

MERGE TECHNOLOGIES INC
Form 10-K
March 07, 2005

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D. C. 20549

FORM 10-K

ý **ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2004

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 0-29486**

MERGE TECHNOLOGIES INCORPORATED

(Exact name of Registrant as specified in its charter)

Wisconsin
(State or other jurisdiction of
incorporation or organization)

39-1600938
(IRS Employer Identification Number)

1126 South 70th Street, Milwaukee, Wisconsin 53214-3151

(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code **(414) 977-4000**

Securities registered under Section 12(b) of the Exchange Act:

Title of class

Name of exchange on which registered

Common Stock

Nasdaq National Market

Securities registered under Section 12(g) of the Exchange Act: **NONE**

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 ý No o

Indicate by check mark if disclosure of delinquent filers in pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ý

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Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

The aggregate value for the registrant's voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2004, based upon the closing sale price of the Common Stock on June 30, 2004, as reported on the Nasdaq National Market, was approximately \$170,414,000. Shares of Common Stock held by each officer and director and by each person who owns five percent or more of the outstanding Common Stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares outstanding of each of the issuer's classes of common equity, as of February 28, 2005: 13,219,627

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III is incorporated by reference from the Registrant's Proxy Statement for the 2005 Annual Meeting of Stockholders.

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PART I

Item 1. BUSINESS

Overview

Merge Technologies Incorporated, a Wisconsin corporation doing business as Merge eFilm, and its subsidiaries or affiliates ("Merge eFilm," "we," "us," or "our"), is a global healthcare software and services company focused on accelerating the productivity of imaging centers, hospitals and clinics. Our products fall into three distinct categories: diagnostic imaging workflow software applications, connectivity and component solutions and professional services. Our diagnostic imaging workflow applications are commonly categorized as Picture Archiving and Communication Systems ("PACS") and Radiology Information Systems ("RIS"), distributed through direct sales and Original Equipment Manufacturer ("OEM") / value added reseller ("VAR") channels throughout the world. We believe the combination of PACS and RIS define the breadth and depth of integrated diagnostic imaging workflow, with the added value of enterprise image and information access. This broader definition is our focus and the manner in which our solutions are positioned to our target market.

Our products fuse business and clinical workflow by intelligently managing and distributing diagnostic images and information throughout the healthcare enterprise. By utilizing our products, our customers enhance the quality of healthcare provided to patients because they improve radiology workflow efficiencies, improving clinical decision making processes. In addition, our products reduce the film, paper and labor costs involved in managing and distributing medical images and information, thereby contributing to the profitability of our customers' businesses. We deliver this tangible value to facilities of all sizes, but we specifically target imaging centers, small to medium size hospitals, and specialty clinics, as well as OEM/VARs that serve these markets.

We were founded in 1987 and built a reputation as a global company that enabled the transformation of legacy radiology (film-based) images into modern (filmless) digitized images for distribution and diagnostic interpretation. We acquired eFilm Medical, Inc. ("eFilm") in June 2002 and began doing business under the name of Merge eFilm in order to leverage eFilm's international name recognition for diagnostic medical image workstation software, with thousands of users worldwide. eFilm was founded in 2000 by Toronto's University Health Network and Mount Sinai Hospitals to develop a clinical electronic image management system.

In July 2003, we acquired 100% of the outstanding shares of RIS Logic, Inc. ("RIS Logic"), a RIS company that designed software to manage business and clinical workflow for imaging centers. RIS Logic was founded in 1997 by a neuroradiologist to develop and market a RIS focused on improving business and clinical workflow for diagnostic outpatient imaging centers. RIS Logic provides RIS software and professional services for imaging centers that streamline operations and accelerate productivity. These software solutions, combined with professional services and training, automate the entire radiology practice workflow to decrease report turnaround time, improve cash flow, enhance patient care and improve the operational efficiency of imaging services.

The RIS system provides efficient management of single or multi-site imaging service operations, from scheduling and exam tracking to clinical information archival, integrated billing, automated dictation/transcription, mammography tracking and reporting, and radiologist reporting and distribution. This is accomplished using industry standard protocols that provide for connectivity, integration and communication of patient data throughout the single or multi-site imaging service operation. The integration of the RIS and PACS functionality provides complete business and clinical operational workflow for the imaging center, specialty clinic and hospital markets.

During our recent period of business growth and strategic development, we have consistently maintained a commitment to industry standards designed to benefit both healthcare providers and

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technology vendors. We have been a 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 Health Level Seven, Inc. ("HL7"), and the Integrated Healthcare Enterprise ("IHE") framework that has been created through an initiative cosponsored by the Radiological Society of North America ("RSNA") and the Healthcare Information and Management Systems Society ("HIMSS"). The IHE initiative represents a consortium of companies in the Radiology and Healthcare Information Systems ("HIS") 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. We have incorporated these standards in our radiology workflow technologies, software applications and OEM connectivity components, establishing the basis for seamless integration of images and healthcare information across an organization's computing infrastructure.

Hospital radiology departments, diagnostic imaging centers, specialty clinics and their patients benefit from our workflow solutions in a variety of ways including:

Accelerated productivity gained by utilizing a single integrated software solution for all mission critical business and clinical workflow tools designed to automate operations, including digital dictation, billing, registration and scheduling, productivity analysis, image and report management and storage and distribution.

Increased accuracy through real time patient demographics matching across all business and clinical workflow tools.

More accountability and convenience in working with one vendor that develops, installs and supports the entire spectrum of radiology workflow tools and integration services.

The creation of permanent electronic archives of diagnostic quality images that enable the retrieval of prior and current images and reports.

Modular, flexible and cost effective systems that grow in conjunction with the growth of the imaging center, hospital or clinic.

Networking of multiple image producing and image using devices to eliminate redundancies and reduce the need for capital equipment expenditures.

Our OEM/VAR partners utilize our connectivity, workflow and professional services, benefiting from them in a number of ways including:

Using our solutions to enhance the workflow of their solutions, expanding the depth and breadth of the digital solutions and product lines they offer their particular target market.

Speeding the time to market in the development of new solutions.

Transitioning their product portfolios from film and paper based products to digital solutions.

Leveraging our technical and deployment skills, allowing our OEM/VARs to focus on their core product competencies.

