VITAL SIGNS INC
Form 10-Q
February 08, 2008

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 DECEMBER 31, 2007

OR

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

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER: 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-2 of the Exchange Act. (Check one)

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

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

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

At February 8, 2008, there were 13,291,324 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 condensed consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission. Vital Signs, Inc. believes that the disclosures are adequate to assure that the information presented is not misleading in any material respect. It is suggested that the following condensed consolidated financial statements be read in conjunction with the year-end consolidated financial statements and notes thereto included in the registrants Annual Report on Form 10-K for the year ended September 30, 2007.

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 this Quarterly Report, references to Vital Signs, the Company, the registrant, we, us, and our refer t Signs, Inc. and its subsidiaries. Actar®, Actar D-FibTM, Babysafe, Breas®, Breas HA50, Breas PV403, Breas SC20, Broselow®, Broselow-Hinkle, Broselow-Luten, C-CO2, Code Blue II, Color Coding Kids®, CUFF-ABLE, enFlow®, iMask, iSleep by Breas®, InfusaScan®, INFUSABLE®, Limb-O, Misty OX®, Pedi Blue II, RediTubeTM, SteeLiteTM, SURE-LOK, TurboHeater, Vital Seal, Vital View, Vital View II , Vivo 30, Vivo 40, and Vivo by Breas® are Company trademarks. The Company also has several registered and unregistered color scheme trademarks related to the Broselow product line. All other trademarks used in this Quarterly Report are the property of their respective owners.

When the Company refers to its fiscal year in this report, the Company is referring to the fiscal year ended on September 30th of that year. Thus, the Company is currently operating in its fiscal 2008 year, which commenced on October 1, 2007. Unless the context expressly indicates a contrary intention, all references to years in this filing are to the Companys fiscal years.

VITAL SIGNS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share amounts)

	December 31, 2007 Unaudited	September 30, 2007 (a)
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 60,638	$ 48,920
Short term investments	85,520	86,671
Accounts receivable, less allowances for rebates and doubtful accounts of $15,404 and $14,979, respectively	35,388	36,915
Inventory	21,482	19,778
Prepaid expenses	4,596	4,140
Deferred income taxes	512	192
Other current assets	4,083	4,650
Total current assets	212,219	201,266
Property, plant and equipment—net	33,725	32,383
Goodwill	81,445	81,984
Deferred income taxes	5,059	4,732
Other assets	9,990	10,579
Total Assets	$ 342,438	$ 330,944
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current Liabilities:		
Accounts payable	$ 8,843	$ 7,120
Current portion of long-term debt	720	868
Accrued expenses	8,893	9,453
Income taxes payable	2,090	385
Total current liabilities	20,546	17,826
Long-term debt	390	486
Other liabilities	2,284	—
Total liabilities	23,220	18,312
Non-controlling share in subsidiary	6,245	6,051
Stockholders’ Equity:		
Common stock—no par value; authorized 40,000,000 shares, issued and outstanding 13,291,324 and 13,286,050, respectively	49,442	48,922
Accumulated other comprehensive income	5,545	5,696
Retained earnings	257,986	251,963
Stockholders’ equity	312,973	306,581
Total Liabilities and Stockholders’ Equity	$ 342,438	$ 330,944

(a) Derived from audited consolidated financial statements.

(See Notes to Unaudited Condensed Consolidated Financial Statements)

VITAL SIGNS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share amounts)
(Unaudited)

	For the Three Months Ended December 31, 2007	2006
Revenue: (Note 1)		
Net sales	$ 44,490	$ 40,679
Service revenue	8,949	7,039
Total revenue	53,439	47,718
Cost of goods sold and services performed:		
Cost of goods sold	21,332	19,501
Cost of services performed	4,704	4,010
Total of cost of goods sold and services performed	26,036	23,511
Gross profit	27,403	24,207
Operating expenses:		
Selling, general and administrative	14,662	12,837
Research and development	2,401	1,844
Other (income) expense, net	(18)	184
Total operating expenses	17,045	14,865
Operating income	10,358	9,342
Other (income)/expense:		
Interest (income)	(1,496)	(1,163)
Interest expense	35	56
(Income) from unconsolidated investment	(439)	(377)
	(1,900)	(1,484)
Income from continuing operations before provision for income taxes, non-controlling interest and discontinued operations	12,258	10,826
Provision for income taxes	4,093	3,292
Income from continuing operations before non-controlling interest	8,165	7,534
Non-controlling share in net income of subsidiary	194	242
Income from continuing operations	7,971	7,292
Discontinued Operations:		
Income from discontinued operations	28	2
Net income	$ 7,999	$ 7,294
Earnings per common share:		
Basic		
Basic income per share from continuing operations	$ .60	$ .55

