SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D. C. 20549

FORM 10-Q

(Mark one)

Х

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 (State or other jurisdiction of incorporation or organization) 11-2279807 (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 (In thousan (Unaudited) | | September 30 2005 | |
|---|---|----------------|----------------------|----------|
| | | | nds of | dollars) |
| 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: | ¢ | 7.017 | ¢ | 6247 |
| Accounts payable | \$ | 7,017 6,727 | \$ | 6,347 |
| Accrued expenses Accrued income taxes | | | | 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, | | | ded | |
|--|--|--------------|----------|-------------------------|--|
| | | 2006 | | 2005 | |
| | | | | nds, except 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 | |
| | | 20,001 | | 20,110 | |
| 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 | |
| | ψ | 7,400 | ψ | 5,620 | |
| | | | | | |
| Earnings per Common Share: | | | | | |
| Basic Income per share from continuing operations | ¢ | 0.50 | ¢ | 0.44 | |
| Income per share from continuing operations Income per share from discontinued operations | \$ \$ | 0.58 0.00 | \$ \$ | 0.46 0.01 | |
| meonie per snare nom uisconunaca operations | φ | 0.00 | φ | 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 Mont Ended March 3 | | | |
|--|-----------------------------------|--------------------|----------------|----------------|
| | 2006 | | | 2005 |
| | (In | thousan share a | | |
| Net Revenues: | ¢ | 00.040 | <i></i> | F (110 |
| Net sales | | 80,949 | \$ | 76,418 |
| Service revenue | | 18,074 | | 16,309 |
| | | 99,023 | | 92,727 |
| Cost of goods sold and services performed: | | 20.055 | | 07.541 |
| 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 |
| | | 50,204 | | 40,124 |
| Operating expenses: | | | | |
| Selling, general and administrative | | 26,166 | | 24,604 |
| Research and development | | 3,397 | | 3,666 |
| Restructuring expense | | 5,597 | | 3,000 |
| Other expense (income) net | | 107 | | (106) |
| Other expense (income) her | | 107 | | (100) |
| Total operating expenses | | 29,670 | | 28,524 |
| | | | | |
| Operating Income | | 20,594 | | 17,600 |
| Other income (expense) | | | | |
| Interest income | | 1,230 | | 634 |
| Interest (expense) | | 1,230 | | (19) |
| | | | | (|
| Total other income | | 1,230 | | 615 |
| | | | | |
| Income from continuing operations before provision for income tax and minority interest in income of | | 21 024 | | 10 015 |
| 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: | | ,110 | | . 1,0 / 1 |
| 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)

| 2006 2005 (In thousands of dollars) Cash Flows from Operating Activities: (In thousands of dollars) Net income \$ 14,128 \$ 11,559 (Income) \$ 14,128 \$ 11,559 Income form continuing operations 14,113 11,591 Adjustments to reconcile income from continuing operations to net cash provided by continuing operations to net cash provided by continuing operation and amorization 2,436 3,288 Defered income taxes 352 716 506 000000000000000000000000000000000000 | | | e Six Months d March 31, |
|--|--|-----------|-----------------------------|
| Cash Flows from Operating Activities: Net income\$ 14,128\$ 11,559(Income) loss from discontinued operations(15)32Income from continuing operations14,11311,591Adjustments to reconcile income from continuing operations to net cash provided by continuing operation and amortization2,4,363,288Deferred income taxes352716Stock compensation expanse764Minority interest in income of consolidated subsidiary372228Charges in operating assets and liabilities: Decrease in accounts receivable3,2731,429Increase in propriating assets and liabilities: | | 2006 | 2005 |
| 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 14,113 11,591 Depreciation and amorization 2,2,36 3,288 2716 Stock compensation expanse 764 776 Minority interest in income of consolidated subsidiary 372 228 Changes in operating assets and liabilities: 2,273 1,429 Increase in accounts receivable 3,273 1,429 Increase in accounts receivable 3,273 1,429 Increase in accounts receivable 735 6180 Decrease in accounts receivable 735 6180 Decrease in accured expenses (1,695) (122) Increase (accureas) in accounts payable 753 (130) Decrease in accured expenses (1,678) (122) Increase in accured expenses (1,678) (122) Increase in accured income taxes (1,570) (1230) | | (In thous | ands of dollars) |