In addition, our VAR partners market our workflow solutions in International markets, where language and local representation are key to building long term relationships with customers and generating revenues.

Business Strategy

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We continue to build on our leadership position as a full solution RIS/PACS solution provider through our expertise in radiology workflow integration, our technically innovative products, our

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modular software solutions and our continued focus on accelerating healthcare's productivity. This fully integrated, standards based radiology workflow solution enables radiology to integrate more efficiently with the rest of the healthcare enterprise. To continue achieving this goal, we are exercising the financial and operational discipline necessary to attain the right combination of financial and human capital resources, products and strategic partnerships. These efforts will accelerate our ability to deploy and service a fully integrated radiology workflow solution directly to the healthcare market and indirectly through our OEM/VARS.

During 2004, we focused on completing our next generation integrated RIS/PACS, World Wide Web ("web") distribution solution, strengthening our financial foundation, enhancing our sales and distribution channels, and leveraging the global brand associated with the Merge eFilm product brands. We also made steady progress in the market's recognition of Merge eFilm as a comprehensive radiology workflow solution provider. In line with this tightly focused operational plan, we:

Launched our next generation integrated RIS/PACS solution.

Expanded our healthcare RIS, PACS and RIS/PACS customer base to approximately 200 organizations.

Through a strategic partnership with SourceOne Healthcare Technologies, Inc. ("SourceOne"), expanded the sales coverage for our RIS/PACS solutions by increasing the number of RIS/PACS sales professionals in North American representing Merge eFilm solutions.

Formed several new international VAR partnerships to expand our distribution and service capabilities.

Initiated a Customer Advisory Panel ("CA Panel"), and conducted our first National Users Group Meeting.

Earned two quality system International Standards Organization ("ISO") certificates by Underwriters Laboratories.

Released eFilm Workstation 2.0, enhancing the clinical capabilities of the world's most widely used diagnostic medical imaging desktop software.

Released a new product, FUSION eFilm , designed to provide enhanced visualization and clinical capabilities in our PACS that speed the process of study interpretation and assist radiologists in their clinical work.

Launched an enhanced version of FUSION PACS , which enhances the web based delivery of images and reports, bringing a new level of information delivery and convenience to our customers' referring physicians.

Launched an Academic Licensing Program to support the instruction of radiology by qualified university and college faculty, acquisition of softcopy reading skills by students in radiology and radiology technology programs, and the implementation of radiology research.

Expanded our penetration into large corporate imaging center companies, including regional and national imaging center chains such as InSight Health Corp. ("InSight Health"), Center for Diagnostic Imaging ("CDI") and Regional Diagnostic Imaging, Inc. ("Regional Diagnostic"), and winning an important new RIS/PACS software and service contract with Radiologix, Inc. ("Radiologix").

Established a stock repurchase program, building shareholder value, while ensuring sufficient resources to enable us to continue investing in our growth strategies.

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Joined the Russell 2000® Small Cap Index when the broad market index was reconstituted June 25, 2004 by Russell Investment Group, increasing our profile and recognition as a growing profitable company.

Were notified that options on Merge eFilm stock commenced trading, providing our shareholders with an additional tool for investing in our stock and enhancing their investment liquidity.

The disciplined management of our resources, strong financial foundation and comprehensive product offering with our RIS/PACS product line has created momentum that we believe will increase throughout 2005, enhancing our diagnostic imaging offerings, entering new clinical markets and creating product offerings beyond radiology. We anticipate future growth will be driven primarily by a continued concentration on the following core aspects of our business:

Direct sales initiatives, including targeted sales/marketing activities with broader geographic coverage, expanded presence in other healthcare vertical markets.

Enhanced product offerings that change the definition of RIS/PACS with clinical applications beyond radiology integrated within FUSION PACS and RIS/PACS.

Expanded our international OEM/VAR focus.

Continued growth and development of our professional services in alignment with our market growth.

Expanded strategic partnerships and initiatives that complement our internal efforts.

Essential to our business strategy are partnerships that contribute to our product innovation efforts or expand the distribution of our products and professional services. In 2004, we initiated a strategic agreement with SourceOne, the nation's leading distributor of medical imaging systems, equipment, radiographic consumable supplies, and services to healthcare facilities. With this new distribution agreement, SourceOne markets and distributes Merge eFilm's entire suite of RIS and PACS solutions throughout the United States of America. This new relationship unites the leader in RIS/PACS healthcare software solutions with the leader in medical imaging distribution, sales and services to the healthcare industry, increasing the number of RIS/PACS sales professionals in the field representing Merge eFilm solutions. The Merge eFilm and SourceOne direct sales and RIS/PACS specialist teams work with healthcare customers to understand their workflow and design digital image and information solutions specific to their needs. Merge eFilm and SourceOne's combined sales, service and technical specialists provide comprehensive market coverage to ensure the United States of America healthcare market has access to the suite of digital and information imaging solutions offered by the two companies, providing the market with a single source for all products and services necessary to achieve filmless and paperless radiology workflow.

During 2004, we successfully expanded key International VAR relationships with existing customers to include a broader offering of our FUSION radiology workflow products, well beyond our traditional connectivity and development toolkits. We have grown our International VAR partnership program, expanding our strong presence in the United Kingdom, and implementing FUSION systems in five new European countries in 2004. In 2005, we will leverage the new installations as reference sites, increasing sales momentum and market presence in these countries. We increased our marketing support of our International VARs, leveraging eFilm Workstation global market penetration to the VARs with the eFilm Workstation purchasers in the United Kingdom and the five new European countries. In Asia, our partnership with Infocom Corporation ("Infocom") of Japan has provided distribution and support services for eFilm in the Japanese market, gaining more than 350 new users of eFilm Workstation in the Japanese language. This relationship builds on over ten years of working with Infocom and expands the reach of the most widely used diagnostic software desktop product in

the world our eFilm Workstation . In 2005, we will continue to expand into other Asian countries as their need for digital radiology solutions grow.

