VITAL IMAGES INC
Form 10-Q
May 12, 2008

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, 2008

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 0-22229

VITAL IMAGES, INC.

(Exact name of registrant as specified in its charter)

Minnesota	**42-1321776**
(State or other jurisdiction of	(I.R.S. Employer Identification No.)

incorporation or organization)

5850 Opus Parkway, Suite 300	
Minnetonka, Minnesota	**55343-4414**
(Address of principal executive offices)	(Zip Code)

(952) 487-9500

(Registrant s telephone number, including area code)

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, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company 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

On May 5, 2008, there were 17,203,652 shares of the Registrant s common stock, par value $.01 per share, outstanding.

Vital Images, Inc.
Form 10-Q
March 31, 2008

Table of Contents

Part I. Financial Information

Item 1. Financial Statements

Vital Images, Inc.
Condensed Consolidated Balance Sheets

(In thousands, except per share amounts)
(Unaudited)

	March 31, 2008	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 144,058	$ 146,685
Marketable securities	31,280	31,709
Accounts receivable, net	16,266	15,962
Deferred income taxes	3,472	3,472
Prepaid expenses and other current assets	2,436	2,441
Total current assets	197,512	200,269
Marketable securities	3,578	
Property and equipment, net	10,909	11,165
Deferred income taxes	8,924	8,621
Other intangible assets, net	1,591	1,852
Goodwill	9,089	9,089
Total assets	$ 231,603	$ 230,996
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 2,579	$ 3,330
Accrued compensation	3,052	3,092
Accrued royalties	1,150	1,113
Other current liabilities	2,487	2,282
Deferred revenue	16,825	16,547
Total current liabilities	26,093	26,364
Deferred revenue	1,250	1,140
Deferred rent	1,178	1,276
Total liabilities	28,521	28,780
Commitments and contingencies (Note 9)		
Stockholders equity:		
Preferred stock: $0.01 par value; 5,000 shares authorized; none issued or outstanding		
Common stock: $0.01 par value; 40,000 shares authorized; 17,177 issued and outstanding as of March 31, 2008; and 17,153 shares issued and outstanding as of December 31, 2007	172	172
Additional paid-in capital	201,054	199,625
Retained earnings	1,826	2,420
Accumulated other comprehensive income (loss)	30	(1)
Total stockholders equity	203,082	202,216
Total liabilities and stockholders equity	$ 231,603	$ 230,996

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

Vital Images, Inc.

Condensed Consolidated Statements of Operations

(In thousands, except per share amounts)
(Unaudited)

	For the three months ended March 31, 2008	For the three months ended March 31, 2007
Revenue:		
License fees	$ 9,358	$ 13,470
Maintenance and services	7,534	7,049
Hardware	425	306
Total revenue	17,317	20,825
Cost of revenue:		
License fees	1,153	1,605
Maintenance and services	2,572	2,523
Hardware	195	217
Total cost of revenue	3,920	4,345
Gross profit	13,397	16,480
Operating expenses:		
Sales and marketing	8,051	8,025
Research and development	4,285	3,541
General and administrative	3,651	3,512
Total operating expenses	15,987	15,078
Operating (loss) income	(2,590)	1,402
Interest income	1,685	2,144
(Loss) income before income taxes	(905)	3,546
(Benefit) provision for income taxes	(311)	1,174
Net (loss) income	$ (594)	$ 2,372
Net (loss) income per share basic	$ (0.03)	$ 0.14
Net (loss) income per share diluted	$ (0.03)	$ 0.14
Weighted average common shares outstanding - basic	17,075	16,845
Weighted average common shares outstanding - diluted	17,075	17,533

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

Vital Images, Inc.
Condensed Consolidated Statements of Cash Flows

(In thousands)
(Unaudited)

