the Delaware General Corporation Law, the corporation, upon approval by the Board of Directors, may purchase insurance on behalf of any person required or permitted to be indemnified pursuant to this Article VII.

Section 9. AMENDMENTS. Any repeal or modification of this Article VII shall only be prospective and shall not affect the rights under this Article VII in effect at the time of the alleged occurrence of any action or omission to act that is the cause of any proceeding against any agent of the corporation.

Section 10. SAVING CLAUSE. If this Article VII or any portion hereof shall be invalidated on any ground by any court of competent jurisdiction, then the corporation shall nevertheless indemnify each Director and officer to the full extent not prohibited by any applicable portion of this Article VII that shall not have been invalidated, or by any other applicable law.

Section 11. CERTAIN DEFINITIONS. For the purposes of this Article VII, the following definitions shall apply:

(a) The term "proceeding" shall be broadly construed and shall include, without limitation, the investigation, preparation, prosecution, defense, settlement, arbitration and appeal of, and the giving of the testimony in, any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative.

(b) The term "expenses" shall be broadly construed and shall include, without limitation, court costs, attorneys' fees, witness fees, fines, amounts paid in settlement or judgment and any other costs and expenses of any nature or kind incurred in connection with any proceeding.

(c) The term the "corporation" shall include, in addition to the resulting corporation, any constituent corporation (including any constituent of a constituent) absorbed in a consolidation or merger which, if its separate existence had continued, would have had power and authority to indemnify its directors, officers, and employees or agents, so that any person who is or was a director, officer, employee or agent of such constituent corporation, or is or was serving at the request of such constituent corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, shall stand in the same position under the provisions of this Article VII with respect to the resulting or surviving corporation as such person would have with respect to such constituent corporation if its separate existence had continued.

(d) References to a "Director," "officer," "employee," or "agent" of the corporation shall include, without limitation, situations where such person is serving at the request of the corporation as a Director, officer, employee, trustee or agent of another corporation, partnership, joint venture, trust or other enterprise.

(e) References to "other enterprises" shall include employee benefit plans; references to "fines" shall include any excise taxes assessed on a person with respect to an employee benefit plan; and references to "serving at the request of the corporation" shall include any service as a Director, officer, employee or agent of the corporation which imposes duties on, or involves services by, such Director, officer, employee, or agent with respect to an employee benefit plan, its participants, or beneficiaries; and a person who acted in good faith and in a manner such person reasonably believed to be in the interest of the participants and beneficiaries of an employee benefit plan shall be deemed to have acted in a manner "not opposed to the best interests of the corporation" as referred to in this Article VII.

ARTICLE VIII
[RESERVED]

ARTICLE IX
GENERAL PROVISIONS

Section 1. DECLARATION OF DIVIDENDS. Dividends upon the capital stock

of the corporation, subject to the provisions of the Certificate of Incorporation, if any, may be declared by the Board of Directors at any regular or special meeting, pursuant to law. Dividends may be paid in cash, in property, or in shares of the capital stock, subject to the provisions of the Certificate of Incorporation.

Section 2. DIVIDEND RESERVE. Before payment of any dividend, there may be set aside out of any funds of the corporation available for dividends such sum or sums as the Directors from time to time, in their absolute discretion, think proper as a reserve or reserves to meet contingencies, or for equalizing dividends, or for repairing or maintaining any property of the corporation, or for such other purposes as the Directors shall think conducive to the interest of the corporation, and the Directors may modify or abolish any such reserve in the manner in which it was created.

Section 3. EXECUTION OF CORPORATE INSTRUMENTS. All checks or demands for money and notes of the corporation shall be signed by such officer or officers or such other person or persons as the Board of Directors may from time to time designate.

Section 4. FISCAL YEAR. The fiscal year of the corporation shall be fixed by resolution of the Board of Directors.

Section 5. CORPORATE SEAL. The Board of Directors may adopt a corporate seal having inscribed thereon the name of the corporation, the year of its organization and the words "Corporate Seal, Delaware." The seal may be used by causing it or a facsimile thereof to be impressed or affixed or reproduced or otherwise.

ARTICLE X
AMENDMENTS

Section 1. AMENDMENTS.

(a) Except as otherwise set forth in Section 9 of Article VII of these Bylaws, the Bylaws may be altered or amended or new Bylaws adopted by the affirmative vote of a majority of the voting power of all of the then-outstanding shares of capital stock of the corporation entitled to vote generally in the election of Directors (the "Voting Stock"). The Board of Directors shall also have the power, if such power is conferred upon the Board of Directors by the Certificate of Incorporation, to adopt, amend or repeal Bylaws by a vote of the majority of the Board of Directors unless a greater or different vote is required pursuant to the provisions of the Bylaws, the Certificate of Incorporation or any applicable provision of law.

(b) Notwithstanding any other provisions of these Bylaws or

any provision of law which might otherwise permit a lesser vote or no vote, but in addition to any affirmative vote of the holders of any particular class or series of the Voting Stock required by law, the Certificate of Incorporation or any Preferred Stock Designation (as the term is defined in the Certificate of Incorporation), the affirmative vote of the holders of at least sixty-six and two-thirds percent (66-2/3%) of the voting power of all of the then-outstanding shares of the Voting Stock, voting together as a single class, shall be required to alter, amend or repeal this paragraph (b) or Section 2, Section 5 or Section 10 of Article II or Section 1 (if such alteration, amendment or repeal relates to the Range), Section 2 or Section 13 of Article III of these Bylaws.

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(c) Notwithstanding any other provisions of these Bylaws or any provision of law which might otherwise permit a lesser vote or no vote, but in addition to any affirmative vote of the holders of any particular class or series of the Voting Stock required by law, the Certificate of Incorporation or any Preferred Stock Designation (as the term is defined in the Certificate of Incorporation), the affirmative vote of at least sixty-six and two-thirds percent (66-2/3%) of the Directors, shall be required to alter, amend or repeal this paragraph (c) or Section 2, Section 5 or Section 10 of Article II or Section 1 (if such alteration, amendment or repeal relates to the Range), Section 2 or Section 13 of Article III of these Bylaws.

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CERTIFICATE OF SECRETARY

The undersigned, being the Secretary of Digirad Corporation, a Delaware corporation, does hereby certify the foregoing to be the Restated Bylaws of said Corporation, as adopted by the requisite vote or votes of the stockholders and Directors of the Corporation and which remain in full force and effect as of the date hereof.

Executed at San Diego, California effective as of June 15, 2004.

/S/ VERA P. PARDEE

Vera P. Pardee

Vice President, General Counsel and Secretary

AMENDMENT #2
TO
LICENSE AGREEMENT FOR DETECTOR

This Amendment (the "Amendment #2"), effective as of October 1, 2003, is entered into by The Regents of the University of California, Department of Energy contract-operators of the Ernest Orlando Lawrence Berkeley National Laboratory, 1 Cyclotron Road, Berkeley, CA 94720, ("Berkeley Lab"), and Digirad Corporation ("Digirad"), a Delaware corporation having its principal place of business at 13950 Stowe Drive, San Diego, CA 92064 (collectively, "the parties").

- A. THE PARTIES ENTERED INTO A LICENSE AGREEMENT FOR DETECTOR (LBNL REFERENCE NUMBER L-99-1261) HAVING AN EFFECTIVE DATE OF MAY 19, 1999 (THE "ORIGINAL AGREEMENT"). THE ORIGINAL AGREEMENT WAS MODIFIED BY AMENDMENT #1 HAVING AN EFFECTIVE DATE OF MAY 24, 2001 ("AMENDMENT #1"). THE ORIGINAL AGREEMENT AS MODIFIED BY AMENDMENT #1 SHALL HEREINAFTER BE REFERRED TO AS THE "AGREEMENT".
- B. BEGINNING IN OCTOBER 2003, THE PARTIES HAVE BEEN IN DISCUSSIONS TO RESOLVE CERTAIN MATTERS RELATING TO THE AGREEMENT. THIS AMENDMENT #2 IS INTENDED TO FULLY RESOLVE SUCH MATTERS.
- C. THE PARTIES NOW DESIRE TO MODIFY THE AGREEMENT AS STATED HEREIN. CAPITALIZED TERMS HEREIN SHALL HAVE THE MEANING AS SET FORTH IN THE AGREEMENT EXCEPT AS OTHERWISE DEFINED IN THIS AMENDMENT #2.

The parties agree as follows:

1. The parties acknowledge that the non-exclusive license granted by Berkeley Lab to Digirad pursuant to Amendment #1 has been terminated by Digirad. Accordingly, Amendment #1 is hereby rescinded, except as stated below:
 - (a) Section 4.1 of the Original Agreement is hereby deleted in its entirety and replaced with the following:
 - 4.1 As consideration for the licenses granted hereunder:
 - 4.1.1 within the Field of Use, Digirad shall pay Berkeley Lab a license issue fee of *** dollars *** of which *** ** dollars *** has been previously paid under the Option Agreement, and the remaining *** dollars *** has been paid to Berkeley Lab under this Agreement.

4.1.2 for the license originally granted pursuant to Amendment #1 which has since been terminated by Digirad, Digirad shall pay Berkeley Lab a license issue fee of *** dollars *** of which *** dollars *** has been previously paid under this Agreement, and the remaining *** dollars *** shall be paid on or before July 30, 2004.

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(b) The modifications to the Original Agreement pursuant to Paragraphs 2, 10, 11, and 12 of Amendment #1 are hereby retained, ratified and confirmed.

2. The parties agree as follows:

(a) Section 5.1 of the Agreement is hereby deleted in its entirety and replaced with the following:

5.1 Digirad shall pay to Berkeley Lab an earned royalty of *** percent *** of the Selling Price of each Licensed Product Digirad sells.

(b) Section 5.4 of the Agreement is hereby deleted in its entirety and replaced with the following:

5.4 Digirad shall pay to Berkeley Lab by August 31 of each year the difference between the earned royalties for that calendar year Digirad has already paid to Berkeley Lab and the minimum annual royalty set forth in the following schedule. Berkeley Lab shall credit that minimum annual royalty paid against the earned royalty due and owing for the calendar year in which Digirad made the minimum payment.

