VITAL SIGNS INC
Form 10-Q
August 14, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-Q

(Mark one)

[X] Quarterly report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934 for the quarterly period ended June 30, 2002 or

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

Commission file number: 0-18793

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

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

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

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

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

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

Yes X No

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

At August 5, 2002 there were 12,919,068 shares of Common Stock, no par value, outstanding.

VITAL SIGNS, INC.

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PART I.

Financial Information

Item 1.

Financial Statements

Certain information and footnote disclosures required under generally accepted accounting principles have been condensed or omitted from the following consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission. Vital Signs, Inc. (the "registrant" or the "Company" or "Vital Signs") believes that the disclosures are adequate to assure that the information presented is not misleading in any material respect. It is suggested that the following consolidated financial statements be read in conjunction with the year-end consolidated financial statements and notes thereto included in the registrant's Annual Report on Form 10-K for the year ended September 30, 2001.

The results of operations for the interim periods presented herein are not necessarily indicative of the results to be expected for the entire fiscal year.

INDEPENDENT ACCOUNTANT'S REPORT

To the Board of Directors
Vital Signs, Inc.

We have reviewed the accompanying consolidated balance sheet of Vital Signs, Inc. as of June 30, 2002 and the related consolidated statements of income (operations) for the three-month and nine-month periods ended June 30, 2002 and 2001, and cash flows for the nine-month periods ended June 30, 2002 and 2001. These financial statements are the responsibility of the Company's management.

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

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

GOLDSTEIN GOLUB KESSLER LLP
New York, New York

August 1, 2002

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VITAL SIGNS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	JUNE 30, 2002 ((UNAUDITED
ASSETS	
Current Assets:	
Cash and cash equivalents	$ 24,73
Accounts receivable, less allowance for doubtful accounts of $379 and $436 respectively	34,82
Inventory	26,39
Prepaid expenses and other current assets	6,43
Total Current Assets	92,40
Property, plant and equipment - net	37,84
Marketable securities	26
Goodwill	66,52
Deferred income taxes	1,98
Other assets	2,60
Total Assets	$201,63
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current Liabilities:	
Accounts payable	$ 5,79
Current portion of long-term debt	42
Accrued expenses	7,37
Notes payable - bank	1,67
Other current liabilities	--
Total Current Liabilities	15,26

Long term debt	1,59
Total Liabilities	16,86
Commitments and contingencies	
Minority interest in subsidiary	2,75
Stockholders' Equity	
Common stock - no par value; authorized 40,000,000 shares, issued and outstanding 12,919,068 and 12,935,656 shares, respectively	29,71
Accumulated other comprehensive loss	(1,06
Retained earnings	153,37
Stockholders' equity	182,01
Total Liabilities and Stockholders' Equity	$201,63

See Notes to Consolidated Financial Statements

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VITAL SIGNS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	FOR THE
	2002
	(In Thousands Ex
Revenue:	
Net sales	$112,048
Service revenue	19,887
	131,935
Cost of goods sold and services performed:	
Cost of goods sold	54,413
Cost of services performed	11,528
	65,941
Gross profit	65,994
Operating expenses:	
Selling, general and administrative	33,618
Research and development	5,541
Special operating (credits) charges	(3,428)
Goodwill amortization	---
Other expense - net	393

Total operating expenses	36,124
Operating Income	29,870
Other (income) expense:	
Interest income	(522)
Interest expense	184
Other (income)	---
Total other (income)	(338)
Income before provision for income taxes and minority interest in income of consolidated subsidiary	30,208
Provision for income taxes	10,156
Income before minority interest in income of consolidated subsidiary	20,052
Minority interest in income of consolidated subsidiary	345
Net income	$ 19,707
Net income per Common Share:	
Basic net income per share	$ 1.53
Diluted net income per share	$ 1.51
Basic weighted average number of shares outstanding	12,893
Diluted weighted average number of shares outstanding	13,040
Dividends paid per share	$ .12

