MERGE TECHNOLOGIES INC
Form 10-Q/A
May 16, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
FORM 10-Q
AMENDMENT NO. 1

X QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2003

TRANSITION REPORT PURSUANT TO 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from __________ to __________
Commission file number 0-29486

Merge Technologies Incorporated
(Exact name of Registrant as specified in its charter.)

Wisconsin	39-1600938
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

1126 South 70th Street, Milwaukee, WI 53214-3151
(Address of principal executive offices)

(414) 977-4000
(Issuer's telephone number)

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

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

As of May 14, 2003, the issuer had 9,862,274 shares of common stock outstanding.

EXPLANATORY NOTE

This Amendment No. 1 to Form 10-Q is filed to amend the Net Sales section of Management's Discussion and Analysis of Financial Condition and Results of Operation, Results of Operations. No other changes are being made to our Form 10-Q as originally filed on May 15, 2003.

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

SPECIAL NOTE ON FORWARD-LOOKING STATEMENTS

Certain statements in this report that are not historical facts constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Discussions containing such forward-looking statements may be included herein in the material set forth under Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as within this report generally. In addition, when used in this report, the words: believes, intends, anticipates, expects and similar expressions are intended to identify forward-looking statements. These statements are subject to a number of risks and uncertainties, including, among others, the Company's lack of consistent profitability, fluctuations in operating results, credit and payment risks associated with end-user sales, involvement with rapidly developing technology in highly competitive markets, acquisition and development of new technologies, dependence on major customers, expansion of the Company's international sales effort, broad discretion of management and dependence on key personnel, risks associated with product liability and product defects, costs of complying with government regulation, changes in external competitive market factors which might impact trends in the Company's results of operation, unanticipated working capital and other cash requirements, general changes in the industries in which the Company competes, and various other competitive factors that may prevent the Company from competing successfully in the marketplace. Actual results could differ materially from those projected in the forward-looking statements. The Company undertakes no obligation to publicly release the result of any revisions to these forward-looking statements that may be made to reflect any future events or circumstances.

OVERVIEW

Merge eFilm is in the business of integrating digital radiology images and information into healthcare enterprise networks, and providing software solutions that manage diagnostic imaging workflow processes. Merge eFilm solutions and services improve radiology workflow efficiencies, reduce healthcare operating costs and improve clinical decision making processes. The Company delivers this tangible value to healthcare facilities of all sizes, but it specifically targets small to medium size hospitals, multi-hospital groups, clinics and diagnostic imaging centers. The Company offers modular, cost effective software solutions that improve its customers' image and information management and radiology workflow. The Company's product and service offerings are commonly categorized as PACS and Radiology Information Systems ("RIS"). The Company believes the combination of PACS and RIS define the breadth and depth of integrated radiology workflow, with the added value of enterprise image and information access. This broader definition is the Company's focus and the manner in which our solutions are positioned to our target market.

The Company, which was founded in 1987, has historically been viewed as a leading provider of medical diagnostic imaging and information connectivity technologies and professional consulting services for original equipment manufacturers ("OEMs"), value added resellers ("VARs") and healthcare facilities worldwide. Now doing business as Merge eFilm, the Company believes it is at the forefront of integrated radiology workflow research and development, bringing modular software applications to the marketplace that will enable the seamless integration of images, information, technology and people across the electronic healthcare enterprise.

Through its founder and Chairman, William C. Mortimore, the Company has been a key contributor to the development of the industry's standard network communications protocol known as Digital Imaging Communications in Medicine ("DICOM"), open medical standards such as HL-7, and the Integrated Healthcare Enterprise ("IHE") framework that has been created through an initiative co-sponsored by the Radiological Society of North America ("RSNA") and the Healthcare Information and Management Systems Society ("HIMSS"). The IHE initiative represents a consortium of more than 30 companies in the Radiology and Healthcare Information Systems fields. This set of requirements has paved the way for healthcare organizations to begin in earnest to integrate the complex workflow systems of the radiology department with the entire healthcare system by using equipment and software applications that connect the various image and communication components. Merge eFilm has incorporated these standards in all its radiology workflow technologies and software applications establishing the basis for seamless integration of images and healthcare information across an organization's intranet or over the internet.

Radiology departments, diagnostic imaging centers and their patients benefit from the Company's solutions in a variety of ways including: (i) networking of multiple image-producing and image-using devices to eliminate duplication and reduce the need for capital equipment expenditures to build digital image and information networks; (ii) creating permanent electronic archives of diagnostic-quality images to enable the retrieval of these images and reports at any time in the future; (iii) accessing the Company's modular architecture of software products that allow radiology departments, clinics and diagnostic imaging centers to build their electronic image and information management systems in a modular, flexible and cost-effective way; (iv) delivering the capability to integrate diagnostic radiology images into the radiologist's report to make it a permanent part of the patient's electronic medical record; and (v) providing the means to view images and reports from any number of remote locations.

