BLOCKBUSTER INC
Form 11-K
June 30, 2008
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 11-K

ANNUAL REPORT PURSUANT TO SECTION 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2007

Or

¨ **TRANSITION REPORT PURSUANT TO SECTION 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ______ to ______

Commission File Number 001-15153

A. Full title of the plan and the address of the plan, if different from that of the issuer named below:

BLOCKBUSTER INVESTMENT PLAN

B. Name of issuer of the securities held pursuant to the plan and the address of its principal executive office:

BLOCKBUSTER INC.

1201 Elm Street

Dallas, Texas 75270

Table of Contents

BLOCKBUSTER INVESTMENT PLAN

INDEX TO FINANCIAL STATEMENTS AND EXHIBITS

	Page
Financial Statements:	
Report of Independent Registered Public Accounting Firm	3
Statements of Net Assets Available for Benefits December 31, 2007 and 2006	4
Statement of Changes in Net Assets Available for Benefits Year Ended December 31, 2007	5
Notes to Financial Statements	6
Supplemental Schedules*:	
Schedule H, Line 4i: Schedule of Assets (Held at End of Year) December 31, 2007	15
Signatures	16
Exhibits:	
Exhibit 23.1 Consent of Independent Registered Public Accounting Firm	

* Other schedules required by the Department of Labor s Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974, as amended, have been omitted because they are not applicable or not required.

Table of Contents

Report of Independent Registered Public Accounting Firm

To the Participants and Administrator of the

Blockbuster Investment Plan:

In our opinion, the accompanying statements of net assets available for benefits and the related statement of changes in net assets available for benefits present fairly, in all material respects, the net assets available for benefits of the Blockbuster Investment Plan (the Plan) at December 31, 2007 and 2006, and the changes in net assets available for benefits for the year ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Plan s management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedule of assets (held at end of year) at December 31, 2007 is presented for the purpose of additional analysis and is not a required part of the basic financial statements but is supplementary information required by the Department of Labor s Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. This supplemental schedule is the responsibility of the Plan s management. The supplemental schedule has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

PricewaterhouseCoopers LLP

Dallas, Texas

June 27, 2008

Table of Contents

BLOCKBUSTER INVESTMENT PLAN

STATEMENTS OF NET ASSETS AVAILABLE FOR BENEFITS

	At December 31	
	2007	**2006**
Investments at fair value (Note 4)	$ 101,433,838	$ 89,172,378
Cash	6,002	8,059,261
Receivables:		
Investment income	9,839	6,504
Contributions:		
Employee	409,944	540,077
Employer	211,946	260,999
Transfer from other plan	1,787,258	
Net assets available for benefits at fair value	103,858,827	98,039,219
Adjustment from fair value to contract value for fully benefit-responsive investment contracts (Note 2)	(232,659)	14,104
Net assets available for benefits	$ 103,626,168	$ 98,053,323

The accompanying notes are an integral

part of these financial statements.

4

Table of Contents

BLOCKBUSTER INVESTMENT PLAN

STATEMENT OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS

	Year Ended December 31, 2007
Contributions:	
Employee	$ 9,970,098
Employer	4,765,223
Rollovers	632,864
Total contributions	15,368,185
Investment income:	
Interest and dividends	4,959,825
Net appreciation in fair value of investments (Note 4)	62,779
Net investment income	5,022,604
Deductions:	
Benefits paid to participants	(16,341,403)
Participant administrative expenses	(263,799)
Total deductions	(16,605,202)
Transfers:	
Transfer from other plan (Note 8)	1,787,258
Net increase	5,572,845
Net assets available for benefits, beginning of period	98,053,323
Net assets available for benefits, end of period	$ 103,626,168

The accompanying notes are an integral

part of these financial statements.

Table of Contents

BLOCKBUSTER INVESTMENT PLAN

NOTES TO FINANCIAL STATEMENTS

NOTE 1 PLAN DESCRIPTION

The following is a brief description of the Blockbuster Investment Plan (the Plan) and is provided for general information only. Participants should refer to the Plan document for more complete information regarding the Plan.

