MERGE TECHNOLOGIES INC
Form 10KSB/A
May 07, 2003

FORM-10-KSB-A
Amendment No. 2

United States Securities and Exchange Commission
Washington, D. C. 20549

[ X ] ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2002

[ ] TRANSITION REPORT UNDER 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
Name of small business issuer in its charter

| | |
|---|---|
| Wisconsin | 39-1600938 |
| (State or other jurisdiction of incorporation or organization) | (IRS Employer Identification Number) |

1126 South 70th Street, Milwaukee, Wisconsin 53214-3151
(Address of principal executive offices) (Zip Code)

Issuer's telephone number: (414) 977-4000

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

Title of each class: Common Name of each exchange on which registered:
Nasdaq SmallCap

Securities registered under Section 12(g) of the Exchange Act: (Title of class)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes X No
 ----- -----

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will 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-KSB or any amendment to this Form 10-KSB. [ ]

Issuer's revenues for its most recent fiscal year. $20,786,369

The aggregate market value for the Registrant's stock held by non-affiliates of the Registrant based upon the closing sale price of the common stock on March 28, 2003, as reported on the Nasdaq SmallCap Market, was approximately $46,960,843. 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 March 28, 2003: 9,634,466

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III is incorporated by reference from the Registrant's Proxy statement for the 2003 Annual Meeting of Stockholders.

Transitional Small Business Disclosure Format (check one): Yes _____ No X

## EXPLANATORY NOTE

This Amendment No. 2 to Form 10-KSB amends Item 7 and Item 13 of the Annual Report on Form 10-KSB, as amended, for the fiscal year ended December 31, 2002. The purpose of this amendment is to include additional disclosure for sales of its products and services in Note 8, Concentrations of the Notes to Consolidated Financials Statements and to include an updated consent from KPMG. No other changes have been made to Item 7 or Item 13 as originally filed on March 31, 2003.

## Item 7. FINANCIAL STATEMENTS

### INDEPENDENT AUDITORS' REPORT

The Board of Directors and Shareholders
Merge Technologies Incorporated:

We have audited the accompanying consolidated balance sheets of Merge Technologies Incorporated and subsidiaries as of December 31, 2002 and 2001, and the related consolidated statements of operations, shareholders' equity, cash flows, and comprehensive income (loss) for each of the years in the three-year period ended December 31, 2002. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Merge Technologies Incorporated and subsidiaries as of December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, the Company adopted the provisions of Statement of Financial Accounting Standards Board No. 142, Goodwill and Other Intangible Assets, on January 1, 2002.

/s/ KPMG LLP

Chicago, Illinois
March 28, 2003

MERGE TECHNOLOGIES INCORPORATED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

ASSETS

| | Years Ended December 31, 2002 | 2001 |
|---|---|---|
| Current assets: | | |
| Cash | $ 4,410,939 | $ 1,042,893 |
| Accounts receivable, net of allowance for doubtful accounts of $292,645 and $170,572 at December 31, 2002 and 2001, respectively | 7,069,163 | 2,669,408 |
| Unbilled accounts receivable | 79,109 | 472,912 |
| Inventory | 452,978 | 542,136 |
| Prepaid expenses | 175,673 | 93,831 |
| Other current assets | 25,526 | 30,906 |
| Total current assets | 12,213,388 | 4,852,086 |
| Computer equipment | 3,725,264 | 3,410,170 |
| Office equipment | 500,609 | 416,216 |
| Leasehold improvements | 146,855 | ---- |
| | 4,372,728 | 3,826,386 |
| Less accumulated depreciation | 3,530,715 | 3,101,960 |
| Net property and equipment | 842,013 | 724,426 |
| Long-term receivable | 143,654 | 193,475 |

Purchased and developed software, net of accumulated

| | | |
|---|---|---|
| amortization of $5,522,307 and $4,342,779 at December 31, 2002 and 2001 respectively | 5,703,247 | 3,824,483 |
| Intangibles - customer contract, net of accumulated amortization of $96,613 at December 31, 2002 | 869,519 | ---- |
| Goodwill | 7,405,650 | 354,999 |
| Other assets | 68,536 | 106,127 |
| Total assets | $ 27,246,007 | $ 10,055,596 |

LIABILITIES AND SHAREHOLDERS' EQUITY

| | | |
|---|---|---|
| Current liabilities: | | |
| Current portion of obligations under capital leases | $ 7,254 | $ 23,384 |
| Accounts payable | 1,492,736 | 815,177 |
| Accrued wages | 685,014 | 645,588 |
| Other accrued liabilities | 264,122 | 258,989 |
| Deferred revenue | 1,892,001 | 480,446 |
| Total current liabilities | 4,341,127 | 2,223,584 |
| Notes payable | 166,911 | 152,141 |
| Redemption value related to exchangeable common stock | 1,038,282 | 1,504,230 |
| Obligations under capital leases, excluding current portion | ---- | 7,131 |
| Other liabilities | 16,546 | ---- |
| Total liabilities | 5,562,866 | 3,887,086 |
| Shareholders' equity: | | |
| Special Voting Preferred Stock, $0.01 par value: 4,000,000 shares authorized; one share issued and outstanding at December 31, 2002 and 2001 | ---- | ---- |
| Series A Preferred Stock, $0.01 par value: 1,000,000 shares authorized; zero and 637,236 shares issued and outstanding at December 31, 2002 and 2001, respectively | ---- | 6,372 |
| Series 2 Special Voting Preferred Stock, $0.01 par value: 1,000,000 shares authorized; one share and zero shares issued and outstanding at December 31, 2002 and 2001, respectively. | ---- | ---- |
| Common stock, $0.01 par value: 30,000,000 shares authorized; 9,481,683 and 7,019,493 shares issued and outstanding at December 31, 2002 and 2001, respectively | 94,817 | 70,195 |
| Common stock subscribed; 3,542 shares and 22,173 shares at December 31, 2002 and 2001, respectively | 15,656 | 17,082 |
| Additional paid-in capital | 28,035,152 | 16,182,483 |
| Common stock subscription receivable, due from related party. | (25,000) | (35,000) |
| Accumulated deficit | (6,295,160) | (9,924,055) |
| Accumulated other comprehensive income (loss) - cumulative translation adjustment | (142,324) | (148,567) |
| Total shareholders' equity | 21,683,141 | 6,168,510 |
| Total liabilities and shareholders' equity | $ 27,246,007 | $ 10,055,596 |

See accompanying notes to consolidated financial statements.

MERGE TECHNOLOGIES INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2002 | 2001 | 2000 |
| Net sales | $ 20,786,369 | $ 15,741,059 | $ 12,612,575 |
| Cost of sales | 7,998,190 | 6,261,109 | 6,472,460 |
| Gross profit | 12,788,179 | 9,479,950 | 6,140,115 |
| Operating costs and expenses: | | | |
| Sales and marketing | 4,305,427 | 3,226,719 | 4,326,178 |
| Product research and development | 1,619,778 | 1,869,809 | 2,411,386 |
| General and administrative | 2,553,016 | 2,286,217 | 2,662,906 |
| Depreciation and amortization | 517,618 | 765,494 | 859,805 |
| Restructuring and related items | ---- | 35,825 | 254,970 |
| Software write-off | ---- | ---- | 1,129,871 |
| Acquired in-process research and development | 148,050 | ---- | ---- |
| Total operating costs and expenses | 9,143,889 | 8,184,064 | 11,645,116 |
| Operating income (loss) | 3,644,290 | 1,295,886 | (5,505,001) |
| Other income (expense): | | | |
| Interest expense | (21,979) | (118,929) | (73,670) |
| Interest income | 49,662 | 44,567 | 23,617 |
| Other, net | 35,851 | 136,520 | (89,061) |
| Total other income (expense) | 63,534 | 62,158 | (139,114) |
| Income (loss) before income taxes | 3,707,824 | 1,358,044 | (5,644,115) |
| Income tax expense | 78,929 | 87,286 | 63,279 |
| Net income (loss) | 3,628,895 | 1,270,758 | (5,707,394) |
| Net income (loss) per share - basic | $ 0.38 | $ 0.17 | $ (1.01) |
| Weighted average number of common shares outstanding - basic | 8,840,059 | 6,178,821 | 5,792,945 |
| Net income (loss) per share - diluted | $ 0.33 | $ 0.15 | $ (1.01) |
| Weighted average number of common shares outstanding - diluted | 10,383,651 | 7,310,731 | 5,792,945 |

See accompanying notes to consolidated financial statements.