See Notes to Consolidated Financial Statements

VITAL SIGNS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME (OPERATIONS)
(Unaudited)

	FOR THE
	2002
	(In Thousand
Revenue:	
Net sales	$37,425
Service revenue	8,952
	46,377
Cost of goods sold and services performed:	

Cost of goods sold	17,378
Cost of services performed	5,029
	22,407
Gross Profit	23,970
Operating expenses:	
Selling, general and administrative	11,852
Research and development	1,871
Special operating charges	1,578
Goodwill amortization	---
Other expense - net	251
Total operating expenses	15,552
Operating income (loss)	8,418
Other (income) expense:	
Interest income	(137)
Interest expense	125
Total other (income) expense	(12)
Income (loss) before provision (benefit) for income taxes and minority interest in income (loss) of consolidated subsidiary	8,430
Provision (benefit) for income taxes	2,789
Income (loss) before minority interest in income (loss) of consolidated subsidiary	5,641
Minority interest in income (loss) of consolidated subsidiary	191
Net income (loss)	$ 5,450
Net income per Common Share:	
Basic net income (loss) per share	$ .42
Diluted net income (loss) per share	$ .42
Basic weighted average number of shares outstanding	12,879
Diluted weighted average number of shares outstanding	13,049
Dividends paid per share	$ .04

See Notes to Consolidated Financial Statements

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

	FOR THE
	2002
	(
Cash Flows from Operating Activities:	
Net income	$19,707
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:	
Depreciation and amortization	2,943
Impairment charge	1,578
Amortization of goodwill	---
Deferred taxes	2,106
Non cash gain on litigation accrual reversal	(5,006)
Minority interest in income of consolidated subsidiary	345
Changes in operating assets and liabilities:	
Decrease (increase) in accounts receivable	633
Decrease (increase) in inventory	469
Decrease (increase) in prepaid expenses and other current assets	5,901
Increase (decrease) in other current liabilities	(1,449)
Decrease (increase) in other assets	804
(Decrease) increase in accounts payable and accrued expenses	(698)
Net cash provided by operating activities	27,333
Cash Flows from Investing Activities:	
Acquisition of subsidiaries, net of cash acquired	(21,796)
Proceeds from sales of available-for-sale securities	76
Acquisition of property, plant and equipment	(3,235)
Net cash used in investing activities	(24,955)
Cash Flows from Financing Activities:	
Purchase of treasury stock	(2,265)
Issuance of treasury stock	191
Dividends paid	(1,553)
Proceeds from exercise of stock options	810
Proceeds from short term note payable	---
Principal payments of long-term debt and notes payable	(5,622)
Net cash provided by (used in) financing activities	(8,439)
Effect of exchange rate changes on cash	(231)
Net increase (decrease) in cash and cash equivalents	(6,292)
Cash and cash equivalents at beginning of period	31,029
Cash and cash equivalents at end of period	$24,737
Supplemental disclosures of cash flow information:	
Cash paid during the nine months for:	
Interest	$ 157
Income taxes	455

See Notes to Consolidated Financial Statements

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

1. The consolidated balance sheet as of June 30, 2002, the consolidated statements of income (operations) for the three and nine months ended June 30, 2002 and 2001 and the consolidated statement of cash flows for the nine months ended June 30, 2002 and 2001 have been prepared by Vital Signs, Inc. (the "Company" or "VSI") and are unaudited. In the opinion of management, all adjustments (consisting solely of normal recurring adjustments) necessary to present fairly the financial position at June 30, 2002, the results of operations for the three-month and nine-month periods ended June 30, 2002 and 2001 and cash flows for the nine-month periods ended June 30, 2002 and 2001 have been made.

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

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

4. At June 30, 2002, the Company's inventory was comprised of raw materials, $15,744,000, and finished goods, $10,227,000.