General

The Plan is a defined contribution 401(k) plan, which was adopted on February 8, 1999 and became effective on May 1, 1999, covering employees of Blockbuster Inc. (the Company or Blockbuster), and its participating subsidiaries. The Plan is offered on a voluntary basis to all eligible full-time and part-time employees and is subject to the provisions of the Internal Revenue Code of 1986, as amended (the Code), and the Employee Retirement Income Security Act of 1974, as amended (ERISA). The Plan is administered by a committee (the Retirement/Investments Committee), the members of which were appointed by the Board of Directors of the Company. The Retirement/Investments Committee has discretionary control over the management and disposition of the Plan s assets as set forth in the Plan document. The Retirement/Investments Committee is a named fiduciary of the Plan.

The Plan is designed to satisfy the requirements of a safe harbor plan and is therefore exempt from the actual deferral and contribution percentage discrimination testing requirements of Code Sections 401(k) and (m). Although the Company anticipates that the Plan will continue indefinitely, it reserves the right to amend the Plan at any time through action of the Board of Directors, or the Retirement/Investments Committee in the case of certain administrative amendments, and to terminate the Plan at any time through action of the Board of Directors, provided that such action is in accordance with applicable law.

Eligibility

Full-time employees are generally eligible to participate in the Plan on the first day of the month in which they have both (i) reached age 21 and (ii) completed one year of eligibility service. Eligibility service is generally based on the number of days for which a full-time employee is given service credit. Part-time employees are generally eligible to participate in the Plan on the first day of the month following the month in which they have both (i) reached age 21 and (ii) completed one year of eligibility service, with eligibility service generally being defined as a consecutive twelve month period in which a part-time employee works at least 1,000 hours.

Investment and Participant Accounts

Mercer HR Services, L.L.C. provides the recordkeeping and administrative services for the Plan. Additionally, Mercer Trust Company (the Trustee) is the trustee and custodian of Plan assets. The Trustee uses various parties, including Putnam Investments, for various administrative functions required by the Plan. Investment options for Plan participants are subject to change in accordance with the terms of the Plan.

Effective December 31, 2005, the company formerly known as Viacom Inc. (Viacom) was separated into two publicly traded entities, CBS Corporation (CBS) and new Viacom Inc. (New Viacom). As a result of the separation, each share of Viacom Class A Common Stock was converted into 0.5 of a share of CBS Class A Common Stock and 0.5 of a share of New Viacom Class A Common Stock and each share of Viacom Class B Common Stock was converted into 0.5 of a share of CBS Class B Common Stock and 0.5 of a share of New Viacom Class B Common Stock (the Share Conversion). Participant accounts were adjusted to reflect the Share Conversion on January 3, 2006, the first day of trading for CBS and New Viacom Common Stock. On December 29, 2006, the shares held in the New Viacom Class A and B Common Stock Funds and CBS Class A and B Common Stock Funds were liquidated (the Stock Liquidation) and the proceeds were invested in the Putnam S&P 500 Index Fund on January 5, 2007. As a result of the Stock Liquidation, proceeds of $8,054,581 are included in Cash in the Plan s Statement of Net Assets Available for Benefits as of December 31, 2006.

Table of Contents

Effective October 4, 2007, the Plan replaced the American Funds Balanced Fund investment option with seven Principal Lifetime Fund investment options. Any balances in the American Funds Balanced Fund not transferred by participants and beneficiaries of deceased participants to another investment option under the Plan by September 27, 2007, were automatically transferred to the new Principal Lifetime Fund investment options indicated below, based on the age of the participant on October 3, 2007:

Participant turns 65:	**New Participant Investment Option:**
Before October 4, 2007	Principal LifeTime Strategic Income Fund
Between October 4, 2007 and December 31, 2014	Principal LifeTime 2010 Fund
Between January 1, 2015 and December 31, 2024	Principal LifeTime 2020 Fund
Between January 1, 2025 and December 31, 2034	Principal LifeTime 2030 Fund
Between January 1, 2035 and December 31, 2044	Principal LifeTime 2040 Fund
After December 31, 2044	Principal LifeTime 2050 Fund

Also effective October 4, 2007, the Plan made the following share class change. Any balances in the Vanguard Total Stock Market Index Fund not transferred to another investment option as of September 27, 2007, were automatically adjusted as follows:

Previous Participant Investment Class:	**New Participant Investment Class:**
Vanguard Total Stock Market Index Fund (Admiral shares)	Vanguard Total Stock Market Index Fund (Signal shares)

As of October 4, 2007, Plan participants have the option of investing their contributions or existing account balances among the following:

<u>Common Stock Funds</u>
Blockbuster Class A Common Stock Fund
Blockbuster Class B Common Stock Fund