MERGE TECHNOLOGIES INCORPORATED AND SUBSIDARIES
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
For Years Ended December 31, 2000, 2001 and 2002

| | Special Voting Preferred Stock | | Series A Preferred Stock | | | |
|---|---|---|---|---|---|---|
| | Shares issued | Issued amount | Shares subscribed | Subscribed amount | Shares issued | Iss Amo |
| Balance at December 31, 1999 | 1 | $ ------ | ----- | $ ----- | ----- | $ |
| Accretion of put value......... | ------ | ------ | ----- | ----- | ----- | |
| Issuance of options for service | ------ | ------ | ----- | ----- | ----- | |
| Issuance of common stock....... | ------ | ------ | ----- | ----- | ----- | |
| Exchange of share rights into common stock................. | ------ | ------ | ----- | ----- | ----- | |
| Shares to be issued for services rendered............ | ------ | ------ | ----- | ----- | ----- | |
| Stock purchased under ESPP..... | | | | | | |
| Common stock subscriptions..... | ------ | ------ | ----- | ----- | ----- | |
| Series A Preferred Stock subscriptions............... | ------ | ------ | 613,236 | 467,316 | ----- | |
| Issuance of common stock warrants..................... | ------ | ------ | ----- | ----- | ----- | |
| Net income..................... | ------ | ------ | ----- | ----- | ----- | |
| Foreign currency cumulative translation adjustment....... | ------ | ------ | ----- | ----- | ----- | |
| Balance at December 31, 2000... | 1 | $ ------ | 613,236 | $ 467,316 | ----- | |
| Accretion of put value......... | ------ | ------ | ----- | ----- | ----- | |
| Issuance of common stock....... | ------ | ------ | ----- | ----- | ----- | |
| Issuance of preferred stock.... | ------ | ------ | (613,236) | (467,316) | 622,236 | |
| Issuance of common stock warrants..................... | ------ | ------ | ----- | ----- | ----- | |
| Stock purchased under ESPP | ------ | ------ | ----- | ----- | ----- | |
| Exchange of share rights into common stock................. | ------ | ------ | ----- | ----- | ----- | |
| Shares issued for services rendered..................... | ------ | ------ | ----- | ----- | 15,000 | |
| Exercise of stock options...... | ------ | ------ | ----- | ----- | ----- | |
| Exercise of stock warrants..... | ------ | ------ | ----- | ----- | ----- | |
| Preferred stock dividends declared..................... | ------ | ------ | ----- | ----- | ----- | |
| Issuance of preferred stock dividend.................... | ------ | ------ | ----- | ----- | ----- | |
| Reduction of stock subscription receivable from related party | ------ | ------ | ----- | ----- | ----- | |
| Net income..................... | ------ | ------ | ----- | ----- | ----- | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Foreign currency cumulative translation adjustment....... | ------ | ------ | ----- | ----- | ----- | |
| Balance at December 31, 2001... | 1 | $ ------ | ----- | $ ----- | 637,236 | $ |
| Accretion of put value......... | ------ | ------ | ----- | ----- | ----- | |
| Issuance of common stock....... | ------ | ------ | ----- | ----- | (637,236) | ( |
| Shares issued for acquisitions. | ------ | ------ | ----- | ----- | ----- | |
| Exchange of share rights into common stock................. | ------ | ------ | ----- | ----- | ----- | |
| Stock purchased under ESPP..... | ------ | ------ | ----- | ----- | ----- | |
| Exercise of stock options...... | ------ | ------ | ----- | ----- | ----- | |
| Exercise of stock warrants..... | ------ | ------ | ----- | ----- | ----- | |
| Preferred stock dividends declared..................... | ------ | ------ | ----- | ----- | ----- | |
| Issuance of preferred stock dividend..................... | ------ | ------ | ----- | ----- | ----- | |
| Reduction of stock subscription receivable from related party | ------ | ------ | ----- | ----- | ----- | |
| Net income..................... | ------ | ------ | ----- | ----- | ----- | |
| Foreign currency cumulative translation adjustment....... | ------ | ------ | ----- | ----- | ----- | |
| Balance at December 31, 2002... | 1 | $ ------ | ----- | $ ----- | ----- | $ |

MERGE TECHNOLOGIES INCORPORATED AND SUBSIDARIES
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
For Years Ended December 31, 2000, 2001 and 2002

| | Series 2 Special Voting Preferred stock | |
|---|---|---|
| | shares issued | issued amount |
| Balance at December 31, 1999 | ----- | $ ------ |
| Accretion of put value......... | ------ | ------ |
| Issuance of options for service | ------ | ------ |
| Issuance of common stock....... | ------ | ------ |
| Exchange of share rights into common stock................. | ------ | ------ |
| Shares to be issued for services rendered............ | ------ | ------ |
| Stock purchased under ESPP..... | ------ | ------ |
| Common stock subscriptions..... | ------ | ------ |
| Series A Preferred Stock subscriptions................ | ------ | ------ |
| Issuance of common stock warrants..................... | ------ | ------ |
| Net income..................... | ------ | ------ |
| Foreign currency cumulative translation adjustment....... | ------ | ------ |
| Balance at December 31, 2000... | ------ | $ ------ |

| | | |
|---|---|---|
| Accretion of put value......... | ------ | ------ |
| Issuance of common stock....... | ------ | ------ |
| Issuance of preferred stock.... | ------ | ------ |
| Issuance of common stock warrants..................... | ------ | ------ |
| Stock purchased under ESPP..... | ------ | ------ |
| Exchange of share rights into common stock................. | ------ | ------ |
| Shares issued for services rendered..................... | ------ | ------ |
| Exercise of stock options...... | ------ | ------ |
| Exercise of stock warrants..... | ------ | ------ |
| Preferred stock dividends declared..................... | ------ | ------ |
| Issuance of preferred stock dividend..................... | ------ | ------ |
| Reduction of stock subscription receivable from related party | ------ | ------ |
| Net income..................... | ------ | ------ |
| Foreign currency cumulative translation adjustment....... | ------ | ------ |
| Balance at December 31, 2001... | ------ | $ ------ |
| Accretion of put value......... | ------ | ------ |
| Issuance of common stock....... | ------ | ------ |
| Shares issued for acquisitions. | 1 | ------ |
| Exchange of share rights into common stock................. | ------ | ------ |
| Stock purchased under ESPP..... | ------ | ------ |
| Exercise of stock options...... | ------ | ------ |
| Exercise of stock warrants..... | ------ | ------ |
| Preferred stock dividends declared..................... | ------ | ------ |
| Issuance of preferred stock dividend..................... | ------ | ------ |
| Reduction of stock subscription receivable from related party | ------ | ------ |
| Net income (loss).............. | ------ | ------ |
| Foreign currency cumulative translation adjustment....... | ------ | ------ |
| Balance at December 31, 2002... | 1 | $ ------ |

MERGE TECHNOLOGIES INCORPORATED AND SUBSIDARIES
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
For Years Ended December 31, 2000, 2001 and 2002

| | Common Stock | | | | | |
|---|---|---|---|---|---|---|
| | Shares subscribed | Subscribed amount | Shares issued | Issued amount | Additional paid-in capital | Acc d |
| Balance at December 31, 1999 | ----- | $ ------ | 5,781,389 | $ 57,814 | $14,333,392 | $ (5 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Accretion of put value......... | ------ | ------ | ----- | ----- | (140,280) | |
| Issuance of options for service | ------ | ------ | ----- | ----- | 49,875 | |
| Issuance of common stock....... | ------ | ------ | 12,011 | 120 | 706 | |
| Exchange of share rights into common stock................ | ------ | ------ | 952 | 10 | (10) | |
| Shares to be issued for services rendered........... | 23,459 | 36,667 | ----- | ----- | ----- | |
| Stock purchased under ESPP..... | 20,861 | 16,082 | 10,818 | 108 | 15,121 | |
| Common stock subscriptions..... | 145,350 | 100,001 | ------ | ----- | ----- | |
| Series A Preferred Stock subscriptions............... | ------ | ------ | ----- | ----- | ----- | |
| Issuance of common stock warrants.................... | ------ | ------ | ----- | ----- | 114,994 | |
| Net income.................... | ------ | ------ | ----- | ----- | ----- | (5 |
| Foreign currency cumulative translation adjustment....... | ------ | ------ | ----- | ----- | ----- | |
| Balance at December 31, 2000... | 189,670 | $ 152,750 | 5,805,170 | $ 58,052 | $14,373,798 | $(11 |
| Accretion of put value......... | ------ | ------ | ----- | ----- | (140,280) | |
| Issuance of common stock....... | (168,809) | (136,668) | 1,005,734 | 10,057 | 1,330,262 | |
| Issuance of preferred stock.... | ------ | ------ | ----- | ----- | 470,094 | |
| Issuance of common stock warrants.................... | ------ | ------ | ----- | ----- | 9,879 | |
| Stock purchased under ESPP | 1,312 | 1,000 | 94,037 | 940 | 68,425 | |
| Exchange of share rights into common stock................ | ------ | ------ | 31,096 | 311 | (311) | |
| Shares issued for services rendered.................... | ------ | ------ | 20,163 | 202 | 43,138 | |
| Exercise of stock options...... | ------ | ------ | 20,622 | 206 | 26,477 | |
| Exercise of stock warrants..... | ------ | ------ | 12,500 | 125 | 12,375 | |
| Preferred stock dividends declared.................... | ------ | ------ | ----- | ----- | (44,236) | |
| Issuance of preferred stock dividend.................... | ------ | ------ | 30,171 | 302 | 32,862 | |
| Reduction of stock subscription receivable from related party | ------ | ------ | ----- | ----- | ----- | |
| Net income.................... | ------ | ------ | ----- | ----- | ----- | 1 |
| Foreign currency cumulative translation adjustment....... | ------ | ------ | ----- | ----- | ----- | |
| Balance at December 31, 2001... | 22,173 | $ 17,082 | 7,019,493 | $ 70,195 | $16,182,483 | $ (9 |
| Accretion of put value......... | ------ | ------ | ----- | ----- | 465,948 | |
| Issuance of common stock....... | ------ | ------ | 645,222 | 6,452 | 44,224 | |
| Shares issued for acquisitions. | ------ | ------ | 93,901 | 939 | 9,117,873 | |
| Exchange of share rights into common stock................ | ------ | ------ | 179,603 | 1,796 | (1,805) | |
| Stock purchased under ESPP..... | (18,631) | (1,426) | 36,976 | 371 | 76,713 | |
| Exercise of stock options...... | ------ | ------ | 778,571 | 7,786 | 1,028,276 | |
| Exercise of stock warrants..... | ------ | ------ | 722,943 | 7,229 | 1,110,433 | |
| Preferred stock dividends declared.................... | ------ | ------ | ----- | ----- | (20,471) | |
| Issuance of preferred stock dividend.................... | ------ | ------ | 4,974 | 49 | 31,478 | |
| Reduction of stock subscription receivable from related party | ------ | ------ | ----- | ----- | ----- | |
| Net income.................... | ------ | ------ | ----- | ----- | ----- | 3 |
| Foreign currency cumulative translation adjustment....... | ------ | ------ | ----- | ----- | ----- | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Balance at December 31, 2002... | 3,542 | $ 15,656 | 9,481,683 | $ 94,817 | $28,035,152 | $ (6 |