5. For details of legal proceedings, see Part II, Item 1, "Legal Proceedings".

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

	FOR THE NINE-MONTHS ENDED JUNE 30,

	2002	2001
	(In Thousands, Except Per Share Amoun	
Reported net income	$19,707	$3,658
Add back: goodwill amortization	---	875
Adjusted net income, net of tax	$19,707	$4,533
Basic earnings per share as reported	$ 1.53	$ .29
Adjusted basic earnings per share	1.53	.36
Diluted earnings per share as reported	1.51	.29
Adjusted diluted earnings per share	1.51	.35

(Notes to Consolidated Financial Statements continued from previous page)

7. On January 1, 2002 the Company's National Sleep Technologies, Inc. ("NST") subsidiary completed its merger with HSI Medical Services, Inc. ("HSI"), a subsidiary of the Johns Hopkins Health System, with the merged entity to be known as Sleep Services of America, Inc. NST issued 7,921,408 shares of its Common Stock with a fair value of approximately $4,753,000, along with warrants to purchase 326,791 shares of NST's common stock in exchange for all of the outstanding common stock of HSI. The excess of the purchase price over the fair value of the net assets acquired, goodwill, was approximately $3,203,000. The Company's interest in the combined NST entity is approximately 68%. Goodwill was recognized in accordance with Statement of Financial Accounting Standards No. 142 ("Goodwill and Other Intangible Assets").

8. On March 28, 2002, the Company consummated the merger of Stelex, Inc. ("Stelex") into the Company's wholly owned subsidiary, The Validation Group, Inc. ("TVG"). The surviving entity is to be known as Stelex/TVG, Inc. The purchase price for the acquisition of Stelex was approximately $13,087,000. The purchase price was allocated to the assets acquired based on their estimated fair values. The excess of the purchase price over the fair value of the net assets acquired, goodwill, was approximately $12,657,000. Goodwill was recognized in accordance with Statement of Financial Accounting Standards No. 142 ("Goodwill and Other Intangible Assets").

9. The following unaudited proforma information presents a summary of the Company's consolidated results of operations and the Stelex and HSI business as if the acquisition had occurred on October 1, 2000:

	FOR THE NINE-MONTHS ENDED JUNE 30,		FOR THE TH JU
	2002	2001	2002

	(In Thousands, Except Per Share Amoun		
Net sales and revenues	139,097	131,857	46,373
Net earnings	21,152	3,862	5,450
Basic net earnings per Common Share	1.64	.31	.42
Diluted net earnings per Common Share	1.62	.30	.42

These unaudited proforma results have been prepared for comparative purposes only and do not purport to be indicative of the results of operations which would have actually resulted had the combinations been in effect on October 1, 2000 or of future results of operations.

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Item 2.

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

Forward Looking Statements

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

The Company wishes to ensure that any forward-looking statements are accompanied by meaningful cautionary statements in order to comply with the terms of the safe harbor provided by the Reform Act. Accordingly, the Company has set forth a list of important factors that could cause the Company's actual results to differ materially from those expressed in forward-looking statements or predictions made herein and from time to time by the Company. Specifically, the Company's business, financial condition, liquidity and results of operations could be materially different from such forward-looking statements and predictions as a result of (i) cost containment pressures on hospitals and competitive factors that could affect the Company's primary markets, including the results of competitive bidding procedures implemented by group purchasing organizations and/or the success of the Company's sales force, (ii) slow-downs in the healthcare industry or interruptions or delays in manufacturing and/or sources of supply, (iii) the Company's ability to develop or acquire new and improved products and to control costs, (iv) market acceptance of the Company's new products, (v) technological change in medical technology, (vi) the scope, timing and effectiveness of changes to manufacturing, marketing and sales

programs and strategies, (vii) intellectual property rights and market acceptance of competitors' existing or new products, (viii) adverse determinations arising in the context of regulatory matters or legal proceedings (see Part II, Item 1 of this Quarterly Report on Form 10-Q), (ix) healthcare industry consolidation resulting in customer demands for price concessions, (x) the reduction of medical procedures in a cost conscious environment, (xi) efficacy or safety concerns with respect to marketed products, whether scientifically justified or not, that may lead to product recalls, withdrawals or declining sales, and (xii) healthcare reform and legislative and regulatory changes impacting the healthcare market both domestically and internationally.