| (Income) loss from discontinued operations(15)32Income from continuing operations14,11311,591Adjustments to reconcile income from continuing operations to net cash provided by continuing operations2,4363,288Depretication and amorization2,4363,288Deferred income taxes352716Stock compensation expenses764764Minority increst in income of consolidated subsidiary764Decrease in operating assets and liabilities:3,2731,429Decrease in operase and other current assets(1,062)(948)Increase in inventory(2,768)(193)Increase in other assets(2,090)382Increase in other assets(2,090)382Increase in other assets(1,655)(738)Decrease in accrued expenses(1,655)(738)Decrease in accrued expenses(1,655)(738)Decrease in accrued income taxes(1,578)(122)Increase in other liabilities194194Net cash provided by continuing operations15(32)Net cash provided by operating activities(2,276)(10,030)Acquisition of assets of Futal AB(2,276)(10,030)Acquisition of assets of sposable airways product line(2,176)(138)Acquisition of assets of sposable airways product line(2,176)(138)Cash flows from investing activities:(4,930)(13,498)Cash flows from inancing activities:12,86212,862Dividends paid <th>Cash Flows from Operating Activities:</th> <th></th> <th></th> | Cash Flows from Operating Activities: | | |
| Income from continuing operations14,11311,591Adjustments to reconcile income from continuing operations to net cash provided by continuing operations2,4363,288Defered income taxes352716Stock compensation expense764764Minority interest in income of consolidated subsidiary372228Changes in operating assets and liabilities:Decrease in accounts receivable3,2731,429Increase in propeid expenses and other current assets(1,062)(0,488)(Increase) decrease in accounts payable753(518)Decrease in accounts receivable753(518)Decrease in accounts payable753(518)Decrease in accrued income taxes(1,695)(1,578)Increase in provided by continuing operations12,87015,309Net cash provided by continuing operations12,87015,309Net cash provided by operating activities:(1,030)(1,043)Acquisition of assets of Futall AB(2,276)(1,030)Acquisition of property, plant and equipment(1,914)(1,562)Cash flows from investing activities:(1,88)(103)Net cash provided by operating activities:(1,286)(1,286)Cash flows from investing activities:(1,154)(1,280)Net cash used in investing activities:(1,280)(1,3498)Cash flows from innexing activities:(1,154)(1,552)Net cash used in investing activities:(2,276)(2,276)Acquisition of property, plant and equipment< | Net income | \$ 14,128 | \$ 11,559 |
| Adjustments to reconcile income from continuing operations 2,436 3,288 Deprectations 352 716 Deprectation and amortization 2,436 3,288 Deterred income taxes 352 716 Minority interest in income of consolidated subsidiary 372 228 Changes in operating assets and liabilities: 2,768 (193) Increase in inventory (2,768) (193) Increase in other assets (1,062) (948) Increase in other assets (1,065) (738) Increase in accrued expenses (1,605) (738) Decrease in accrued expenses (1,605) (738) Decrease in accrued expenses (1,605) (738) Net cash provided by continuing operations 15 (32) Net cash provided by continuing operations 15 (32) Net cash provided by operating activities: 2,285 15,277 Cash flows from investing activities: 2,285 15,277 Acquisition of asset of bruall AB (2,276) 2,2000 Acquisition of poserup lant and equipment (1,914) (1,562) Cash flows from inv | (Income) loss from discontinued operations | (15 |) 32 |
| Adjustments to reconcile income from continuing operations 2,436 3,288 Deprectations 352 716 Deprectation and amortization 2,436 3,288 Deterred income taxes 352 716 Minority interest in income of consolidated subsidiary 372 228 Changes in operating assets and liabilities: 2,768 (193) Increase in inventory (2,768) (193) Increase in other assets (1,062) (948) Increase in other assets (1,065) (738) Increase in accrued expenses (1,605) (738) Decrease in accrued expenses (1,605) (738) Decrease in accrued expenses (1,605) (738) Net cash provided by continuing operations 15 (32) Net cash provided by continuing operations 15 (32) Net cash provided by operating activities: 2,285 15,277 Cash flows from investing activities: 2,285 15,277 Acquisition of asset of bruall AB (2,276) 2,2000 Acquisition of poserup lant and equipment (1,914) (1,562) Cash flows from inv | Income from continuing operations | 14,113 | 11,591 |