MERGE TECHNOLOGIES INCORPORATED AND SUBSIDARIES
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
For Years Ended December 31, 2000, 2001 and 2002

| | Common stock | | |
|---|---|---|---|
| | Stock subscription receivable | Cummulative translation adjustment | Total shareholders' equity |
| Balance at December 31, 1999 | ----- | $ 60,452 | $ 8,964,239 |
| Accretion of put value......... | ------ | ------ | (140,280) |
| Issuance of options for service | ------ | ------ | 49,875 |
| Issuance of common stock....... | ------ | ------ | 826 |
| Exchange of share rights into common stock................. | ------ | ------ | ------ |
| Shares to be issued for services rendered............ | ------ | ------ | 36,667 |
| Stock purchased under ESPP..... | ------ | ------ | 31,311 |
| Common stock subscriptions..... | (50,000) | ------ | 50,001 |
| Series A Preferred Stock subscriptions................ | ------ | ------ | 467,316 |
| Issuance of common stock warrants..................... | ------ | ------ | 114,994 |
| Net income (loss).............. | ------ | ------ | (5,707,394) |
| Foreign currency cumulative translation adjustment....... | ------ | ------ | (114,675) |
| Balance at December 31, 2000... | (50,000) | $ (54,223) | $3,752,880 |
| Accretion of put value......... | ------ | ------ | (140,280) |
| Issuance of common stock....... | (10,000) | ------ | 1,193,651 |
| Issuance of preferred stock.... | ------ | ------ | 9,000 |
| Issuance of common stock warrants..................... | ------ | ------ | 9,879 |
| Stock purchased under ESPP..... | ------ | ------ | 70,365 |
| Exchange of share rights into common stock................. | ------ | ------ | ------ |
| Shares issued for services rendered..................... | ------ | ------ | 43,490 |
| Exercise of stock options...... | ------ | ------ | 26,683 |
| Exercise of stock warrants..... | ------ | ------ | 12,500 |
| Preferred stock dividends declared..................... | ------ | ------ | (44,236) |
| Issuance of preferred stock dividend..................... | ------ | ------ | 33,164 |
| Reduction of stock subscription receivable from related party | 25,000 | ------ | 25,000 |

| | | | |
|---|---|---|---|
| Net income (loss)............. | ------ | ------ | 1,270,758 |
| Foreign currency cumulative translation adjustment....... | ------ | (94,344) | (94,344) |
| Balance at December 31, 2001... | (35,000) | $ (148,567) | $6,168,510 |
| Accretion of put value......... | ------ | ------ | 465,948 |
| Issuance of common stock....... | ------ | ------ | 44,304 |
| Shares issued for acquisitions. | ------ | ------ | 9,118,812 |
| Exchange of share rights into common stock................ | ------ | ------ | (9) |
| Stock purchased under ESPP..... | ------ | ------ | 75,658 |
| Exercise of stock options...... | ------ | ------ | 1,036,062 |
| Exercise of stock warrants..... | ------ | ------ | 1,117,662 |
| Preferred stock dividends declared.................... | ------ | ------ | (20,471) |
| Issuance of preferred stock dividend.................... | ------ | ------ | 31,527 |
| Reduction of stock subscription receivable from related party | 10,000 | ------ | 10,000 |
| Net income (loss)............. | ------ | ------ | 3,628,895 |
| Foreign currency cumulative translation adjustment....... | ------ | 6,243 | 6,243 |
| Balance at December 31, 2002... | (25,000) | $ (142,324) | $21,683,141 |

See accompanying notes to consolidated financial statements.

MERGE TECHNOLOGIES INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Years Ended December | | |
|---|---|---|---|
| | 2002 | 2001 | |
| Cash flows from operating activities: | | | |
| Net income (loss)............................................ | $ 3,628,895 | $ 1,270,758 | $ |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | | |
| Depreciation and amortization................................. | 1,862,275 | 1,697,955 | |
| Amortization of discount on note assumed in merger............. | 12,891 | 18,681 | |
| Provision for doubtful accounts receivable..................... | 264,319 | 132,986 | |
| Impairment of other intangibles............................... | ---- | ---- | |
| Acquired in-process technology and software write-off.......... | 148,050 | ---- | |
| Issuance of options and stock for services rendered............ | 44,304 | 68,490 | |
| Issuance of warrants for financing transactions................ | ---- | 9,879 | |
| Change in assets and liabilities, net of acquisition: | | | |

| | | | |
|---|---|---|---|
| Accounts receivable | (3,987,522) | (1,272,761) | |
| Inventory | 89,158 | 613,783 | |
| Prepaid and other expenses | (80,389) | (35,913) | |
| Accounts payable | 758,821 | (1,158,717) | |
| Accrued wages | (38,071) | 193,600 | |
| Other accrued expenses | (34,719) | 45,840 | |
| Deferred revenue | 1,015,479 | 269,539 | |
| Other | 121,257 | 45,045 | |
| Net cash provided by (used in) operating activities | 3,804,748 | 1,899,165 | |
| Cash flows from investing activities: | | | |
| Acquisitions of businesses, net of cash acquired | (242,927) | ---- | |
| Leasehold improvements | (146,855) | ---- | |
| Purchases of property and equipment | (410,515) | (148,318) | |
| Development of software | (1,850,222) | (1,436,345) | |
| Net cash used in investing activities | (2,650,519) | (1,584,663) | |
| Cash flows from financing activities: | | | |
| Proceeds from revolving credit agreement | ---- | ---- | |
| Repayment of revolving credit agreement | ---- | (1,350,000) | |
| Proceeds from note receivable | 10,000 | ---- | |
| Proceeds from sale of Series A Preferred Stock | ---- | 9,000 | |
| Proceeds from exercise of stock options | 1,036,053 | 26,683 | |
| Proceeds from exercise of warrants | 1,117,662 | 12,500 | |
| Proceeds from sale of common stock | 75,658 | 1,264,017 | |
| Principal payments under capital leases | (23,296) | (30,768) | |
| Net cash provided by (used in) financing activities | 2,216,077 | (68,568) | |
| Effect of exchange rate changes on cash | (2,260) | (14,951) | |
| Net increase (decrease) in cash | 3,368,046 | 230,983 | |
| Cash, beginning of period | 1,042,893 | 811,910 | |
| Cash, end of period | $ 4,410,939 | $ 1,042,893 | $ |

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

| | | | |
|---|---|---|---|
| Cash paid for income taxes | $ 90,752 | $ 69,286 | $ |
| Cash paid for interest | 10,054 | 116,129 | |

NON CASH INVESTING AND FINANCING ACTIVITIES:

| | | |
|---|---|---|
| Property and equipment acquired through capital leases | ---- | 3,343 |
| Payment of preferred stock dividends through issuance of common stock | 31,527 | 33,164 |
| Redemption value related to exchangeable common stock | 98,953 | 140,280 |
| Exchangeable shares issued for acquisition of 1,000,000 shares | 7,736,667 | ---- |
| Common stock issued for acquisition of 93,301 shares | 791,585 | ---- |

See accompanying notes to consolidated financial statements.