CALENDAR YEAR	MINIMUM ANNUAL ROYALTY	
-----	-----	
1999	***	(paid)
2000	***	(paid)
2001	***	(paid)
2002	***	(paid)
2003	***	
2004	***	
2005	***	
2006	***	
2007	***	
2008	***	

3. Pursuant to Article 21 (Notices), the parties desire to update their address for notice purposes as follows:

In the case of Berkeley Lab (for payments and all other notices): In the case of Digirad:

Lawrence Berkeley National Laboratory
Technology Transfer Department
One Cyclotron Road, Bldg. 90R1070
Berkeley, CA 94720-8125

Attn: Licensing Manager
Tel: (510) 486-6467
Fax: (510) 486-6457

Digirad Corporation
13950 Stowe Drive
San Diego, CA 92064

Attn: General Counsel
Tel: (858) 726-1530
Fax: (858) 726-1700

4. Pursuant to paragraphs 5.5 and 7.4 of the Agreement, Digirad shall provide to Berkeley Lab on or before July 30, 2004, the following:

- (a) for the period from April 1, 2003 - June 30, 2003:
(i) quarterly royalty report;
(ii) payment of royalties calculated using an earned royalty rate of ***

- (b) for the period from July 1, 2003 - September 30, 2003:
(i) quarterly royalty report;
(ii) payment of royalties calculated using an earned royalty rate of ***

- (c) for the period from October 1, 2003 - December 31, 2003:
(i) quarterly royalty report;
(ii) payment of royalties calculated using an earned royalty rate of ***

- (d) for the period from January 1, 2004 - March 31, 2004:
(i) quarterly royalty report;
(ii) payment of royalties calculated using an earned royalty rate of ***

5. Pursuant to paragraph 1(a) of this Amendment #2, Digirad shall pay to Berkeley Lab, on or before July 30, 2004, *** as the final installment of the license issue fee.

6. Digirad shall pay to Berkeley Lab, on or before July 30, 2004, *** in underpaid royalties for the period from January 1, 2000 - December 31, 2002.
7. Digirad shall pay to Berkeley Lab, on or before July 30, 2004, *** as reimbursement of the maintenance fee for European Patent Convention Application

8. Settlement and Release.

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(a) Digirad claims that the *** made or sold by, or made or sold on behalf of, Digirad are not covered by the Licensed Patents because such *** do not have an *** Berkeley Lab disputes Digirad's claim. Digirad's claim, and Berkeley Lab's dispute thereof, is hereinafter referred to as the "Patent Dispute."

(b) For and in consideration of the parties' execution of this Amendment #2:

Digirad, its parents, subsidiaries, affiliates, divisions, officers, directors, shareholders, joint venturers, agents, partners, attorneys, heirs, servants, representatives, employees, assigns, predecessors, and successors, forever discharge and release Berkeley Lab, The Regents of the University of California, the U.S. Department of Energy, and their respective affiliates, divisions, officers, directors, joint venturers, agents, parents, attorneys, heirs, servants, representatives, employees, assigns, predecessors, and successors, from any and all claims, debts, costs, expenses, damages, injuries, liabilities, demands, and causes of action of any kind, nature and description, whether known or unknown, suspected or unsuspected, fixed or contingent, which Digirad now has, owns or claims to have or own, or at any time heretofore had, owned, or claimed to have or own, upon or by reason of any matter, cause or thing, arising out of or in any way related to the Patent Dispute. Digirad covenants that at no time will it, its successors, or its assigns make any claim or commence or prosecute against Berkeley Lab, its directors, officers, successors, assigns, customers, or other transferees, any suit, action, or proceeding of any kind based on the Patent Dispute, nor assert the Patent Dispute as a defense of non-payment of royalties to Berkeley Lab.

Berkeley Lab, its affiliates, divisions, officers, directors, joint venturers, agents, parents, partners, attorneys, heirs, servants, representatives, employees, assigns, predecessors, and successors,

forever discharge and release Digirad, its affiliates, divisions, officers, directors, shareholders, agents, parents, attorneys, heirs, servants, representatives, employees, assigns, predecessors, and successors, from any and all claims, debts, costs, expenses, damages, injuries, liabilities, demands, and causes of action of any kind, nature and description, whether known or unknown, suspected or unsuspected, fixed or contingent, which Berkeley Lab now has, owns or claims to have or own, or at any time heretofore had, owned, or claimed to have or own, upon or by reason of any matter, cause or thing, arising out of or in any way related to the Patent Dispute. Berkeley Lab covenants that at no time will it, its successors, or its assigns make any claim or commence or prosecute against Digirad, its directors, officers, successors, assigns, customers, or other transferees, any suit, action, or proceeding of any kind based on the Patent Dispute.

Notwithstanding anything to the contrary in this Amendment #2, nothing herein shall prevent, or otherwise limit in any way, the right and ability of Berkeley Lab, The Regents of the University of California, the U.S. Department of Energy, or their respective affiliates, divisions, officers, directors, joint venturers, agents, parents, attorneys, heirs, servants, representatives, employees, assigns, predecessors, and successors from making any claim or commencing or prosecuting against Digirad, its directors, officers, successors, assigns, customers, or other transferees any suit, action, or proceeding of any kind based on:

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- (i) non-payment of royalties that are payable after July 30, 2004; or
- (ii) infringement of the Licensed Patents, if this Agreement is terminated.

For the avoidance of doubt, notwithstanding anything to the contrary in this Amendment #2, nothing herein shall prevent, or otherwise limit in any way, the right and ability of Berkeley Lab, pursuant to Article 8 (Books and Records) of the Agreement, to inspect and examine Digirad's books and records to ascertain the accuracy of Digirad's reporting of Licensed Products manufactured, used, or sold under the terms of the Agreement and to collect any deficiencies in royalties based on such examination.

- (c) Each party hereby acknowledges that it has been advised by its attorneys concerning, and is familiar with, the provisions of section 1542 of the California Civil Code, which reads as follows:

A general release does not extend to claims which the creditor

does not know or suspect to exist in his favor at the time of executing the release, which if known by him must have materially affected his settlement with the debtor.

Each party hereby acknowledges that it may have sustained damages, losses, costs or expenses that are presently unknown or unexpected, that may have materially affected such party's decision to enter into this Amendment #2 and that said damages, losses, costs or expenses may give rise to additional damages, losses, costs or expenses in the future. Both Digirad and Berkeley Lab acknowledge that this Amendment #2 has been entered into with the knowledge that said damages, losses, costs or expenses may exist, and both Digirad and Berkeley Lab hereby waive any and all rights each party may have had under section 1542, or under any other statute or rule or similar effect.

(d) This settlement is made solely as a compromise of disputed claims made by the parties. Neither party makes any admission of any kind as part of entering into this Agreement.

9. Except as specifically amended herein, the Agreement is hereby ratified and confirmed.
10. Both Berkeley Lab and Digirad represent that neither has relied on any promise, inducement, representation or other statement made in connection with or with respect to this Amendment #2 that is not expressly contained in this Amendment #2 and that this Amendment #2 embodies the entire and final understanding of the parties on this subject. This Amendment #2 supersedes any previous representations, agreements, or understandings, whether oral or written.
11. If any term of this Agreement is deemed to be illegal or unenforceable, then this Agreement shall be treated as though that illegal or unenforceable term were excised, and the remainder of this Agreement shall be enforced to the exclusion of that illegal or unenforceable term; provided, however, that the parties shall negotiate in good faith to substitute legal and enforceable provisions that more clearly effect the parties' intent in entering into this Agreement.

Berkeley Lab and Digirad execute this Agreement in duplicate originals through their authorized respective officers in one or more counterparts that, taken together, are but one instrument.

OF CALIFORNIA, THROUGH THE
ERNEST ORLANDO LAWRENCE
BERKELEY NATIONAL LABORATORY

By /S/ PIERMARIA ODDONE

(Signature)

By PIERMARIA ODDONE

Title DEPUTY DIRECTOR

Date 7/26/04

By /S/ DAVID M. SHEEHAN

(Signature)

By DAVID M. SHEEHAN

Title PRESIDENT AND CEO

Date 7/26/04

Approved as to form

/S/ GLENN R. WOODS

GLENN R. WOODS
LAWRENCE BERKELEY NATIONAL LABORATORY

DIGIRAD CORPORATION
2004 STOCK INCENTIVE PLAN

1. PURPOSES OF THE PLAN. The purposes of this Plan are to attract and retain the best available personnel, to provide additional incentives to Employees, Directors and Consultants and to promote the success of the Company's business.

2. DEFINITIONS. The following definitions shall apply as used herein and in the individual Award Agreements except as defined otherwise in an individual Award Agreement. In the event a term is separately defined in an individual Award Agreement, such definition shall supercede the definition contained in this Section 2.

(a) "ADMINISTRATOR" means the Board or any of the Committees appointed to administer the Plan.

(b) "AFFILIATE" and "ASSOCIATE" shall have the respective meanings ascribed to such terms in Rule 12b-2 promulgated under the Exchange Act.

(c) "APPLICABLE LAWS" means the legal requirements relating to the Plan and the Awards under applicable provisions of federal securities laws, state corporate and securities laws, the Code, the rules of any applicable stock exchange or national market system, and the rules of any non-U.S. jurisdiction applicable to Awards granted to residents therein.

(d) "ASSUMED" means that pursuant to a Corporate Transaction either (i) the Award is expressly affirmed by the Company or (ii) the contractual obligations represented by the Award are expressly assumed (and not simply by operation of law) by the successor entity or its Parent in connection with the Corporate Transaction with appropriate adjustments to the number and type of securities of the successor entity or its Parent subject to the Award and the exercise or purchase price thereof which at least preserves the compensation element of the Award existing at the time of the Corporate Transaction as determined in accordance with the instruments evidencing the agreement to assume the Award.

(e) "AWARD" means the grant of an Option, SAR, Dividend Equivalent Right, Restricted Stock, Restricted Stock Unit or other right or benefit under the Plan.

(f) "AWARD AGREEMENT" means the written agreement evidencing the grant of an Award executed by the Company and the Grantee, including any amendments thereto.

(g) "BOARD" means the Board of Directors of the Company.

(h) "CAUSE" means, with respect to the termination by the Company or a Related Entity of the Grantee's Continuous Service, that such termination is for "Cause" as such term is expressly defined in a then-effective written agreement between the Grantee and the Company or such Related Entity, or in the absence of such then-effective written agreement and definition, is based on, in the determination of the Administrator, the Grantee's commission of a serious crime involving dishonesty, breach of trust, or physical or emotional harm to any person.