	For the three months ended March 31, 2008	2007
Cash flows from operating activities:		
Net (loss) income	$ (594)	$ 2,372
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization of property and equipment	1,244	1,026
Amortization of identified intangibles	261	326
Provision for doubtful accounts	135	53
Deferred income taxes	(311)	1,174
Excess tax benefit from stock transactions	(66)	(958)
Amortization of discount and accretion of premium on marketable securities	(299)	(153)
Employee stock-based compensation	1,232	1,275
Amortization of deferred rent	(93)	(70)
Changes in operating assets and liabilities:		
Accounts receivable	(439)	(942)
Prepaid expenses and other assets	5	(144)
Accounts payable	(439)	(915)
Accrued expenses and other liabilities	65	(1,292)
Deferred revenue	388	876
Deferred rent		199
Net cash provided by operating activities	1,089	2,827
Cash flows from investing activities:		
Purchases of property and equipment	(1,300)	(1,937)
Purchases of marketable securities	(20,609)	(9,764)
Proceeds from maturities of marketable securities	16,227	10,950
Proceeds from sale of marketable securities	1,581	
Net cash used in investing activities	(4,101)	(751)
Cash flows from financing activities:		
Proceeds from sale of common stock under stock plans	319	1,292
Excess tax benefit from stock transactions	66	958
Net cash provided by financing activities	385	2,250
Net (decrease) increase in cash and cash equivalents	(2,627)	4,326
Cash and cash equivalents, beginning of period	146,685	144,382
Cash and cash equivalents, end of period	$ 144,058	$ 148,708

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

Vital Images, Inc.

Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Basis of presentation

The accompanying unaudited Condensed Consolidated Financial Statements of Vital Images, Inc. (the Company) have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States of America. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, for a fair statement have been included. Operating results for the three months ended March 31, 2008 are not necessarily indicative of the results that may be expected for any subsequent quarter or for the year ending December 31, 2008. The December 31, 2007 condensed consolidated balance sheet information was derived from audited financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America. These financial statements should be read in conjunction with the financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2007.

The Condensed Consolidated Financial Statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated. The Company views its operations and manages its business as one reportable segment the development and marketing of software and related services for enterprise-wide advanced visualization and analysis solutions for use by medical professionals in clinical analysis and therapy planning. Factors used to identify the Company s single operating segment include the financial information available for evaluation by the chief operating decision maker in making decisions about how to allocate resources and assess performance. The Company markets its products and services through a direct sales force and independent distributors in the United States and international markets.

2. Major customer and geographic data

Major customers (dollars in thousands):

	For the three months ended March 31, 2008	2007
Toshiba Medical Systems Corporation	$ 8,782	$ 9,937
Percentage of total revenue	51%	48%
McKesson Information Systems LLC	$ 1,590	$ 1,737
Percentage of total revenue	9%	8%

As of March 31, 2008 and December 31, 2007, Toshiba Medical Systems Corporation accounted for 53% and 34% of accounts receivable, respectively. As of March 31, 2008 and December 31, 2007, McKesson Information Systems LLC accounted for 9% and 6% of accounts receivable, respectively.

6

Revenue by geographic area is summarized as follows (dollars in thousands):

	For the three months ended March 31, 2008	For the three months ended March 31, 2007
United States	$ 13,224	$ 16,834
Europe	2,039	2,643
Asia and Pacific Region	887	719
Canada	728	55
Other Foreign Countries	439	574
Totals	$ 17,317	$ 20,825
Export revenue as a percent of total revenue	24%	19%

Substantially all of the Company s export sales are negotiated, invoiced and paid in U.S. dollars.

3. Equity-based compensation

The following table illustrates how equity-based compensation was allocated to the statements of operations (in thousands):

	For the three months ended March 31, 2008	For the three months ended March 31, 2007
Cost of revenue	$ 76	$ 97
Sales and marketing	368	529
Research and development	265	137
General and administrative	523	513
Total equity-based compensation expense	$ 1,232	$ 1,276

As of March 31, 2008, approximately $11.2 million of unrecognized compensation expense related to stock options was expected to be recognized over a weighted-average period of 3.1 years. As of March 31, 2008, approximately $1.0 million of unrecognized compensation expense related to restricted stock awards was expected to be recognized over a weighted-average period of 1.4 years.

The fair value of each option award is estimated on the date of grant using the Black-Scholes option valuation model. The Black-Scholes option valuation model requires the development of assumptions that are input into the model. These assumptions are the expected stock volatility, the risk-free interest rate, the option s expected life and the dividend yield on the underlying stock.

For purposes of calculating the fair value of options under Statement of Accounting Standard (SFAS) No. 123(R), Share-Based Payment, the weighted-average fair value of options granted was $5.67 and $13.94 for the three months ended March 31, 2008 and 2007, respectively. The weighted-average fair values for the options were based on the fair values on the dates of grant. The fair values for the options were calculated using the Black-Scholes option-pricing model, with the following weighted-average assumptions and expense adjusted using the following expected forfeiture rate assumptions:

	For the three months ended March 31,	
	2008	**2007**
Expected option life	3.75 years	3.75 years
Expected volatility factor	46%	52%
Expected dividend yield	0%	0%
Risk-free interest rate	2.35%	4.49%
Expected forfeiture rate	1.06%	1.07%

The following table summarizes stock option activity for the three months ended March 31, 2008:

	Shares Underlying Options
Total outstanding as of December 31, 2007	1,981,404
Options granted	689,120
Options exercised	(24,040)
Options cancelled	(25,256)
Total outstanding as of March 31, 2008	2,621,228

Options granted during the three months ended March 31, 2008 primarily consisted of the Company s annual grant to employees.