| operations2,4363,288Depreciation and amortization2,4363,288Deferred income taxes352716Stock compensation expense764Minority interest in income of consolidated subsidiary372228Changes in operating assets and liabilities:2,6768(193)Increase in inventory(2,768)(193)Increase in prepaid expenses and other current assets(1,062)(948)(Increase) (crease in other assets(2,090)382Increase in accrued expenses(1,695)(738)Decrease in accrued expenses(1,695)(738)Decrease in accrued expenses(1,578)(122)Increase in other hiabilities194194Net cash provided by continuing operations12,87015,309Net cash provided by continuing operations15(32)Net cash provided by operating activities(1,914)(1,562)Cash flows from investing activities:(1,914)(1,562)Acquisition of Baxter disposable airways product line(1,914)(1,562)Cash flows from investing activities:(1,349)(1,3498)Cash flows from financing activities:(4,930)(13,498)Cash flows from financing activities:12,80013,622Net cash used in investing activities:12,800(1,3498)Cash flows from financing activities:12,800(1,3498)Cash flows from financing activities:12,800(1,3498)Cash flows from financing activities:12,800(1,34 | | , - | y |
| Depreciation and amoritation 2.436 3.288 Deferred income taxes 352 716 Stock compensation expense 764 776 Minority interest in income of consolidated subsidiary 372 2.28 Changes in operating assets and liabilities: 3273 1,429 Increase in prepaid expenses and other current assets (1,062) (948) Increase in prepaid expenses and other current assets (2,090) 382 Increase in other assets (2,090) 382 Increase in accrued expenses (1,695) (738) Decrease in accrued income taxes (1,578) (122) Increase (decrease) in accounts payable 153 (312) Net cash provided by continuing operations 12,870 15,309 Net cash provided by continuing operations 15 (32) Net cash provided by operating activities: (10,030) Acquisition of assets of Full AB (2,276) Acquisition of assets of current assets (138) (10,030) Acquisition of assets of Full AB (2,276) Cash flows from innecting activitites: (38,277) (13,49 | | | |
| Deferred income taxes 352 716 Stock compensation expense 764 764 Minority interest in income of consolidated subsidiary 372 228 Changes in operating assets and liabilities: 764 772 228 Decrease in accounts recivable 3,273 1,429 1073 102 104 Increase in inventory (2,768) (193) 104 104 1052 10448 1052 10448 1052 10448 1052 10448 1053 115 1053 1053 1053 1053 1053 1053 1053 1053 1053 1053 1053 1053 | | 2,436 | 3,288 |
| Minority interest in income of consolidated subsidiary372228Changes in operating assets and liabilities:2,7781,429Increase in accounts receivable3,2731,429Increase in inventory(2,768)(193)Increase in prepaid expenses and other current assets(2,000)382Increase (decrease) in accounts payable753(518)Decrease in accrued expenses(1,655)(738)Decrease in accrued expenses(1,655)(738)Decrease in accrued expenses(1,655)(738)Decrease in accrued expenses(1,678)(122)Increase in other liabilities194194Net cash provided by continuing operations12,87015,309Net cash provided by operating activities12,88515,277Cash flows from investing activities(1,030)(1,944)(1,562)Acquisition of Baxter disposable airways product line(10,030)(1,944)(1,562)Capitalized oftware costs(602)(1,801)(1,801)Capitalized software costs(602)(1,801)(1,801)Cash flows from financing activities:(4,930)(13,498)(13,498)Net cash used in investing activities:(1,654)(1,562)(1,564)Net cash used in investing activities:(1,644)(1,536)(1,536)Net cash used in investing activities:(1,764)(1,536)(1,280)Net cash used in investing activities:(1,297)(6,542)Net proceeds from sale of common stock(217) <td>Deferred income taxes</td> <td>352</td> <td>716</td> | Deferred income taxes | 352 | 716 |