Results of Operations

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

	INCREASE/(DECREASE) FROM PR	
	THREE MONTHS ENDED JUNE 30,2002 COMPARED WITH THREE MONTHS ENDED JUNE 30, 2001	JUNE
Revenues	9.1%	
Cost of goods sold and services performed	8.2%	
Gross profit	10.0%	
Operating expenses:		
Selling, general and administrative expense	7.2%	
Research and development expenses	(9.7)%	
Total operating expenses	(54.2)%	
Provision for income taxes	171.9%	
Net income	165.4%	

COMPARISON: QUARTER ENDED JUNE 30, 2002
AND QUARTER ENDED JUNE 30, 2001

Net sales and revenues for the quarter ended June 30, 2002 increased by $3,873,000 or 9.1% compared with the same period last year. The increase was

primarily due to the growth within the Company's sleep companies, Breas Medical and Sleep Services of America, and the growth due to the merger of Stelex, Inc. and The Validation Group to form Stelex-TVG.

Sales of anesthesia products, representing 37.9% of net sales and revenues, decreased by approximately $409,000 or 2.3% from the quarter ended June 30, 2001 due primarily to reduced sales by Thomas Medical Products, Inc., which were partially offset by volume growth in anesthesia circuit sales. Sales of respiratory/critical care products, representing 39.1% of net sales and revenues, increased by approximately $2,063,000 or 12.8%, primarily due to the acquisition of Stelex, Inc., to be part of the Company's validation consulting service company. Sales by the Company's sleep service companies, representing 22.9% of net sales and revenues, increased by $2,221,000, or 26.4% due primarily to a growth in sales of the Company's Breas subsidiary, and the merger of NST with HSI, effective January, 1, 2002.

The Company's reported gross profit percentage for the quarter was 51.7%, compared to 51.3% in the same period of the last fiscal year. Improved gross profits in our anesthesia, respiratory/critical care and Vital Pharma unit, resulted from cost improvement programs.

Selling, general and administrative expenses (S, G & A) for the quarter ended June 30, 2002 increased by $792,000 or 7.2% over the prior year's quarter primarily due to additional employees resulting from the merger of NST and HSI, and the merger of Stelex, Inc. and The Validation Group.

Research and development expenses ("R&D") decreased by $202,000 due to reduced expenditures on R & D projects.

Other expense, net, for the quarter ended June 30, 2002 increased $61,000 from $190,000 in the quarter ended June 30, 2001 to $251,000, primarily resulting increased contributions.

The Company recorded an impairment charge of $1.6 million related principally to its Chinese subsidiary due to unusual circumstances effecting that subsidiary's operations, which are the subject of an on-going internal investigation. Our Chinese operations have not been profitable. We are re-evaluating our strategy of selling direct in China and may consider selling through distributors.

Interest income decreased 9.9%, from $152,000 during the three months ended June 30, 2001 to $137,000 during the three months ended June 30, 2002, reflecting lower interest rates. Interest expense decreased 30.9% from $181,000 during the three months ended June 30, 2001 to $125,000 during the three months ended June 30, 2002 reflecting reduced loan balances.

During the quarter ended June 30, 2001, a major consulting firm was engaged to assist the Company in an impairment analysis of the Company's subsidiary, Vital Pharma,Inc. which has sustained significant sales erosion and operating losses. The Company recorded a special charge relating to the Vital Pharma subsidiary of approximately $18.2 million dollars. Further special charges were taken for various other impairments and charges aggregating $2.2 million.