Discontinued operations	—	—
Basic net earnings per share	$ .60	$ .55
Diluted		
Diluted income per share from continuing operations	$ .60	$ .55
Discontinued operations	—	—
Diluted net earnings per share	$ .60	$ .55
Basic weighted-average number of shares outstanding	13,287	13,217
Diluted weighted-average number of shares outstanding	13,321	13,287
Dividends declared and paid per common share	$ 0.10	$ 0.09

(See Notes to Unaudited Condensed Consolidated Financial Statements)

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

	For the Three Months Ended December 31, 2007	2006
Cash flows from operating activities:		
Net income	$ 7,999	$ 7,294
(Income)/loss from discontinued operations	(28)	(2)
Income from continuing operations	7,971	7,292
Adjustments to reconcile income from continuing operations to net cash provided by continuing operations:		
Depreciation and amortization	1,722	1,432
Deferred income taxes	284	127
Non-cash compensation expense	352	468
Non-controlling share in net income of subsidiary	194	242
Changes in operating assets and liabilities, net of assets acquired and liabilities assumed:		
Decrease in short term investments	1,151	1,937
Decrease in accounts receivable	1,550	3,064
Increase in inventory	(1,673)	(2,024)
Decrease in prepaid expenses and other current assets	116	1,234
(Decrease)/increase in other assets	1,098	(437)
Increase in accounts payable	1,661	343
Decrease in accrued expenses	(775)	(1,170)
Increase in income taxes payable	2,554	2,083
Increase in other liabilities	43	—
Net cash provided by continuing operations	16,248	14,591
Net cash provided by discontinued operations	28	2
Net cash provided by operating activities	16,276	$ 14,593
Cash flows from investing activities:		
Acquisition of property, plant and equipment	(2,596)	(695)
Capitalization of software development costs	(371)	(89)
Capitalization of patent costs	(47)	(86)
Net cash used in investing activities	(3,014)	(870)
Cash flows from financing activities:		
Dividends paid	(1,330)	(1,190)
Tax benefit on stock options in excess of benefit provided	50	6
Proceeds from exercise of stock options	117	38
Long-term debt and notes payable	(244)	294
Net cash (used in) financing activities	(1,407)	(852)
Effect of foreign currency translation	(137)	1,295
Net increase in cash and cash equivalents	11,718	14,166
Cash and cash equivalents at beginning of period	48,920	41,242
Cash and cash equivalents at end of period	$ 60,638	$ 55,408
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		

Interest	$ 40	$ 56
Income taxes	68	22

(See Note to Unaudited Condensed Consolidated Financial Statements)

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

1. The condensed consolidated balance sheet as of December 31, 2007, the condensed consolidated statements of income for three months ended December 31, 2007 and 2006, and the condensed consolidated statements of cash flows for the three months ended December 31, 2007 and 2006 have been prepared by Vital Signs, Inc. and are unaudited. In the opinion of management, all adjustments necessary to present fairly the financial position at December 31, 2007 and 2006, and the results of operations for the three months ended December 31, 2007 and 2006, and the cash flows for the three months ended December 31, 2007 and 2006, have been made.

2. See the Company’s Annual Report on Form 10-K for the year ended September 30, 2007 (the “Form 10-K”) for additional disclosures relating to the Company’s consolidated financial statements and accounting principles.

3. At December 31, 2007, the Company’s inventory was comprised of raw materials of $15,790,260 and finished goods of $ 5,691,305. At September 30, 2007, the Company’s inventory was comprised of raw materials of $12,895,415 and finished goods of $ 6,882,209.