MERGE TECHNOLOGIES INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

| | Years ended December 31, | | |
|---|---|---|---|
| | 2002 | 2001 | 2000 |
| Net income (loss) | $ 3,628,895 | $ 1,270,758 | $ (5,707 |
| Accumulated other comprehensive income (loss) - Cumulative translation adjustment | 6,243 | (94,344) | (114 |
| Comprehensive net income (loss) | $ 3,635,138 | $ 1,176,414 | $ (5,822 |

See accompanying notes to consolidated financial statements.

MERGE TECHNOLOGIES INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Nature of Operations.

Merge eFilm is in the business of integrating radiology images and information into healthcare enterprise networks. Merge eFilm products and services enhance the quality of healthcare provided to patients because they improve radiology workflow efficiencies, reduce healthcare operating costs and improve clinical decision making processes. The Company delivers this tangible value both to OEM/VARs and directly to healthcare facilities of all sizes, but it specifically targets small to medium size hospitals, multi-hospital groups, clinics and diagnostic imaging centers by working with its customers to offer modular, cost effective solutions to solve their image and information management and radiology workflow needs.

(b) Principles of Consolidation.

The consolidated financial statements include the financial statements of the Company and its wholly owned subsidiaries, Aurora and eFilm. All significant intercompany balances and transactions have been eliminated in consolidation.

(c) Inventory.

Inventory, consisting principally of raw materials and finished goods, is stated at the lower of cost or market. Cost is determined using the first-in, first-out method.

(d) Property and Equipment.

Property and equipment are stated at cost. Equipment under capital leases is stated at the present value of minimum lease payments.

Depreciation on property and equipment is calculated on the straight-line method over the estimated useful lives of the assets. Useful lives of the Company's major classes of property and equipment are: five years for computer equipment placed in service prior to December 31, 1997, and three years for computer equipment acquired after December 31, 1997; and seven years for office equipment. Equipment held under capital leases is amortized using the straight-line method over the shorter of the estimated useful life of the asset or the term of the lease, depending on the lease terms. Leasehold improvements are amortized using the straight-line method over the shorter of the estimated vested life of the asset or the term of the lease.

(e) Purchased and Developed Software.

All research and development costs incurred prior to the point at which management believes a project has reached technological feasibility are expensed as incurred. Engineering costs incurred subsequent to reaching technological feasibility are capitalized and reported at the lower of unamortized cost or net realizable value in accordance with SFAS No. 86, Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed. Amortization of purchased and developed software is provided on a product-by-product basis over the expected economic life of the related software, generally five years, using the straight-line method. This method results in greater amortization than the method based on the ratio that current gross revenues for a product bear to the total of current and anticipated future gross revenues for that product. During 2002, 2001 and 2000, the Company capitalized $1,850,000, $1,436,000 and $1,584,000, respectively. Amortization expense of purchased and developed software for 2002, 2001 and 2000, was $1,344,000, $773,000 and $992,000, respectively.

The Company assesses the recoverability of these costs each period by determining whether the unamortized capitalized costs can be recovered through future net operating cash flows through the sale of that product.



(f) Fair Value of Financial Instruments.

The Company's financial instruments include cash, accounts receivable, line of credit, accounts payable and certain accrued expenses. The carrying amounts approximate fair value because of the short maturity of these instruments or the rate is variable. The carrying value of notes payable is not materially different from its fair value.

(g) Long-Lived Assets.

The Company accounts for long lived assets in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, under which the Company has reviewed long-lived assets and certain intangible assets with estimable useful lives and determined that their carrying values as of December 31, 2002, are recoverable in future periods.

(h) Goodwill and Other Intangibles.

Effective January 1, 2002, the Company adopted SFAS No. 142, Goodwill and Other Intangible Assets ("SFAS No. 142"). The standard requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead be tested for impairment at least annually. The standard also specifies criteria that intangible assets must meet to be recognized and reported apart from goodwill.

As of the date of adoption of SFAS 142, the Company has discontinued amortization of all existing goodwill. Additionally, pursuant to the provisions of SFAS 142, the Company confirmed its recorded purchased software as an other intangible asset that must be recognized apart from goodwill and amortized over its estimated useful lives of three to five years. Purchased software is included as part of purchased and developed software and the classification and useful life is consistent with the Company's presentation at December 31, 2001. The Company has not identified any other intangible assets that must be recognized apart from goodwill as of the adoption date.

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

| | | December 31, 2002 | | December 31, 2001 | |
|---|---|---|---|---|---|
| | Weighted Average Remaining Amortization Period (Years) | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| Purchased software | 2.9 | 1,418,000 | (227,000) | 140,000 | (63,000) |
| Customer contracts | 4.5 | 966,000 | (97,000) | ---- | ---- |
| Total | 3.3 | 2,384,000 | (324,000) | 140,000 | (63,000) |

Amortization expense was $261,000, $28,000 and $75,000 for the years ended 2002, 2001 and 2000, respectively. Estimated aggregate amortization expense for each of the next five years is as follows:

| | | |
|---|---|---|
| For the year ended: | 2003 | $ 488,000 |
| | 2004 | $ 481,000 |
| | 2005 | $ 444,000 |
| | 2006 | $ 432,000 |
| | 2007 | $ 216,000 |

The provisions of SFAS 142 require that goodwill and other intangible assets with indefinite useful lives be tested at least annually for impairment or when indicators of potential impairment exist, using a fair-value-based approach. Additionally, a transitional impairment evaluation must be completed within the first six months of adoption. During the second quarter of 2002,

MERGE TECHNOLOGIES INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

the Company completed the transitional impairment test, which did not result in impairment of recorded goodwill. The Company will continue to monitor the carrying value of goodwill through annual impairment tests. At December 31, 2002, the Company performed its annual impairment tests and found none of its goodwill to be impaired.

The changes in the carrying amount of goodwill for the year ended December 31, 2002, are as follows:

| | |
|---|---|
| Balance as of January 1, 2002............ | $ 355,000 |
| Goodwill acquired in Aurora acquisition.. | 744,000 |
| Goodwill acquired in eFilm acquisition... | 6,306,000 |
| Balance as of December 31, 2002.......... | $ 7,405,000 |

The following table shows the impact on the Company's financial statements as if SFAS 142 were adopted on January 1, 2000:

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2002 | 2001 | 2000 |
| Reported net income......................... | $ 3,628,895 | $ 1,270,758 | $ (5,707,394) |
| Goodwill amortization....................... | ---- | 73,924 | 57,375 |
| Adjusted net income......................... | $ 3,628,895 | $ 1,344,682 | $ (5,650,019) |
| Reported net income (loss) per share - basic. | $ 0.38 | $ 0.17 | $ (1.01) |
| Goodwill amortization....................... | ---- | 0.01 | 0.01 |
| Adjusted net income per share - basic........ | $ 0.38 | $ 0.18 | $ (1.00) |
| Reported net income (loss) per share - diluted.................................. | $ 0.33 | $ 0.15 | $ (1.01) |
| Goodwill amortization....................... | ---- | 0.01 | 0.01 |
| Adjusted net income per share - diluted...... | $ 0.33 | $ 0.16 | $ (1.00) |

(i) Income Taxes.

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, operating losses and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

(j) Stock Option Plan.

As of December 31, 2002, the Company maintains two stock-based employee compensation plans and one director option plan, which are described more fully in Note 7. The Company applies the provisions of the SFAS 123, Accounting for Stock-Based Compensation ("SFAS No. 123"), as amended ("SFAS No. 148"), which requires entities to recognize as expense over the vesting period the fair value of all stock-based awards on the date of grant. Alternatively, SFAS No. 123 also allows entities to continue to apply the provision of APB Opinion No. 25 and provide pro forma disclosures as if the fair-value-based method defined in SFAS No. 123 had been applied.

The Company has elected to continue to apply the provisions of APB Opinion No. 25 in accounting for its plans. All stock options under the plans have been granted at exercise prices of not less than the market value at the



date of the grant. Had the Company determined compensation cost based on the fair value at the grant date for its stock options under SFAS No. 123, the Company's net income would have been decreased in 2002 and 2001 and its net loss increased in 2000 to the pro forma amounts indicated below:

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Net income (loss), as reported............. | $ 3,628,895 | $ 1,270,758 | $ (5,707,394) |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax benefits............... | (456,311) | (299,719) | (376,947) |
| Pro forma net income (loss)................. | $ 3,172,584 | $ 971,039 | $ (6,084,341) |
| Earnings per share: | | | |
| Basic - as reported....................... | $ 0.38 | $ 0.17 | $ (1.01) |
| Basic - pro forma......................... | $ 0.33 | $ 0.12 | $ (1.07) |
| Diluted - as reported..................... | $ 0.33 | $ 0.15 | $ (1.01) |

| | | | |
|---|---|---|---|
| Diluted - pro forma...................... | $ 0.29 | $ 0.11 | $ (1.07) |

(k) Revenue Recognition.

