VITAL SIGNS INC
Form 10-Q
May 09, 2006

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-Q

(Mark one)

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2006

OR

¨ **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: 0-18793

VITAL SIGNS, INC.

(Exact name of registrant as specified in its charter)

New Jersey	**11-2279807**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

20 Campus Road
Totowa, New Jersey 07512
(Address of principal executive office, including zip code)

973-790-1330
(Registrant s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-12 of the Exchange Act.

o Large accelerated filer x Accelerated filer o Non-accelerated filer

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

At April 30, 2006 there were 13,146,172 shares of Common Stock, no par value, outstanding.

VITAL SIGNS, INC.

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PART I.

FINANCIAL INFORMATION

Item 1. ***Financial Statements***

Certain information and footnote disclosures required under generally accepted accounting principles have been condensed or omitted from the following consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission. Vital Signs, Inc. (the registrant , the Company , Vital Signs , we , us , or our) believes that the disclosures are adequate to assure that the informati presented is not misleading in any material respect. It is suggested that the following consolidated financial statements be read in conjunction with the year-end consolidated financial statements and notes thereto included in the registrant s Annual Report on Form 10-K for the year ended September 30, 2005.

The results of operations for the interim periods presented herein are not necessarily indicative of the results to be expected for the entire fiscal year, or any other period.

In Management s Discussion and Analysis of Results of Operations and Financial Condition, we refer to the Broselow-Luten System; Broselow; ComplianceBuilder; Limb-O and Misty-OX, all of which are trademarks of Vital Signs, Inc.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors
Vital Signs, Inc.

We have reviewed the accompanying consolidated balance sheet of Vital Signs, Inc. and Subsidiaries as of March 31, 2006 and the related consolidated statements of income for the three months and six months ended March 31, 2006 and 2005, and the consolidated statements of cash flows for the six months ended March 31, 2006 and 2005. These interim financial statements are the responsibility of the Company s management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the consolidated interim financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the consolidated financial statements referred to above for them to be in conformity with United States generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board, the consolidated balance sheet of Vital Signs, Inc. and Subsidiaries as of September 30, 2005 and the related consolidated statements of income, stockholders equity and cash flows for the year then ended (not presented herein); and in our report dated November 29, 2005 we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of September 30, 2005 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Effective October 1, 2005, Vital Signs, Inc. changed its method of accounting for stock options. The effects of these changes are disclosed in Note 6.

Goldstein Golub Kessler LLP

New York, New York
May 3, 2006

VITAL SIGNS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	March 31, 2006	September 30, 2005
	(In thousands of dollars) (Unaudited)	
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 108,254	$ 81,767
Accounts receivable, less allowances for rebates and doubtful accounts of $8,314 and $7,821, respectively	31,086	34,417
Inventory	19,387	16,659
Prepaid expenses	3,173	2,917
Other current assets	1,814	1,016
Total Current Assets	163,714	136,776
Property, plant and equipment net	30,073	29,938
Goodwill	79,272	77,167
Deferred income taxes	913	1,141
Other assets	10,900	8,680
Total Assets	$ 284,872	$ 253,702
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 7,017	$ 6,347
Accrued expenses	6,727	8,203
Accrued income taxes	1,175	2,671
Total Current Liabilities	14,919	17,221
Minority interest in subsidiary	4,147	3,775
Commitments and contingencies		
Stockholders Equity:		
Common stock no par value; authorized 40,000,000 shares, issued and outstanding 13,072,290 and 12,593,579 shares, respectively	39,677	18,832
Accumulated other comprehensive income	1,900	2,012
Retained earnings	224,229	211,862
Stockholders equity	265,806	232,706
Total Liabilities and Stockholders Equity	$ 284,872	$ 253,702

(See Notes to Condensed Consolidated Financial Statements)