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(i) "CHANGE IN CONTROL" means a change in ownership or control of the Company after the Registration Date effected through either of the following transactions:

(i) the direct or indirect acquisition by any person or related group of persons (other than an acquisition from or by the Company or by a Company-sponsored employee benefit plan or by a person that directly or indirectly controls, is controlled by, or is under common control with, the Company) of beneficial ownership (within the meaning of Rule 13d-3 of the Exchange Act) of securities possessing more than fifty percent (50%) of the total combined voting power of the Company's outstanding securities pursuant to a tender or exchange offer made directly to the Company's stockholders which a majority of the Continuing Directors who are not Affiliates or Associates of the offeror do not recommend such stockholders accept, or

(ii) a change in the composition of the Board over a period of twenty-four (24) months or less such that a majority of the Board members (rounded up to the next whole number) ceases, by reason of one or more contested elections for Board membership, to be comprised of individuals who are Continuing Directors.

(j) "CODE" means the Internal Revenue Code of 1986, as amended.

(k) "COMMITTEE" means any committee composed of members of the Board appointed by the Board to administer the Plan.

(l) "COMMON STOCK" means the common stock of the Company.

(m) "COMPANY" means Digirad Corporation, a Delaware corporation.

(n) "CONSULTANT" means any person (other than an Employee or a Director, solely with respect to rendering services in such person's capacity as a Director) who is engaged by the Company or any Related Entity to render consulting or advisory services to the Company or such Related Entity.

(o) "CONTINUING DIRECTORS" means members of the Board who either (i) have been Board members continuously for a period of at least twenty-four (24) months or (ii) have been Board members for less than twenty-four (24)

months and were elected or nominated for election as Board members by at least a majority of the Board members described in clause (i) who were still in office at the time such election or nomination was approved by the Board.

(p) "CONTINUOUS SERVICE" means that the provision of services to the Company or a Related Entity in any capacity of Employee, Director or Consultant is not interrupted or terminated. In jurisdictions requiring notice in advance of an effective termination as an Employee, Director or Consultant, Continuous Service shall be deemed terminated upon the actual cessation of providing services to the Company or a Related Entity notwithstanding any required notice period that must be fulfilled before a termination as an Employee, Director or Consultant can be effective under Applicable Laws. A Grantee's Continuous Service shall be deemed to have terminated either upon an actual termination of Continuous Service or upon the entity for which the Grantee provides services ceasing to be a Related Entity. Continuous Service

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shall not be considered interrupted in the case of (i) any approved leave of absence, (ii) transfers among the Company, any Related Entity, or any successor, in any capacity of Employee, Director or Consultant, or (iii) any change in status as long as the individual remains in the service of the Company or a Related Entity in any capacity of Employee, Director or Consultant (except as otherwise provided in the Award Agreement). An approved leave of absence shall include sick leave, military leave, or any other authorized personal leave. For purposes of each Incentive Stock Option granted under the Plan, if such leave exceeds ninety (90) days, and reemployment upon expiration of such leave is not guaranteed by statute or contract, then the Incentive Stock Option shall be treated as a Non-Qualified Stock Option on the day three (3) months and one (1) day following the expiration of such ninety (90) day period.

(q) "CORPORATE TRANSACTION" means any of the following transactions, provided, however, that the Administrator shall determine under parts (iv) and (v) whether multiple transactions are related, and its determination shall be final, binding and conclusive:

(i) a merger or consolidation in which the Company is not the surviving entity, except for a transaction the principal purpose of which is to change the state in which the Company is incorporated;

(ii) the sale, transfer or other disposition of all or substantially all of the assets of the Company;

(iii) the complete liquidation or dissolution of the Company;

(iv) any reverse merger or series of related transactions culminating in a reverse merger (including, but not limited to, a tender offer followed by a reverse merger) in which the Company is the surviving entity but (A) the shares of Common Stock outstanding immediately prior to such merger are

converted or exchanged by virtue of the merger into other property, whether in the form of securities, cash or otherwise, or (B) in which securities possessing more than forty percent (40%) of the total combined voting power of the Company's outstanding securities are transferred to a person or persons different from those who held such securities immediately prior to such merger or the initial transaction culminating in such merger, but excluding any such transaction or series of related transactions that the Administrator determines shall not be a Corporate Transaction; or

(v) acquisition in a single or series of related transactions by any person or related group of persons (other than the Company or by a Company-sponsored employee benefit plan) of beneficial ownership (within the meaning of Rule 13d-3 of the Exchange Act) of securities possessing more than fifty percent (50%) of the total combined voting power of the Company's outstanding securities but excluding any such transaction or series of related transactions that the Administrator determines shall not be a Corporate Transaction.

(r) "COVERED EMPLOYEE" means an Employee who is a "covered employee" under Section 162(m) (3) of the Code.

(s) "DIRECTOR" means a member of the Board or the board of directors of any Related Entity.

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(t) "DISABILITY" means as defined under the long-term disability policy of the Company or the Related Entity to which the Grantee provides services regardless of whether the Grantee is covered by such policy. If the Company or the Related Entity to which the Grantee provides service does not have a long-term disability plan in place, "Disability" means that a Grantee is unable to carry out the responsibilities and functions of the position held by the Grantee by reason of any medically determinable physical or mental impairment for a period of not less than ninety (90) consecutive days. A Grantee will not be considered to have incurred a Disability unless he or she furnishes proof of such impairment sufficient to satisfy the Administrator in its discretion.

(u) "DIVIDEND EQUIVALENT RIGHT" means a right entitling the Grantee to compensation measured by dividends paid with respect to Common Stock.

(v) "EMPLOYEE" means any person, including an Officer or Director, who is in the employ of the Company or any Related Entity, subject to the control and direction of the Company or any Related Entity as to both the work to be performed and the manner and method of performance. The payment of a director's fee by the Company or a Related Entity shall not be sufficient to constitute "employment" by the Company.

(w) "EXCHANGE ACT" means the Securities Exchange Act of 1934, as

amended.

(x) "FAIR MARKET VALUE" means, as of any date, the value of Common Stock determined as follows:

(i) If the Common Stock is listed on one or more established stock exchanges or national market systems, including without limitation The Nasdaq National Market or The Nasdaq SmallCap Market of The Nasdaq Stock Market, its Fair Market Value shall be the closing sales price for such stock (or the closing bid, if no sales were reported) as quoted on the principal exchange or system on which the Common Stock is listed (as determined by the Administrator) on the date of determination (or, if no closing sales price or closing bid was reported on that date, as applicable, on the last trading date such closing sales price or closing bid was reported), as reported in The Wall Street Journal or such other source as the Administrator deems reliable;

(ii) If the Common Stock is regularly quoted on an automated quotation system (including the OTC Bulletin Board) or by a recognized securities dealer, its Fair Market Value shall be the closing sales price for such stock as quoted on such system on the date of determination, but if selling prices are not reported, the Fair Market Value of a share of Common Stock shall be the mean between the high bid and low asked prices for the Common Stock on the date of determination (or, if no such prices were reported on that date, on the last date such prices were reported), as reported in The Wall Street Journal or such other source as the Administrator deems reliable; or

(iii) In the absence of an established market for the Common Stock of the type described in (i) and (ii), above, the Fair Market Value thereof shall be determined by the Administrator in good faith.

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(y) "GRANTEE" means an Employee, Director or Consultant who receives an Award under the Plan.

(z) "INCENTIVE STOCK OPTION" means an Option intended to qualify as an incentive stock option within the meaning of Section 422 of the Code

(aa) "NON-QUALIFIED STOCK OPTION" means an Option not intended to qualify as an Incentive Stock Option.

(bb) "OFFICER" means a person who is an officer of the Company or a Related Entity within the meaning of Section 16 of the Exchange Act and the rules and regulations promulgated thereunder.

(cc) "OPTION" means an option to purchase Shares pursuant to an Award Agreement granted under the Plan.

(dd) "PARENT" means a "parent corporation", whether now or

hereafter existing, as defined in Section 424(e) of the Code.

(ee) "PERFORMANCE-BASED COMPENSATION" means compensation qualifying as "performance-based compensation" under Section 162(m) of the Code.

(ff) "PLAN" means this 2004 Stock Incentive Plan.

(gg) "REGISTRATION DATE" means the first to occur of (i) the closing of the first sale to the general public pursuant to a registration statement filed with and declared effective by the Securities and Exchange Commission under the Securities Act of 1933, as amended, of (A) the Common Stock or (B) the same class of securities of a successor corporation (or its Parent) issued pursuant to a Corporate Transaction in exchange for or in substitution of the Common Stock; and (ii) in the event of a Corporate Transaction, the date of the consummation of the Corporate Transaction if the same class of securities of the successor corporation (or its Parent) issuable in such Corporate Transaction shall have been sold to the general public pursuant to a registration statement filed with and declared effective by the Securities and Exchange Commission under the Securities Act of 1933, as amended, on or prior to the date of consummation of such Corporate Transaction.

(hh) "RELATED ENTITY" means any Parent or Subsidiary of the Company and any business, corporation, partnership, limited liability company or other entity in which the Company or a Parent or a Subsidiary of the Company holds a substantial ownership interest, directly or indirectly.

(ii) "REPLACED" means that pursuant to a Corporate Transaction the Award is replaced with a comparable stock award or a cash incentive program of the Company, the successor entity (if applicable) or Parent of either of them which preserves the compensation element of such Award existing at the time of the Corporate Transaction and provides for subsequent payout in accordance with the same (or a more favorable) vesting schedule applicable to such Award. The determination of Award comparability shall be made by the Administrator and its determination shall be final, binding and conclusive.

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(jj) "RESTRICTED STOCK" means Shares issued under the Plan to the Grantee for such consideration, if any, and subject to such restrictions on transfer, rights of first refusal, repurchase provisions, forfeiture provisions, and other terms and conditions as established by the Administrator.

(kk) "RESTRICTED STOCK UNITS" means an Award which may be earned in whole or in part upon the passage of time or the attainment of performance criteria established by the Administrator and which may be settled for cash, Shares or other securities or a combination of cash, Shares or other securities as established by the Administrator.

(ll) "RULE 16b-3" means Rule 16b-3 promulgated under the Exchange

Act or any successor thereto.

(mm) "SAR" means a stock appreciation right entitling the Grantee to Shares or cash compensation, as established by the Administrator, measured by appreciation in the value of Common Stock.

(nn) "SHARE" means a share of the Common Stock.