Revenues are derived primarily from the sublicensing and licensing of computer software, installations, training, consulting, software maintenance, and sales of PACS solutions. Inherent in the revenue recognition process, are significant management estimates and judgements, which influence the timing and amount of revenue recognition.

For sales of software arrangements, the Company recognizes revenue according to the American Institute of Certified Public Accountants Statement of Position 97-2 (SOP 97-2), Software Revenue Recognition, and related amendments. SOP 97-2, as amended, generally requires revenue earned on software arrangements involving multiple elements to be allocated to each element based on the relative fair values of those elements. Revenue from multiple-element software arrangements is recognized using the residual method. Under the residual method, revenue is recognized in a multiple element arrangement when Company-specific objective evidence of fair value exists for all of the undelivered elements in the arrangement, but does not exist for one or more of the delivered elements in the arrangement. The Company allocates revenue to each undelivered element in a multiple element arrangement based on its respective fair value, with the fair value determined by the price charged when that element is sold separately. Specifically, the Company determines the fair value of the maintenance portion of the arrangement based on the renewal price of the maintenance offered to clients, which is stated in the contract and fair value of the installation based upon the price charged when the services are sold separately. If evidence of the fair value cannot be established for an undelivered element of a software sale, the entire amount of revenue under the arrangement is deferred until these elements have been delivered or vendor-specific objective evidence of fair value can be established.

Revenue from the sale of sublicenses sold on an individual basis and computer software licenses is recognized upon shipment provided that evidence of an arrangement exists, title and risk of loss have passed to the customer, fees are fixed or determinable and collection of the related receivable is reasonably assured.

Revenue from software usage sublicenses sold through annual contracts and software maintenance is deferred and recognized ratably over the contract period. Revenue from installation, training, and consulting services is recognized as services are performed.

Revenue from sales of PACS solutions sold directly to healthcare institutions where installation services are considered essential to the functionality of the solution sold is recognized on a percentage-of-completion method, as prescribed by the American Institute of Certified Public Accountants Statement of Position 81-1, Accounting for Performance on Construction-Type and



Certain Production-Type Contracts. Percentage-of-completion is determined by the output method based upon the achievement of delivery milestones.

The Company's policy is to allow returns when the Company has preauthorized the return. Based on the Company's historical experience of very limited returns and the Company's expectation that returns, if any, will be insignificant, the Company has not provided for an allowance for potential items to be returned.

(l) Warranties.

The Company provides twelve months of hardware warranty on its connectivity sales. The Company has provided for expected warranty costs based on its historical experience. Accrued warranty was $67,000 at December 31, 2002 and 2001.

(m) Use of Estimates.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(n) Income (Loss) Per Share.

Basic earnings per share is computed by dividing income available to common shareholders by the weighted average number of shares outstanding. The Company has made an accounting policy election to use the if-converted method for convertible securities that participate in common stock dividends; however, the two-class method must be used if the effect is more dilutive. Diluted earnings per share reflects the potential dilution that could occur based on the effect of the conversion of outstanding convertible preferred shares and the exercise of stock options and warrants with an exercise price of less than the average market price of the Company's common stock. The following table sets forth the computation of basic and diluted earnings per share for the years ended December 31, 2002, 2001 and 2000.

| | December 31, | | |
|---|---|---|---|
| | 2002 | 2001 | 2000 |
| Numerator: | | | |
| Net income (loss)............................ | $ 3,628,895 | $ 1,270,758 | $ (5,707,394) |
| Preferred stock dividends.................... | (20,471) | (44,236) | ---- |
| Accretion of redemption value related to Interpra exchangeable common stock.......... | (98,952) | (140,280) | (140,280) |
| Allocation of income to Interpra exchangeable shares.................................... | (117,498) | (66,920) | ---- |
| Numerator for net income (loss) per share - basic.................................... | $ 3,391,974 | $ 1,019,322 | $ (5,847,674) |
| Adjustment for effect of assumed conversion | | | |

| | | | |
|---|---|---|---|
| of preferred stock.......................... | 20,471 | 44,236 | ---- |
| Numerator for net income (loss) per share - diluted.................................... | $ 3,412,445 | $ 1,063,558 | $ (5,847,674) |
| Denominator: | | | |
| Weighted average number shares of common stock outstanding........................... | 8,840,059 | 6,178,821 | 5,792,945 |
| Effect of convertible preferred stock......... | 295,714 | 634,203 | ---- |
| Effect of stock options...................... | 925,277 | 312,373 | ---- |
| Effect of warrants........................... | 322,601 | 185,334 | ---- |
| Denominator for net income (loss) per share - diluted.................................. | 10,383,651 | 7,310,731 | 5,792,945 |
| Net income (loss) per share - basic........... | $ 0.38 | $ 0.17 | $ ( 1.01) |
| Net income (loss) per share - diluted......... | $ 0.33 | $ 0.15 | $ ( 1.01) |

MERGE TECHNOLOGIES INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2002 and 2001, 544,341 and 648,594, respectfully, weighted average options and warrants to purchase shares of the Company's common stock had exercise prices greater than the average market price of the shares of common stock.

The following potentially dilutive common stock equivalent securities, including securities considered in the calculation of diluted earnings per share, were outstanding at December 31, 2002, 2001 and 2000.

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Stock options.......... | 1,435,298 | 1,844,274 | 1,806,663 |
| Exchangeable shares.... | 1,205,172 | 384,779 | 415,875 |
| Warrants............... | 301,667 | 1,024,610 | 596,618 |
| Preferred stock........ | ---- | 634,203 | ---- |
| | 2,942,137 | 3,887,866 | 2,819,156 |

(o) Reclassifications.

Where appropriate, certain items relating to the prior years have been reclassified to conform to the current year presentation.

As a result of the eFilm acquisition on June 28, 2002, the Company has presented costs associated with service revenues as a component of cost of sales.

(p) Segment Reporting.

In June 1997, the Financial Accounting Standards Board issued Statement No. 131, Disclosures about Segments of an Enterprise and Related Information ("SFAS No. 131"). SFAS No. 131 establishes annual and interim reporting standards for operating segments of a company. It also requires entity-wide disclosures about the products and services an entity provides, the material countries in which it holds assets and reports revenues, and its major customers. The Company is not organized by multiple operating segments for the purpose of making operating decisions or assessing performance. Accordingly, the Company operates in one operating segment and reports only certain enterprise-wide disclosures.

(q) Foreign Currency Translation.

The Company uses the United States of America Dollar ("U. S. Dollar") for financial reporting purposes as substantially all of the Company's billings are in U. S. Dollars. The balance sheets of the Company's foreign subsidiaries are translated into U. S. Dollars using the balance sheet date exchange rate, and revenues and expenses are translated using the average exchange rate for the period. The resulting translation gains and losses are recorded as a component of stockholders' equity. Foreign currency transaction gains and losses are reflected in the consolidated statements of income, as a component of other income (expense) net.

On January 1, 2002, the Company changed the functional currency for the sales office in Nuenen, The Netherlands to the U. S. Dollar from the Dutch Guilder, as the majority of sales to customers transacted in U. S. Dollars continues to increase. The functional currency for the Company's operations in Japan and Canada remain the Yen and Canadian Dollar, respectively.

MERGE TECHNOLOGIES INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(2) ACQUISITIONS

During May 2002, the Company acquired certain assets of Aurora, pursuant to an Asset Acquisition Agreement dated April 18, 2002. On June 28, 2002, the Company acquired all the outstanding capital stock of eFilm pursuant to a Stock Acquisition Agreement dated April 15, 2002.

The acquisitions were accounted for using the purchase method of accounting. Accordingly, the assets and liabilities of the acquired businesses are included in the consolidated balance sheet as of December 31, 2002. The accompanying consolidated statement of operations for the year ended December 31, 2002, include the results of operations from the May 22, 2002, through December 31, 2002, for Aurora operations and the results of operations from the June 28, 2002, through December 31, 2002, for eFilm operations. The amounts allocated to purchased and developed software are being amortized over periods ranging from three to five years. The estimated asset lives are determined based on projected future economic benefits and expected life cycles of the technologies. The amounts allocated to goodwill are not being amortized, but will be tested for impairment annually or under certain circumstances that may indicate a potential impairment, and written-off when impaired. The following is a summary of purchase consideration for the acquisition:

| | Aurora | eFilm |
|---|---|---|

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

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

The Company paid a significant premium above eFilm's tangible and intangible assets principally for two reasons: eFilm's knowledge of the Company's software products through the joint development projects that were undertaken prior to the acquisition and the ability to sell the Company's products into existing eFilm customers. Also, eFilm's software development ability is particularly important because as the Company looked to the future, it foresaw the need to expand the Company's software product offerings to its healthcare institutions as many of the Company's competitors are promising more integrated solutions. In addition, the Company expected to be able to sell its higher price and high margin software products to eFilm's customers and to use the eFilm Workstation as a way to have the healthcare institutions become aware of the Company.