The Company's effective tax rates were a provision of 33.0% and a benefit of 31.8% for the quarters ended June 30, 2002 and 2001, respectively. The increase in the effective tax rate is related to the higher tax bracket resulting from increased operating profits.

COMPARISON: NINE MONTHS ENDED JUNE 30, 2002
AND NINE MONTHS ENDED JUNE 30, 2001

Net sales and revenues for the nine months ended June 30, 2002 increased by $7,959,000 or 6.4% compared with the same period last year. The increase was primarily due to the growth within the Company's sleep companies, Breas and Sleep Services of America, the growth due to the merger of Stelex, Inc. and The Validation Group to form Stelex-TVG, and the growth in the anesthesia business.

Sales of anesthesia products, representing 40.3% of net sales and revenues, increased by approximately $2,694,000 or 5.3% from the nine-month period ended June 30, 2001 due primarily to volume growth in anesthesia circuit sales led by the Company's new anesthesia breathing circuit Limb-O'TM'. Sales ofrespiratory/critical care products, representing 37.7% of net sales and revenues, decreased by approximately $516,000 or 1.0% primarily due to the loss of a major customer by the Company's validation service company. This loss is partially offset by increased revenues from the acquisition of Stelex, Inc. Sales by the Company's sleep service companies, representing 22.0% of net sales and revenues, increased by $5,781,000 or 24.9% due primarily to a growth in sales of the Company's Breas subsidiary and the merger of NST with HSI to form Sleep Services of America, effective January, 1, 2002.

The Company's reported gross profit percentage for the nine months ended June 30, 2002 was 50.0% compared to 51.4% in the same time period of the last fiscal year. The decrease in gross profit percentage is primarily due to two factors. One factor was the re-evaluation of the carrying value of the Company's inventory, charges to Cost of Goods of approximately $1,400,000 were taken in the current fiscal year. The second factor is an increase in service revenue of approximately $2,765,000 at a lower gross profit. The gross profit percentage in anesthesia, respiratory/critical care and Breas averaged 52.7% (before inventory reserves), for the nine month periods ended June 30, 2002 and averaged 52.4% for the nine months ended June 30, 2001.

Selling, general and administrative expenses (S, G & A) increased by $1,889,600 or 6.0% primarily due to additional employees resulting from the merger of NST and HSI, (approximately $1.1 million), the acquisition of Stelex, Inc. (approximately $463,000), with the balance of the increase related to increased legal accruals and bad debt expense.

Research and development expenses ("R&D") decreased by $362,000 or 6.1% due to reduced expenditures on R & D projects.

During the nine months ended June 30, 2002, we reversed $5.0 million in litigation accruals as a result of the successful conclusion of a patent infringement suit. This litigation predated our 1997 acquisition of Marquest Medical Products. At the time of this acquisition, we were advised that Marquest had potential liability as the indemnitor of a distributor which was being sued for patent infringement in Japan. We recorded a sizable reserve at the time of the Marquest acquisition and increased that reserve during the pendency of the litigation as a result of a lower court decision against us. The accruals were reversed during the quarter ended March 31, 2002 when the Tokyo Supreme Court ruled in favor of our distributor, thereby ending the legal proceeding.

Other expense, net of other income included in operating income, decreased by 39.4% from a net expense of $648,000 for the nine months ended June 30, 2001 to $393,000 for the nine months ended June 30, 2002. This change

resulted from a decrease in expense related to charitable contributions.

The Company took an impairment charge of $1.5 million in its Chinese subsidiary due to unusual circumstances effecting that subsidiary's operations, which are the subject of an on-going internal investigation. Our Chinese operations have not been profitable. We are re-evaluating our strategy of selling direct in China and may consider selling through distributors.

Interest income decreased 18.6%, from $641,000 during the nine months ended June 30, 2001 to $522,000 during the nine months ended June 30, 2002, reflecting lower interest rates. Interest expense decreased 68.6% from $586,000 during the nine months ended June 30, 2001 to $184,000 during the nine months ended June 30, 2002 reflecting pay-downs of existing debt and loans.