4. In September 2002, the Company classified its Vital Pharma, Inc. subsidiary as a discontinued operation. On October 30, 2003, the Company sold Vital Pharma, Inc. to Pro-Clinical, Inc. All activity for this transaction is presented in discontinued operations.

(In thousands of dollars)	**Three Months Ended December 31,**	
	2007	**2006**
Revenue	$ —	$ —
Pre-Tax income	42	3
Income tax benefit/(expense)	(14)	(1)
Income from discontinued operations	$ 28	$ 2

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

5.Vital Signs, Inc. sells single-patient-use medical products to the anesthesia, respiratory, critical care, interventional cardiology/radiology, and emergency markets. The Company provides pharmaceutical technology services, principally to the pharmaceutical companies and also, from time to time, to medical device, diagnostic, and biotechnology companies. The Company has aggregated its business units into five reportable segments: anesthesia, respiratory/critical care, sleep disorders, interventional cardiology/ radiology, and pharmaceutical technology services. There are no material intersegment sales. Anesthesia and Respiratory/Critical Care share certain manufacturing facilities, sales, and administration support; therefore the operating expenses, total assets, and capital expenditures are not specifically identifiable. However, the Company has allocated operating expenses, total assets, and capital expenditures on a net sales basis. Management evaluates performance on gross profits and operating results of the five business segments. Summarized financial information concerning the Companys reportable segments is shown in the following table:

Three months Ended December 31, (In thousands of dollars)	**Anesthesia**	**Respiratory/ Critical Care**	**Sleep Disorders**	**Interventional Cardiology/ Radiology**	**Pharmaceutical Technology**	**Consolidated**
2007						
Net revenues	$ 19,442	$ 10,902	$ 14,722	$ 5,607	$ 2,766	$ 53,439
Gross profit	10,057	5,756	7,651	3,066	873	27,403
Gross profit percentage	51.7%	52.8%	52.0%	54.7%	31.6%	51.3%
Operating income	4,165	2,335	1,692	2,143	23	10,358
Total assets	169,224	94,892	60,408	12,490	5,424	342,438
Capital expenditures	1,553	871	378	64	148	3,014
2006						
Net revenues	$ 17,707	$ 11,302	$ 10,271	$ 5,888	$ 2,550	$ 47,718
Gross profit	8,740	6,314	5,381	3,172	600	24,207
Gross profit percentage	49.4%	55.8%	52.4%	53.9%	23.5%	50.7%
Operating income	3,831	2,448	994	2,399	(330)	9,342
Total assets	147,978	94,583	44,833	10,903	18,239	316,536
Capital expenditures	423	270	55	27	95	870

6. Other comprehensive income for the period ended December 31, 2007 and 2006 consisted of:

(In thousands of dollars)	**Three Months Ended December 31, 2007**	**2006**
Net income	$ 7,999	$ 7,294
Foreign currency translation	(151)	1,154
Comprehensive income	$ 7,848	$ 8,448

7. In accordance with SFAS No. 123R, the Companys net income for the three months ended December 31, 2007 and December 31, 2006 include $352,000 and $468,000, respectively, of compensation expense and $50,000 and $6,000, respectively, of income tax benefits related to the Companys stock options. The stock based compensation expense is included as a component of both selling, general, and administrative and research and development expenses. The stock based compensation expense for selling, general, and administrative and research and development for the three months ended December 31, 2007 was $257,000 and $95,000, respectively and $342,000 and $126,000, respectively for the three months ended December 31, 2006.

8. In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes

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

recognized in an enterprises financial statements in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes (SFAS 109). This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition. The Company adopted FIN 48 effective October 1, 2007. As a result of implementing FIN 48 as of October 1, 2007, the Company recognized a $2,194,000 liability for unrecognized tax benefits, of which $2,019,000 is classified as a long-term liability and $175,000 as a short-term liability, $532,000 was accounted for as a reduction to retained earnings and $800,000 was accounted for as a deferred tax asset and $862,000 reclassified from SFAS No. 5 tax accrual.