(oo) "SUBSIDIARY" means a "subsidiary corporation", whether now or hereafter existing, as defined in Section 424(f) of the Code.

3. STOCK SUBJECT TO THE PLAN.

(a) Subject to the provisions of Section 10, below, the maximum aggregate number of Shares which may be issued pursuant to all Awards (including Incentive Stock Options) is 1,400,000 Shares. In addition, the maximum aggregate number of Shares which may be issued pursuant to all Awards (including Incentive Stock Options) shall be increased by any Shares (up to a maximum of 1,500,000 Shares) that are represented by awards under the Company's 1998 Stock Option/Stock Issuance Plan that are forfeited, expire or are cancelled without delivery of the Shares or which result in forfeiture of the Shares back to the Company on or after the Registration Date. The Shares to be issued pursuant to Awards may be authorized, but unissued, or reacquired Common Stock.

(b) Any Shares covered by an Award (or portion of an Award) which is forfeited, canceled or expires (whether voluntarily or involuntarily) shall be deemed not to have been issued for purposes of determining the maximum aggregate number of Shares which may be issued under the Plan. Shares that actually have been issued under the Plan pursuant to an Award shall not be returned to the Plan and shall not become available for future issuance under the Plan, except that if unvested Shares are forfeited, or repurchased by the Company at the lower of their original purchase price or their Fair Market Value at the time of repurchase, such Shares shall become available for future grant under the Plan. To the extent not prohibited by Section 422(b)(1) of the Code (and the corresponding regulations thereunder), the listing requirements of The Nasdaq National Market (or other established stock exchange or national market system on which the Common Stock is traded) and Applicable Law, any Shares covered by an Award which are surrendered (i) in payment of the Award exercise or purchase price or (ii) in satisfaction of tax withholding obligations incident to the exercise of an Award shall be deemed not to have been issued for purposes of determining the maximum number of Shares which may be issued pursuant to all Awards under the Plan, unless otherwise determined by the Administrator.

4. ADMINISTRATION OF THE PLAN.

(a) PLAN ADMINISTRATOR.

(i) ADMINISTRATION WITH RESPECT TO DIRECTORS AND OFFICERS.

With respect to grants of Awards to Directors or Employees who are also Officers or Directors of the Company, the Plan shall be administered by (A) the Board or (B) a Committee designated by the Board, which Committee shall be constituted in such a manner as to satisfy the Applicable Laws and to permit such grants and related transactions under the Plan to be exempt from Section 16(b) of the Exchange Act in accordance with Rule 16b-3. Once appointed, such Committee shall continue to serve in its designated capacity until otherwise directed by the Board.

(ii) ADMINISTRATION WITH RESPECT TO CONSULTANTS AND OTHER

EMPLOYEES. With respect to grants of Awards to Employees or Consultants who are neither Directors nor Officers of the Company, the Plan shall be administered by (A) the Board or (B) a Committee designated by the Board, which Committee shall be constituted in such a manner as to satisfy the Applicable Laws. Once appointed, such Committee shall continue to serve in its designated capacity until otherwise directed by the Board. The Board may authorize one or more Officers to grant such Awards and may limit such authority as the Board determines from time to time.

(iii) ADMINISTRATION WITH RESPECT TO COVERED EMPLOYEES.

Notwithstanding the foregoing, as of and after the date that the exemption for the Plan under Section 162(m) of the Code expires, as set forth in Section 18 below, grants of Awards to any Covered Employee intended to qualify as Performance-Based Compensation shall be made only by a Committee (or subcommittee of a Committee) which is comprised solely of two or more Directors eligible to serve on a committee making Awards qualifying as Performance-Based Compensation. In the case of such Awards granted to Covered Employees, references to the "Administrator" or to a "Committee" shall be deemed to be references to such Committee or subcommittee.

(iv) ADMINISTRATION ERRORS. In the event an Award is granted

in a manner inconsistent with the provisions of this subsection (a), such Award shall be presumptively valid as of its grant date to the extent permitted by the Applicable Laws.

(b) POWERS OF THE ADMINISTRATOR. Subject to Applicable Laws and the provisions of the Plan (including any other powers given to the Administrator hereunder), and except as otherwise provided by the Board, the Administrator shall have the authority, in its discretion:

(i) to select the Employees, Directors and Consultants to whom Awards may be granted from time to time hereunder;

(ii) to determine whether and to what extent Awards are granted hereunder;

(iii) to determine the number of Shares or the amount of other consideration to be covered by each Award granted hereunder;

(iv) to approve forms of Award Agreements for use under the Plan;

(v) to determine the terms and conditions of any Award granted hereunder;

(vi) to amend the terms of any outstanding Award granted under the Plan, provided that (A) any amendment that would adversely affect the Grantee's rights under an outstanding Award shall not be made without the Grantee's written consent, (B) the reduction of the exercise price of any Option awarded under the Plan shall be subject to stockholder approval and (C) canceling an Option at a time when its exercise price exceeds the Fair Market Value of the underlying Shares, in exchange for another Option, Restricted Stock, or other Award shall be subject to stockholder approval, unless the cancellation and exchange occurs in connection with a Corporate Transaction;

(vii) to construe and interpret the terms of the Plan and Awards, including without limitation, any notice of award or Award Agreement, granted pursuant to the Plan;

(viii) to grant Awards to Employees, Directors and Consultants employed outside the United States on such terms and conditions different from those specified in the Plan as may, in the judgment of the Administrator, be necessary or desirable to further the purpose of the Plan;

(ix) to take such other action, not inconsistent with the terms of the Plan, as the Administrator deems appropriate.

(c) INDEMNIFICATION. In addition to such other rights of indemnification as they may have as members of the Board or as Officers or Employees of the Company or a Related Entity, members of the Board and any Officers or Employees of the Company or a Related Entity to whom authority to act for the Board, the Administrator or the Company is delegated shall be defended and indemnified by the Company to the extent permitted by law on an after-tax basis against all reasonable expenses, including attorneys' fees, actually and necessarily incurred in connection with the defense of any claim, investigation, action, suit or proceeding, or in connection with any appeal therein, to which they or any of them may be a party by reason of any action taken or failure to act under or in connection with the Plan, or any Award granted hereunder, and against all amounts paid by them in settlement thereof (provided such settlement is approved by the Company) or paid by them in satisfaction of a judgment in any such claim, investigation, action, suit or proceeding, except in relation to matters as to which it shall be adjudged in such claim, investigation, action, suit or proceeding that such person is liable for gross negligence, bad faith or intentional misconduct; provided, however, that within thirty (30) days after the institution of such claim, investigation, action, suit or proceeding, such person shall offer to the Company, in writing,

the opportunity at the Company's expense to defend the same.

5. ELIGIBILITY. Awards other than Incentive Stock Options may be granted to Employees, Directors and Consultants. Incentive Stock Options may be granted only to Employees of the Company or a Parent or a Subsidiary of the Company. An Employee, Director or Consultant who has been granted an Award may, if otherwise eligible, be granted additional Awards. Awards may be granted to such Employees, Directors or Consultants who are residing in non-U.S. jurisdictions as the Administrator may determine from time to time.

6. TERMS AND CONDITIONS OF AWARDS.

(a) TYPES OF AWARDS. The Administrator is authorized under the Plan to award any type of arrangement to an Employee, Director or Consultant that is not inconsistent with the provisions of the Plan and that by its terms involves or might involve the issuance of (i) Shares, (ii) cash or (iii) an Option, a SAR, or similar right with a fixed or variable price related to the Fair Market Value of the Shares and with an exercise or conversion privilege related to the passage of time, the occurrence of one or more events, or the satisfaction of performance criteria or other conditions. Such awards include, without limitation, Options, SARs, sales or bonuses of Restricted Stock, Restricted Stock Units or Dividend Equivalent Rights, and an Award may consist of one such security or benefit, or two (2) or more of them in any combination or alternative.

(b) DESIGNATION OF AWARD. Each Award shall be designated in the Award Agreement. In the case of an Option, the Option shall be designated as either an Incentive Stock Option or a Non-Qualified Stock Option. However, notwithstanding such designation, to the extent that the aggregate Fair Market Value of Shares subject to Options designated as Incentive Stock Options which become exercisable for the first time by a Grantee during any calendar year (under all plans of the Company or any Parent or Subsidiary of the Company) exceeds \$100,000, such excess Options, to the extent of the Shares covered thereby in excess of the foregoing limitation, shall be treated as Non-Qualified Stock Options. For this purpose, Incentive Stock Options shall be taken into account in the order in which they were granted, and the Fair Market Value of the Shares shall be determined as of the grant date of the relevant Option.

(c) CONDITIONS OF AWARD. Subject to the terms of the Plan, the Administrator shall determine the provisions, terms, and conditions of each Award including, but not limited to, the Award vesting schedule, repurchase provisions, rights of first refusal, forfeiture provisions, form of payment (cash, Shares, or other consideration) upon settlement of the Award, payment contingencies, and satisfaction of any performance criteria. The performance criteria established by the Administrator may be based on any one of, or combination of, the following: (i) increase in share price, (ii) earnings per share, (iii) total stockholder return, (iv) operating margin, (v) gross margin,

(vi) return on equity, (vii) return on assets, (viii) return on investment, (ix) operating income, (x) net operating income, (xi) pre-tax profit, (xii) cash flow, (xiii) revenue, (xiv) expenses, (xv) earnings before interest, taxes and depreciation, (xvi) economic value added, (xvii) market share and (xviii) personal management objectives. The performance criteria may be applicable to the Company, Related Entities and/or any individual business units of the Company or any Related Entity. Partial achievement of the specified criteria may result in a payment or vesting corresponding to the degree of achievement as specified in the Award Agreement.

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(d) ACQUISITIONS AND OTHER TRANSACTIONS. The Administrator may issue Awards under the Plan in settlement, assumption or substitution for, outstanding awards or obligations to grant future awards in connection with the Company or a Related Entity acquiring another entity, an interest in another entity or an additional interest in a Related Entity whether by merger, stock purchase, asset purchase or other form of transaction.

(e) DEFERRAL OF AWARD PAYMENT. The Administrator may establish one or more programs under the Plan to permit selected Grantees the opportunity to elect to defer receipt of consideration upon exercise of an Award, satisfaction of performance criteria, or other event that absent the election would entitle the Grantee to payment or receipt of Shares or other consideration under an Award. The Administrator may establish the election procedures, the timing of such elections, the mechanisms for payments of, and accrual of interest or other earnings, if any, on amounts, Shares or other consideration so deferred, and such other terms, conditions, rules and procedures that the Administrator deems advisable for the administration of any such deferral program.