VITAL SIGNS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	For the Three Months Ended March 31,	
	2006	**2005**
	(In thousands, except per share amounts)	
Net Revenues:		
Net sales	$ 42,426	$ 39,161
Service revenue	8,867	7,868
	51,293	47,029
Cost of goods sold and services performed:		
Cost of goods sold	20,453	19,026
Cost of services performed	4,779	4,588
	25,232	23,614
Gross profit	26,061	23,415
Operating expenses:		
Selling, general and administrative	13,443	12,596
Research and development	1,739	1,882
Restructuring expense		305
Other expense (income) net	61	(144)
Total operating expenses	15,243	14,639
Operating Income	10,818	8,776
Other income (expense)		
Interest income	652	375
Interest (expense)		(19)
Income from continuing operations before provision for income tax and minority interest in income of consolidated subsidiary	11,470	9,132
Provision for income taxes	3,830	3,245
Income from continuing operations before minority interest in income of consolidated subsidiary	7,640	5,887
Minority interest in income of consolidated subsidiary	188	119
Income from continuing operations	7,452	5,768
Discontinued Operations:		
Income from operations of Vital Pharma, net of income tax provision of $8 and $30	16	58
Net income	$ 7,468	$ 5,826
Earnings per Common Share:		
Basic		
Income per share from continuing operations	$ 0.58	$ 0.46
Income per share from discontinued operations	$ 0.00	$ 0.01

Net earnings per share	$ 0.58	$ 0.47
Diluted		
Income per share from continuing operations	$ 0.57	$ 0.46
Income per share from discontinued operations	$ 0.00	$ 0.00
Net earnings per share	$ 0.57	$ 0.46
Basic weighted average number of shares outstanding	12,898	12,456
Diluted weighted average number of shares outstanding	13,001	12,618
Dividends paid per share	$ 0.07	$ 0.07

(See Notes to Condensed Consolidated Financial Statements)

VITAL SIGNS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	For the Six Months Ended March 31,	
	2006	2005
	(In thousands, except per share amounts)	
Net Revenues:		
Net sales	$ 80,949	$ 76,418
Service revenue	18,074	16,309
	99,023	92,727
Cost of goods sold and services performed:		
Cost of goods sold	38,957	37,541
Cost of services performed	9,802	9,062
	48,759	46,603
Gross profit	50,264	46,124
Operating expenses:		
Selling, general and administrative	26,166	24,604
Research and development	3,397	3,666
Restructuring expense		360
Other expense (income) net	107	(106)
Total operating expenses	29,670	28,524
Operating Income	20,594	17,600
Other income (expense)		
Interest income	1,230	634
Interest (expense)		(19)
Total other income	1,230	615
Income from continuing operations before provision for income tax and minority interest in income of consolidated subsidiary	21,824	18,215
Provision for income taxes	7,339	6,396
Income from continuing operations before minority interest in income of consolidated subsidiary	14,485	11,819
Minority interest in income of consolidated subsidiary	372	228
Income from continuing operations	14,113	11,591
Discontinued Operations:		
Income (loss) from operations of Vital Pharma, net of income tax provision (benefit) of $8 and ($30)	15	(32)
Net income	$ 14,128	$ 11,559
Earnings (loss) per Common Share:		
Basic		

Income per share from continuing operations	$	1.11	$	0.93
Income (loss) per share from discontinued operations	$	0.00	$	(0.01)
Net earnings per share	$	1.11	$	0.92
Diluted				
Income per share from continuing operations	$	1.10	$	0.92
Loss per share from discontinued operations	$	0.00	$	(0.01)
Net earnings per share	$	1.10	$	0.91
Basic weighted average number of shares outstanding		12,743		12,498
Diluted weighted average number of shares outstanding		12,840		12,655
Dividends paid per share	$	0.14	$	0.14

(See Notes to Condensed Consolidated Financial Statements)

