MERGE TECHNOLOGIES INC
Form 10-Q
May 15, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
FORM 10-Q

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.

INDEX

PART I

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

MERGE TECHNOLOGIES INCORPORATED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands, except for share data)

	March 31, 2003 (Unaudited)	December 31, 2002
ASSETS		
Current assets:		
Cash	$ 6,570	$ 4,411
Accounts receivable, net of allowance for doubtful accounts of $273 and $293 at March 31, 2003 and December 31, 2002, respectively	6,125	7,069
Unbilled accounts receivable	282	79
Inventory	737	453
Prepaid expenses	277	176

Other current assets	42	25
Total current assets	14,033	12,213
Property and equipment:		
Computer equipment	3,965	3,725
Office equipment	509	501
Leasehold improvements	148	147
	4,622	4,373
Less accumulated depreciation and amortization	3,641	3,531
Net property and equipment	981	842
Purchased and developed software, net of accumulated amortization of $5,937 and $5,522 at March 31, 2003 and December 31, 2002, respectively	5,850	5,703
Intangibles - customer contract, net of accumulated amortization of $145 and $97 at March 31, 2003 and December 31, 2002, respectively	821	869
Long-term accounts receivable	141	144
Goodwill	7,406	7,406
Other	59	69
Total assets	$ 29,291	$ 27,246

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:		
Accounts payable	$ 1,417	$ 1,493
Current portion of obligations under capital leases	----	7
Accrued wages	550	685
Other accrued liabilities	694	264
Deferred revenue	2,245	1,892
Total current liabilities	4,906	4,341
Notes payable	182	167
Put options related to redeemable common stock	555	1,038
Other	15	17
Total liabilities	5,658	5,563
Shareholders' equity		
Preferred stock, $0.01 par value: 4,000,000 shares authorized; one share issued and outstanding at March 31, 2003 and December 31, 2002	$ ----	$ ----
Series A Preferred Stock, $0.01 par value: 1,000,000 shares authorized; zero shares issued and outstanding at March 31, 2003 and December 31, 2002	----	----
Series 2 Special Voting Preferred stock, no par value: one share authorized; one share issued and outstanding at March 31, 2003 and December 31, 2002	----	----
Common stock, $0.01 par value: 30,000,000 shares authorized; 9,634,466 shares and 9,481,683 shares issued and outstanding at March 31, 2003 and December 31, 2002, respectively	96	95
Common stock subscribed: 5,021 and 3,542 shares at March 31, 2003 and December 31, 2002, respectively	29	15
Additional paid-in capital	28,558	28,035

Common stock subscription receivable	(25)	(25)
Accumulated deficit	(4,979)	(6,295)
Accumulated other comprehensive loss - cumulative translation adjustment	(46)	(142)
Total shareholders' equity	23,633	21,683
Total liabilities and shareholders' equity	$ 29,291	$ 27,246

See accompanying notes to consolidated financial statements.

MERGE TECHNOLOGIES INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(in thousands, except for share data)

	Three Months Ended March 31,	
	2003	2002
Net sales	$ 6,117	$ 4,535
Cost of sales	2,051	1,788
Gross profit	4,066	2,747
Operating costs and expenses:		
Sales and marketing	1,325	867
Product research and development	439	364
General and administrative	721	668
Depreciation and amortization	106	113
Total operating costs and expenses	2,591	2,012
Operating income	1,475	735
Other income (expense):		
Interest expense	(4)	(7)
Interest income	13	6
Other, net	12	(9)
Total other income (expense)	21	(10)
Income before income taxes	1,496	725
Income tax expense	180	21
Net income	$ 1,316	$ 704

Net income per share - basic	$ 0.12	$ 0.09
Weighted average number of common shares outstanding - basic	10,462,086	7,079,482
Net income per share - diluted	$ 0.11	$ 0.07
Weighted average number of common shares outstanding - diluted	11,238,171	9,600,168

See accompanying notes to consolidated financial statements.

MERGE TECHNOLOGIES INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(in thousands)

	Three Months Ended March 31,	
	2003	2002
Cash flows from operating activities:		
Net income	$ 1,316	$ 704
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	555	373
Amortization of discount on note acquired in merger	4	3
Provision for (recoveries of) doubtful accounts receivable	(20)	44
Change in assets and liabilities:		
Accounts receivable	807	(238)
Inventory	(284)	38
Prepaid expenses	(101)	(182)
Accounts payable	(272)	148
Accrued wages	(140)	(122)
Other accrued expenses	580	68
Deferred revenue	309	114
Other	(3)	19
Net cash provided by operating activities	2,751	969
Cash flows from investing activities:		
Leasehold improvements	(1)	----
Purchases of property and equipment	(232)	(218)

Development of software	(468)	(482)
Net cash used in investing activities	(701)	(700)
Cash flows from financing activities:		
Proceeds from exercise of stock options	25	61
Proceeds from sale of common stock	----	8
Proceeds from exercise of warrants	----	14
Proceeds from employee stock purchase plan	28	20
Principal payments under capital leases	(7)	(8)
Net cash provided by financing activities	46	95
Effect of exchange rate changes on cash	63	----
Net increase in cash and cash equivalents	2,159	364
Cash, beginning of period	4,411	1,043
Cash, end of period	$ 6,570	$ 1,407
Supplemental Disclosures of Cash Flow Information:		
Cash paid for income taxes	$ 61	$ 5
Cash paid for interest	1	3
Non-cash Financing and Investing Activities:		
Payment of preferred stock dividends through issuance of common stock	----	11
Redemption value related to exchangeable common stock	22	32

See accompanying notes to consolidated financial statements.

MERGE TECHNOLOGIES INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(in thousands)

	Three Months Ended March 31,	
	2003	2002
Net income	$ 1,316	$ 704
Accumulated other comprehensive income (loss) - cumulative translation adjustment	97	(2)
Comprehensive net income	$ 1,413	$ 702

See accompanying notes to consolidated financial statements.

MERGE TECHNOLOGIES INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited and in thousands, except for share data)

(1) BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

The accompanying unaudited consolidated financial statements have been prepared pursuant to the rules and regulations for reporting on Form 10-Q. Accordingly, certain information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements are not included herein. The interim statements should be read in conjunction with the consolidated financial statements and notes thereto included in the latest Annual Report on Form 10-KSB of Merge Technologies Incorporated, a Wisconsin corporation dba Merge eFilm, and its subsidiaries and affiliates (the "Company" or "Merge eFilm").

The accompanying unaudited consolidated financial statements of the Company reflect all adjustments of a normal recurring nature, which are, in the opinion of management, necessary to present a fair statement of its financial position and results of operations.

As a result of the eFilm Medical acquisition on June 28, 2002, the Company has presented costs associated with service revenues as a component of cost of sales. Where appropriate, certain items relating to the prior years have been reclassified to conform to the presentation in the current year.

The Company maintains two stock-based employee compensation plans and one director option plan. The Company applies the provisions of the SFAS 123, Accounting for Stock-Based Compensation ("SFAS No. 123"), as amended ("SFAS No. 148"), which requires entities to recognize as expense over the vesting period the fair value of all stock-based awards on the date of grant. Alternatively, SFAS No. 123 also allows entities to continue to apply the provision of APB Opinion No. 25 and provide pro forma disclosures as if the fair-value-based method defined in SFAS No. 123 had been applied.

The Company has elected to continue to apply the provisions of APB Opinion No. 25 in accounting for its plans. All stock options under the plans have been granted at exercise prices of not less than the market value at the date of the grant. Had the Company determined compensation cost based on the fair value at the grant date for its stock options under SFAS No. 123, the Company's net income would have been decreased in the three months ended March 31, 2003 and 2002 to the pro forma amounts indicated below:

	Three Months ended March 31, 2003	2002
Net income, as reported........................	$ 1,316	$ 704
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax benefits.....	(133)	(47)
Pro forma net income...........................	$ 1,183	$ 657

Earnings per share:

Basic - as reported	$ 0.12	$ 0.09
Basic - pro forma	$ 0.11	$ 0.08
Diluted - as reported	$ 0.11	$ 0.07
Diluted - pro forma	$ 0.10	$ 0.06

(2) GOODWILL AND OTHER INTANGIBLES

Goodwill is the Company's only unamortized intangible asset. There were no changes to the carrying amount of goodwill or amortizable intangibles during the three months ended March 31, 2003.

The Company's intangible assets, other than internally developed software, subject to amortization are summarized as follows:

	March 31, 2003 (in thousands)		
	Weighted Average Remaining Amortization Period (Years)	Gross Carrying Amount	Accumulated Amortization
Purchased software	2.7	1,418	(277)
Customer contracts	4.3	966	(145)
Total	3.1	2,384	(422)

Amortization expense was $122 for the three months ended March 31, 2003. Estimated aggregate amortization expense for each of the next five years is as follows (in thousands):

For the remaining nine months:	2003	$ 366
For the year ended:	2004	$ 481
	2005	$ 444
	2006	$ 432
	2007	$ 216

(3) INCOME PER SHARE

Basic earnings per share are computed by dividing income available to common shareholders by the weighted- average number of common shares and share exchange rights outstanding if conversion is dilutive to the calculation. Diluted earnings per share reflects the potential dilution that could occur based on the effect of the conversion of outstanding convertible preferred shares and the exercise of stock options and warrants with an exercise price of less than the average market price of the Company's common stock. The following table sets forth the computation of basic and diluted earnings per share for the three months ended March 31, 2003 and 2002.

(in thousands, except for share data)

	March 31, 2003	March 31, 2002
Numerator:		
Net income....................................	$ 1,316	$ 704
Preferred stock dividends......................	----	(11)
Accretion of redemption value related to Interpra exchangeable shares..................	(22)	(32)
Allocation of income to Interpra exchangeable shares......................................	(28)	(34)
Numerator for net income per share - basic......	$ 1,266	$ 627
Adjustment for effect of assumed conversion of preferred stock...........................	----	11
Numerator for net income per share - diluted....	$ 1,266	$ 638

MERGE TECHNOLOGIES INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited and in thousands, except for share data

Denominator:		
Weighted average number of shares of common stock and participating securities outstanding.......	10,462,086	7,079,482
Effect of convertible preferred stock..........	----	637,236
Effect of stock options........................	682,762	1,147,339
Effect of warrants.............................	93,323	736,111
Denominator for net income per share - diluted..	11,238,171	9,600,168
Net income per share - basic...................	$ 0.12	$ 0.09
Net income per share - diluted.................	$ 0.11	$ 0.07

For the three months ended March 31, 2003 and 2002, 178,700 and 188,816, respectively, weighted average options and warrants to purchase shares of the Company's common stock had exercise prices greater than the average market price of the shares of common stock.

(4) ACQUISITIONS

In May of 2002, the Company acquired certain assets of Aurora, pursuant to an Asset Acquisition Agreement dated April 18, 2002. On June 28, 2002, the

(Unaudited and in thousands, except for share data)

Company acquired all the outstanding capital stock of eFilm pursuant to a Stock Acquisition Agreement dated April 15, 2002.

The acquisitions were accounted for using the purchase method of accounting. Accordingly, the assets and liabilities of the acquired businesses are included in the consolidated balance sheet as of March 31, 2003. The accompanying consolidated statement of operations for the three months ended March 31, 2003, include the results of operations for Aurora operations and the results of operations for eFilm operations. The amounts allocated to purchased and developed software are being amortized over periods ranging from three to five years. The estimated asset lives are determined based on projected future economic benefits and expected life cycles of the technologies. The amounts allocated to goodwill are not being amortized, but will be tested for impairment annually or under certain circumstances that may indicate a potential impairment, and written-off when impaired. The following is a summary of purchase consideration for the acquisition:

Form of Consideration	Aurora Fair Value	eFilm Fair Value
Cash................................	$ 100	$ ----
93,901 shares of common stock........	792	----
1,000,000 eFilm exchangeable shares..	----	7,737
Vested stock options................	----	437
Transaction costs...................	25	223
TOTAL:	$ 917	$ 8,397

The fair value of shares issued to Aurora was determined to be $8.43 per share or equal to the closing price of the Company's Common Shares as of May 17, 2002. The fair values of exchangeable shares issued in the eFilm acquisition was determined using a three-day average $7.736 closing price of the Company's common stock after signing the definitive agreement.

The Company paid a significant premium above eFilm's tangible and intangible assets principally for two reasons: eFilm's knowledge of the Company's software products through the joint development projects that were undertaken prior to the acquisition and the ability to sell the Company's products into existing eFilm customers. Also, eFilm's software development ability is particularly important because as the Company looked to the future, it foresaw the need to expand the Company's software product offerings to its

healthcare institutions as many of the Company's competitors are promising more integrated solutions. In addition, the Company expected to be able to sell its higher price and high margin software products to eFilm's customers and to use the eFilm Workstation as a way to have the healthcare institutions become aware of the Company.

Each holder of eFilm exchangeable shares has the right, at any time within five years of the acquisition date, to exchange their shares for the Company's Common Shares on a one for one basis, subject to adjustment provisions. At June 28, 2007, any remaining shares will automatically be converted to common stock of the Company.

Each eFilm exchangeable share is entitled to vote together with the Company's Common Shares on matters relating to the Company and include dividend rights equivalent to the Company's Common Shares. The Company established an escrow holdback of 116,590 exchangeable shares for 18 months, for indemnification with respect to certain potential claims.

The Company established an escrow holdback of 18,780 shares related to the Aurora transaction for 12 months, for indemnification with respect to certain potential claims.

The total purchase considerations of approximately $917 and $8,397 was allocated to the fair value of the net assets acquired as follows (in thousands):

	Aurora	eFilm
Current assets	$ 59	$ 403
Other assets	29	44
Purchased and developed technologies	85	1,193
Purchased contracts	----	966
Goodwill	744	6,306
In-process research and development	----	148
Liabilities assumed	----	(663)
Total consideration:	$ 917	$ 8,397

The value assigned to acquire in-process technology was determined by identifying the acquired specific in-process research and development projects that would be continued, and for which (1) technological feasibility had not been established at the acquisition date, (2) there was no alternative future use, and (3) the fair value was estimable with reasonable reliability. The Company estimated the fair value of the eFilm eRis (eRIS) project to be $148. Accordingly, this amount was immediately expenses in the consolidated statement of income upon the acquisition date.

The estimated fair value of these projects was determined by the utilization of the income or consumption approach. Appraisal assumptions utilized under this method included a forecast of estimated future net cash flows, as well as discounting the future net cash flows to their present value. The Company used a 25% discount rate, which was calculated using an industry beta and capital structure.

Of the amounts allocated to goodwill in the acquisitions of eFilm and Aurora, $6,306 and $744, respectively, the $6,306 relating to the eFilm transaction will not be deductible for federal income tax purposes, and the $744 relating to the Aurora transaction will be deductible for federal income tax purposes.

Additionally, in the Aurora acquisition, the Company assumed an operating lease obligation for office space located in the Chicago, Illinois metropolitan area. The aggregate minimum lease payment assumed amounted to $122. In October of 2002, the Company terminated the operating lease acquired in the Aurora acquisition. The total cost to terminate the lease was $14.

MERGE TECHNOLOGIES INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited and in thousands, except for share data)

The following unaudited pro forma information shows the results of operations of the Company for the three months ended March 31, 2002, as if the business combinations had occurred at the beginning of the period. This data is not indicative of the results of operations that would have arisen if the business combinations had occurred at the beginning of the respective periods. Moreover, this data is not intended to be indicative of future results of operations.

	Three Months ended March 31, 2002 (in thousands, except share data)
Revenue.................................	$ 5,323
Net income..............................	625
Earnings per share:	
Basic...........................	$ 0.07
Diluted.........................	$ 0.06

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION OF PLAN 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 decreased 8% to $1,157 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 22% to $3,154 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 164% to $1,806 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.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not Applicable

ITEM 4. CONTROLS AND PROCEDURES

Our Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of a date within 90 days prior to the filing date of this report, that our disclosure controls and procedures are effective for gathering, analyzing and disclosing the information we are required to disclose in our reports filed under the Exchange Act. There have been no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of the previously mentioned evaluation.

PART II

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 2. CHANGES IN SECURITIES

In the three months ended March 31, 2003, the Company sold no shares of its common stock in transactions that were not registered under the Securities Act of 1933, as amended (the "Securities Act").

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

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

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

See Exhibit Index.

(b) No reports on Form 8-K were filed during the first fiscal quarter.

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 15, 2003 By: /s/ Richard A. Linden

Richard A. Linden
President and Chief Executive Officer

May 15, 2003 By: /s/ Scott T. Veech

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

CERTIFICATION

Pursuant to Section 302 of the Sarbanes - Oxley Act of 2002

I, Richard A. Linden, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Merge Technologies Incorporated;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The Registrant's other certifying officer and I (herein, the "Certifying Officers") are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the Registrant and we have:

   a) designed such disclosure controls and procedures to ensure that material information relating to the Registrant, including its consolidated subsidiaries (collectively, the "Company") is made known to the Certifying Officers by others within the Company, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the Registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report the conclusions of the Certifying Officers about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date.

5. The Registrant's Certifying Officers have disclosed, based on the Certifying Officers' most recent evaluation, to the Registrant's auditors and the audit committee of the Registrant's board of directors:

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the Registrant's ability to record, process, summarize and report financial data and have identified for the Registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal controls; and

6. The Registrant's other Certifying Officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 15, 2003

/s/ Richard A. Linden

Richard A. Linden, Chief Executive Officer

See also the certification pursuant to Section 906 of the Sarbanes - Oxley Act of 2002, which is included as an exhibit to this report.

CERTIFICATION

Pursuant to Section 302 of the Sarbanes - Oxley Act of 2002

I, Scott T. Veech, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Merge Technologies Incorporated;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The Registrant's other certifying officer and I (herein, the "Certifying Officers") are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the Registrant and we have:

   a) designed such disclosure controls and procedures to ensure that material information relating to the Registrant, including its consolidated subsidiaries (collectively, the "Company") is made known to the Certifying Officers by others within the Company, particularly during the period in which this quarterly report is being prepared;

   b) evaluated the effectiveness of the Registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

   c) presented in this quarterly report the conclusions of the Certifying Officers about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date.

5. The Registrant's Certifying Officers have disclosed, based on the Certifying Officers' most recent evaluation, to the Registrant's auditors and the audit committee of the Registrant's board of directors:

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the Registrant's ability to record, process, summarize and report financial data and have identified for the Registrant's auditors any material weaknesses in internal controls; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal controls; and

6. The Registrant's other Certifying Officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 15, 2003

/s/ Scott T. Veech

Scott T. Veech, Chief Financial Officer

See also the certification pursuant to Section 906 of the Sarbanes - Oxley Act of 2002, which is included as an exhibit to this report.

EXHIBIT INDEX

3.1 Articles of Incorporation of Registrant (2), Articles of Amendment as of June 16, 1998 (3), Articles of Amendment as of September 1, 1999 (6), and Articles of Amendment as of November 29, 2000 (6)

3.2 Amended and Restated Bylaws of Registrant as of February 3, 1998 (1)

10.2 Employment Agreement entered into as of November 29, 2001, between Registrant and Richard A. Linden (7)

10.3 Employment Agreement entered into as of December 21, 2001, between Registrant and William C. Mortimore (7)

10.5 1996 Stock Option Plan for Employees of Registrant dated May 13, 1996 (2)

10.6 Office Lease for West Allis Center dated May 24, 1996, between Registrant and Whitnall Summit Company, LLC, Supplemental Office Lease dated July 3, 1997 (1), Supplemental Office Space Lease dated January 30, 1999 (2), Supplemental Office Space Lease for 1126 West Allis Operating Associates Limited Partnership dated April 11, 2000 (4) and Second Amendment to Lease dated January 11, 2002, between Registrant and 1126 West Allis Operating Associates, Limited Partnership (7)

10.8 1999 Stock Option Plan For Directors (1)

10.9 Merge Technologies Incorporated 2000 Employee Stock Purchase Plan (5)

10.10 Loan Agreement dated as of December 30, 2002, by and between Registrant and Lincoln State Bank (8)

10.11 Employment Agreement entered into as of July 15, 2002, between Registrant and Scott T. Veech (8)

99.1 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes - Oxley Act of 2002

----

(1) Incorporated by reference to Annual Report on Form 10-KSB for the fiscal year ended December 31, 1997.

(2) Incorporated by reference to Registration Statement on Form SB-2 (No. 333-39111) effective January 29, 1998.

(3) Incorporated by reference to Quarterly Report on Form 10-QSB for the three months ended March 31, 1999.

(4) Incorporated by reference to Quarterly Report on Form 10-QSB for the three months ended March 31, 2000.

(5) Incorporated by reference to Proxy Statement for 2000 Annual Mailing of Shareholders dated May 9, 2000.

(6) Incorporated by reference to Annual Report on Form 10-KSB for the fiscal year ended December 31, 2000.

(7) Incorporated by reference to Annual Report on Form 10-KSB for the fiscal

year ended December 31, 2001.

(8) Incorporated by reference to Annual Report on Form 10-KSB for the fiscal year ended December 31, 2002.

EXHIBIT 99.1

CERTIFICATION of CHIEF EXECUTIVE OFFICER and CHIEF FINANCIAL OFFICER

Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to
Section 906 of the Sarbanes - Oxley Act of 2002

In connection with the Quarterly Report on Form 10-Q of MERGE TECHNOLOGIES INCORPORATED (the "Company") for the quarterly period ended March 31, 2003, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Richard A. Linden, as Chief Executive Officer of the Company, and Scott T. Veech, as Chief Financial Officer of the Company, each hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes - Oxley Act of 2002, that, to the best of their knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 15, 2003 By: /s/ Richard A. Linden

Richard A. Linden
Chief Executive Officer

Date: May 15, 2003 By: /s/ Scott T. Veech

Scott T. Veech
Chief Financial Officer

This certification accompanies the Report pursuant to Section 906 of the Sarbanes - Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes - Oxley Act of 2002, be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

See also the certification pursuant to Section 302 of the Sarbanes - Oxley Act of 2002, which is included in this quarterly report on Form 10-Q.