With our OEM customers, we are able to leverage our integration expertise to provide additional opportunities and resources that will help expand our OEM customers' businesses. In 2004, we strengthened our relationship with our largest OEM customer, creating customized software that enhances the workflow of their PACS offering. We provided workflow software and our enhanced imaging toolkits not only to major radiology vendors, but also to new vendors who create solutions in other specialty markets to speed their development as they realize the importance of imaging in practices beyond radiology. In 2004, we also strengthened our focus on creating solutions for our OEM partners, partnering with them in the upstream development of imaging technologies, working as partners and jointly gaining insight into the trends and directions of future development of medical imaging.

We believe our global presence and immersion into the creation of radiology communications and open medical standards place us in a strong position to monitor healthcare and technological forces that impact both medical equipment and software application innovations for the medical imaging industry. In addition, our established OEM/VAR relationships allow us to work with leading modality manufacturers as they develop plans for new product introductions. The product planning cycle is such that we can build on this knowledge and be prepared to meet market demand at the appropriate time. This strategy allows us to partner with leading OEM companies in the design and development of new medical imaging software applications both within and outside of radiology, then incorporate those innovative medical imaging software modules within our integrated RIS/PACS solutions for sale on a direct basis to our end user customers. This unique model of both OEM and direct sale RIS/PACS solution development accelerates our ability to innovate our products ahead of the needs of our current and future target markets. This model gives us the product innovation speed to continue changing the definition of the RIS/PACS solutions available to our market, in addition to innovating more rapidly than the competition.

Products and Services

Focusing product innovation around the functions related to image and information management is a hallmark of our product development strategy. We view our expertise as developing software that manages the people, process, images and information workflow in such a way as to increase productivity and reduce costs for our customers. Products in place and those in development are applied to all aspects of the complex continuum of business (billing, scheduling, modality management, practice analysis), image and information management (integrating results of CT, MRI, X-ray, etc., and the associated patient information related to them), and interpretation and reporting (medical image visualization, analysis and management of medical imaging data, enhancing physicians' interpretation and reporting of data from medical imaging modalities, such as computer tomography and magnetic resonance imaging). We believe that the Merge eFilm solution is differentiated by the integration of all of these elements to create a broad data set around a single patient experience. The results are increased efficiency and productivity, more time devoted to accurate analysis and diagnosis, improved patient care because the waiting time from diagnosis to treatment is reduced and all pertinent information is quickly and accurately provided to the primary care giver from radiology in a single electronic report which can be accessed wherever the physician is located. This integrated solution with enterprise wide accessibility to images and information reinforces our strategy of delivering end to end clinical and business workflow solutions that accelerate our customers' productivity.

Our product offerings fall into three distinct categories: diagnostic imaging workflow software applications; connectivity and component products; and professional services. In the end user market, the radiology workflow software applications and the associated professional services are our market-leading offering. In the OEM/VAR market, our product mix of component software applications,

connectivity products, toolkits and professional services continues to strengthen and expand our long-term OEM/VAR relationships. We will continue our product innovation in this area in order to provide flexible, state of the art solutions to our OEM/VAR partners who incorporate these products directly into their RIS or PACS solutions and/or new modality equipment offerings. While the OEM/VAR relationships are central to the distribution of these products, interest continues from healthcare organizations to purchase connectivity products directly from us to complete their individual image management strategies.

Our RIS/PACS product mix strengthened in 2004 as we fortified our product line by adding an integrated single desktop RIS/PACS solution to our FUSION RIS and PACS product suite. The software modules within FUSION are designed to complete our fully integrated radiology workflow system product line and are sold as individual modules or as a fully integrated solution, depending on the needs of the customer. These software modules consist of the following:

FUSION RIS

We have developed a comprehensive, Health Insurance Portability and Accountability Act of 1996 ("HIPAA") supportive RIS product designed with input from clients to replicate radiology workflow "best practices" within multiple or single site imaging centers or small hospitals.

FUSION RIS allows clients to realize improvements in productivity by integrating information and automating traditional manual or paper methods related to scheduling, patient registration and tracking, dictation, report turnaround, billing, claims processing, practice analysis and other mission critical operational functions. This automation reduces administrative workload, while increasing patient, referring physician and employee satisfaction. Additionally, the practice can uncover ways to reduce bottlenecks, maximize profits and increase revenue through practice analysis tools. FUSION RIS utilizes Microsoft®-based, open systems client/server architecture and industry standard integration protocols that enable other external systems to connect and share information throughout the workflow. FUSION RIS is the foundation for the following integrated software application add on modules:

FUSION Embedded Document Management. The optional document management module's functionality is fully embedded throughout RIS workflow to scan, view, import, export, edit, modify and store documents and images directly in the RIS. Document management reduces paper and the chance of losing documents, and ensures all patient related information is stored electronically within the patient record.

FUSION Mammography Tracking. The optional mammography module supports reporting compliance, categorizing and tracking rules, and provides automatic generation of patient "lay" letters to report results and appointment reminder letter management. Mammography workflow is integrated within FUSION RIS and managed and tracked, including patient history, procedure history, mammography findings and biopsy information.

FUSION Embedded Digital Dictation. The optional embedded Dictaphone® digital dictation module provides seamless dictation and playback throughout RIS workflow. The resulting benefits include the elimination of an interface between RIS and dictation systems, faster report turnaround and increased accuracy of patient information.

FUSION Integrated Billing. FUSION RIS accelerates the billing and collection cycle by generating charges immediately after exam completion, and reduces errors by utilizing information from the patient profile. Claims are more accurate which results in faster payments. Once approved, charges are sent via a bi-directional interface or output to file.

FUSION PACS

FUSION PACS is an integrated repository of healthcare information and a suite of software application modules that provide PACS, teleradiology and web distribution on a single, integrated PACS platform. FUSION PACS is the foundation for the following integrated software application modules:

FUSION Base Module. Provides database management, security services, performance monitoring, scalability and load balancing.

FUSION Archive Module. Provides image and information storage management and archiving through a variety of storage devices such as RAID, NAS, SAN, tape, DVD and CD.

FUSION Image Visualization and Distribution Module. Distributes images on demand through wavelet streaming technology, and provides desktop medical image visualization tools with unlimited access via network or the web.

FUSION HIS/RIS Interface Module. Provides an HL7 message interface between FUSION PACS and any other vendor's RIS. This interface drives the workflow for technologists and radiologists by integrating the patient's prior radiology reports, and demographic and scheduled procedure information with their medical images. This alleviates redundant data entry and assures information accuracy.