Other income and expense in the nine month period ended June 30, 2001 consisted of gain on certain investments. There was no gain in the nine month period ended June 30, 2002.

During the quarter ended June 30, 2001, a major consulting firm was engaged to assist the Company in an impairment analysis of the Company's subsidiary, Vital Pharma, Inc, which has sustained significant sales erosion and operating losses. The Company recorded a special charge relating to the Vital Pharma subsidiary of approximately $18.2 million dollars. Further special charges were taken for various other impairments and charges aggregating $2.2 million.

The Company's effective tax rates were 33.6% and 26.0% for the nine month period ended June 30, 2002 and 2001 respectively. The increase in effective tax rate over the prior year's nine-month period reflects the higher tax bracket resulting from the increase in taxable income.

Liquidity and Capital Resources

The Company continues to rely upon cash flow from its operations. During the nine-month period ended June 30, 2002, cash and cash equivalents decreased by approximately $6,292,000, reflecting net cash provided by operations of approximately $27.3 million and from the proceeds from the exercise of stock options of $810,000, offset by cash used for the acquisition of Stelex, Inc., Breas and certain SSA shareholders of approximately $21.8 million, net of cash acquired; capital expenditures of approximately $3.2 million; dividend payments of approximately $1.6 million; the purchase of treasury stock of approximately $2.3 million; and principal payments on notes payable and debt of approximately $5.6 million. The combined total of cash and cash equivalents and long-term marketable securities was approximately $25.0 million at June 30, 2002 as compared to $31.5 million at September 30, 2001.

At June 30, 2002, the Company had approximately $24,737,000 in cash and cash equivalents. On that date, the Company's working capital was $77,135,000 and the current ratio was 6.2 to 1, as compared to $70,493,000 and 3.5 to 1 at September 30, 2001.

Capital expenditures of approximately $3.2 million for the nine-month period primarily reflected the buy-out of its operating lease for the fair market value of the Company's Colorado plant equipment, the purchase of a packaging line for that facility, and other equipment.

The Company's current policy is to retain working capital and earnings for use in its business, subject to the payment of certain cash dividends and treasury stock repurchases. Such funds may be used for product development, product acquisitions and business acquisitions, among other things. The Company regularly evaluates and negotiates with domestic and foreign medical device companies regarding potential business or product line acquisitions or licensing arrangements by the Company.

The Company has a $20 million line of credit with Chase Manhattan Bank ("Chase"). Chase has also expressed its intention to provide additional funds for the Company's future acquisitions, provided that each such acquisition meets certain criteria. The terms for any borrowing would be negotiated at the date of origination. There were no amounts outstanding at June 30, 2002.

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

ITEM 3.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risks, including the impact of commodity price changes and changes in the market value of its investments and, to a lesser extent, interest rate changes and foreign currency fluctuations. In the normal course of business as described below, the Company employs policies and procedures with the objective of limiting the impact of market risks on earnings and cash flows and to lower its overall borrowing costs. The Company does not believe that its exposure to market risks would be material to the consolidated statements as a whole.

The Company believes that the impact of interest rate changes and foreign currency fluctuations is not material to the Company's financial condition. The Company does not enter into interest rate and foreign currency transactions for speculative purposes. Other than for its operations at Breas Medical, which is headquartered in Sweden, it is the Company's policy to price products from vendors and to customers in U.S. dollars and to receive payment in U.S. dollars. Historically, the international portion of the

Company's sales has been relatively small and the effect of changes in interest rates and foreign exchange rates on the Company's earnings generally has been small relative to other factors that also affect earnings, such as unit sales and operating margins. However, the international segment is expected to grow both in terms of actual sales and as a percentage of the Company's total sales and the Company may in the future need to revise or change its approach to managing interest rate and foreign currency transactions.