VITAL SIGNS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	For the Six Months Ended March 31,	
	2006	2005
	(In thousands of dollars)	
Cash Flows from Operating Activities:		
Net income	$ 14,128	$ 11,559
(Income) loss from discontinued operations	(15)	32
Income from continuing operations	14,113	11,591
Adjustments to reconcile income from continuing operations to net cash provided by continuing operations		
Depreciation and amortization	2,436	3,288
Deferred income taxes	352	716
Stock compensation expense	764	
Minority interest in income of consolidated subsidiary	372	228
Changes in operating assets and liabilities:		
Decrease in accounts receivable	3,273	1,429
Increase in inventory	(2,768)	(193)
Increase in prepaid expenses and other current assets	(1,062)	(948)
(Increase) decrease in other assets	(2,090)	382
Increase (decrease) in accounts payable	753	(518)
Decrease in accrued expenses	(1,695)	(738)
Decrease in accrued income taxes	(1,578)	(122)
Increase in other liabilities		194
Net cash provided by continuing operations	12,870	15,309
Net cash provided by (used in) discontinued operations	15	(32)
Net cash provided by operating activities	12,885	15,277
Cash flows from investing activities:		
Acquisition of Baxter disposable airways product line		(10,030)
Acquisition of assets of Futall AB	(2,276)	
Acquisition of property, plant and equipment	(1,914)	(1,562)
Capitalized software costs	(602)	(1,801)
Capitalized patent costs	(138)	(105)
Net cash used in investing activities	(4,930)	(13,498)
Cash flows from financing activities:		
Net proceeds from sale of common stock	18,622	
Dividends paid	(1,764)	(1,536)
Tax benefit on stock options	397	875
Proceeds from exercise of stock options	1,280	2,766
Purchase of common stock	(217)	(6,542)
Net cash provided by (used in) financing activities	18,318	(4,437)
Effect of foreign currency translation	214	274
Net increase (decrease) in cash and cash equivalents	26,487	(2,384)
Cash and cash equivalents at beginning of period	81,767	76,468

Cash and cash equivalents at end of period	$ 108,254	$ 74,084
Supplemental disclosures of cash flow information:		
Cash paid during the six months for:		
Interest	$	$ 19
Income taxes	$ 7,215	$ 4,196

(See Notes to Condensed Consolidated Financial Statements)

VITAL SIGNS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. The consolidated balance sheet as of March 31, 2006, the consolidated statements of income for the three months and six months ended March 31, 2006 and 2005, and the consolidated statements of cash flows for the six months ended March 31, 2006 and 2005, have been prepared by Vital Signs, Inc. (the registrant , the Company , Vital Signs , we , us , or our) and are unaudited. The September 30, 2005 consolidated ba sheet has been derived from the audited financial statements for the year ended September 30, 2005. In the opinion of management, all adjustments necessary to present fairly the financial position at March 31, 2006 and the results of operations for the three months and six months ended March 31, 2006 and 2005, and the cash flows for the six months ended March 31, 2006 and 2005, have been made.

2. See the Company s Annual Report on Form 10-K for the year ended September 30, 2005 (the Form 10-K) for additional disclosures relating to the Company s consolidated financial statements.

3. At March 31, 2006, the Company s inventory was comprised of raw materials of $13,011,000 and finished goods of $6,376,000. At September 30, 2005, the Company s inventory was comprised of raw materials of $11,142,000 and finished goods of $5,517,000.

4. The Company has aggregated its business units into four reportable segments, Anesthesia, Respiratory/Critical Care, Sleep and Pharmaceutical Technology Services. There are no material intersegment sales. Anesthesia and Respiratory/Critical Care share certain manufacturing, sales and administration costs; therefore the operating profit, total assets, and capital expenditures are not specifically identifiable. However the Company has allocated these shared costs on a net sales basis to arrive at operating profit for the anesthesia and respiratory/critical care segments. Total assets and capital expenditures for anesthesia and respiratory/critical care have also been allocated on a net sales basis. Management evaluates performance on the basis of the gross profits and operating results of the four business segments. Summarized financial information concerning the Company s reportable segments is shown in the following table:

VITAL SIGNS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

(dollars in thousands)	Anesthesia	Respiratory Critical Care	Sleep	Pharmaceutical Technology Services	Consolidated
For the three months ended March 31, 2006					
Net revenues	$ 24,677	$ 10,960	$ 11,632	$ 4,024	$ 51,293
Gross profit	12,795	5,776	6,099	1,391	26,061
Gross profit percentage	51.9%	52.7%	52.4%	34.6%	50.8%
Operating income	6,193	2,750	1,509	366	10,818
2005					
Net revenues	$ 21,567	$ 10,806	$ 10,779	$ 3,877	$ 47,029
Gross profit	11,464	5,814	4,893	1,244	23,415
Gross profit percentage	53.2%	53.8%	45.4%	32.1%	49.8%
Operating income (loss)	5,898	2,955	108	(185)	8,776
For the six months ended March 31, 2006					
Net revenues	$ 47,043	$ 21,505	$ 21,807	$ 8,668	$ 99,023
Gross profit	24,358	11,462	11,458	2,986	50,264
Gross profit percentage	51.8%	53.3%	52.5%	34.4%	50.8%
Operating income	11,711	5,353	2,627	903	20,594
Total assets	156,574	71,575	37,503	19,220	284,872
Capital expenditures	1,369	626	503	156	2,654
2005					
Net revenues	$ 41,696	$ 20,954	$ 21,531	$ 8,546	$ 92,727
Gross profit	22,111	11,168	9,600	3,245	46,124
Gross profit percentage	53.0%	53.3%	44.6%	38.0%	49.7%
Operating income (loss)	11,245	5,651	(4)	708	17,600
Total assets	124,774	62,704	36,434	19,172	243,084
Capital expenditures	2,299	523	587	59	3,468

5. Other comprehensive income for the three months ended March 31, 2006 and 2005 consisted of:

(in thousands)	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005	Six months ended March 31, 2006	Six months ended March 31, 2005
Net income	$ 7,468	$ 5,826	$ 14,128	$ 11,559
Foreign currency translation	435	(1,498)	(112)	626
Comprehensive income	$ 7,903	$ 4,328	$ 14,016	$ 12,185

6. Effective October 1, 2005, the Company began recording compensation expense associated with stock options in accordance with SFAS No. 123R, Share-Based Payment . Prior to October 1, 2005, the Company accounted for stock-based compensation related to stock options under the recognition and measurement principles of Accounting Principles Board Opinion No. 25; therefore, the Company measured compensation expense for its stock option plans using the intrinsic value method, that is, as the excess, if any, of the fair market value of the Company s stock at the grant date over the amount required to be paid to acquire the stock, and provided the disclosures required by SFAS Nos. 123 and 148. The Company has adopted the modified prospective transition method provided under SFAS No. 123R, and as a result, has not retroactively adjusted results from prior periods. Under this transition method, compensation expense associated with stock options recognized in the first and second quarters of fiscal year 2006 includes: 1) expense related to the remaining unvested portion of all stock option awards granted prior to October 1, 2005, based on the grant date fair value estimated in accordance with the original

provisions of SFAS No. 123; and 2) expense related to all stock option awards granted subsequent to October 1, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123R.

As a result of the adoption of SFAS No. 123R, the Company s net income for the three month and six month periods ended March 31, 2006 includes $382,000 and $764,000, respectively, of compensation expense and related reductions in income tax expenses of $128,000 and $256,000, respectively. The compensation expense related to all of the Company s stock-based compensation arrangements is recorded as a component of both selling, general and administrative and research and development expenses. Prior to the Company s adoption of SFAS No. 123R, the Company presented tax benefits resulting from the exercise of stock options as cash flows from operating activities on the Company s consolidated statements of cash flows. SFAS No. 123R requires that cash flows resulting from tax deductions in excess of the cumulative compensation cost recognized for options exercised (excess tax benefits) be classified as cash inflows from financing activities and cash outflows from operating activities.