FUSION Radiologist Workspace Module. Provides an integrated, work list driven workspace for the radiologist including their customized "to do" list and diagnostic image viewing and reading tools.

FUSION Order Entry & Patient Registration Module. Provides customers without a RIS basic automated entry of new patient information and scheduling procedures. This information drives the work list activities for radiologists and technicians. Additionally, this module, in combination with our image visualization, can be used by referring physicians to request patient information, view images and report results.

FUSION RIS/PACS

FUSION RIS/PACS is a fusion of information workflow from FUSION RIS, and the image visualization and efficient server, archive and web distribution functionality of FUSION PACS into a unified, single desktop solution that helps our customers accelerate their productivity by integrating business and clinical workflow and allowing images and information to be distributed fast and efficiently.

FUSION RIS/PACS stretches far beyond traditional systems that depend on patched together interfaces or "joint vendor partnerships." The true value of this solution lies in the native integration that facilitates interoperability between the RIS and PACS allowing the user to experience a single, unified desktop to access and utilize RIS, PACS, dictation, document management, billing and practice analysis workflow, while removing the complexities associated with multiple, separate system and interface deployments. We offer greater accountability, convenience and value because we develop, install, integrate and support the entire spectrum of radiology workflow tools backed by 18 years experience in radiology connectivity and thousands of customers worldwide.

FUSION RIS/PACS is a comprehensive, easy to use solution designed with input from customers to replicate radiology workflow "best practices." It allows clients to realize substantial improvements in productivity, profitability and patient care by integrating images, information and voice data, and automating and streamlining traditional manual, paper and film processes related to scheduling, registration, interpretation, report turnaround, image distribution and storage, billing, claims processing, and other critical workflows.

eFilm Workstation

eFilm Workstation is a desktop diagnostic, image and analysis tool for viewing and interpreting medical images. eFilm Workstation is sold as stand alone software that allows radiologists to view and manipulate any digital diagnostic study, and is integrated into FUSION RIS/PACS and FUSION PACS as its diagnostic workstation. eFilm Workstation, sold via eCommerce from our web site and through VAR distributors, is the most widely used diagnostic workstation in the world.

FUSION eFilm

Used as the visualization program with FUSION PACS, FUSION eFilm leverages the visualization tools of eFilm Workstation, but adds functionality such as hanging protocols and key images, reducing the time that is required to interpret diagnostic studies by providing a reading configuration the radiologist prefers.

Professional Services

Professional services are provided by our consultants, service engineers and project managers and consist of training, advisory services, solution design consulting, solution installation, project management, ongoing help desk and on-site service and medical standards validation to healthcare organizations, healthcare professionals and medical equipment manufacturers. Proprietary training materials are used to complement project planning, management tools and diagnostic testing products. Annual customer service packages are offered to meet the unique needs and configuration requirements of each client. These service packages are priced according to service intensity required and are reviewed annually to assure all customer needs are met. We offer this suite of professional services on a global basis, with twenty-four hours per day, seven days per week ("24/7") coverage through a combination of remote and onsite delivery. Growing revenues from the sale of professional services continues to be an important focal point for the company. In addition to professional services personnel, we utilize a proprietary on line technology designed to proactively monitor the status of deployed FUSION solutions. ViewCheck proactively monitors key elements of the FUSION modules, captures statistics and routes alarms to our professional services staff for prompt attention. This service is core to our ability to provide a level of support and 24/7 coverage to our full FUSION solution customers as they rely on our products and services to run their operations.

Markets and Customers

Healthcare providers continue to be challenged by declining reimbursements, competition and reduced operating profits brought about by the double-digit increases in healthcare expenditures. Our end user customers focus on strong business management of their healthcare delivery organizations. Key areas of emphasis are high quality diagnostic and treatment protocols for the care of the patients in their communities and operational efficiencies to increase patient satisfaction, address patient safety concerns and mitigate rising costs. The expenditures to re-tool the infrastructure of healthcare are significant and are directed at making more comprehensive use of the advances in medical technologies and automated workflow solutions. This is seen as a cost effective means to reach optimum efficiency and market their services to the broadest population. Radiology image and information management (RIS and PACS solutions), as well as many of the technologies offered by our OEM/VAR partners, plays a central role in the revamping of the healthcare delivery system.

RIS is a specialized system that supports radiology charge capture and billing, storage of patient data, scheduling and reporting.

PACS is an image storage, retrieval, and viewing system for X-ray, CT, MRI, nuclear medicine and ultrasound. Users are linked with display workstations over a high-speed network to an image server, archives and printers. Customers use the PACS to store, view, manage, and distribute images and reports.

The combined RIS/PACS supports complete operational management of a single or multi site-imaging center. For hospitals, when integrated with their HIS, the RIS/PACS provides all the information and images necessary for complete digital workflow, both clinical and operational. This integrated combination is the comprehensive solution that we provide to our customers' imaging centers and hospitals.

Our RIS and PACS customer base grew to approximately 200 organizations in 2004.

A CA Panel was formed, comprised of radiologists, chief information officers, and radiology and business managers. The purpose of the CA Panel is to provide direct feedback to our organization with respect to products and services, market trends and to gauge customer feedback on strategies being considered. This group has provided feedback to the company in 2004, including clinical guidance in the development of FUSION eFilm, and we anticipate increased activity in 2005. In addition to the formation of the CA Panel, we conducted our first National Users Group Meeting, which drew over 100 radiologists, administrators, chief information officers and center administrations, who spent two and a half days learning how to optimize their systems, and providing feedback for our future development. In 2005, we will continue to strengthen our customer relationships that serve as a foundation of our business.

Employees

We employ approximately 200 individuals who embody our reputation as recognized leaders in the design and engineering of diagnostic imaging workflow software solutions. We have assembled a staff with deep expertise, global presence and a thorough understanding of diagnostic imaging workflow processes, blended with the interpersonal skills necessary to guide our end user customers through the change of going from a film to filmless environment, and partnering with our OEM/VAR customers as they integrate our solutions into theirs. We also have grown our expertise in the design and development of IHE concepts, which are gaining acceptance as the standard for interoperability between imaging and healthcare information systems throughout the healthcare enterprise. These standards, and our staff's knowledge, expertise and contributions toward their development, enable us to design future solutions beyond radiology into other specialties such as cardiology, gastroenterology, pulmonology and orthopedics. We surround our technical and clinical teams with a talented group of individuals that support our business operations, allowing us to effectively market and sell our solutions, support our customers and manage our business.