RESULTS OF OPERATIONS

(in thousands)

Three Months Ended March 31, 2003 Compared to Three Months Ended March 31, 2002

NET SALES.

Net sales increased 35% to $6,117 in the three months ended March 31, 2003 from $4,535 three months ended March 31, 2002. Net sales of products and software made directly to healthcare facilities increased 6% to $1,338 in the three months ended March 31, 2003 from $1,264 in the three months ended March 31, 2002. Net sales in the three months ended March 31, 2003 were reduced buy a $430 provision for a sales return from one customer related to a sale made in 2002. Net sales to OEM/VARs and dealers increased 32% to $3,422 in the three months ended March 31, 2003 from $2,588 in the three months ended March 31, 2002. The Company anticipates continued growth in the OEM/VAR group, although at a lower rate than sales made directly to healthcare facilities and the professional services group. Net sales from the professional services group increased 99% to $1,357 in the three months ended March 31, 2003 from $683 in the three months ended March 31, 2002. The net sales growth from the professional services group is due to the growth in sales made directly to healthcare facilities and imaging centers, where such sales are accompanied by installation services and service contracts, and to the revenue related to the acquisition of eFilm Medical Inc. ("eFilm") completed in June of 2002. The Company anticipates net sales from the professional services group to continue to grow as part of the overall growth in the sales made directly to healthcare facilities and imaging centers. Given our sales growth during 2003 and our assessment of the market, the Company believes information technology spending on new technologies by our targeted customer base will continue to grow. Based upon this expected demand and customer receptiveness to the Merge eFilm suite of products, the Company anticipates sales for the remainder of 2003 to continue to increase, largely driven by sales made directly to healthcare facilities and imaging centers and the services to be provided related to these customers.

COST OF SALES.

Cost of sales consists of purchased components, service costs associated with revenues, amortization of purchased and developed software and amortization of customer contracts. The cost of purchased components decreased as a percentage of net sales to 16% in the three months ended March 31, 2003 from 26% in the three months ended March 31, 2002. This decrease in the cost of purchased components as a percentage of net sales, is primarily due to the Company's sales mix, which consists of a greater percentage of higher margin products and services and reduced component costs. Service costs associated with revenues increased to $605 in the three months ended March 31, 2003 from $356 in the three months ended March 31, 2002. The increase is due to the Company's acquisition of eFilm and additional service department staff. Amortization of purchased and developed software increased to $462 or 8% of net sales in the three months ended March 31, 2003 from $260 or 6% of net sales in the three months ended March 31, 2002. The increase is due to the commencement of amortization on software available for general release and the amortization of the intellectual property and customer contracts acquired in the acquisition of eFilm.

As a result of the eFilm acquisition on June 28, 2002, the Company has presented costs associated with service revenues as a component of cost of sales. The prior year presentation has been reclassified to conform to the current year presentation.

GROSS PROFIT.

Gross profit increased 48% to $4,066 in the three months ended March 31, 2003 from $2,747 in the three months ended March 31, 2002. As a percentage of net sales, gross profit increased to 66% of net sales in the three months ended March 31, 2003 compared to 61% in the three months ended March 31, 2002. The Company implemented a number of initiatives to improve gross profit in 2002, including the acquisition of eFilm, targeted price increases, reductions in component costs and a gradual shift in product mix to higher margin software applications. The Company anticipates these initiatives will continue to slightly increase overall margins in 2003.

SALES AND MARKETING.

Sales and marketing expense increased 53% to $1,325 in the three months ended March 31, 2003 from $867 in the three months ended March 31, 2002. The increase is the result of the Company's objective to invest in sales and marketing activities and staff count in order to grow net sales.

PRODUCT RESEARCH AND DEVELOPMENT.

Research and development expense increased 21% to $439 in the three months ended March 31, 2003 from $364 in three months ended March 31, 2002. The Company anticipates research and development costs will continue to increase in 2003 as the Company increases its new product development, particularly related to developing its Fusion application modules, including RIS functionality. Capitalization of software development costs decreased $14 to $468 in the three months ended March 31, 2003 from $482 in the three months ended March 31, 2002.

GENERAL AND ADMINISTRATIVE.

General and administrative expense increased 8% to $721 in the three months ended March 31, 2003 from $668 in the three months ended March 31, 2002. General and administrative expense includes costs for information systems, accounting, administrative support, management personnel, bad debt expenses and general corporate matters.

DEPRECIATION AND AMORTIZATION.

Depreciation and amortization expense decreased 6% or $7 to $106 in the three months ended March 31, 2003 from $113 in the three months ended March 31, 2002. The decrease is due primarily to certain assets becoming fully depreciated. Depreciation and amortization is assessed on capital equipment and intangible assets with estimable useful lives. This is net of amortization of capitalized software, which is a component of cost of sales.