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

CRITICAL ACCOUNTING PRINCIPLES AND ESTIMATES

We have identified the following critical accounting policies that affect the more significant judgments and estimates used in the preparation of our consolidated financial statements. The preparation of our consolidated financial statements in conformity with generally accepted accounting principles requires us to make estimates and judgments that affect our reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to asset impairment, revenue recognition, allowance for doubtful accounts, and contingencies and litigation. We state these accounting policies in the notes to our consolidated financial statements and at relevant places in this discussion and analysis. These estimates are based on the information that is currently available to us and on various other assumptions that we believe to be reasonable under the circumstances. Actual results could vary from these estimates under different assumptions or conditions.

We believe that the following critical accounting policies affect the more significant judgments and estimates used in the preparation of our consolidated financial statements:

- Through September 30, 2001, we amortized goodwill and intangibles on a straight-line basis over their estimated lives. Upon our adoption of SFAS No. 142 on October 1, 2001, we ceased amortizing goodwill and will perform an annual impairment analysis based upon discounted cash flows to assess the recoverability of the goodwill, in accordance with the provisions of SFAS No. 142. During the quarter ended [March 31, 2002] we completed this impairment test and found no impairment. If we are required to record an impairment charge in the future, it would have an adverse impact on our results of operations and financial condition.

- We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments, which results in bad debt expense. As of June 30, 2002, the allowance for doubtful accounts was $379,000. We determine the adequacy of this allowance by evaluating individual customer receivables, considering the customer's financial condition and credit history and analyzing current economic conditions. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

- For each accounting period, we estimate the amount of rebates that we will credit to our distributors, based on sales made to those distributors during such period. We utilize a moving average based on prior history to make these estimates.

- We are subject to various claims and legal actions in the ordinary course of our business. These matters frequently arise in disputes regarding the rights to intellectual property, where it is difficult to assess the likelihood of success and even more difficult to assess the probable ranges of recovery. Although we currently are not aware of any legal proceeding that is reasonably likely to have a material adverse effect on us, if we become aware of any such claims against us, we will evaluate the probability of an adverse outcome and provide accruals for such contingencies as necessary.

- We have established a reserve for inventory obsolescence. The reserve was determined by performing an aging analysis of the inventory, and reserving for that portion of the inventory that was estimated to be in excess of one year. As of June 30, 2002, our inventory reserves were $1,341,000.

PART II.
OTHER INFORMATION

ITEM 1.

Legal Proceedings:

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

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

(c) On April 4, 1997 a complaint was filed against us for an incident which occurred on April 6, 1995. The plaintiff, representing the estate of the alleged victim, alleges that her mother died due to defects in a valve manufactured by us. Such defects are alleged to include inadequate labeling and instructions. The plaintiff seeks an unspecified amount of compensation for damages for wrongful death and for recovery under the Illinois Survival Act. In addition, the plaintiff has sought to amend the complaint to add an additional cause of action for punitive damages. On June 20, 2002, the Magistrate issued a Report and Recommendation that the plaintiff's motion with the District Court Judge to amend the complaint

be denied. The plaintiff has filed an objection to the Magistrate's Report and Recommendation. No decision has been rendered by the District Court. A claim for punitive damages would not be covered by our product liability insurance. Our excess liability carrier has denied its coverage responsibility on the grounds that plaintiff's entire claim falls outside of the applicable policy period. On August 9, 2002 we began a lawsuit seeking a judicial determination that if it becomes necessary to access our excess liability policy, either the carrier or our insurance broker will be liable to provide us with coverage.

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

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

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ITEM 6.

Exhibits and Reports on Form 8-K

A) There were no reports on Form 8-K filed in the period.

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Signatures

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

VITAL SIGNS, INC.

By: /s/ Joseph F. Bourgart

Joseph F. Bourgart
Executive Vice President and
Chief Financial Officer

Date: August 14, 2002

STATEMENT OF DIFFERENCES

The trademark symbol shall be expressed as .... 'TM'