In 2004, our Human Resources and Organizational Development team executed numerous initiatives to enhance the work experiences and benefits that employees identified as being most important to them. With recognition that our employees are our most important assets, we will continue to invest in ensuring our continued reputation as a highly desirable employer within our industry.

The Merge eFilm Market

Within the United States of America, we are focusing our direct sales efforts on single and multi-site imaging centers with more than 10,000 studies per year, small to medium sized hospitals (less than 400 beds), and specialty clinics such as orthopedics, cardiology, pulmonology, and gastroenterology practices that utilize diagnostic imaging as part of their service offering. Less than 30% of those markets are currently using a PACS to achieve a filmless workflow environment and an even smaller percentage has a fully integrated RIS/PACS delivering filmless and paperless workflow.

This market represents a segment of healthcare providers that desires diagnostic imaging workflow, particularly as it relates to communicating throughout the healthcare enterprise and over long distances. This market has historically been underserved by image management and radiology system companies due to the high cost of hardware-centric and proprietary RIS and PACS solutions. To capitalize on this underserved market, our focus is on providing flexible radiology workflow solutions

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with modular software, with a phased-in approach that allows for meeting short term needs quickly and offering additional products to complete the filmless radiology workflow solution over time. In addition, our solutions are scalable as our customers' business expands, protecting the initial investment they make in our software. Approximately 75% of our existing customers are part of the imaging center, small to medium sized hospital or specialty clinic market segment. While our RIS and PACS solutions are used by several large healthcare facilities demonstrating the scalability of the software products, the primary focus for new business development is in the market segment previously described.

The eFilm Workstation market presence and installed base is a primary target for our direct sales activities, with the introduction of FUSION as the next logical step in deploying an integrated filmless workflow solution. In 2004, we accelerated the distribution of eFilm Workstation as both a revenue annuity product offering and a marketing tool to further expand our presence. Leads and revenues generated by this strategy will continue to be a core component of our marketing, new lead generating and direct sales activities in 2005.

Our OEM/VAR efforts are focused on two target markets: producers of radiology software, modality and other diagnostic imaging products, and VARs that service the end user market for connectivity components worldwide and FUSION software outside of North America. In 2004, we expanded the number of OEM/VAR relationships, including those in alternative vertical markets where digital diagnostic imaging is just recently introduced, such as veterinary medicine. We continue to use a dual product innovation and distribution model whereby we create products in partnership with our OEMs and leverage those innovations in the rapid development of enhanced RIS/PACS offerings for our end user customers. This accelerated product innovation cycle helps to ensure our full RIS/PACS end user solutions are enabled with leading edge OEM medical imaging software innovations. We further benefit from this model by distributing medical imaging software components through both channels, enhancing the return on our engineering investments.

We place a strong emphasis on sustaining our reputation for high quality services and well-engineered products. We maintain strict compliance with the tenets of the international quality standards under ISO. In 2004, we received our ISO 13485 and 13488 certification, further demonstrating our ongoing commitment to quality processes that translate into internal efficiencies and quality products for our customers. Ongoing activities related to the ISO standard are a reflection of our commitment to maintaining service and product quality for our customers.

Several independent market studies have been conducted, the results of which supported the significant market opportunity in RIS, PACS and RIS/PACS solutions. A study by Frost & Sullivan in 2002 estimates that by the end of 2008, annual expenditures for electronic image and information management systems, or PACS, will be approximately \$1.1 billion. The Concord Consulting Group released data in 2002, which indicates that, with service and upgrades, the total PACS and teleradiology market will exceed \$2.7 billion annually. Driving these expenditures is the realization that within our target market, approximately 15% to 18% of the diagnostic imaging procedures are processed digitally, with the remaining portion still produced on film. Market studies indicate an acceleration in converting the healthcare diagnostic imaging setting to digital workflow now that modular, integrated and cost effective software solutions running on industry standard computer hardware like those offered by us are now available.

Additional studies indicate that the money being spent by healthcare organizations for these technologies is increasing 18% to 20% annually, with European data suggesting an annual growth rate of 20% to 25%. Our strategy is to provide a full suite of radiology workflow solutions to our target market and our existing client base of thousands of healthcare facilities, and to deliver functionality and value that taps into this combined RIS/PACS \$1.3 billion annual market.

Sales, Marketing and Distribution

We use a multi-channel approach to reach our target customers. In the direct sales market, our strategic partnership with SourceOne, initiated in July 2004, greatly increased our market coverage in North America, increasing the number of opportunities in our direct sales pipeline. In addition, we have added seasoned sales professionals to our sales force, and refined our sales processes and tracking mechanisms to provide real time information to manage our sales efforts. We have focused our International sales team on the countries and OEM/VAR customer profiles that have the greatest opportunity for future growth. Our combined direct and OEM/VAR sales, supported by an expanded technical sales support team, has extensive experience in radiology and diagnostic imaging services and has the ability to work in a consultative manner to design and customize the right solution for each customer afforded by the flexibility of our products. These combined multi-channel strategies have led to our 2004 revenue successes.

Continued visibility in the marketplace is important to our overall marketing strategy. We expanded our marketing activities in 2004 around our fully integrated RIS/PACS solution, positioning us as a full solution provider with strong historical integration expertise. This allowed us to leverage our installed base of RIS and PACS customers, improving their workflow with a fully integrated solution, which yielded immediate productivity savings in their business and clinical operations. We have successfully reached thousands of current and prospective customers through a core strategy of proactive electronic marketing, utilizing the email database provided through eFilm Workstation downloads, that now number approximately 50,000. This form of creating market awareness, generating leads and following up on our historical customer base is expected to continue in 2005. In addition, we regularly participate in major radiology and healthcare information system industry trade shows. The largest trade show, the RSNA 2004, which was held in Chicago, Illinois, was a highly visible launch for our integrated product offerings and demonstrating our value proposition for end user customers and VAR partners. Finally, our ongoing participation in the IHE initiative and radiology industry panels regarding open communications and medical standards, including our Director of Medical Standards serving as the co-chair of the International DICOM committee, is an added opportunity to maintain our thought leader position, which is recognized by the healthcare industry and enables us to demonstrate our value on many levels.