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

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

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



The total purchase considerations of approximately $917,000 and $8,397,000 was allocated to the fair value of the net assets acquired as follows (in thousands):

| | Aurora | eFilm |
|---|---|---|

| | | |
|---|---|---|
| Current assets........................ | $ 59,000 | $ 403,000 |
| Other assets.......................... | 29,000 | 44,000 |
| Purchased and developed technologies.. | 85,000 | 1,193,000 |
| Purchased contracts................... | ---- | 966,000 |
| Goodwill.............................. | 744,000 | 6,306,000 |
| In-process research and development... | ---- | 148,000 |
| Liabilities assumed................... | ---- | (663,000) |
| Total consideration: | $ 917,000 | $8,397,000 |

The value assigned to acquire in-process technology was determined by identifying the acquired specific in-process research and development projects that would be continued, and for which (1) technological feasibility had not been established at the acquisition date, (2) there was no alternative future use, and (3) the fair value was estimable with reasonable reliability. The Company estimated the fair value of the eFilm eRis ("eRIS") project to be $148,000. Accordingly, this amount was immediately expenses in the consolidated statement of income upon the acquisition date.

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

Of the amounts allocated to goodwill in the acquisitions of eFilm and Aurora, $6,306,000 and $744,000, respectively, the $6,306,000 relating to the eFilm transaction will not be deductible for federal income tax purposes, and the $744,000 relating to the Aurora transaction will be deductible for federal income tax purposes.

Additionally, in the Aurora acquisition, the Company assumed an operating lease obligation for office space located in the Chicago, Illinois metropolitan area. The aggregate minimum lease payment assumed amounted to $122,000. In October of 2002, the Company terminated the operating lease acquired in the Aurora acquisition. The total cost to terminate the lease was $13,905.

The following unaudited pro forma information shows the results of operations of the Company for the years ended December 31, 2002 and 2001, as if the business combinations had occurred at the beginning of each period. This data is not indicative of the results of operations that would have arisen if the business combinations had occurred at the beginning of the respective periods. Moreover, this data is not intended to be indicative of future results of operations.

| | Years Ended December 31, | |
|---|---|---|
| | 2002 | 2001 |
| | (in thousands, except per share amounts) | |
| Revenue | $ 22,347 | $ 18,086 |
| Net income | 3,356 | 402 |
| Earnings per share: | | |
| Basic | 0.10 | $ 0.03 |
| Diluted | $ 0.09 | $ 0.03 |

(3) INDEBTEDNESS

(a) Line of Credit.

In May 2000, the Company entered into a $3,000,000 revolving credit agreement with a bank. In November 2001, the Company re-negotiated the revolving credit agreement and obtained more favorable advance ratios increasing the borrowing base to 25% of inventory, 75% of qualified domestic accounts receivable and 65% of qualified foreign accounts receivable effective January 2, 2002. The revolving credit agreement matures in April 2003. The Company incurred interest expense under the agreements of $87,000 and $43,000 in 2001 and 2000, respectively.

In December 2002, the Company negotiated a new revolving line of credit agreement with its bank, increasing its line to $5,000,000, effective December 30, 2002 and maturing December 30, 2005. The interest rate on the line of credit is at a variable rate that is equal to the prime rate as published in the Wall Street Journal, less 0.75 percentage points and is collateralized by substantially all of the Company's assets. At December 31, 2002, the loan's interest rate was 3.50%. Availability under the new line of credit is subject to a borrowing base consisting of 50% of inventory balances under $2,000,000, 80% of qualified accounts receivable under 90 days and 100% of the Company's depository cash balances held at the bank if borrowings exceed the existing base of inventory and qualified accounts receivable. Under the formula, $5,000,000 was calculated to be available at December 31, 2002. No amounts were outstanding on the line of credit as of December 31, 2002.

(b) Note Payable to Investor

The Company has a $300,000 Canadian dollar five-year non-interest bearing note assumed in the 1999 acquisition of Interpra. At December 31, 2002, the U. S. Dollar equivalent of the note was approximately $191,000. The note was discounted to reflect the current interest rate of 8% at the time the note was assumed. The discount is being amortized over a five-year period. The Company recognized interest expense related to this note of approximately $13,000, $19,000 and $12,000 in 2002, 2001 and 2000, respectively. The note is due and payable in August 2004.

(4) EMPLOYEE BENEFIT PLAN

The Company maintains a defined contribution retirement plan (401(k)) covering employees who meet the minimum service requirements and have elected to participate. Company contributions, which are at the discretion of the Board of Directors, totaled $77,000, $70,000 and $78,000 for the years ended December 31, 2002, 2001 and 2000, respectively.

(5) INCOME TAXES

The provision for income tax consists of the following for the years ended December 31, 2002, 2001 and 2000.

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Current: | | | |
| Federal | $ (18,000) | $ 18,000 | $ ---- |
| State | 2,000 | 2,000 | 2,000 |
| Foreign | 95,000 | 67,000 | 61,000 |
| Total Current | 79,000 | 87,000 | 63,000 |
| Deferred: | | | |
| Federal | ----- | ----- | ---- |
| State | ----- | ----- | ---- |
| Total Deferred | ----- | ----- | ---- |
| Total Provision | $ 79,000 | $ 87,000 | $ 63,000 |

MERGE TECHNOLOGIES INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Actual income taxes vary from the expected income taxes (computed by applying the statutory income tax rate of 34% to income (loss) before income taxes) as a result of the following:

| | Years ended December 31, | | |
|---|---|---|---|
| | 2002 | 2001 | 2000 |
| Expected tax expense (benefit)................ | $ 1,261,000 | $ 462,000 | $ (1,919,000) |
| Total increase (decrease) in income taxes resulting from: | | | |
| Nondeductible amortization and acquired in-process technology.................. | 50,000 | 32,000 | 109,000 |
| Change in the valuation allowance allocated to income tax expense......... | (1,650,000) | (630,000) | 2,304,000 |
| Research and experimentation credit....... | (40,000) | 16,000 | (376,000) |
| Nondeductible expenses.................... | 85,000 | 69,000 | 362,000 |
| Foreign tax credits....................... | (95,000) | (67,000) | (61,000) |
| State and local income taxes, net of federal income tax benefits............ | 204,000 | 66,000 | (145,000) |
| Foreign withholding taxes................. | 95,000 | 67,000 | 61,000 |
| Foreign rate differential................. | 28,000 | (38,000) | (120,000) |
| Other..................................... | 141,000 | 110,000 | (152,000) |
| Actual tax expense.......................... | $ 79,000 | $ 87,000 | $ 63,000 |

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2002 and 2001 are presented below:

| | December 31, 2002 | December 31, 2001 |
|---|---|---|
| Deferred tax assets: | | |
| Accounts receivable, principally due to allowance for doubtful accounts | $ 178,000 | $ 59,000 |
| Accrued wages | 86,000 | 193,000 |
| Research and experimentation credit carryforwards | 1,713,000 | 1,674,000 |
| Other credit carryforwards | 425,000 | 367,000 |
| Net operating loss carryforwards | 980,000 | 2,054,000 |
| Foreign net operating loss carryforwards | 1,242,000 | 1,158,000 |
| Other | 148,000 | 39,000 |
| Total gross deferred tax assets | 4,772,000 | 5,544,000 |
| Less valuation allowance | (2,660,000) | (3,929,000) |
| Net deferred tax asset | 2,112,000 | 1,615,000 |
| Deferred tax liabilities: | | |
| Software development costs and intangible assets | (2,070,000) | (1,606,000) |
| Other | (42,000) | (9,000) |
| Total gross deferred liabilities | (2,112,000) | (1,615,000) |
| Net deferred taxes | $ ---- | $ ---- |

MERGE TECHNOLOGIES INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The net change in the valuation allowance for the years ended December 31, 2002, 2001 and 2000, was a decrease of $1,269,000 and $633,000 and an increase of $2,304,000, respectively. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income, management believes it is more likely than not the Company will realize the benefits of these deductible differences net of the existing valuation allowances.

At December 31, 2002, the Company had federal net operating loss carryforwards and research credit carryforwards approximating $2,467,000 and $1,373,000, respectively, state net operating loss carryforwards and research credit carryforwards of $2,679,000 and $341,000, respectively, and foreign federal and provincial net operating loss carryforwards of $3,124,000. These losses and credits are available to offset future taxable income and tax, if any. The federal net operating loss carryforwards and research credit carryforwards expire in varying amounts beginning in 2009 and 2006, respectively, and continuing through 2021 and 2022, respectively. The state net operating losses and research credits expire in varying amounts beginning in 2012 and continuing through 2016. The foreign federal and provincial net operating loss carryforwards expire in varying amounts beginning in 2004 and continuing through 2009. A portion of the income tax loss carryforwards and credits are subject to certain limitations, which could impair the Company's ability to utilize the benefits of these losses and credits in the future. In addition, if certain substantial changes in the Company's ownership should occur, tax loss and tax credit carryforwards may be further limited.