| Changes in operating assets and liabilities:Decrease in incounts receivable3,2731,429Increase in inventory(2,768)(193)Increase in prepaid expenses and other current assets(1,062)(948)Increase (decrease) in accounts payable753(518)Decrease in accrued expenses(1,695)(738)Decrease in accrued expenses(1,695)(738)Decrease in accrued income taxes(1,695)(738)Decrease in accrued income taxes(1,695)(738)Net cash provided by continuing operations12,87015,309Net cash provided by continued operations15(32)Net cash provided by operating activities12,88515,277Cash flows from investing activities:(1,030)(1,602)(1,801)Acquisition of Baxter disposable airways product line(1,914)(1,562)Capitalized software costs(602)(1,801)Capitalized software costs(602)(1,801)Cash flows from financing activities:(1,38)(105)Net cash used in investing activities:(1,38)(105)Net cash used in investing activities:(1,39)(13,498)Net cash used in investing activities:(1,764)(1,536)Net cash used in investing activities:(1,764)(1,536)Net cash used in investing activities:(1,280)(2,170)Net cash used in investing activities:(2,170)(6,542)Net cash used in investing activities:(2,170)(6,542)Net cash used | Stock compensation expense | 764 | |
| 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 in accrued expenses (1,695) (738) Decrease in accrued income taxes (1,578) (122) Increase in other liabilities 194 194 Net cash provided by continuing operations 12,870 15,309 Net cash provided by continuing operations 12,870 15,309 Net cash provided by operating activities 12,870 15,309 Cash flows from investing activities 12,885 15,277 Cash flows from investing activities: 22,276 42,276 Acquisition of Baxter disposable airways product line (10,030) 42,913 (1,562) Capitalized software costs (602) (1,801) (1,562) Capitalized patent costs (602) (1,801) (1,943) (10,562) Net cash used in investing activities: 138 (105) (1,692) | Minority interest in income of consolidated subsidiary | 372 | 228 |
| Increase in inventory (2,768) (193) Increase in prepaid expenses and other current assets (1,062) (948) (Increase) (accrease 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 (1,695) (738) Decrease in other liabilities 194 Net cash provided by continuing operations 12,870 15,309 Net cash provided by operating activities 15 (32) Acquisition of Baxter disposable airways product line (10,030) Acquisition of property, plant and equipment (1,914) (1,562) Cash flows from investing activities (138) (105) Acquisition of property, plant and equipment (138) (105) Cash flows from financing activities (138) (105) Net cash used in investing activities: (138) (1349) Cash flows from financing activities: 12,800 2,766 Proceeds from sale of common stock 12,800 2,766 Prividends paid (1,764) (1,536) < | Changes in operating assets and liabilities: | | |
| Increase in prepaid expenses and other current assets (1,062) (948) (Increase) decrease in accrued expenses (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 (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 operating activities 12,870 15,309 Acquisition of Baxter disposable airways product line (10,030) Acquisition of Baxter disposable airways product line (10,030) Acquisition of property, plant and equipment (1,914) (1,562) (1,849) Capitalized software costs (602) (18,010) (1,3498) Cash flows from financing activities: (4,930) (1,3498) (15,542) Net cash used in investing activities: (1,764) (1,536) 7875 Proceeds from sale of common stock 18,622 1074 (1,544) (1,544) Dividends paid (1,764) (1,536) | Decrease in accounts receivable | 3,273 | 1,429 |
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| Decrease in accrued income taxes(1,578)(122)Increase in other liabilities194Net cash provided by continuing operations12,87015,309Net cash provided by (used in) discontinued operations15(32)Net cash provided by operating activities12,88515,277Cash flows from investing activities:(10,030)Acquisition of Baxter disposable airways product line(10,030)Acquisition of property, plant and equipment(1,914)Capitalized software costs(602)Cash flows from financing activities:(138)Net cash used in investing activities:(1,930)Net cash used in investing activities:(1,764)Net proceeds from sale of common stock18,622Dividends paid(1,764)Cash flows from financing activities:12,880Net proceeds from exercise of stock options397Rot cash used in investing activities:(217)Net cash used in investing activities:12,880Net cash used in investing activities:12,880Net proceeds from sale of common stock12,800Dividends paid(1,764)Cash flows from financing activities12,800Net cash provided by (used in) financing activities18,318Net cash provided by (used in) financing activities18,318Net cash provided by (used in) financing activities18,318Net increase (decrease) in cash and cash equivalents26,487Net increase (decrease) in cash and cash equivalents26,487Net increase (decrease) | Increase (decrease) in accounts payable | 753 | (518) |