The value proposition to our customers is aimed at accelerating their productivity, improving efficiency and quality of patient care while reducing their costs. We emphasize how the implementation of various diagnostic imaging workflow strategies reduces operational costs. Cost savings are attributed to a reduction of the cycle of time involved in acquiring, interpreting and distributing diagnostic studies. This time efficiency improves patient care through increasing the speed with which the radiologist and primary caregiver can discuss diagnostic findings and institute appropriate treatment. Additionally, our systems can enhance revenue due to increased referral activity from primary care physicians and increased accuracy of diagnostic imaging billing and coding.

Competition

The markets for our products are highly competitive. Many customers purchase products from us and from our competitors as well, and rely upon Merge eFilm for their integration. Competition is present from new competitors entering the market as well as current OEM partners who can offer RIS and PACS products similar to our solutions. Analyzing the competitive environment by product line is illustrative of our perspective and our strategies to mitigate the impact of competition on our sales or market penetration.

In the developing area of RIS and PACS workflow applications, there are many newly emerging competitors who offer portions of the integrated radiology solution through their RIS and PACS to the market targeted by us. Additionally, certain competitors are integrating RIS and PACS technologies through development, partnership and acquisition activities.

Our historical connectivity solutions product line continues to be a niche market leader, and they continue to reinforce our legacy reputation for integration expertise. The primary products are either retrofit products (e.g. Merge Boxes), which enable a legacy diagnostic imaging device to digitize their images and deliver them over a network, or OEM toolkits that enable users to hasten the development of DICOM-based software. The competitive danger to our Merge Box product today is that it is readily available and largely incorporated into most new imaging modalities purchased by our customers. We view our value added services, global operations, recognized brand and engineering strength as the way to protect our market share in this area. In addition, we have adopted an approach to engineering these products into the OEMs medical device through cross platform standard-based software that features a proprietary Application Program Interface that protects our intellectual capital. Upgrades to our products are continuous as changes are made by the radiology industry in the DICOM and HL7 standards. Our customers can receive full benefit of these upgrades through annual service contracts.

We rely on our 18 years experience in working in all aspects of the diagnostic imaging industry, our growing RIS/PACS customer base and the accelerated productivity that they have experienced, and our strong customer relations as barriers to losing our market potential for our fully integrated solution. We also rely on our global brand and historical installation base as the market leader in connectivity products (Merge Boxes) and desktop software image viewing applications, eFilm Workstation . Our installed base and our reputation for clinical and technical quality are key differentiators from the competition. In addition, the FUSION, RIS, PACS and RIS/PACS software modular approach to implementing a customized, fully integrated solution is appealing to our target market and is the foundation of our approach to this emerging area.

Many of the current and potential competitors have greater resources than us, including greater financial wherewithal, research and development, intellectual property and marketing. Many of these competitors may also have broader product lines and longer standing relationships with customers. Our ability to compete successfully depends on a number of factors both within and outside our control, including: product innovation; product quality and performance; price; experienced sales, marketing and service professionals; rapid development of new products and features; continued active involvement in the development of DICOM and other medical communication standards; and product and policy decisions announced by competitors. There can be no assurance that we will be able to compete successfully.

Intellectual Property Rights

We have received and maintain United States Patent No. 5,740,428 dated April 14, 1998, United States Patent No. 5,950,207 dated September 7, 1999 and Australia Patent No. 704804 dated August 12, 1999. However, we do not rely solely on patent protection with respect to our products. Instead, we rely on a combination of copyright and trade secret laws, employee and third party confidentiality agreements and other measures to protect intellectual property rights pertaining to our systems and technology.

Medical, Regulatory and Government Standards and Reforms

The healthcare industry is subject to changing political, economic and regulatory influences that may affect the procurement practices and operation of the entire healthcare industry. Proposals to reform the United States of America healthcare system have been, and will continue to be, considered by the United States of America Congress. We embrace the general philosophy that we will accept and utilize all appropriate industry standards in the development of our product and service offerings. We have positioned ourselves to assist our customers in the utilization, implementation, and adherence to most major radiology standards and regulations. We, however, cannot predict with any certainty what impact, if any, new proposals, healthcare reforms or standards might have on the business, our financial condition and our results of operations.

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The following are examples of some of the environmental issues, standards and regulations that we monitor and prepare ourselves to address to protect our enterprise and that of our customers:

HIPAA has mandated the use of standard transactions and identifiers, prescribed security measures and other provisions designed to simplify and secure the exchange of medical information. The compliance dates for initial phases of the requirements phase into effect began on April 14, 2003 and continue through 2005. We are taking the necessary measures to assist our customers to meet HIPAA compliance.

The United States of America Food and Drug Administration ("FDA"), which is responsible for assuring the safety and effectiveness of medical devices under the Federal Food, Drug and Cosmetic Act, has regulatory jurisdiction over computer software applications when they are labeled or intended to be used in the diagnosis of disease or other conditions.

International sales of products outside of the United States of America are subject to foreign regulatory requirements that can vary from country to country.

Laws and regulations may be adopted to address Internet commerce such as online content, user privacy, pricing and characteristics and quality of applications and services.

The tax treatment of the Internet and eCommerce is currently unsettled.

We continue to allocate internal resources to industry standards committees and working groups who are tasked with setting and promoting both technology and functionality standards within the diagnostic imaging and healthcare information systems markets. Participating in IHE and a variety of DICOM working groups specializing in HIPAA, HL7 and other standards helps to ensure that our products and services align with the efforts of these committees and meet the evolving interoperability needs of healthcare technologies.

Item 2. PROPERTIES

Our principal facilities are located in Milwaukee, Wisconsin, in an approximately 22,000 square foot office leased through April 2011 at a rate of approximately \$300,000 per year. We also lease a sales, administrative and service support office in Nuenen, the Netherlands, a professional services and engineering office in Toronto, Canada, a sales and engineering office in Hudson, Ohio, and a sales office in Tokyo, Japan.