(f) SEPARATE PROGRAMS. The Administrator may establish one or more separate programs under the Plan for the purpose of issuing particular forms of Awards to one or more classes of Grantees on such terms and conditions as determined by the Administrator from time to time.

(g) INDIVIDUAL LIMITATIONS ON AWARDS. Following the date that the exemption from application of Section 162(m) of the Code described in Section 18 (or any exemption having similar effect) ceases to apply to Awards, the following limitations shall apply.

(i) INDIVIDUAL LIMIT FOR OPTIONS AND SARs. The maximum number of Shares with respect to which Options and SARs may be granted to any Grantee in any fiscal year of the Company shall be 1,000,000 Shares. In connection with a Grantee's commencement of Continuous Service, a Grantee may be granted Options or SARs for up to an additional 750,000 Shares which shall not count against the limit set forth in the previous sentence. The foregoing limitations shall be adjusted proportionately in connection with any change in the Company's capitalization pursuant to Section 10, below. To the extent required by Section 162(m) of the Code or the regulations thereunder, in applying the foregoing

limitations with respect to a Grantee, if any Option or SAR is canceled, the canceled Option or SAR shall continue to count against the maximum number of Shares with respect to which Options and SARs may be granted to the Grantee. For this purpose, the repricing of an Option (or in the case of a SAR, the base amount on which the stock appreciation is calculated is reduced to reflect a reduction in the Fair Market Value of the Common Stock) shall be treated as the cancellation of the existing Option or SAR and the grant of a new Option or SAR.

(ii) INDIVIDUAL LIMIT FOR RESTRICTED STOCK AND RESTRICTED STOCK UNITS. For awards of Restricted Stock and Restricted Stock Units that are intended to be Performance-Based Compensation, the maximum number of Shares with respect to which such Awards may be granted to any Grantee in any fiscal year of the Company shall be 750,000 Shares. The foregoing limitation shall be adjusted proportionately in connection with any change in the Company's capitalization pursuant to Section 10, below.

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(iii) DEFERRAL. If the vesting or receipt of Shares under an Award is deferred to a later date, any amount (whether denominated in Shares or cash) paid in addition to the original number of Shares subject to such Award will not be treated as an increase in the number of Shares subject to the Award if the additional amount is based either on a reasonable rate of interest or on one or more predetermined actual investments such that the amount payable by the Company at the later date will be based on the actual rate of return of a specific investment (including any decrease as well as any increase in the value of an investment).

(h) EARLY EXERCISE. The Award Agreement may, but need not, include a provision whereby the Grantee may elect at any time while an Employee, Director or Consultant to exercise any part or all of the Award prior to full vesting of the Award. Any unvested Shares received pursuant to such exercise may be subject to a repurchase right in favor of the Company or a Related Entity or to any other restriction the Administrator determines to be appropriate.

(i) TERM OF AWARD. The term of each Award shall be the term stated in the Award Agreement, provided, however, that the term of an Incentive Stock Option shall be no more than ten (10) years from the date of grant thereof. However, in the case of an Incentive Stock Option granted to a Grantee who, at the time the Option is granted, owns stock representing more than ten percent (10%) of the voting power of all classes of stock of the Company or any Parent or Subsidiary of the Company, the term of the Incentive Stock Option shall be five (5) years from the date of grant thereof or such shorter term as may be provided in the Award Agreement. Notwithstanding the foregoing, the specified term of any Award shall not include any period for which the Grantee has elected to defer the receipt of the Shares or cash issuable pursuant to the Award.

(j) TRANSFERABILITY OF AWARDS. Incentive Stock Options may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner

other than by will or by the laws of descent or distribution and may be exercised, during the lifetime of the Grantee, only by the Grantee. Other Awards shall be transferable (i) by will and by the laws of descent and distribution and (ii) during the lifetime of the Grantee, to the extent and in the manner authorized by the Administrator. Notwithstanding the foregoing, the Grantee may designate one or more beneficiaries of the Grantee's Award in the event of the Grantee's death on a beneficiary designation form provided by the Administrator.

(k) TIME OF GRANTING AWARDS. The date of grant of an Award shall for all purposes be the date on which the Administrator makes the determination to grant such Award, or such other date as is determined by the Administrator.

7. AWARD EXERCISE OR PURCHASE PRICE, CONSIDERATION AND TAXES.

(a) EXERCISE OR PURCHASE PRICE. The exercise or purchase price, if any, for an Award shall be as follows:

(i) In the case of an Incentive Stock Option:

(A) granted to an Employee who, at the time of the grant of such Incentive Stock Option owns stock representing more than ten percent (10%) of the voting power of all classes of stock of the Company or any Parent or Subsidiary of the Company, the per Share exercise price shall be not less than one hundred ten percent (110%) of the Fair Market Value per Share on the date of grant; or

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(B) granted to any Employee other than an Employee described in the preceding paragraph, the per Share exercise price shall be not less than one hundred percent (100%) of the Fair Market Value per Share on the date of grant.

(ii) In the case of a Non-Qualified Stock Option, the per Share exercise price shall be not less than eighty-five percent (85%) of the Fair Market Value per Share on the date of grant unless otherwise determined by the Administrator.

(iii) In the case of Options or SARs intended to qualify as Performance-Based Compensation, the exercise or base appreciation amount shall be not less than one hundred percent (100%) of the Fair Market Value per Share on the date of grant.

(iv) In the case of other Awards, such price as is determined by the Administrator.

(v) Notwithstanding the foregoing provisions of this Section 7(a), in the case of an Award issued pursuant to Section 6(d), above, the exercise or purchase price for the Award shall be determined in accordance with

the provisions of the relevant instrument evidencing the agreement to issue such Award.

(b) CONSIDERATION. Subject to Applicable Laws, the consideration to be paid for the Shares to be issued upon exercise or purchase of an Award including the method of payment, shall be determined by the Administrator (and, in the case of an Incentive Stock Option, shall be determined at the time of grant). In addition to any other types of consideration the Administrator may determine, the Administrator is authorized to accept as consideration for Shares issued under the Plan the following, provided that the portion of the consideration equal to the par value of the Shares must be paid in cash or other legal consideration permitted by the Delaware General Corporation Law:

(i) cash;

(ii) check;

(iii) if the exercise or purchase occurs on or after the Registration Date, surrender of Shares or delivery of a properly executed form of attestation of ownership of Shares as the Administrator may require which have a Fair Market Value on the date of surrender or attestation equal to the aggregate exercise price of the Shares as to which said Award shall be exercised, provided, however, that Shares acquired under the Plan or any other equity compensation plan or agreement of the Company must have been held by the Grantee for a period of more than six (6) months (and not used for another Award exercise by attestation during such period);

(iv) with respect to Options, if the exercise occurs on or after the Registration Date, payment through a broker-dealer sale and remittance procedure pursuant to which the Grantee (A) shall provide written instructions to a Company designated brokerage firm to effect the immediate sale of some or all of the purchased Shares and remit to the Company sufficient funds to cover the aggregate exercise price payable for the purchased Shares and (B) shall provide written directives to the Company to deliver the certificates for the purchased Shares directly to such brokerage firm in order to complete the sale transaction; or

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(v) any combination of the foregoing methods of payment.

The Administrator may at any time or from time to time, by adoption of or by amendment to the standard forms of Award Agreement described in Section 4(b) (iv), or by other means, grant Awards which do not permit all of the foregoing forms of consideration to be used in payment for the Shares or which otherwise restrict one or more forms of consideration.

(c) TAXES. No Shares shall be delivered under the Plan to any Grantee or other person until such Grantee or other person has made arrangements

acceptable to the Administrator for the satisfaction of any non-U.S., federal, state, or local income and employment tax withholding obligations, including, without limitation, obligations incident to the receipt of Shares or the disqualifying disposition of Shares received on exercise of an Incentive Stock Option. Upon exercise of an Award the Company shall withhold or collect from Grantee an amount sufficient to satisfy such tax obligations.

8. EXERCISE OF AWARD.

(a) PROCEDURE FOR EXERCISE; RIGHTS AS A STOCKHOLDER.

(i) Any Award granted hereunder shall be exercisable at such times and under such conditions as determined by the Administrator under the terms of the Plan and specified in the Award Agreement.

(ii) An Award shall be deemed to be exercised when written notice of such exercise has been given to the Company in accordance with the terms of the Award by the person entitled to exercise the Award and full payment for the Shares with respect to which the Award is exercised, including, to the extent selected, use of the broker-dealer sale and remittance procedure to pay the purchase price as provided in Section 7(b) (iv).

(b) EXERCISE OF AWARD FOLLOWING TERMINATION OF CONTINUOUS SERVICE.

(i) An Award may not be exercised after the termination date of such Award set forth in the Award Agreement and may be exercised following the termination of a Grantee's Continuous Service only to the extent provided in the Award Agreement.

(ii) Where the Award Agreement permits a Grantee to exercise an Award following the termination of the Grantee's Continuous Service for a specified period, the Award shall terminate to the extent not exercised on the last day of the specified period or the last day of the original term of the Award, whichever occurs first.

(iii) Any Award designated as an Incentive Stock Option to the extent not exercised within the time permitted by law for the exercise of Incentive Stock Options following the termination of a Grantee's Continuous Service shall convert automatically to a Non-Qualified Stock Option and thereafter shall be exercisable as such to the extent exercisable by its terms for the period specified in the Award Agreement.

9. CONDITIONS UPON ISSUANCE OF SHARES.

(a) Shares shall not be issued pursuant to the exercise of an Award unless the exercise of such Award and the issuance and delivery of such Shares pursuant thereto shall comply with all Applicable Laws, and shall be further

subject to the approval of counsel for the Company with respect to such compliance.

(b) As a condition to the exercise of an Award, the Company may require the person exercising such Award to represent and warrant at the time of any such exercise that the Shares are being purchased only for investment and without any present intention to sell or distribute such Shares if, in the opinion of counsel for the Company, such a representation is required by any Applicable Laws.