At March 31, 2006, the Company had two stock option plans. The Vital Signs 2003 Investment Plan, provides for the grant of options to employees, officers and directors to purchase the Company s common stock. The 2003 Investment Plan is a renewal of the Company s 1994 Investment Plan, which expired in January 2004. One million shares of the Company s common stock have been authorized for share purchase and option grants. Options may be granted at prices not less than fair value at the date of grant. The options have a ten-year life. Options generally vest after a two-year period. Shares purchased by may be financed through the Company. The 2002 Stock Incentive Plan provides for the grant of options to employees, officers, directors and consultants to purchase a maximum of one million shares. Although the Vital Signs option plans allow for the grants of stock options to consultants, to date no options have been granted to consultants under either plan. Options may be granted at prices not less than fair value at the date of grant. The options have a ten-year life. Options generally vest ratably over a five-year period commencing on the first anniversary of the grant with respect to options granted to employees under the 2002 Stock Incentive Plan and over two years with respect to the Company s options granted as part of its investment plan and to directors. The 2002 Stock Incentive Plan expires on May 31, 2012.

For stock option grants prior to October 1, 2005, the estimated fair value of each option award granted was determined on the date of grant using the Black-Scholes option valuation model. For stock option grants on and after October 1, 2005, the estimated fair value of each option award granted was determined on the date of grant using a lattice based option valuation model. The following weighted-average assumptions were used for option grants during the three month and six month periods ended March 31, 2006 and 2005:

	Three Months Ended March 31,		**Six Months Ended March 31,**	
	2006	**2005**	**2006**	**2005**
Risk-free interest rate	N/A	5.00%	4.18%	5.00%
Expected volatility of common stock	N/A	33.00%	34.75%	33.00%
Dividend yield	N/A	0.70%	0.70%	0.70%
Expected option term	N/A	5.0 -10.0 years	3.4 -6.5 years	5.0 - 10.0 years

The risk-free interest rate for the six months ended March 31, 2006 is based on the 5 year U.S. Treasury bill rate on the day of the grant. There were no grants during the three months ended March 31, 2006. For the three months and six months ended March 31, 2005 the rate is based on the implied yield on a U.S. Treasury bond with constant maturities with a remaining term equal to the expected term of the option. The expected volatility is based on the historical volatility of the Company s stock. For options granted during the six months ended March 31, 2006, the expected volatility computation is based on the average of the volatility over the most recent four year period. For options granted during the three months and six months ended March 31, 2005, the expected volatility computation is based on the volatility over a 1.67 year period prior to the date of grant of such options.

A summary of the status of the Company s stock option plans as of March 31, 2006 and of changes in options outstanding under the plans during the six months ended March 31, 2006 is as follows:

	Number of Shares	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Options outstanding at September 30, 2005	582,211	$ 29.32		
Options granted	37,750	$ 43.54		
Options exercised	(49,711)	$ 25.74		
Options forfeited or expired	(17,376)	$ 38.61		
Options outstanding at March 31, 2006	552,874	$ 30.32	6.14	$ 13,608,08
Options vested and exercisable at March 31, 2006	369,938	$ 26.79	4.91	$ 10,409,055

The weighted-average fair value of each option granted during the six month periods ended March 31, 2006 and 2005, estimated as of the grant date using a lattice based option valuation model (2006) and the Black-Scholes option valuation model (2005), was $11.85 per option and $20.73 per option, respectively.

A summary of the status of the Company s nonvested shares as of September 30, 2005, and changes during the six months ended March 31, 2006 is presented below:

	Number of Shares	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Contractual Term (in years)
Nonvested shares at September 30, 2005	206,146	$ 36.05	8.43
Options granted	37,750	$ 43.54	9.35
Options vested	(44,024)	$ 35.61	8.19
Options forfeited or expired	(16,937)	$ 44.53	9.36