Item 3. LEGAL PROCEEDINGS

On October 24, 2003, ScheduleQuest, Inc. filed a patent infringement lawsuit (Civil Action No. 03-5900) against us in the United States of America District Court for the Eastern District of Pennsylvania alleging that our "RIS Logic CS Scheduling System" product, which we acquired in connection with our RIS Logic acquisition, infringes upon their United States Patent No. 6,389,454 for their "Multi-Facility Appointment Scheduling System" product. We cannot currently predict the outcome of the litigation or the amount of any potential loss if our defense is unsuccessful. Our merger agreement with RIS Logic contains a representation that the RIS Logic technology does not infringe others' proprietary rights and 173,093 shares of our Common Stock conveyed to the former RIS Logic owners are in an escrow holdback to cover any claims of breach of representation or warranty. We believe that all the claims in the lawsuit are without merit and we intend to vigorously defend against such claims. However, we cannot provide any assurances as to the outcome of this litigation or whether the escrow holdback will be adequate to satisfy any costs, expenses or losses that we may incur in connection with such litigation.

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

None.

PART II

Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

(a) Our Common Stock commenced trading on the Nasdaq SmallCap Market on January 29, 1998, under the symbol MRGE. On June 3, 2003, our Common Stock commenced trading on the Nasdaq National Market.

The following table sets forth for the periods indicated, the high and low closing sale prices of our Common Stock as reported by Nasdaq:

Common Stock Market Prices

2004	4 th Quarter	3 rd Quarter	2 nd Quarter	1 st Quarter
High	\$ 23.14	\$ 17.74	\$ 17.92	\$ 19.93
Low	\$ 16.53	\$ 12.95	\$ 14.30	\$ 12.85
2003				
High	\$ 19.90	\$ 20.21	\$ 13.62	\$ 8.84
Low	\$ 16.05	\$ 12.38	\$ 6.00	\$ 6.00

According to the transfer agent's records, we have 236 stockholders of record of Common Stock as of February 28, 2005. As of the same date, we estimate that there are in excess of 4,500 beneficial holders of our Common Stock.

Dividend Policy

We have not paid any cash dividends on our Common Stock since formation. We currently do not intend to declare or pay any cash dividends on our Common Stock in the foreseeable future.

Securities Authorized for Issuance under Equity Compensation Plans

The following table sets forth information as of December 31, 2004, with respect to shares of our Common Stock that may be issued under an existing equity compensation plan adopted by our Board of Directors for the acquisition of RIS Logic. The table does not include employee benefit plans intended to meet the qualification requirements of Section 401(a) of the Internal Revenue Code. All equity compensation plans are described more fully in Note 8 to our consolidated financial statements.

Plan Category	Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights (a)	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights (b)	Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans Excluding Securities Reflected in Column(a) (c)
Equity compensation plans Approved by security holders			
Equity compensation plans not Approved by security holders	132,735	\$ 14.73	
Total	132,735	\$ 14.73	

Recent Sales of Unregistered Securities During Fourth Quarter 2004

During the fourth quarter of 2004, we sold no shares of our Common Stock in transactions not registered under the Securities Act of 1933, as amended (the "Securities Act").

(b) Not applicable.

(c) On August 24, 2004, we announced a stock repurchase plan providing for the purchase of up to \$10 million of our Common Stock. Purchases may be made over a period of two years and the timing, price and volume of repurchases will be based on market conditions, applicable securities laws and other factors. As of December 31, 2004, we have not made any repurchases under this plan.

Item 6. SELECTED FINANCIAL DATA

Year Ended December 31,

	2004	2003	2002	2001	2000
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(In thousands, except for share and per share data)

Statements of Operations Data:

Net sales	\$ 37,005	\$ 28,677	\$ 20,786	\$ 15,741	\$ 12,613
Operating income (loss)	9,336	7,001	3,644	1,296	(5,505)
Income (loss) before income taxes	9,805	6,899	3,708	1,358	(5,644)
Income tax expense	2,338	660	79	87	63
Net income (loss)	7,467	6,239	3,629	1,271	(5,707)

Earnings (loss) per share:

Basic	\$ 0.57	\$ 0.53	\$ 0.38	\$ 0.17	\$ (1.01)
Diluted	0.54	0.49	0.33	0.15	(1.01)

Weighted average shares outstanding:

Basic	13,013,927	11,566,054	8,840,059	6,178,821	5,792,945
Diluted	13,827,522	12,586,900	10,383,651	7,310,731	5,792,945

Balance Sheet Data:

Working capital	\$ 31,923	\$ 21,723	\$ 7,872	\$ 2,628	\$ 262
Total assets	78,943	63,895	27,246	10,056	9,526
Long-term obligations			167	159	180
Stockholders' equity	63,567	53,523	21,683	6,169	3,753

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

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 and in addition to those listed under *Factors That May Affect Future Results of Operations, Financial Condition or Business*, our 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, short product life cycles, acquisition and development of new technologies, dependence on major customers, expansion of our international sales effort, broad discretion of management and dependence on key personnel, risks associated with product liability and product defects, risks of loss associated with potential infringement of our products or services on the intellectual property rights of others, costs of complying with government regulation, changes in external competitive market factors which might impact trends in our results of operations, unanticipated working capital and other cash

requirements, general changes in the industries in which we compete, and various other competitive factors that may prevent us from competing successfully in the marketplace. Actual results could differ materially from those projected in the forward-looking statements. We undertake 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. Our actual results and the timing of certain events may differ materially from those reflected in the forward-looking statements. The following discussion should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere in this report.

Overview

We are a leading provider of PACS, and RIS software to imaging centers, specialty clinics, small and medium sized hospitals, and of PACS component and connectivity technologies to many OEMs throughout the world. We also are a leader in the development in the industry standard network communications protocol known as DICOM technology, which defines the standard configuration for digital imaging used in the medical and healthcare industry. DICOM is used by virtually all OEMs building modalities for healthcare.

Our products link business and clinical workflow by intelligently managing and distributing diagnostic images and information throughout the healthcare enterprise. By utilizing our products, our customers enhance the quality of healthcare provided to patients because they improve radiology workflow efficiencies and improve the clinical decision making processes. In addition, our products reduce the film, paper and labor costs involved in managing and distributing medical images and information, thereby contributing to the profitability of our customers' businesses. We deliver this tangible value to facilities of all sizes, but we specifically target imaging centers, small to medium size hospitals, and specialty clinics.