Of the Companys unrecognized tax benefits of approximately $2,194,000, $1,394,000, if recognized, would result in a reduction of the Companys income tax provision. The difference between the total amount of unrecognized tax benefits and the amount that would impact the income tax provision consists of items that are offset by deferred tax assets, and the federal tax benefits will change significantly within the next twelve months. In accordance with FIN 48, the Company classifies interest as a component of interest expense and penalties as a component of income tax expense. The total amount of estimated accrued interest and penalties are $181,000 and $0, respectively as of October 1, 2007. As of December 31, 2007 the total amount of estimated accrued interest and penalties was $214,000 and $0, respectively.

The Company files Federal income tax returns, as well as multiple state, local and foreign jurisdiction tax returns. The Company recently settled an audit of its Federal income tax return through the year ended September 30, 2004. Accordingly, tax years ended September 30, 2005 or later remain subject to examination by the IRS. In most instances, state, local and foreign income tax returns remain subject to examination for tax years ended September 30, 2004 or later.

9. In September 2006, the Financial Accounting Standards Board released SFAS 157, Fair Value Measurements, which takes effect for the first fiscal year beginning after November 15, 2007. This statement defines fair value and establishes a framework for measuring fair value in accordance with generally accepted accounting principles and expands disclosures about fair value measurements. This statement does not require any new fair value measurements; however, the application of this statement is expected to change current practice.

The Company is currently in the process of evaluating the materiality of the impact of SFAS 157 on the Companys Condensed Consolidated Financial Statements.

In February 2007, the Financial Accounting Standards Board released SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities, which takes effect for the first fiscal year beginning after November 15, 2007. Under SFAS 159, entities are provided with an option to report selected financial assets and liabilities at fair value. The standard permits an entity to elect the fair value option on an instrument-by-instrument basis. In addition, SFAS 159 establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities.

The Company is currently in the process of evaluating the materiality of the impact of SFAS 159 on the Companys Condensed Consolidated Financial Statements.

In December 2007, the Financial Accounting Standards Board released SFAS 141R, Business Combinations that is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The pronouncement resulted from a joint project between the FASB and the International Accounting Standards Board and continues the movement toward the greater use of fair values in financial reporting. SFAS 141R is expected to significantly change how future business acquisitions are accounted for and will impact financial statements both on the acquisition date and in subsequent periods.

In December 2007, the Financial Accounting Standards Board released SFAS 160 Non-controlling Interests in Consolidated Financial Statements that is effective for annual periods beginning December 15, 2008. The pronouncement resulted from a joint project between the FASB and the International Accounting Standards Board

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

and continues the movement toward the greater use of fair values in financial reporting. Upon adoption of SFAS 160, the Company will re-classify non-controlling interests as a component of equity.

The Company does not believe that any other recently issued but not yet effective accounting standards will have a material effect on the Company's consolidated financial position or results of operations.

10. In connection with a finalization of an Internal Revenue Service examination of the Company's 2003 and 2004 Federal income tax returns, the Company decreased its tax provision in the first quarter of fiscal 2007 by $419,000.

11. Included in the Company's revenues in the Anesthesia and Respiratory/ Critical Care segments, are sales made to distributors. For the three month period ended December 31, 2007 and 2006, these sales accounted for approximately 27.8% and 31.0%, respectively, of the net sales of the Company. The Company estimates and records the applicable rebates that have been or are expected to be granted or made for products sold through distributions during the period. These rebate amounts are estimated to be $18.0 and $16.6 million for the three months ended December 31, 2007 and 2006, respectively and are deducted from the gross sales to arrive at the Company's reportable net sales for each period.

12. In accordance with Statement of Financial Standards No. 142, "Goodwill and Other Intangible Assets", goodwill and intangible assets that have indefinite useful lives are no longer amortized but rather are to be tested for impairment annually or more frequently if impairment indicators arise. The Company completed this impairment test during the three-month period ended March 31, 2007 and found no impairment. If the Company is required to record impairment charges in the future, it could have a material adverse impact on the Company's results of operations and financial condition.

Summary of Goodwill: