VITAL SIGNS INC
Form 10-Q
February 14, 2002

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, 2001 or

[ ] Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from _______ to ________

Commission file number: 0-18793

VITAL SIGNS, INC.
(Exact name of registrant as specified in its charter)

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

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes X No ___

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

At February 5, 2002 there were 12,947,335 shares of Common Stock, no par value, outstanding.

VITAL SIGNS, INC.

INDEX

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" or the "Company" or "Vital Signs") 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 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, 2001.

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.

INDEPENDENT ACCOUNTANT'S REPORT

To the Board of Directors
Vital Signs, Inc.

We have reviewed the accompanying consolidated balance sheet of Vital Signs, Inc. as of December 31, 2001, and the related consolidated statements of income, and cash flows for the three-month period then ended. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

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

GOLDSTEIN GOLUB KESSLER LLP
New York, New York

February 5, 2002

2

VITAL SIGNS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET

	December 31, 2001 (In
ASSETS	
	(Unaudited)
Current Assets:	
Cash and cash equivalents	$ 36,766
Accounts receivable, less allowance for doubtful accounts of $491 and $436 respectively	32,159
Inventory	26,389
Prepaid expenses and other current assets	9,488
Total Current Assets	104,802
Property, plant and equipment - net	36,274
Marketable securities	407
Goodwill	47,750

Deferred income taxes	4,579
Other assets	2,382
Total Assets	$196,194
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current Liabilities:	
Accounts payable	$ 4,829
Current portion of long-term debt	377
Accrued expenses	6,643
Notes payable - bank	4,140
Other current liabilities	11,720
Total Current Liabilities	27,709
Long term debt	1,622
Total Liabilities	29,331
Commitments and contingencies:	
Minority interest in subsidiary	344
Stockholders' Equity	
Common stock - no par value; authorized 40,000,000 shares, issued and outstanding 12,940,635 and 12,935,656 shares, respectively	27,786
Accumulated other comprehensive loss	(2,281)
Retained earnings	141,014
Stockholders' equity	166,519
Total Liabilities and Stockholders' Equity	$196,194

(See Notes to Consolidated Financial Statements)

3

VITAL SIGNS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF INCOME
(UNAUDITED)

	For th
	2001
	(In Thousands
Revenue:	
Net sales	$36,926
Service revenue	5,173
	42,099
Cost of goods sold and services performed:	
Cost of goods sold	18,202
Cost of services performed	3,408
Gross profit	21,610
Operating expenses:	
Selling, general and administrative	10,416
Research and development	1,799
Interest income	(233)
Interest expense	59
Other expense	67
Goodwill amortization	---
	12,108

Income before provision for income taxes and minority interest in loss of consolidated subsidiary	9,502
Provision for income taxes	3,186
Income before minority interest in loss of consolidated subsidiary	6,316
Minority interest in loss of consolidated subsidiary	---
Net income	$ 6,316
Earnings per Common Share:	
Basic net income per share	$ .49
Diluted net income per share	$ .49
Basic weighted average number of shares	12,890
Diluted weighted average number of shares	13,013
Dividends paid per share	$ .04

(see Notes to Consolidated Financial Statements)

VITAL SIGNS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS
(UNAUDITED)

	For th
	2001
Cash Flows from Operating Activities:	
Net income	$ 6,316
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:	
Depreciation and amortization	1,295
Minority interest in income (loss) of consolidated subsidiary	---
Amortization of goodwill	---
Changes in operating assets and liabilities:	
Decrease (increase) in accounts receivable	1,264
(Increase) in inventory	(236)
Decrease in prepaid expenses and other current assets	277
Increase in accounts payable and accrued expenses	241
Increase (decrease) in other liabilities, net	534
Net cash provided by operating activities	9,691
Cash Flows from Investing Activities:	
Proceeds from sales of available-for-sale securities	79
Acquisition of property, plant and equipment	(1,859)
Net cash used in investing activities	(1,780)
Cash Flows from Financing Activities:	
Net reissuance of treasury stock	---

Dividends paid	(519)
Proceeds from exercise of stock options	93
Principal payments of long-term debt and notes payable	(1,857)
Net cash used in financing activities	(2,283)
Effect of foreign currency translation	109
Net increase in cash and cash equivalents	5,737
Cash and cash equivalents at beginning of period	31,029
Cash and cash equivalents at end of period	$36,766
Supplemental disclosures of cash flow information:	
Cash paid during the three months for:	
Interest	$ 84
Income taxes	198

(See Notes to Consolidated Financial Statements)

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

1. The consolidated balance sheet as of December 31, 2001, the consolidated statement of income for the three months ended December 31, 2001 and 2000 and the consolidated statement of cash flows for the three months ended December 31, 2001 and 2000 have been prepared by Vital Signs, Inc. (the "Company" or "VSI") and are unaudited. In the opinion of management, all adjustments (consisting solely of normal recurring adjustments) necessary to present fairly the financial position at December 31, 2001 and the results of operations and cash flows for the three months ended December 31, 2001 and 2000 and for all periods presented have been made.

2. See the Company's Annual Report on Form 10-K for the year ended September 30, 2001 (the "Form 10-K") for additional disclosures relating to the Company's consolidated financial statements.

3. The Company adopted Statement of Financial Accounting Standards No. 131 "Disclosures about Segments of an Enterprise and Related Information" at September 30, 1999. The Company designs, manufactures and distributes single-use medical products. The Company's other business segments do not meet the criteria for separate disclosures.

4. At December 31, 2001, the Company's inventory was comprised of raw materials, $16,425,000, and finished goods, $9,964,000.

5. For Details of Legal Proceedings, see Part II, Item 1, "Legal Proceedings".

6. In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets", which is required to be applied for fiscal years beginning after December 15, 2001. The Company has adopted SFAS 142 as of October 1, 2001. SFAS 142 eliminates the amortization of goodwill and certain other intangible assets. It also requires Vital Signs to complete a test for impairment of these assets annually, as well as a transitional goodwill impairment test within six months from the date of adoption. The Company is in the process of performing this impairment test. SFAS 142 also requires disclosure of what net income would have been in all periods presented had SFAS 142 been in effect.
The following table is provided to disclose what net income would have been had SFAS 142 been adopted in prior periods:

	FOR THE THREE-MONTHS ENDED DECEMBER 31,	
	2001	2000
Reported net income	$6,316	$5,903
Add back: goodwill amortization	---	359
Adjusted net income	6,316	6,262
Basic earnings per share as reported	$ .49	$ .48
Adjusted basic earnings per share	.49	.51
Diluted earnings per share as reported	.49	.47
Adjusted diluted earnings per share	.49	.50

ITEM 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

Forward Looking Statements

This Quarterly Report on Form 10-Q contains, and from time to time the Company expects to make, certain forward-looking statements regarding its business, financial condition and results of operations. In connection with the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995 (the "Reform Act"), the Company intends to caution investors that there are important factors that could cause the Company's actual results to differ materially from those projected in its forward-looking statements, whether written or oral, made herein or that may be made from time to time by or on behalf of the Company. Investors are cautioned that such forward-looking statements are only predictions and that actual events or results could differ materially from such statements. The Company undertakes no obligation to publicly release the results of any revisions to its forward-looking statements to reflect subsequent events or circumstances or to reflect the occurrence of unanticipated events.

The Company wishes to ensure that any forward-looking statements are accompanied by meaningful cautionary statements in order to comply with the terms of the safe harbor provided by the Reform Act. Accordingly, the Company has set forth a list of important factors that could cause the Company's actual results to differ materially from those expressed in forward-looking statements or predictions made herein and from time to time by the Company. Specifically, the Company's business, financial condition, liquidity and results of operations could be materially different from such forward-looking statements and predictions as a result of (i) cost containment pressures on hospitals and competitive factors that could affect the Company's primary markets, including the results of competitive bidding procedures implemented by group purchasing organizations and/or the success of the Company's sales force, (ii) slow downs in the healthcare industry or interruptions or delays in manufacturing and/or sources of supply, (iii) the Company's ability to develop or acquire new and improved products and to control costs, (iv) market acceptance of the Company's new products, (v) technological change in medical technology, (vi) the scope, timing and effectiveness of changes to manufacturing, marketing and sales programs and strategies, (vii) intellectual property rights and market acceptance of competitors' existing or new products, (viii) adverse determinations arising in the context of regulatory matters or legal proceedings (see Part II, Item 1 of this Quarterly Report on Form 10-Q), (ix) healthcare industry consolidation resulting in customer demands for price concessions, (x) the reduction of medical procedures in a cost conscious environment, (xi) efficacy or safety concerns with respect to marketed products, whether scientifically justified or not, that may lead to product recalls, withdrawals or declining sales, and (xii) healthcare reform and legislative and regulatory changes impacting the healthcare market both domestically and internationally.

Results of Operations

The following table sets forth, for the periods indicated, the percentage increase of certain items included in the Company's consolidated statement of income.

	Increase from prior period Three Months Ended December 31, 2001 vs. Three Months Ended December 31, 2000
Net revenue	3.7%
Cost of revenue	4.2
Gross profit	3.2
Selling, general and administrative expense	2.3
Research and development expenses	1.4
Income before provision for income taxes and minority interest in income of consolidated subsidiary	14.3
Provision for income taxes	26.9
Net income	7.0

COMPARISON: QUARTER ENDED DECEMBER 31, 2001
AND QUARTER ENDED DECEMBER 31, 2000

Net revenue for the quarter ended December 31, 2001 increased 3.7% compared with the same period last year. The increase was primarily due to an increase in both the Breas Medical AB sleep and ventilation product revenues and other revenues generated within the anesthesia product line.

Sales of anesthesia products, representing 44.0% of net revenue, grew by approximately 9.5% from the quarter ended December 31, 2000 due primarily to license and other revenue. Sales of respiratory/critical care products, representing 31.3% of net revenue decreased by approximately 5.1% due principally to the fact that the flu season has been milder than expected.

Sales of the Breas sleep and ventilation product, representing 12.4% of net revenue, increased by 27.0%, due largely to sales volume increases in international markets. Sales of services representing 12.3% of revenue, decreased by 4.4%, due largely to the temporary effect of the September 11th tragedy, together with a shutdown of one hospital due to an anthrax infection scare, had a negative effect on our sleep centers in the New York and Baltimore/Washington DC areas. We were also negatively effected by the loss of a major pharmaceutical customer at our subsidiary, The Validation Group, (TVG). This reduced our revenue and profits at TVG.

Gross profit dollars increased by 3.2% from the quarter ended December 31, 2000. The Company's overall gross profit percentage for the quarter ended December 31, 2001 was 51.3% compared to 51.6% for the same period last year. Improved gross profit margins in the anesthesia product lines were offset by reduced gross profit margins in the respiratory/critical care, sleep center and ventilator product lines.

Selling, general and administrative expenses increased by $231,000, a 2.3% increase, primarily due to the inclusion in the quarter ended December 31, 2001 of quality assurance and logistics costs which in the prior year were classified as cost of sales.

Research and development expenses increased by $25,000, an increase of 1.4%.

Other expense, which includes dividend income, realized capital gains and losses, legal and other expenses and currency gains and losses, decreased by $106,000 from the quarter ended December 31, 2000 to the quarter ended December 31, 2001 primarily due to reduction in legal expense and contributions.

For information regarding the impact of the new Financial Accounting Standard on the amortization of goodwill, please refer to Note 6 to the financial statements.

The Company's effective tax rates were 33.5% and 30.2% for the quarters ended December 31, 2001 and 2000, respectively. The Company's tax rate in the current period is lower than statutory rates primarily due to benefits realized from its international operations.

Liquidity and Capital Resources

During the three months ended December 31, 2001, cash and cash equivalents increased by $5,737,000. The Company continues to rely upon cash flow from its operations, which generated $9.7 million of cash and cash equivalents during the first quarter of the current fiscal year. Cash flow from operations was offset in part by dividends of approximately $519,000, $1,859,000 of capital expenditures and reduction in long term debt and notes payable of $1,857,000. The combined total of cash, cash equivalents and long-term marketable securities was approximately $37.2 million at December 31, 2001 as compared to $31.5 million at September 30, 2001.

At December 31, 2001, the Company had approximately $36.8 million in cash and cash equivalents. On that date, the Company's working capital was $77.1 million and the current ratio was 3.8 to 1, as compared to $70.5 million and 3.5 to 1 at September 30, 2001.

The Company's current policy is to retain working capital and earnings for use in its business, subject to the payment of certain cash dividends and treasury stock repurchases. Such funds may be used for product development, product acquisitions and business acquisitions, among other things. The Company regularly evaluates and negotiates with domestic and foreign medical device companies regarding potential business or product line acquisitions or licensing arrangements by the Company. The Board of Directors has approved the purchase of up to $20 million of Vital Signs stock at such times and prices deemed appropriate to Company management.

The Company has a $25 million line of credit with JP Morgan Chase ("Chase"). Chase has also expressed its intention to provide additional funds for the Company's future acquisitions, provided that each such acquisition meets certain criteria. The terms for any borrowing would be negotiated at the date of origination. There were no amounts outstanding under the Chase line of credit at December 31, 2001.

Management believes that the funds generated from operations, along with the Company's current working capital position and bank credit, will be sufficient to satisfy the Company's capital requirements for the foreseeable future. This statement constitutes a forward-looking statement under the Reform Act. The Company's liquidity could be adversely impacted and its need for capital could materially change if costs are higher than anticipated, the Company were to undertake acquisitions demanding significant capital, operating results were to differ significantly from recent experience or adverse events were to affect the Company's operations.

ITEM 3.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risks, including the impact of commodity price changes and changes in the market value of its investments and, to a lesser extent, interest rate changes and foreign currency fluctuations. In the normal course of business as described below, the Company employs policies and procedures with the objective of limiting the impact of market risks on earnings and cash flows and to lower its overall borrowing costs.

The impact of interest rate changes and foreign currency fluctuations is not material to the Company's financial condition. The Company does not enter into interest rate and foreign currency transactions for speculative purposes. It is also the Company's policy to price products from vendors and to customers in U.S. dollars and to receive payment in U.S. dollars. Historically, the international portion of the Company's sales has been relatively small and the effect of changes in interest rates and foreign exchange rates on the Company's earnings generally has been small relative to other factors that also affect earnings, such as unit sales and operating margins. However, the international segment is expected to grow both in terms of actual sales and as a percentage of the Company's total sales and the Company may in the future need to revise or change its approach to managing interest rate and foreign currency transactions.

The Company's risks involving commodity price changes relate to prices of raw materials used in its operations. The Company is exposed to changes in the prices of latex and various plastics and resins for the manufacture of its products. The Company does not enter into commodity futures or derivative instrument transactions. Except with respect to its single source for face masks, it is the Company's policy to maintain commercial relations with multiple suppliers and when prices for raw materials rise to attempt to source alternative supplies.

Subsequent Events

Effective January 1, 2002 the Company's National Sleep Technologies, Inc. ("NST") subsidiary completed its merger with HSI Medical Services, Inc., a subsidiary of the Johns Hopkins Health System. Effective with the merger, NST changed its name to Sleep Services of America, Inc.

PART II.
Other Information

ITEM 1.

Legal Proceedings:

(a) Reference is made to Item 3 of the Company's Annual Report on Form 10-K for the year ended September 30, 2001.

(b) In September 1996, a patent infringement action was filed in Japan against an OEM medical device distributor in connection with the sale in Japan of Marquest Medical Products, Inc.'s ABG syringe product line. In July 1999 the Court indicated at a hearing that, based on one exhibit submitted by the plaintiff, the Marquest ABG syringe products appear to infringe the plaintiff's patent, and requested that the plaintiff submit an updated proof of damages. In July 1999, plaintiff filed an updated proof of damages of approximately $6.5 million, plus interest and costs. On June 23, 2000 the Court entered a judgment against the Company's distributor for Yen 336,872,689 ($2,887,645) plus five percent annual interest. The distributor (which has patent indemnification protection from Marquest) has appealed the judgment to the Tokyo Supreme Court. The appelate court has closed the proceedings on the presentation of additional evidence. A decision is expected by the end of the Company's second fiscal quarter. The Company continues to believe that Marquest ABG syringe products do not infringe the plaintiff's patent.

(c) On December 6, 1999 a complaint was filed against the Company on behalf of the former shareholders of Vital Pharma, Inc. alleging breach of contract for failure to pay earnout payments allegedly due under the stock purchase agreement for the sale of VPI in December, 1995. The Company answered the complaint, filed counter-claims and moved to transfer the case to arbitration. In August, 2000 the court ordered plaintiff to submit such claims to binding arbitration and stayed all other proceedings pending the outcome of the arbitration. The matter is in the discovery phase before the arbitrator. The arbitrator has ordered the parties to complete discovery by April, 2002.

The Company is also involved in other legal proceedings arising in the ordinary course of business.

The Company cannot predict the outcome of its legal proceedings with certainty. However, based upon its review of pending legal proceedings, the Company does not believe the ultimate disposition of its pending legal proceedings will be material to its financial condition. Predictions regarding the impact of pending legal proceedings constitute forward-looking statements under the Reform Act. The actual results and impact of such proceedings could differ materially from the impact anticipated, primarily as a result of uncertainties involved in the proof of facts in legal proceedings.

ITEM 6.

Exhibits and Reports on Form 8-K

a) Reports on Form 8-K filed during the quarter ended December 31, 2001: None.

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

VITAL SIGNS, INC.

By: /s/ Joseph F. Bourgart

Joseph F. Bourgart
Executive Vice President and
Chief Financial Officer

Date: February 14, 2002