10. ADJUSTMENTS UPON CHANGES IN CAPITALIZATION. Subject to any required action by the stockholders of the Company, the number of Shares covered by each outstanding Award, and the number of Shares which have been authorized for issuance under the Plan but as to which no Awards have yet been granted or which have been returned to the Plan, the exercise or purchase price of each such outstanding Award, the maximum number of Shares with respect to which Awards may be granted to any Grantee in any fiscal year of the Company, as well as any other terms that the Administrator determines require adjustment shall be proportionately adjusted for (i) any increase or decrease in the number of issued Shares resulting from a stock split, reverse stock split, stock dividend, combination or reclassification of the Shares, or similar transaction affecting the Shares, (ii) any other increase or decrease in the number of issued Shares effected without receipt of consideration by the Company, or (iii) as the Administrator may determine in its discretion, any other transaction with respect to Common Stock including a corporate merger, consolidation, acquisition of property or stock, separation (including a spin-off or other distribution of stock or property), reorganization, liquidation (whether partial or complete) or any similar transaction; provided, however that conversion of any convertible securities of the Company shall not be deemed to have been "effected without receipt of consideration." Such adjustment shall be made by the Administrator and its determination shall be final, binding and conclusive. Except as the Administrator determines, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason hereof shall be made with respect to, the number or price of Shares subject to an Award.

11. CORPORATE TRANSACTIONS AND CHANGES IN CONTROL.

(a) TERMINATION OF AWARD TO EXTENT NOT ASSUMED IN CORPORATE TRANSACTION. Effective upon the consummation of a Corporate Transaction, all outstanding Awards under the Plan shall terminate. However, all such Awards shall not terminate to the extent they are Assumed in connection with the Corporate Transaction.

(b) ACCELERATION OF AWARD UPON CORPORATE TRANSACTION OR CHANGE IN CONTROL.

(i) CORPORATE TRANSACTION. Except as provided otherwise in an individual Award Agreement, in the event of a Corporate Transaction and:

(A) for the portion of each Award that is Assumed or Replaced, then such Award (if Assumed), the replacement Award (if Replaced), or the cash incentive (if Replaced) program automatically shall become fully vested, exercisable and payable and be released from any repurchase or forfeiture rights (other than repurchase rights exercisable at fair market value) for all of the Shares at the time represented by such Assumed or Replaced portion of the Award, immediately upon termination of the Grantee's Continuous Service if such Continuous Service is terminated by the successor company or the Company without Cause within twelve (12) months after the Corporate Transaction; and

(B) for the portion of each Award that is neither Assumed nor Replaced, such portion of the Award shall automatically become fully vested and exercisable and be released from any repurchase or forfeiture rights (other than repurchase rights exercisable at fair market value) for all of the Shares at the time represented by such portion of the Award, immediately prior to the specified effective date of such Corporate Transaction, provided that the Grantee's Continuous Service has not terminated prior to such date. The portion of the Award that is not Assumed shall terminate under subsection (a) of this Section 11 to the extent not exercised prior to the consummation of such Corporate Transaction.

(ii) CHANGE IN CONTROL. Except as provided otherwise in an individual Award Agreement, in the event of a Change in Control (other than a Change in Control which also is a Corporate Transaction), each Award which is at the time outstanding under the Plan automatically shall become fully vested and exercisable and be released from any repurchase or forfeiture rights (other than repurchase rights exercisable at Fair Market Value), immediately prior to the specified effective date of such Change in Control, for all of the Shares at the time represented by such Award, provided that the Grantee's Continuous Service has not terminated prior to such date.

(c) EFFECT OF ACCELERATION ON INCENTIVE STOCK OPTIONS. Any Incentive Stock Option accelerated under this Section 11 in connection with a Corporate Transaction or Change in Control shall remain exercisable as an Incentive Stock Option under the Code only to the extent the \$100,000 dollar limitation of Section 422(d) of the Code is not exceeded. To the extent such dollar limitation is exceeded, the excess Options shall be treated as Non-Qualified Stock Options.

12. EFFECTIVE DATE AND TERM OF PLAN. The Plan shall become effective upon the earlier to occur of its adoption by the Board or its approval by the stockholders of the Company. It shall continue in effect for a term of ten (10) years unless sooner terminated. Subject to Section 17, below, and Applicable Laws, Awards may be granted under the Plan upon its becoming effective.

13. AMENDMENT, SUSPENSION OR TERMINATION OF THE PLAN.

(a) The Board may at any time amend, suspend or terminate the Plan; provided, however, that no such amendment shall be made without the approval of the Company's stockholders to the extent such approval is required by Applicable Laws, or if such amendment would change any of the provisions of Section 4(b) (vi) or this Section 13(a).

(b) No Award may be granted during any suspension of the Plan or after termination of the Plan.

(c) No suspension or termination of the Plan (including termination of the Plan under Section 12, above) shall adversely affect any rights under Awards already granted to a Grantee.

14. RESERVATION OF SHARES.

(a) The Company, during the term of the Plan, will at all times reserve and keep available such number of Shares as shall be sufficient to satisfy the requirements of the Plan.

(b) The inability of the Company to obtain authority from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be necessary to the lawful issuance and sale of any Shares hereunder, shall relieve the Company of any liability in respect of the failure to issue or sell such Shares as to which such requisite authority shall not have been obtained.

15. NO EFFECT ON TERMS OF EMPLOYMENT/CONSULTING RELATIONSHIP. The Plan shall not confer upon any Grantee any right with respect to the Grantee's Continuous Service, nor shall it interfere in any way with his or her right or the right of the Company or any Related Entity to terminate the Grantee's Continuous Service at any time, with or without Cause, and with or without notice. The ability of the Company or any Related Entity to terminate the employment of a Grantee who is employed at will is in no way affected by its determination that the Grantee's Continuous Service has been terminated for Cause for the purposes of this Plan.

16. NO EFFECT ON RETIREMENT AND OTHER BENEFIT PLANS. Except as specifically provided in a retirement or other benefit plan of the Company or a Related Entity, Awards shall not be deemed compensation for purposes of computing benefits or contributions under any retirement plan of the Company or a Related Entity, and shall not affect any benefits under any other benefit plan of any kind or any benefit plan subsequently instituted under which the availability or amount of benefits is related to level of compensation. The Plan is not a "Retirement Plan" or "Welfare Plan" under the Employee Retirement Income Security Act of 1974, as amended.

17. STOCKHOLDER APPROVAL. The grant of Incentive Stock Options under the Plan shall be subject to approval by the stockholders of the Company within

twelve (12) months before or after the date the Plan is adopted excluding Incentive Stock Options issued in substitution for outstanding Incentive Stock Options pursuant to Section 424(a) of the Code. Such stockholder approval shall be obtained in the degree and manner required under Applicable Laws. The Administrator may grant Incentive Stock Options under the Plan prior to approval by the stockholders, but until such approval is obtained, no such Incentive Stock Option shall be exercisable. In the event that stockholder approval is not obtained within the twelve (12) month period provided above, all Incentive Stock Options previously granted under the Plan shall be exercisable as Non-Qualified Stock Options.

18. EFFECT OF SECTION 162(M) OF THE CODE. Section 162(m) of the Code does not apply to the Plan prior to the Registration Date. Following the Registration Date, the Plan, and all Awards issued thereunder, are intended to be exempt from the application of Section 162(m) of the Code, which restricts under certain circumstances the Federal income tax deduction for compensation paid by a public company to named executives in excess of \$1 million per year. The exemption is based on Treasury Regulation Section 1.162-27(f), in the form existing on the effective date of the Plan, with the understanding that such regulation generally exempts from the application of Section 162(m) of the Code compensation paid pursuant to a plan that existed before a company becomes publicly held. Under such Treasury Regulation, this exemption is available to the Plan for the duration of the period that lasts until the earlier of (i) the expiration of the Plan, (ii) the material modification of the Plan, (iii) the exhaustion of the maximum number of shares of Common Stock available for Awards under the Plan, as set forth in Section 3(a), (iv) the first meeting of shareholders at which directors are to be elected that occurs after the close of the third calendar year following the calendar year in which the Company first becomes subject to the reporting obligations of Section 12 of the Exchange Act, or (v) such other date required by Section 162(m) of the Code and the rules and regulations promulgated thereunder. To the extent that the Administrator determines as of the date of grant of an Award that (i) the Award is intended to qualify as Performance-Based Compensation and (ii) the exemption described above is no longer available with respect to such Award, such Award shall not be effective until any stockholder approval required under Section 162(m) of the Code has been obtained.

19. UNFUNDED OBLIGATION. Grantees shall have the status of general unsecured creditors of the Company. Any amounts payable to Grantees pursuant to the Plan shall be unfunded and unsecured obligations for all purposes, including, without limitation, Title I of the Employee Retirement Income Security Act of 1974, as amended. Neither the Company nor any Related Entity shall be required to segregate any monies from its general funds, or to create any trusts, or establish any special accounts with respect to such obligations. The Company shall retain at all times beneficial ownership of any investments, including trust investments, which the Company may make to fulfill its payment obligations hereunder. Any investments or the creation or maintenance of any

trust or any Grantee account shall not create or constitute a trust or fiduciary relationship between the Administrator, the Company or any Related Entity and a Grantee, or otherwise create any vested or beneficial interest in any Grantee or the Grantee's creditors in any assets of the Company or a Related Entity. The Grantees shall have no claim against the Company or any Related Entity for any changes in the value of any assets that may be invested or reinvested by the Company with respect to the Plan.

20. CONSTRUCTION. Captions and titles contained herein are for convenience only and shall not affect the meaning or interpretation of any provision of the Plan. Except when otherwise indicated by the context, the singular shall include the plural and the plural shall include the singular. Use of the term "or" is not intended to be exclusive, unless the context clearly requires otherwise.

THIS WARRANT AND THE COMMON STOCK ISSUABLE UPON THE EXERCISE HEREOF (COLLECTIVELY, THE "SECURITIES") HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), AND MAY NOT BE OFFERED, SOLD OR OTHERWISE TRANSFERRED, PLEDGED OR HYPOTHECATED IN THE ABSENCE OF A REGISTRATION STATEMENT IN EFFECT UNDER THE ACT WITH RESPECT TO THE SECURITIES OR DELIVERY TO THE COMPANY OF AN OPINION OF COUNSEL IN FORM AND SUBSTANCE SATISFACTORY TO THE COMPANY THAT SUCH OFFER, SALE OR TRANSFER, PLEDGE OR HYPOTHECATION IS IN COMPLIANCE WITH THE ACT OR UNLESS SOLD IN FULL COMPLIANCE WITH RULE 144 UNDER THE ACT.