Healthcare providers continue to be challenged by declining reimbursements, competition and reduced operating profits brought about by the double-digit increases in healthcare expenditures in the past several years. In the United States of America, we are focusing our direct sales efforts on single and multi-site imaging centers with more than 10,000 studies per year, small to medium sized hospitals (fewer than 400 beds), and certain specialty clinics like orthopedic practices that offer imaging services. The Frost and Sullivan 2002 North American, Latin America and Asian PACS Market Report indicated that less than 30% of those markets are currently using a PACS to achieve a filmless workflow environment and an even smaller percentage has a fully integrated RIS/PACS delivering filmless and paperless workflow.

The markets for our products are highly competitive. Many customers purchase products both from us and from our competitors. Our connectivity solutions product line historically has been the mainstay of our business and pioneered our development. Our competitive challenge is that similar products are readily available and the connectivity products are incorporated into most imaging modalities. In the developing area of RIS and PACS workflow software applications, there are many newly emerging competitors who offer portions of the integrated radiology solution through their RIS and PACS to the market targeted by us. Additionally, certain competitors are integrating RIS and PACS technologies through development, partnership and acquisition activities. We rely on our global brand and historical installation base as the market leader in connectivity products and desktop software image viewing applications (eFilm Workstation). This installed base, along with our reputation for clinical and technical quality and long-term service is a key differentiator from our competitors. In addition, we believe our software modular technique to implementing a customized, fully integrated solution is appealing to our target market and is the foundation of our approach.

We have aggressively expanded our product offering, especially in the past three years, through our acquisitions of eFilm, RIS Logic and AccuImage Diagnostics Corp. ("AccuImage") in January 2005. We

became a full PACS provider in September 2002 through our acquisition of eFilm which provided the visualization platform, which when combined with our existing PACS components, allowed us to release our first integrated PACS system for the small and medium sized hospital and imaging center market. The eFilm Workstation also is core to our strategy ~~to~~own the clinician desktop market. We sell our eFilm Workstation on the Internet, for either a small annual subscription or for an unlimited time-based license fee. This strategy allows those radiologists or clinicians who are reluctant to move to reading images digitally, to do so easily and inexpensively, particularly relative to other similar clinical diagnostic tools on the market.

Our July 2003 acquisition of RIS Logic allowed us to become one of the first providers of integrated RIS/PACS solutions in our target markets. We saw this as a growing need of our target market. The integrated RIS/PACS solution positions us to fundamentally own the technology necessary to run an imaging center by having PACS deliver filmless workflow and a RIS deliver paperless workflow. We see these products as core elements behind our success in achieving our results in the twelve months ended December 31, 2004, and for the foreseeable future.

2004 Accomplishments

During 2004, we focused on five key initiatives: expanding our business development and sales distribution capabilities; improving our OEM international and VAR business; expanding our RIS/PACS product features and market share; implementing strategies to enhance and strengthen the relationship with our customers and the investment options for our shareholders; and forming strategic relationships to expand our products and services in line with emerging medical imaging market trends.

In 2004, we expanded our business development and sales distribution capabilities to broaden our coverage of the North American healthcare market and form long-term relationships with national imaging center chains. We developed a distribution relationship with SourceOne, which increased our market coverage and exposed our RIS/PACS solutions to SourceOne's customers. Our relationship with SourceOne continued to build momentum throughout the second half of 2004 following the signing of our agreement in July, resulting in three new FUSION contracts during the fourth quarter. We are encouraged by the progress of this distribution relationship and the strength of the SourceOne sales pipeline as we move into 2005.

Additionally, our ability to understand the intricacies of business and clinical workflow within our healthcare target market, especially imaging centers, resulted in expanding our relationship with regional and national imaging center chains such as InSight Health, CDI and Regional Diagnostic, and winning an important new RIS/PACS software and service contract with Radiologix. We are pleased that medical imaging corporations of this size and stature continue to choose our RIS/PACS solutions to support their business and clinical operations.

Our European VARs implemented FUSION PACS in five new countries in 2004, providing reference sites for our solutions. We also revitalized relationships with our OEM customers, including the creation of a new software product line customized for a leading OEM in Europe. In partnership with our OEMs, we entered a new vertical market, veterinary medicine, where our software components complete our OEMs broader digital offering to the emerging veterinary medicine market. We expect the OEM/VAR business development progress we made during the second half of 2004 to continue in 2005.

We expanded our market presence in 2004, including 21 new FUSION contracts that were added during the fourth quarter, growing our total number of FUSION solution customers to 195, representing over 400 healthcare facilities. Use of our eFilm Workstation desktop medical imaging software increased substantially during the year, delivering strong software licensing revenues and exposing eFilm Workstation to over 50,000 clinicians and healthcare professionals worldwide. This unique eCommerce marketing and software distribution strategy continues to be a strong source of

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FUSION RIS/PACS sales leads and will serve as a platform for distribution of our new advanced visualization products obtained from the acquisition of AccuImage.

In 2004, we initiated a number of activities to strengthen our relationship with our customers, built long-term and scalable employee development programs and enhanced our shareholders investment options. We held our first annual National Users Group Meeting in October, and formed a CA Panel, creating stronger mutually beneficial relationships with our customers that support the sharing of best practice information and the contribution of ideas to FUSION RIS/PACS functional enhancements. We also continued our steady investments in Human Resources and Organizational Development initiatives to support our growing organization and the very important human intellectual capital that drives its success. In 2004, we joined the Russell 2000® Small Cap Index, established a stock repurchase program, and options on our stock commenced trading, all of which strengthened the financial foundation that supports our growth initiatives and value to our shareholders.

Our strategic and operational initiatives for 2005 will build on our business and financial accomplishments of 2004. In 2005, we intend to develop products and services that enhance the value of our FUSION RIS/PACS foundation beyond radiology, creating clinical applications for use by the increasing number of specialists that utilize diagnostic imaging in their practices. We anticipate accelerating product innovation in partnership with our OEM customers and leveraging those relati