Included in the Company's gross deferred tax asset is approximately $400,000 related to stock option deductions. A reduction in the valuation allowance with regard to this amount will be included directly in the Company's paid in capital and will not result in an income statement benefit.

(6) LEASES

The Company is obligated under various capital leases for computer equipment that expire in early 2003. The gross amount of computer equipment under capitalized leases and related depreciation at the following balance sheet dates was: at December 31, 2002, equipment of $43,000 and accumulated



depreciation of $14,000; at December 31, 2001, equipment of $102,000 and accumulated depreciation of $29,000; and at December 31, 2000, equipment of $98,000 and accumulated depreciation of $22,000.

The Company has a non-cancelable operating lease for its main office facility that expires in June 2005. Total rent expense associated with this lease for the years ended December 31, 2002, 2001 and 2000, was approximately $304,000, $334,000 and $247,000, respectively. Future minimum lease payments under non-cancelable operating leases (with initial or remaining lease terms in excess of one year) and future minimum capital lease payment as of December 31, 2002, are:

| | Operating | Capital |
|---|---|---|
| 2003......................... | $ 402,558 | $ 7,717 |
| 2004......................... | 383,662 | ---- |
| 2005......................... | 228,652 | ---- |
| 2006......................... | 6,637 | ---- |
| Total minimum lease payments.. | $ 1,021,509 | $ 7,717 |
| Less amount representing interest................... | | 463 |
| Present value of net minimum capital lease payments...... | | 7,254 |
| Less current installments of obligations under capital leases..................... | | 7,254 |

| | |
|---|---|
| Obligations under capital leases, excluding current installments................ | $ ---- |

MERGE TECHNOLOGIES INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In February 2002, the Company entered into a lease amendment for its main office facility in which it surrendered a portion of the premises. As a result, the aggregate minimum future lease payment commitment decreased $240,000.

(7) SHAREHOLDER'S EQUITY

(a) Common Stock.

In August and September of 2002, the Company issued 1,910 shares of common stock to non-employee directors as consideration for meeting fees.

In July 2002, the Company issued 2,846 shares of common stock to Series A Preferred Stock shareholders as payment for dividends.

In July 2002, the Company issued 2,066 shares of common stock to non-employee directors as consideration for meeting fees.

In May and June of 2002, warrants to purchase 709,343 shares of common stock were exercised.

In May and June of 2002, the Company issued 637,236 shares of common stock for the conversion of Series A Preferred Stock.

In May 2002, the Company issued 93,901 shares of common stock as part of the purchase price for the Asset Purchase Agreement between Signal Stream, Inc., a wholly owned subsidiary known know as Merge Aurora Solutions Inc., and Aurora.

In April 2002, the Company issued 1,484 shares of common stock to non-employee directors as consideration for meeting fees.

In January 2002, the Company issued 2,526 shares of common stock to non-employee directors as consideration for meeting fees.

MERGE TECHNOLOGIES INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In January 2002, the Company issued 2,128 shares of common stock to Series A Preferred Stock shareholders as payment for dividends.

In January 2002, warrants to purchase 13,600 shares of common stock were exercised.

In October 2001, the Company received subscriptions for $1,183,651, net of selling expenses of $66,351 as consideration for 806,452 shares of common stock. In conjunction with the sale of common stock, the Company also issued warrants to purchase 403,224 shares of common stock. The warrants are exercisable six months from the date of issuance for shares of the Company's common stock at a price of $2.00 per share and have a term of four years. The Company may demand exercise of the warrants within 30 days after notice when the closing bid price of its common stock is at least $4.00 for 30 consecutive trading days and the underlying shares of common stock have been registered under federal securities law.

In October and July 2001, the Company issued an aggregate of 30,171 shares of common stock to Series A Preferred Stock shareholders as payment for dividends.

In September and July 2001, the Company issued an aggregate of 20,163 shares of common stock to non-employee directors as consideration for meeting fees.

In March 2001, the Company issued 23,459 shares of common stock to one individual, which were subscribed for in 2000, in consideration for services rendered in 2000.

In February 2001, 30,473 shares of common stock were sold to William C. Mortimore, Chairman and Chief Strategist, in connection with his employment agreement.

(b) Special Voting Preferred Stock.

At the end of 2002 and 2001, the Company had one share of its Special Voting Preferred Stock issued and outstanding. The one share issued to its transfer agent, serves as a trustee in voting matters on behalf of the exchangeable shareholders of Interpra.

(c) Series 2 Special Voting Preferred Stock.

In June of 2002, the Company issued one share of Series 2 Special Voting Preferred Stock to its transfer agent, which serves as a trustee in voting matters on behalf of the eFilm exchangeable shareholders.

(d) Series A Preferred Stock.

In the second quarter of 2002, the Company exercised its right to convert all outstanding shares of Series A Preferred stock on a one-for-one basis into 637,236 common shares.

(e) Stock Option Plan.

The Company maintains a stock option plan for employees of Merge eFilm that provides for the grant of a maximum of 2,515,826 shares of common stock. Under this plan, options have an exercise price equal to the fair market value of the stock at the date of grant. The majority of the options vest over a four-year period at 25% per year. The majority of the options granted under this plan expire six years from the date of grant.

The Company also maintains a stock option plan for non-employee directors of Merge, which provided for the granting of a maximum of 100,000 options to purchase common stock. In May 2000, shareholders of the Company voted to increase the number of shares of common stock subject to the director stock option plan to 300,000. Under this plan, options have an exercise price equal to the fair market value of the stock at the date of grant. The majority of options granted under this plan are vested at the date of grant. The options granted under this plan expire ten years and one day from the date of grant.

MERGE TECHNOLOGIES INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

| Year of Grant | Expected Option Life (in years) | Excepted Volatility | Dividend Yield | Risk-free Interest Rate |
|---|---|---|---|---|
| 1999 | 6 - 10 | 50% | 0% | 5.83% - 6.49% |
| 2000 | 6 - 10 | 50% - 70% | 0% | 5.73% - 6.50% |
| 2001 | 6 - 10 | 50% | 0% | 3.90% - 5.41% |
| 2002 | 6 - 10 | 50% | 0% | 2.95% - 5.18% |

A summary of stock options is as follows:

| | NUMBER | WEIGHTED AVERAGE EXERCISE PRICE | WEIGHTED AVERAGE FAIR VALUE OF OPTIONS GRANTED |
|---|---|---|---|
| Options outstanding, December 31, 1999......... | 1,409,326 | $ 2.21 | |
| Options granted.............................. | 589,028 | 1.78 | 1.02 |
| Options exercised............................ | (23,867) | 1.48 | |
| Options forfeited............................ | (167,824) | 1.88 | |
| Options outstanding, December 31, 2000......... | 1,806,663 | $ 2.09 | |
| Options granted.............................. | 185,000 | $ 1.60 | 0.89 |
| Options exercised............................ | (23,422) | 1.29 | |
| Options forfeited............................ | (123,967) | 2.63 | |
| Options outstanding, December 31, 2001......... | 1,844,274 | $ 2.01 | |
| Options granted.............................. | 532,281 | $ 6.30 | 3.40 |
| Options exercised............................ | (851,812) | 1.81 | |
| Options forfeited and expired................. | (89,445) | 3.21 | |
| Options outstanding, December 31, 2002......... | 1,435,298 | $ 3.62 | |
| Options exercisable, December 31, 2002......... | 774,603 | $ 3.27 | |

MERGE TECHNOLOGIES INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table summarizes information about stock options outstanding at December 31, 2002:

| Options Outstanding | | | | Options Ex |
|---|---|---|---|---|
| RANGE OF EXERCISE PRICES | NUMBER OF SHARES | WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE IN YEARS | WEIGHTED AVERAGE EXERCISE PRICE | NUMBER OF SHARES |
| $1.00 - $1.47 | 409,250 | 3.45 | $ 1.130 | 247,875 |
| $1.51 - $2.13 | 347,278 | 3.72 | 1.990 | 251,083 |
| $2.75 - $4.00 | 61,000 | 4.28 | 3.423 | 22,500 |
| $4.16 - $6.00 | 243,270 | 3.75 | 5.186 | 111,770 |
| $6.72 - $8.19 | 374,500 | 5.78 | 6.958 | 141,375 |
| | 1,435,298 | 4.21 | $ 3.644 | 774,603 |

(f) Stock Purchase Plan.

The Company maintains an employee stock purchase plan which allows employees to purchase stock at 85% of the lesser of the stock price at the start of the plan year or the end of each calendar quarter. Contributions to the employee stock purchase plan are made through payroll deductions Employees contributed $75,658, $70,365, and $31,311 during 2002, 2001, and 2000, respectively, to purchase shares of the Company's common stock under the employee stock purchase plan.

(g) Warrants.