WARRANT TO PURCHASE COMMON STOCK

OF

DIGIRAD CORPORATION

Date of Issuance - June 16, 2004

Void after June 16, 2008

Digirad Corporation, a Delaware corporation (the "COMPANY"), hereby certifies that, for value received _____ (including any successors and assigns, the "HOLDER"), is entitled, subject to the terms set forth below, to purchase from the Company at any time or from time to time, before 5:00 PM, Pacific time on June 16, 2008 (the "EXPIRATION DATE") up to _____ shares of Common Stock of the Company (the "WARRANT SHARES"), subject to adjustment as provided herein. The purchase price per share of such Common Stock upon exercise of this Warrant shall be \$12.00 (the "EXERCISE PRICE"), subject to adjustment as provided herein. This Warrant is issued to the Holder in connection with and subject to the terms and conditions of that certain Loan Modification and Warrant Issuance Agreement dated May 7, 2004, by and among the Company, Holder and/or his assignor and the other parties thereto (the "LOAN MODIFICATION AGREEMENT").

1. EXERCISE PERIOD. Subject to Section 2.2 herein, this Warrant may be exercised by the Holder at any time or from time to time after the Date of Issuance noted above but before 5:00 PM, Pacific time on the Expiration Date (the "EXERCISE PERIOD").

2. EXERCISE OF WARRANT; NUMBER OF WARRANT SHARES; TERMINATION.

2.1 EXERCISE OF WARRANT; PARTIAL EXERCISE. This Warrant may be exercised in full or in part by the Holder with respect to any or all of the Warrant Shares by surrender of this Warrant, together with the form of subscription attached hereto as SCHEDULE 1, duly executed by the Holder, to the Company at its principal office, accompanied by payment, in cash or by certified

or official bank check payable to the order of the Company, of the aggregate Exercise Price for the Warrant Shares to be purchased hereunder. For any partial exercise hereof, the Holder shall designate in a notice of exercise or net issue election notice that number of shares of Common Stock that he wishes to purchase. On any such partial exercise, the Company at its expense shall forthwith issue and deliver to the Holder a new warrant of like tenor, in the name of the Holder, which shall be exercisable for such number of shares of Common Stock represented by this Warrant which have not been purchased upon such exercise.

2.2 TERMINATION OF THE WARRANT UPON A CORPORATE TRANSACTION.

Immediately following the occurrence of a Corporate Transaction, this Warrant shall terminate and cease to be outstanding, provided that written notice has been given to the Holder at least 20 days prior to the occurrence of the Corporate Transaction. For the purposes of this Warrant, a "Corporate Transaction" shall mean: (i) a merger or consolidation in which securities possessing more than fifty percent (50%) of the total combined voting power of the Company's outstanding securities are transferred to a person or persons different from the persons holding those securities immediately prior to such transaction; or (ii) the sale, transfer or other disposition of all or substantially all of the Company's assets in complete liquidation or dissolution of the Company.

3. NET ISSUANCE.

3.1 RIGHT TO CONVERT. The Holder shall have the right to convert this Warrant or any portion thereof (the "CONVERSION RIGHT") into shares of Common Stock as provided in this Section 3 at any time or from time to time during the Exercise Period. Upon exercise of the Conversion Right with respect to a particular number of Warrant Shares (the "CONVERTED WARRANT SHARES"), the Company shall deliver to the Holder (without payment by the Holder of any exercise price or any cash or other consideration) that number of shares of fully paid and nonassessable shares of Common Stock computed using the following formula:

$$X = \frac{Y (A - B)}{A}$$

Where

- X = the number of shares of Common Stock to be delivered to the Holder
- Y = the number of Converted Warrant Shares
- A = the fair market value of one share of the Company's Common Stock on the Conversion Date (as defined below)

B = the Exercise Price (as adjusted through the Conversion Date)

The Conversion Right may only be exercised with respect to a whole number of Warrant Shares. No fractional shares shall be issuable upon exercise of the Conversion Right, and if the number of shares to be issued determined in accordance with the foregoing formula is other than a whole number, the Company shall pay to the Holder an amount in cash equal to the fair market value of the resulting fractional share on the Conversion Date (as defined below). Shares issued pursuant to the Conversion Right shall be treated as if they were issued upon the exercise of this Warrant.

3.2 METHOD OF EXERCISE. The Conversion Right may be exercised by the Holder by the surrender of this Warrant at the principal office of the Company together with a written statement specifying that the Holder thereby intends to exercise the Conversion Right and indicating the total number of shares under this Warrant that the Holder is exercising through the Conversion Right. Such conversion shall be effective upon receipt by the Company of this Warrant together with the aforesaid written statement, or on such later date as is specified therein (the "CONVERSION DATE") and at such time the person in whose name any certificate for shares of Common Stock shall be issuable upon such exercise shall be deemed to be the record holder of such Common Stock for all purposes. Certificates for the shares issuable upon exercise of the Conversion Right and, if applicable, a new warrant evidencing the balance of the shares remaining subject to the Warrant, shall be issued as of the Conversion Date and shall be delivered to the Holder promptly following the Conversion Date.

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3.3 DETERMINATION OF FAIR MARKET VALUE. For purposes of this Section 3, fair market value of a share of Common Stock on the Conversion Date shall mean:

(1) If traded on a stock exchange, the fair market value of the Common Stock shall be deemed to be the average of the closing selling prices of the Common Stock on the stock exchange determined by the Board of Directors of the Company (the "BOARD") to be the primary market for the Common Stock over the ten (10) trading day period (or such shorter period immediately following the closing of the Company's initial public offering) ending on the date prior to the Conversion Date, as such prices are officially quoted in the composite tape of transactions on such exchange;

(2) If traded over-the-counter, the fair market value of the Common Stock shall be deemed to be the average of the closing bid prices (or, if such information is available, the closing selling prices) of the Common Stock over the ten (10) trading day period (or such shorter period immediately following the closing of the Company's initial public offering) ending on the date prior to the Conversion Date, as such prices are reported by the National

Association of Securities Dealers through its NASDAQ system or any successor system; and

(3) If there is no public market for the Common Stock, the fair market value of the Common Stock shall be determined in good faith by the Board.

4. WHEN EXERCISE EFFECTIVE. The exercise of this Warrant pursuant to Section 2 shall be deemed to have been effected immediately prior to the close of business on the business day on which this Warrant is surrendered to the Company as provided in Section 2.1, or on such later date as is specified in the form of subscription, and at such time the person in whose name any certificate for shares of Common Stock shall be issuable upon such exercise, as provided in Section 5, shall be deemed to be the record holder of such Common Stock for all purposes.

5. DELIVERY ON EXERCISE. As soon as practicable after the exercise of this Warrant in full or in part pursuant to Section 2, the Company at its expense (including the payment by it of any applicable issue taxes) will cause to be issued in the name of and delivered to the Holder, or as the Holder may direct, a certificate or certificates for the number of fully paid and nonassessable full shares of Common Stock to which the Holder shall be entitled on such exercise, together with cash, in lieu of any fraction of a share, equal to such fraction of the current market value of one full share of Common Stock as determined pursuant to Section 3.3.

6. ADJUSTMENTS. The number and kind of shares of Common Stock (or any shares of stock or other securities which may be) issuable upon the exercise of this Warrant and the Exercise Price shall be subject to adjustment from time to time upon the happening of certain events, as follows:

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6.1 DIVIDENDS, DISTRIBUTIONS, STOCK SPLITS OR COMBINATIONS. If the Company shall at any time or from time to time after the date hereof (a) make or issue, or fix a record date for the determination of holders of Common Stock (or any shares of stock or other securities which may be issuable upon the exercise of this Warrant) entitled to receive, a dividend or other distribution payable in additional shares of common or preferred stock (as the case may be), (b) subdivide its outstanding shares of Common Stock (or any shares of stock or other securities which may be issuable upon the exercise of this Warrant) into a larger number of shares of Common Stock (or any shares of stock or other securities which may be issuable upon the exercise of this Warrant) or (c) combine its outstanding shares of Common Stock (or any shares of stock or other securities which may be issuable upon the exercise of this Warrant) into a smaller number of shares of Common Stock (or any shares of stock or other securities which may be issuable upon the exercise of this Warrant), then and in each such event the Exercise Price then in effect and the number of shares issuable upon exercise of this Warrant shall be appropriately adjusted.

6.2 RECLASSIFICATION OR REORGANIZATION. If the Common Stock (or any shares of stock or other securities which may be) issuable upon the exercise of this Warrant shall be changed into the same or different number of shares of any class or classes of stock, whether by capital reorganization, reclassification or otherwise (other than a subdivision or combination of shares or stock dividend provided for in Section 6.1 above, or pursuant to a Corporate Transaction), then and in each such event the Holder shall be entitled to receive upon the exercise of this Warrant the kind and amount of shares of stock and other securities and property receivable upon such reorganization, reclassification or other change to which a holder of the number of shares of Common Stock (or any shares of stock or other securities which may be) issuable upon the exercise of this Warrant would have received if this Warrant had been exercised immediately prior to such reorganization, reclassification or other change, all subject to further adjustment as provided herein.

6.3 NOTICE OF ADJUSTMENTS AND RECORD DATES. The Company shall promptly notify the Holder in writing of each adjustment or readjustment of the Exercise Price and the number of shares of Common Stock (or any shares of stock or other securities which may be) issuable upon the exercise of this Warrant. Such notice shall state the adjustment or readjustment and show in reasonable detail the facts on which that adjustment or readjustment is based. In the event of any taking by the Company of a record of the holders of Common Stock (or any shares of stock or other securities which may be issuable upon the exercise of this Warrant) for the purpose of determining the holders thereof who are entitled to receive any dividend or other distribution, the Company shall notify Holder in writing of such record date at least twenty (20) days prior to the date specified therein.

6.4 WHEN ADJUSTMENTS TO BE MADE. No adjustment in the Exercise Price shall be required by this Section 6 if such adjustment either by itself or with other adjustments not previously made would require an increase or decrease of less than one percent (1%) in such price. Any adjustment representing a change of less than such minimum amount which is postponed shall be carried forward and made as soon as such adjustment, together with other adjustments required by this Section 6 and not previously made, would result in a minimum adjustment. Notwithstanding the foregoing, any adjustment carried forward shall be made no later than ten (10) business days prior to the Expiration Date. All calculations under this Section 6.4 shall be made to the nearest cent. For the purpose of any adjustment, any specified event shall be deemed to have occurred at the close of business on the date of its occurrence.