In the first quarter of 2007, the Company granted shares of restricted stock with performance-based vesting to certain employees. No equity-based compensation expense for the awards was recognized for the three months ended March 31, 2008, as the Company did not consider achievement of the performance metrics to be probable. The cumulative amount of the expense related to the awards not recognized as of March 31, 2008 but which may be recognized in future periods if performance metrics are met was $124,000.

4. Per share data

Basic net income (loss) per share is computed using net income (loss) and the weighted-average number of common shares outstanding. Diluted net income (loss) per share reflects the weighted-average number of common shares outstanding plus any potentially dilutive shares outstanding during the period. Potentially dilutive shares consist of shares issuable upon the exercise of stock options, as well as unvested restricted stock. For the 2008 first quarter, all common share equivalents were anti-dilutive because the Company generated a net loss. For the 2007 first quarter, options and restricted stock awards for 736,000 shares were excluded from the computation of diluted earnings per share because their effect would have been anti-dilutive.

8

The computations for basic and diluted net (loss) income per share are as follows (in thousands, except per share amounts):

	For the three months ended March 31, 2008		For the three months ended March 31, 2007	
Numerator:				
Net (loss) income	$	(594)	$	2,372
Denominator:				
Denominator for weighted average common shares outstanding - basic		17,075		16,845
Dilution associated with the Company s stock-based compensation plans				688
Denominator for weighted average common shares outstanding - diluted		17,075		17,533
Net (loss) income per share basic	$	(0.03)	$	0.14
Net (loss) income per share diluted	$	(0.03)	$	0.14
Antidilutive stock options and restricted stock awards excluded from above calculation		2,687		736

5. Comprehensive (loss) income

Comprehensive (loss) income as defined by SFAS No. 130, Reporting Comprehensive Income (SFAS 130), includes net (loss) income and items defined as other comprehensive income. SFAS 130 requires that items defined as other comprehensive (loss) income, such as unrealized gains and losses on certain marketable securities, be separately classified in the financial statements. Such items are reported in the consolidated statements of stockholders equity as comprehensive (loss) income.

The components of comprehensive (loss) income were as follows (in thousands):

	For the three months ended March 31, 2008		For the three months ended March 31, 2007	
Net (loss) income	$	(594)	$	2,372
Other comprehensive income (loss):				
Net change in unrealized gain or loss on available-for-sale investments, net of tax		31		(4)
Cumulative translation adjustment				1
Comprehensive (loss) income	$	(563)	$	2,369

6. Other intangible assets

Acquired intangible assets subject to amortization were as follows (in thousands):

	March 31, 2008			December 31, 2007		
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Existing software technology	$ 3,400	$ (2,821)	$ 579	$ 3,400	$ (2,650)	$ 750
Patents and patent applications	2,500	(1,488)	1,012	2,500	(1,398)	1,102
Total intangible assets subject to amortization	$ 5,900	$ (4,309)	$ 1,591	$ 5,900	$ (4,048)	$ 1,852

Intangible assets subject to amortization are amortized on a straight-line basis over the estimated period of benefit. Amortization expense related to other intangible assets was $261,000 and $296,000 for the three months ended March 31, 2008 and 2007, respectively. The estimated future amortization expense for identified intangible assets as of March 31, 2008 is as follows (in thousands):

Remainder of 2008	$ 783
2009	426
2010	360
2011	22
	$ 1,591

The preceding expected amortization expense is an estimate. Actual amortization expense may differ from estimates due to additional intangible asset acquisitions, impairment of intangible assets, accelerated amortization of intangible assets and other events. A patent acquired in the HInnovation, Inc. acquisition having a net book value of $810,000 as of March 31, 2008 is currently under review by the United States Patent and Trademark Office.

7. Deferred revenue

The components of deferred revenue were as follows:

	March 31, 2008	December 31, 2007
Maintenance and support	$ 12,592	$ 12,376
Customer education	3,284	3,311
Installation	670	762
Professional services	242	186
Software	917	755
Hardware and other	370	297