In May and June of 2002, 709,343 warrants to purchase shares of common stock were exercised. Of the 709,343 warrants exercised, 403,225 were issued in October of 2001, 12,000 were issued in February of 2001, and the remaining 294,118 were issued in December of 2000. The warrants issued in October of 2001 were exercised at $2.00 per share and the warrants issued in February of 2001 and December of 2000 were exercised at $1.00 per share.

In January 2002, 13,600 of the 25,267 warrants to purchase shares of common stock, issued in January of 2001, were exercised at $1.00 per share.

In October 2001, 12,500 warrants to purchase shares of common stock, issued in December of 2000, were exercised at $1.00 per share.

In October 2001, in conjunction with the sale of common stock, the Company issued warrants to purchase 403,225 shares of common stock at $2.00

per share. The warrants will expire in October 2005. The grant-date fair values of warrants calculated using the Black-Scholes model ranged from $0.84 to $1.87 per warrant.

In January and February 2001, the Company issued warrants to purchase 25,267 shares of common stock at $1.00 per share to two employees in conjunction with a bank guarantee. The warrants were valued using the Black-Scholes option-pricing model with the following assumptions: expected life of three years, expected volatility of 50%, dividend yield of 0% and a risk free interest rate of 5.77% and 5.90%. The warrants will expire in January and February 2004. The grant-date fair value of warrants calculated using the Black-Scholes model was $0.35 and $0.44 per warrant.

In February 2001, the Company issued warrants to purchase 12,000 shares of common stock at $1.00 per share to one individual and one director in conjunction with the sale of Series A Preferred Stock. The warrants were valued using the Black-Scholes option-pricing model with the following assumptions: expected life of three years, expected volatility of 50%, dividend yield of 0% and a risk free interest rate of 4.71% and 4.72%. The warrants will expire in February 2004. The grant-date fair value of warrants calculated using the Black-Scholes model was $0.38 and $0.22 per warrant.

MERGE TECHNOLOGIES INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

At December 31, 2002, the following warrants to purchase the Company's common stock were outstanding. All of the warrants listed were exercisable at December 31, 2002.

| Issue Date | Expiration Date | Shares Under Warrants | Exercise Price |
|---|---|---|---|
| January, 1998 | January, 2003 | 190,000 | $ 7.800 |
| October, 2000 | October, 2005 | 100,000 | 1.156 |
| February, 2001 | February, 2004 | 11,667 | 1.000 |
| Total: | | 301,667 | |

(h) Exchange Rights.

As part of its acquisition of eFilm, the Company granted rights for the issuance of 1,000,000 shares of common stock to holders of eFilm exchangeable shares on a one-for-one basis. As of December 31, 2002, there were 940,000 eFilm exchangeable shares outstanding.

As part of its acquisition of Interpra, the Company granted rights for the issuance of 420,000 shares of common stock to holders of Interpra exchangeable shares on a one-for-one basis. Exchangeable shareholders also have the right to require the Company to purchase the exchangeable shares at $4.50 per share from August 31, 2004 through September 30, 2004. As of December 31, 2002, there were 265,172 Interpra exchangeable shares outstanding.

(8) CONCENTRATIONS

At December 2001, the Company had a long term accounts receivable balance from one customer in the amount of $193,475. Monthly payments due over 63 months commenced in March 2002. The receivable bears interest at a rate of 6.3%. As of December 31, 2002, the balance due was $179,493 of which the current portion of $35,839 is classified as accounts receivable.

Foreign sales, denominated in U. S. Dollars, accounted for approximately 38%, 36%, and 41% of the Company's net sales for the years ended December 31, 2002, 2001, and 2000, respectively. For the years ended December 31, 2002, 2001 and 2000, sales in foreign currency represented 4%, 5%, and 4%, respectively, of the Company's net sales.

The Company sells it products and services to OEM/VAR's and directly to healthcare facilities. Sales to OEM/VAR's totaled $10,787,000, $10,534,000 and $10,141,000 for the years ended December 31, 2002, 2001, and 2000, respectively. Sales made directly to healthcare facilities totaled $6,264,000, $2,922,000 and $1,095,000 for the years ended December 31, 2002, 2001, and 2000, respectively. Sales from the professional services group totaled $3,735,000, $2,285,000 and $1,377,000 for the years ended December 31, 2002, 2001 and 2000, respectively.

The Company maintains offices in Nuenen, The Netherlands and Toronto, Ontario, Canada. Revenues are attributed to countries based on the originating office of the related orders. Net sales for The Netherlands sales office were approximately $5,440,000, $4,440,000 and $4,139,000 in the years ended December 31, 2002, 2001 and 2000, respectively. Net sales for the sales office in Canada were $1,749,000 for the year ended December 31, 2002. For 2001 and 2000 there were no sales attributed to the Company's office in Canada. The value of long-lived assets in service at the Nuenen and Toronto sales offices was not material in 2002 and 2001.

Although the Company maintains a sales office in Tokyo, Japan, orders from customers in Japan are processed in the United States of America and are considered United States of America based sales. The value of long-lived assets in service at the Tokyo office was not material in 2002 and 2001.



The Company had one customer that comprised 18% of net sales for the year ended December 31, 2002. For the year ended December 31, 2001, the Company had one customer and two distributors that comprised 16%, 13%, and 10% of net sales, respectively. One customer represented 13% of accounts receivable at December 31, 2002. At December 31, 2001, accounts receivable from two customers accounted for 18% and 16% of accounts receivable.

## (9) RELATED PARTY TRANSACTIONS

In December 2002, William C. Mortimore, Chairman and Chief Strategist, repaid the $10,000 promissory note, issued in February 2001.

In November 2001, the Company forgave $25,000 of a $50,000 note receivable for a stock subscription from Richard A. Linden, President and Chief Executive Officer. The loan forgiveness occurred pursuant to Mr. Linden's employment contract. The remainder of the note is due in December of 2006.

In March 2001, the Company entered into a consulting arrangement with a director who received $35,000 in compensation for consulting services provided in 2001. The consulting services consist of marketing, strategic planning and investor relations. The consulting agreement ended in December 2001.

In February 2001, the Company sold 30,473 shares of non-registered common stock to William C. Mortimore, Chairman and Chief Strategist, in connection with his employment agreement. In consideration for these shares, Mr. Mortimore paid $10,000 in cash and issued a promissory note in the amount of $10,000. The promissory note is a full recourse note with a term of six years. Interest is payable monthly at 5.07% per annum.

## Item 13. EXHIBITS

23.1 Consent of KPMG LLP

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

## SIGNATURES

In accordance with Section 13 or 15(d) of the Securities Exchange of 1934, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

REGISTRANT:

MERGE TECHNOLOGIES INCORPORATED

Date: May 7, 2003

By: /s/ Richard A. Linden

Richard A. Linden
President and Chief Executive Officer

Date: May 7, 2003

By: /s/ Scott T. Veech

Scott T. Veech
Chief Financial Officer, Treasurer and Secretary

## CERTIFICATION

PURSUANT TO SECTION 302 OF THE SARBANES - OXLEY ACT OF 2002

I, Richard A. Linden, certify that:

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

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

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

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

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

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

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

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

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

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

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

Date: May 7, 2003

/s/ Richard A. Linden
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Richard A. Linden, Chief Executive Officer

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

CERTIFICATION

PURSUANT TO SECTION 302 OF THE SARBANES - OXLEY ACT OF 2002

I, Scott T. Veech, certify that:

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

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

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

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

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

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

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

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

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

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

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

Date: May 7, 2003

/s/ Scott T. Veech

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Scott T. Veech, Chief Financial Officer

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

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EXHIBIT 23.1

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CONSENT OF INDEPENDENT AUDITORS

The Board of Directors
Merge Technologies Incorporated:

We consent to the incorporation by reference in the registration statements on Form S-3 (Nos. 333-93965, 333-75900 and 333-100103) and on Form S-8 (Nos. 333-34884, 333-40832, 333-40882 and 333-100104) of Merge Technologies Incorporated of our report dated March 28, 2003, with respect to the consolidated balance sheets of Merge Technologies Incorporated as of December 31, 2002 and 2001, and the related statements of operations, shareholders' equity, cash flows and comprehensive income (loss) for each of the years in the three-year period ended December 31, 2002, which report appears in the annual report on Form 10-KSB/A of Merge Technologies Incorporated for the year ended December 31, 2002. Our report on the consolidated financial statements refers to the adoption of the provisions of Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets" on January 1, 2002.

/s/ KPMG LLP

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KPMG LLP

Chicago, Illinois

May 6, 2003

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EXHIBIT 99.1
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CERTIFICATION of CHIEF EXECUTIVE OFFICER and CHIEF FINANCIAL OFFICER

PURSUANT TO U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES - OXLEY ACT OF 2002

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

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

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

Date: May 7, 2003 By: /s/ Richard A. Linden
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Richard A. Linden
Chief Executive Officer

Date: May 7, 2003 By: /s/ Scott T. Veech
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Scott T. Veech
Chief Financial Officer

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

See also the certification pursuant to Sec. 302 of the Sarbanes - Oxley Act of 2002, which is also attached to this Report.