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| Net cash provided by (used in) discontinued operations15(32)Net cash provided by operating activities12,88515,277Cash flows from investing activities:(10,030)Acquisition of Baxter disposable airways product line(10,030)Acquisition of property, plant and equipment(1,914)Capitalized software costs(602)Cash flows from financing activities:(138)Net cash used in investing activities:(4,930)Net cash used in investing activities:(4,930)Cash flows from financing activities:18,622Dividends paid(1,764)Cash from exercise of stock options397Proceeds from exercise of stock options1,280Purchase of common stock(217)Purchase of common stock18,318Purchase of common stock214274214Net increase (decrease) in cash and cash equivalents26,487Vet increase (decrease) in cash and cash equivalents26,487 | Net cash provided by continuing operations | 12.870 | 15,309 |
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| Cash flows from financing activities: Net proceeds from sale of common stock18,622Dividends paid(1,764)(1,536)Tax benefit on stock options397875Proceeds from exercise of stock options1,2802,766Purchase of common stock(217)(6,542)Net cash provided by (used in) financing activities18,318(4,437)Effect of foreign currency translation214274Net increase (decrease) in cash and cash equivalents26,487(2,384) | Nat cash usad in invacting activities | (4.030 | (13.408) |
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| Proceeds from exercise of stock options1,2802,766Purchase of common stock(217)(6,542)Net cash provided by (used in) financing activities18,318(4,437)Effect of foreign currency translation214274Net increase (decrease) in cash and cash equivalents26,487(2,384) | | | |
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| Effect of foreign currency translation 214 274 Net increase (decrease) in cash and cash equivalents 26,487 (2,384) | | | |
| Effect of foreign currency translation 214 274 Net increase (decrease) in cash and cash equivalents 26,487 (2,384) | | | · |
| Net increase (decrease) in cash and cash equivalents26,487(2,384) | | | |
| | Effect of foreign currency translation | 214 | 274 |
| | Net increase (decrease) in cash and cash equivalents | 26,487 | (2,384) |
| | | | |

| 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) | A | nesthesia | spiratory Critical Care | Sleep | armaceutical Technology Services | Co | nsolidated |
|---|----|-----------|-------------------------------|-----------|--|----|------------|
| 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:

| | Three Mon Marc | | Six months end March 31, | | |
|--|-------------------|---------------------|-----------------------------|------------------|--|
| (in thousands) | 2006 | 2005 | 2006 | 2005 | |
| Net income Foreign currency translation | \$ 7,468 435 | \$ 5,826 (1,498) | \$ 14,128 (112) | \$ 11,559 626 | |
| 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 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 | ed 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 termN/A5.0 - 10.0 years3.4 - 6.5 years5.0 - 10.0 yearsThe 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 isbased 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. Theexpected 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 average of the volatility computation is based on 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 | A E Pi | eighted- verage xercise ·ice per Share | Weighted- Average Remaining Contractual Term (in years) | Aggr | egate 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 yested and avaraisable at March 21, 2006 | 360.028 | ¢ | 26.70 | 4 01 | ¢ | 10 400 055 |
| 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 |