6.5 CERTAIN OTHER EVENTS. If any change in the outstanding Common Stock (or any shares of stock or other securities which may be issuable upon the exercise of this Warrant) or any other event occurs as to which the other provisions of this Section 6 are not strictly applicable or if strictly applicable would not fairly protect the purchase rights of the Holder of the

Warrant in accordance with such provisions, then the Board shall make an adjustment in the number and class of shares available under this Warrant, the Exercise Price or the application of such provisions, so as to protect such purchase rights as aforesaid. The adjustment shall be such as will give the Holder, upon exercise of this Warrant, the same aggregate Exercise Price and the same total number, class and kind of shares as the Holder would have owned had this Warrant been exercised prior to the event and had the Holder continued to hold such shares until after the event requiring adjustment.

7. REPLACEMENT OF WARRANTS. On receipt by the Company of evidence reasonably satisfactory to the Company of the loss, theft, destruction or mutilation of this Warrant and, in the case of any such loss, theft or destruction of this Warrant, on delivery of an indemnity agreement reasonably satisfactory in form and amount to the Company or, in the case of any such mutilation, on surrender and cancellation of such Warrant, the Company at its expense will execute and deliver to the Holder, in lieu thereof, a new warrant of like tenor.

8. NO RIGHTS OR LIABILITY AS A STOCKHOLDER. This Warrant does not entitle the Holder hereof to any voting rights or other rights as a stockholder of the Company. No provisions hereof, in the absence of affirmative action by the Holder to purchase Common Stock, and no enumeration herein of the rights or privileges of the Holder, shall give rise to any liability of the Holder as a stockholder of the Company.

9. REPRESENTATIONS OF HOLDER.

The Holder hereby represents, covenants and acknowledges to the Company that:

(1) this Warrant and the Warrant Shares are "restricted securities" as such term is used in the rules and regulations under the Securities Act of 1933, as amended (the "ACT") and that this Warrant and the Warrant Shares have not been registered under the Act and the Company has no present intention of registering the Securities under the Act or any state securities law, and that this Warrant and the Warrant Shares must be held indefinitely unless a transfer can be made pursuant to appropriate exemptions (including, without limitation, pursuant to Rule 144 under the Act);

(2) the Holder has read, and fully understands, the terms of this Warrant set forth on its face and the attachments hereto, including the restrictions on transfer contained herein;

(3) the Holder is purchasing for investment for his own account and not with a view to or for sale in connection with any distribution of this Warrant or the Warrant Shares and he has no intention of selling such securities in a public distribution in violation of the federal securities laws or any

applicable state securities laws; and

(4) the Holder (i) has received all information the Holder has requested from the Company and considers necessary or appropriate for deciding whether to acquire this Warrant and the Warrant Shares, (ii) has had an opportunity to ask questions and receive answers from the Company regarding the terms and conditions of this Warrant and the Warrant Shares and to obtain any additional information necessary to verify the accuracy of the information given to the Holder, and (iii) has such knowledge and experience in financial and business matters such that the Holder is capable of evaluating the merits and risks of the investment in this Warrant and the Warrant Shares.

10. MARKET STAND-OFF AGREEMENT. The Holder hereby agrees that, during the period of duration specified by the Company and an underwriter of Common Stock or other securities of the Company, following the effective date of a registration statement of the Company filed under the Act, he shall not, to the extent requested by the Company and such underwriter, directly or indirectly sell, offer to sell, contract to sell (including, without limitation, any short sale), grant any option to purchase or otherwise transfer or dispose of (other than to donees who agree to be similarly bound) any securities of the Company held by it at any time during such period except Common Stock included in such registration; provided, however, that:

(1) Such agreement shall not exceed 180 days for the first such registration statement of the Company which covers Common Stock (or other securities) to be sold on its behalf to the public in an underwritten offering;

(2) Such agreement shall not exceed ninety (90) days for any subsequent registration statement of the Company which covers Common Stock (or other securities) to be sold on its behalf to the public in an underwritten offering; and

(3) All directors and officers of the Company as well as all holders of one percent (1%) or more of the Company's outstanding capital stock are similarly bound.

In order to enforce the foregoing covenant, the Company may impose stop-transfer instructions with respect to securities held by the Holder (and the shares or securities of every other person subject to the foregoing restriction) until the end of such period.

11. MISCELLANEOUS.

11.1 TRANSFER OF WARRANT. This Warrant shall not be transferable or assignable by the Holder without the express written consent of the Company; provided, however, that one hundred eighty (180) days after the Date of Issuance the Holder may transfer or assign this Warrant, without the Company's written consent, to any recipient of least 5,714 of the Warrant Shares (as adjusted for any stock split, combination, reclassification or reorganization) who agrees in writing to be bound by the provisions of this Warrant.

11.2 NOTICES. Any notice required or permitted under this Warrant shall be in writing and shall be hand delivered, sent by facsimile or other electronic medium, by registered or certified mail, postage prepaid, or by nationally recognized overnight carrier to the Company or to the Holder at the address set forth below on the signature page to this Warrant or to such other address as may be furnished in writing to the other party hereto. Such notice shall be deemed effectively given (i) if hand delivered, upon delivery, (ii) if sent by facsimile or other electronic medium, when confirmed, if sent during the normal business hours of the recipient (if not sent during the normal business hours of the recipient, then on the next business day), (iii) if sent by mail, five days after having been sent, or (iv) if sent by nationally recognized overnight courier, one day after deposit with such courier.

11.3 ATTORNEYS' FEES. If any action at law or in equity is necessary to enforce or interpret the terms of this Warrant, the prevailing party shall be entitled to reasonable attorneys' fees, costs and disbursements in addition to any other relief to which such party may be entitled.

11.4 AMENDMENTS AND WAIVERS. Any term of this Warrant may be amended and the observance of any other term of this Warrant may be waived (either generally or in a particular instance and either retroactively or prospectively), only with the written consent of the Company and holders of Warrants representing at least a majority of the aggregate number of Warrant Shares issuable upon exercise of all outstanding Warrants issued pursuant to the Loan Modification Agreement. Any amendment or waiver effected in accordance with this paragraph shall be binding upon the Company, the Holder and the holders of all Warrants issued pursuant to the Loan Modification Agreement.

11.5 SEVERABILITY. If one or more provisions of this Warrant are held to be unenforceable under applicable law, such provision shall be excluded from this Warrant and the balance of the Warrant shall be interpreted as if such provision were so excluded and shall be enforceable in accordance with its terms.

11.6 GOVERNING LAW. This Warrant shall be governed by and construed and enforced in accordance with the laws of the State of California as applied to agreements among California residents entered into and to be performed entirely within California.

[REMAINDER OF THIS PAGE INTENTIONALLY LEFT BLANK]

IN WITNESS WHEREOF, the undersigned have caused this Warrant to be executed by its officers thereunto duly authorized.

COMPANY:

DIGIRAD CORPORATION

By:

Todd P. Clyde
Chief Financial Officer

Address: 13950 Stowe Drive
Poway, CA 92064

HOLDER:

Address:

[COUNTERPART SIGNATURE PAGE TO
WARRANT TO PURCHASE COMMON STOCK OF DIGIRAD CORPORATION]

SCHEDULE 1

FORM OF SUBSCRIPTION

(To be signed only on exercise of Warrant)

To: Digirad Corporation

The undersigned, the holder of the Warrant attached hereto, hereby irrevocably elects to exercise the purchase rights represented by such Warrant for, and to purchase thereunder, _____* shares of common stock of Digirad Corporation, and herewith makes payment of \$_____ therefor, and requests

that the certificates for such shares be issued in the name of, and delivered to _____, whose address is _____.

(Signature must conform in all respects to name of the Holder as specified on the face of the Warrant)

(Print Name)

(Address)

Dated: _____

* Insert here the number of shares as to which the Warrant is being exercised.

SCHEDULE OF INVESTORS

WARRANTHOLDER	NO. OF SHARES
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Clinton L. Lingren	23,809
Jack F. Butler	19,009
Alice G. Butler	1,200
Jack F. Butler, Jr.	1,200
Michael Butler	1,200
Patricia Butler	1,200

TOTAL:	47,618

**CERTIFICATION OF
PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002**

I, David M. Sheehan, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Digirad Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ DAVID M. SHEEHAN

David M. Sheehan
President and Chief Executive Officer
(Principal Executive Officer)

**CERTIFICATION OF
PRINCIPAL FINANCIAL OFFICER
PURSUANT TO SECTION 302
OF THE SARBANES-OXLEY ACT OF 2002**

I, Todd P. Clyde, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Digirad Corporation
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ TODD P. CLYDE

Todd P. Clyde
Chief Financial Officer
(Principal Financial Officer)

**CERTIFICATION OF
PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350
(SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002)**

In connection with the accompanying Quarterly Report on Form 10-Q of Digirad Corporation for the period ended June 30, 2004, I, David M. Sheehan, Chief Executive Officer of Digirad Corporation, hereby certify pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

- (1) such Quarterly Report on Form 10-Q of Digirad Corporation for the period ended June 30, 2004, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) the information contained in such Quarterly Report on Form 10-Q of Digirad Corporation for the period ended June 30, 2004, fairly presents, in all material respects, the financial condition and results of operations of Digirad Corporation at the dates and for the periods indicated.

This certification has not been, and shall not be deemed, “filed” with the Securities and Exchange Commission.

/s/ DAVID M. SHEEHAN

David M. Sheehan
President and Chief Executive Officer
(Principal Executive Officer)

August 11, 2004

**CERTIFICATION OF
PRINCIPAL FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350
(SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002)**

In connection with the accompanying Quarterly Report on Form 10-Q of Digirad Corporation for the period ended June 30, 2004, I, Todd P. Clyde, Chief Financial Officer of Digirad Corporation, hereby certify pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

- (1) such Quarterly Report on Form 10-Q of Digirad Corporation for the period ended June 30, 2004, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) the information contained in such Quarterly Report on Form 10-Q of Digirad Corporation for the period ended June 30, 2004, fairly presents, in all material respects, the financial condition and results of operations of Digirad Corporation at the dates and for the periods indicated.

This certification has not been, and shall not be deemed, "filed" with the Securities and Exchange Commission.

/s/ TODD P. CLYDE

Todd P. Clyde
Chief Financial Officer
(Principal Financial Officer)

August 11, 2004