OTHER INCOME, EXPENSE.

The Company's interest expense decreased to $4 in the three months ended March 31, 2003 from $7 in three months ended March 31, 2002, and interest income was $13 compared to interest income of $6 in three months ended March 31, 2002. The increase in interest income was relatively small compared to the increase in the Company's cash balance due to declining interest rates. Other income, net, was $12 in the three months ended March 31, 2003 compared to other expense, net in the three months ended March 31, 2002 of $9. The increase in other income, net is due primarily to unrealized foreign exchange gains and losses.

INCOME TAXES.

The Company recorded income tax expense of $180 in the three months ended March 31, 2003 and $21 in the three months ended March 31, 2002. The Company anticipates becoming a taxpayer in 2003 and has continued utilizing its remaining net operating loss carryforwards to offset income tax liabilities. The Company has estimated its domestic and international effective rate to be 12%, which has been applied to the three month period ended March 31, 2003.

LIQUIDITY AND CAPITAL RESOURCES

(in thousands)

OPERATING CASH FLOWS.

Cash provided by operating activities was $2,751 in the in the three months ended March 31, 2003. The Company's positive operating cash flow in the three months ended March 31, 2003 was due primarily to its net income of $1,316, depreciation and amortization expense of $555, a decrease of $807 in accounts receivable and a $309 increase in deferred revenue, offset by a decrease of $272 in accounts payable. Accounts receivable and deferred revenue increases are a direct result of the increase in net sales.

The total days sales outstanding for the three months ended March 31, 2003, improved to 97 days compared to 130 days for the year ended December 31, 2002. The decrease in days sales outstanding is attributed to the collection of receivables from healthcare facilities in 2003.

INVESTING CASH FLOWS.

Cash used in investing activities was $701 in the three months ended March 31, 2003, due primarily to cash outflows for capitalized software development costs of $468 and purchases of capital equipment of $232. The Company expects to continue to invest in software development projects that will continue to accelerate sales.

FINANCING CASH FLOWS.

Cash provided by financing activities was $46 in the three months ended March 31, 2003. The Company received net proceeds of $25 from employee and director stock option exercises and $28 from purchases of common stock under its employee stock purchase plan.

Total outstanding commitments at March 31, 2003 were as follows:

Contractual Obligations	Total	Less than 1 Year	1 - 3 Years
Long Term Debt......................	$ 204	$ ----	$ 204
Operating Leases....................	928	396	532
Total Contractual Cash Obligations...	$ 1,132	$ 396	$ 736

The Company also has a liability recorded of $555 for put options on the remaining 138,731 of 420,000 Interpra exchangeable shares, which may be exercised for a price of $4.50 per share during the period from August 31, 2004, until September 30, 2004.

In December 2002, the Company negotiated a new revolving line of credit agreement with its bank, increasing its line to $5,000 effective December 30, 2002, and maturing December 30, 2005. The interest rate on the line of credit is a variable rate that is equal to the prime rate as published in the Wall Street Journal, less 0.75 percentage points and is collateralized by the Company's assets. At March 31, 2003, the loan's interest rate was 3.50%. Availability under the new line of credit is subject to a borrowing base consisting of 50% of inventory balances under $2,000, 80% of qualified accounts receivable under 90 days and 100% of the Company's depository cash balances held at the bank if borrowings exceed the existing base of inventory and qualified accounts receivable. Under the formula, $5,000 was calculated to be available at March 31, 2003. No amounts were outstanding on the line of credit as of March 31, 2003.

The Company does not have any other significant long-term obligations, contractual obligations, lines of credit, standby letters of credit, guarantees, standby repurchase obligations or other commercial commitments.

The Company believes that existing cash, together with the availability under its revolving credit agreement and future cash flows from operations will be sufficient to execute the business plan in 2003. However, any projections of future cash inflows and outflows are subject to uncertainty. In 2003, it may be necessary to raise additional capital for activities necessary to meet the Company's business objectives or its long-term liquidity needs. If it is determined that additional capital is needed, it may be raised by selling additional equity or raising debt from third party sources. The sale of additional equity or convertible debt securities could result in dilution to current stockholders. In addition, debt financing, if available, could involve restrictive covenants, which could adversely affect operations. There can be no assurance that any of these financing alternatives will be available in amounts or on terms acceptable to the Company.

SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, the Registrant caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

MERGE TECHNOLOGIES INCORPORATED

May 16, 2003 By: /s/ Richard A. Linden

Richard A. Linden
President and Chief Executive Officer

May 16, 2003 By: /s/ Scott T. Veech

Scott T. Veech
Chief Financial Officer, Treasurer and Secretary (Principal Financial Officer and Principal Accounting Officer)