<u>Blend</u>
Davis New York Venture Fund
Putnam S&P 500 Index Fund
Oppenheimer Main Street Small Cap Growth Fund
Vanguard Total Stock Market Index Fund

<u>Income</u>
PIMCO Total Return Fund

<u>Capital Preservation</u>
Putnam Stable Value Fund

<u>Growth</u>
American Funds Growth Fund of America

<u>International</u>
American Funds EuroPacific Growth Fund

<u>Value</u>
Allianz NFJ Dividend Value Fund

<u>Asset Allocation (Ready-Mixed)</u>
Principal LifeTime 2010 Fund
Principal LifeTime 2020 Fund
Principal LifeTime 2030 Fund
Principal LifeTime 2040 Fund
Principal LifeTime 2050 Fund
Principal LifeTime Strategic Income Fund

Investment elections must be made in multiples of 1%. Common Stock Funds consist only of the applicable common stock. The Plan is intended to meet the requirements of ERISA Section 404(c). Thus, because the Plan permits participants to exercise control over assets in their Plan accounts in accordance with the requirements of ERISA Section 404(c), no person who is otherwise a fiduciary will be liable for any loss, or by reason of any breach, which results from such exercise of control.

Employer matching contributions are invested according to each participant s investment elections.

Contributions

The Plan permits participants to contribute up to 75% of annual Compensation (as defined under the Plan) on a before-tax basis subject to Code limitations. The Plan provides that the employer s matching contribution is equal to (i) 100% of the first 3% of annual compensation contributed and 50% of the next 2% of annual compensation contributed if the participant is not a highly compensated employee, as determined under the Code rules; or (ii) 50% of the first 5% of annual

7

compensation contributed if the participant is a highly compensated employee. For the 2007 Plan year, any employee whose prior year s Compensation (as defined under the Plan) exceeded $100,000 was considered a highly compensated employee for Plan purposes. Pursuant to Code limits, total compensation considered under the Plan for purposes of determining contribution limits could not exceed $225,000 for 2007.

An employee is permitted to rollover into the Plan at any time part or all of the employee s eligible distributions from other tax-qualified savings plans, including profit-sharing plans, pension plans and certain individual retirement arrangements.

The Code limits the amount of annual participant contributions that can be made on a before-tax basis; the limit was $15,500 for 2007. The Code also contains a per participant annual limit on aggregate participant and employer contributions to defined contribution plans maintained by the Company and certain related entities, which for 2007 was equal to the lesser of $45,000 or 100% of annual participant Earnings (as defined under the Plan).

All participants who have attained age 50 before the close of the calendar year are allowed to make catch-up contributions. These contributions can be made if the eligible participants make the maximum contribution permitted under the Plan for a Plan year. Catch-up contributions cannot exceed 75% of the participant s Compensation. The limit for catch-up contributions was $5,000 in 2007.

Loans to Participants

Participants are eligible to receive loans based on their vested account balances. The maximum loan available to a participant is the lesser of 50% of the participant s vested account balance or $50,000 (determined by aggregating loans from all qualified defined contribution plans of the Company or any affiliated company), reduced by the highest aggregate outstanding balance of all Plan loans from all defined contribution plans of the Company or any affiliated company made to the participant during the twelve-month period ending on the day before the loan is made. The minimum loan available to a participant is $500. Loans are collateralized by the participant s remaining vested account balance. The interest rate on participant loans is established on the first day of the calendar quarter of the loan origination at a rate of 1% above the annual prime commercial rate, and a participant can only have one loan outstanding at any time. The loans outstanding at December 31, 2007 carry interest rates ranging from 5.0% to 10.5% and mature at various dates through March 2032. Participants may elect repayment periods from twelve to sixty months through payroll deductions commencing as soon as administratively possible following the distribution of the loan. The Plan allows participants to elect a repayment term of up to 300 months for loans used for the acquisition of a principal residence. Transfers of participant balances for loan disbursements and repayments of loan principal and interest are specifically identified in the respective participants accounts and allocated in accordance with their current investment elections. A loan origination fee of $75 is assessed by Mercer HR Services, L.L.C. to borrowing participants of the Plan upon funding of the loan. Loans that are considered in default according to Plan provisions are reported as a deemed distribution, which is a taxable event for the participant.

Participant Accounts

Each participant s account is credited with the participant s contribution, the Company s matching contribution and allocation of Plan earnings. Expenses are charged for the administration of certain investment options. These expenses are allocated to participants accounts and thus are included as a component of the changes in net assets available for benefits.

Vesting

Participants in the Plan are immediately vested in their contributions and earnings thereon. In addition, all employer matching contributions are 100% vested at the time of contribution.

Payment of Benefits Upon Termination of Employment or Disability

Subject to certain Code limitations, participants in the Plan, or their beneficiaries, may receive their account balances, in a lump sum or in installments over a period of up to 20 years, in the event of retirement, termination of employment, disability or death. Participants must receive a required minimum distribution upon attainment of age 70 $^{1}/2$ unless they are still employed. All distributions are paid in cash except that a participant may elect to have the portion of his or her account that is invested in a Common Stock Fund distributed in shares of the applicable common stock.

Withdrawals During Employment

Participants in the Plan who are still actively employed may elect to withdraw part or all of their after-tax and rollover contributions and earnings thereon.

Table of Contents

Participants who are not age 59 1/2 may also elect to withdraw up to 100% of their vested employer matching contributions contributed prior to January 1, 2001, and earnings thereon. Additionally, participants who are not age 59 1/2 may obtain hardship withdrawals of (i) any of their vested employer matching contributions that were contributed to the Plan before January 1, 2001 and (ii) any of their before-tax contributions to the Plan.

Upon attainment of age 59 1/2, participants may also elect to withdraw all or part of their before-tax contributions and matching contributions, and earnings thereon.

With the exception of hardship withdrawals, participants are limited to one withdrawal in any calendar year. There is no restriction on the number of hardship withdrawals permitted.

Termination Priorities

In the event that the Plan is terminated, subject to conditions set forth in ERISA, the Plan provides that the net assets of the Plan will be distributed to participants in proportion to their respective vested interests in such net assets at that date.

Plan Expenses

Plan loan origination fees and distribution charges are allocated to participants accounts and thus are included in Participant administrative expenses in the Plan s Statement of Changes in Net Assets Available for Benefits.

The Company pays for all other expenses incurred in connection with the administration of the Plan. For the 2007 Plan year the Company incurred a total of $25,028 in administrative expenses and $56,300 of audit expenses. Effective January 1, 2006, account maintenance fees, Common Stock Fund fees and investment advisory fees are paid from Plan assets.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Accounting Method

The accrual method of accounting is used for financial statement presentation.

Investment Valuation and Income Recognition

The Blockbuster Class A and B Common Stock Funds and CBS Class A and B Common Stock Funds are reported at fair value based on the quoted market price of the stock on the New York Stock Exchange. Investments with registered investment companies and the Putnam S&P 500 Index Fund are reported at fair value based upon the market value of the underlying securities as priced by national security exchanges. Participant loans consist of the outstanding principal of loans to Plan participants at December 31, 2007 and 2006, which approximates fair value. Interest income is accrued as earned and dividend income is recorded on the ex-dividend date.

The Putnam Stable Value Fund invests primarily in investment contracts, including guaranteed and security-backed investment contracts. As required by the Financial Accounting Standards Board s (FASB) Staff Position Nos. AAG INV-1 and SOP 94-4-1, *Reporting of Fully Benefit-Responsive Investment Contracts Held by Certain Investment Companies Subject to the AICPA Investment Company Guide and Defined-Contribution Health and Welfare and Pension Plans* (the FSP), investment contracts held by a defined-contribution plan are required to be reported at fair value. However, the contract value is the relevant measurement attribute for that portion of the net assets available for benefits of a defined-contribution plan attributable to fully benefit-responsive investment contracts because contract value is the amount participants would receive if they were to initiate permitted transactions under the terms of the Plan. The Plan adopted the financial statement and disclosure requirements of the FSP effective December 31, 2006. As a result, the Statement of Net Assets Available for Benefits presents the fair value of the investment contracts as well as the adjustment of the fully benefit-responsive investment contracts from fair value to contract value. The Statement of Changes in Net Assets Available for Benefits is prepared on a contract value basis. Fair value of the investment contracts is determined by the fund manager or the fair value of the fund s investments in externally managed stable value commingled investment funds provided to the fund by external managers of these funds. Contract value consists of the book value, or cost plus accrued interest, of the underlying investment contracts.

Security Transactions

Purchases and sales of securities are recorded on the trade date.

The Plan presents in the Statement of Changes in Net Assets Available for Benefits the net appreciation (depreciation) in the fair value of its investments which consists of the realized gains or losses and the unrealized appreciation (depreciation) on those investments.

Table of Contents

Contributions

Employee and employer contributions are accrued in the period that payroll deductions are made from Plan participants in accordance with salary deferral agreements and, as such, become obligations of the Company and assets of the Plan.

Payment of Benefits

Benefits are recorded when paid.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the Plan to make estimates and assumptions, such as those regarding fair value, 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 changes in net assets available for benefits during the reporting period. Actual results could differ from those estimates.

Risks and Uncertainties

The Plan provides for various investment options. Investment securities are exposed to various risks such as interest rate, market and credit risk. Due to the level of risk associated with investment securities and the level of uncertainty related to changes in the value of such securities, it is at least reasonably possible that changes in risks in the near term could materially affect participants account balances and the amounts reported in the Statements of Net Assets Available for Benefits and the related Statement of Changes in Net Assets Available for Benefits.

NOTE 3 COMMITMENTS AND CONTINGENCIES

On September 8, 2006, John Halaris filed a putative class action complaint under ERISA in the United States District Court for the Northern District of Texas purporting to act on behalf of all persons who were participants in or beneficiaries of the Blockbuster Investment Plan whose accounts included investments in Blockbuster stock, at any time, since November 15, 2003. Plaintiff asserts claims against Viacom, the Viacom Investment Committee, the Viacom Retirement Committee, William A. Roskin, John R. Jacobs, Mary Bell, Bruce Lewis, Robert G. Freedline, Larry J. Zine, Keith M. Holtz, Barbara Mickowski, Dan Satterthwaite, Phillipe P. Dauman, Sumner M. Redstone, Richard Bressler, Michael D. Fricklas, John L. Muething, Linda Griego, Jackie M. Clegg, John F. Antioco, Peter A. Bassi, Robert A. Bowman, Gary J. Fernandes, Mel Karmazin, Blockbuster, the Blockbuster Retirement Committee and the Blockbuster Investment Committee. Plaintiff claims that the above-named defendants breached their fiduciary duties in violation of ERISA. Plaintiff seeks declaratory relief, recovery of actual damages, court costs, attorneys fees, a constructive trust, restoration of lost profits to the Blockbuster Investment Plan and an injunction. On September 21, 2007, the trial court partially granted the above-named defendants motions to dismiss the complaint and dismissed plaintiff s claims for restitution damages and alleged omissions by the above-named defendants. The trial court denied other portions of defendants motions to dismiss and reserved judgment on other portions of defendants motions to dismiss. The trial court allowed plaintiff the opportunity to re-plead his claims in light of the trial court s partial dismissal. On November 5, 2007, plaintiff Halaris filed an amended class action complaint adding Dennis Conniff as an additional named plaintiff. Blockbuster believes that the claims are without merit and intends to vigorously defend itself in the lawsuit.

Table of Contents

NOTE 4 INVESTMENTS

Individual investments that represent greater than 5% of net assets available for benefits are identified below:

	At December 31,			
	2007		2006	
	Units/ Principal Amount/ Shares	Net Assets	Units/ Principal Amount/ Shares	Net Assets
Allianz NFJ Dividend Value Fund	718,571	$ 11,992,947	699,096	$ 12,066,390
American Funds Balanced Fund			462,357	8,766,285
American Funds EuroPacific Growth Fund	250,964	12,563,257	216,794	9,950,840
American Funds Growth Fund of America	405,742	13,600,479	367,154	11,914,147
Blockbuster Class A Common Stock Fund	1,276,098	4,976,784	1,390,003	7,353,118
Davis New York Venture Fund	245,498	9,822,384	258,718	9,965,831
Putnam S&P 500 Index Fund	342,453	13,400,169	160,979	5,983,590
Putnam Stable Value Fund	11,228,718	11,461,377	11,077,511	11,063,407

11

The Plan s investments (including investments bought, sold and held during the year) appreciated (depreciated), as follows:

	Year Ended December 31, 2007
Registered Investment Companies:	
Allianz NFJ Dividend Value Fund	$ (387,855)
American Funds Balanced Fund [1]	571,187
American Funds EuroPacific Growth Fund	906,571
American Funds Growth Fund of America	410,675
Davis New York Venture Fund	406,379
Oppenheimer Main Street Small Cap Growth Fund	(383,923)
PIMCO Total Return Fund	136,005
Principal Lifetime 2010 Fund	(39,382)
Principal Lifetime 2020 Fund	(181,898)
Principal Lifetime 2030 Fund	(271,170)
Principal Lifetime 2040 Fund	(210,371)
Principal Lifetime 2050 Fund	(38,763)
Principal Lifetime Strategic Income Fund	(13,809)
Vanguard Total Stock Market Index Fund - Signal Shares	(136,101)
Vanguard Total Stock Market Index Fund - Admiral Shares [1]	224,661
	992,206
Collective Investment Trusts:	
Putnam S&P 500 Index Fund	787,683
	787,683
Common Stock Funds:	
Blockbuster Class A Common Stock Fund	(1,625,562)
Blockbuster Class B Common Stock Fund	(91,548)
	(1,717,110)
Net appreciation	$ 62,779

[1] These investment options were replaced and their balances transferred to other investment options during the 2007 Plan year. See Note 1.

Table of Contents

NOTE 5 RECONCILIATION OF FINANCIAL STATEMENTS TO FORM 5500

The following is a reconciliation of net assets available for benefits per the financial statements to the Form 5500:

	At December 31,	
	2007	2006
Net assets available for benefits per the financial statements	$ 103,626,168	$ 98,053,323
Adjustment from contract value to fair value for fully benefit-responsive investment contracts	232,659	(14,104)
Amounts allocated to withdrawing participants	(76,544)	(47)
Net assets available for benefits per the Form 5500	$ 103,782,283	$ 98,039,172

The following is a reconciliation of benefits paid to participants per the financial statements to the Form 5500 for the year ended December 31, 2007:

	December 31, 2007
Benefits paid to participants per the financial statements	$ 16,341,403
Add: Amounts allocated to withdrawing participants at December 31, 2007	76,544
Less: Amounts allocated to withdrawing participants at December 31, 2006	(47)
Benefits paid to participants per the Form 5500	$ 16,417,900

Amounts allocated to withdrawing participants are recorded on the Form 5500 for benefit claims that have been processed and approved for payment prior to December 31, but are not paid as of that date.

The following is a reconciliation of investment income per the financial statements to the Form 5500 for the year ended December 31, 2007:

Net investment income per the financial statements	$ 5,022,604
Adjustment from contract value to fair value for fully benefit-responsive investment contracts	246,763
Net investment income per the Form 5500	$ 5,269,367

NOTE 6 INCOME TAX STATUS

The Internal Revenue Service has determined and informed the Company by a letter dated July 23, 2003, that the Plan is designed in accordance with the requirements of 401(a) of the Code and that the trust thereunder is exempt from federal income taxes under the provisions of Section 501(a) of the Code. The Plan has subsequently been amended and management has requested a similar determination letter from the Internal Revenue Service for the Plan. The Plan administrator believes that the Plan is currently designed and being operated in compliance with the applicable requirements of the Code.

NOTE 7 RELATED PARTY TRANSACTIONS

The Putnam funds are managed by either Mercer HR Services, L.L.C. or the Trustee. Therefore, these transactions are identified as parties-in-interest.

Table of Contents

NOTE 8 PLAN MERGER

Effective December 31, 2007, the MovieLink 401(k) Profit Sharing Plan was merged into the Plan. The net assets merged with Plan assets totaled $1,787,258.

Table of Contents

BLOCKBUSTER INVESTMENT PLAN

SCHEDULE H, Line 4i

SCHEDULE OF ASSETS (HELD AT END OF YEAR)

AT DECEMBER 31, 2007

(a)	(b) Identity of issuer, borrower, lessor or similar party	(c) Unit/Principal Amount/Shares/ Maturity and Interest Rates	Cost	(d) Current Value
	Registered Investment Companies:			
	Allianz NFJ Dividend Value Fund	718,571	* *	$ 11,992,947
	American Funds EuroPacific Growth Fund	250,964	* *	12,563,257
	American Funds Growth Fund of America	405,742	* *	13,600,479
	Davis New York Venture Fund	245,498	* *	9,822,384
	Oppenheimer Main Street Small Cap Growth Fund	154,245	* *	3,041,712
	PIMCO Total Return Fund	454,724	* *	4,861,001
	Principal Lifetime 2010 Fund	36,995	* *	473,162
	Principal Lifetime 2020 Fund	160,059	* *	2,170,400
	Principal Lifetime 2030 Fund	229,074	* *	3,133,735
	Principal Lifetime 2040 Fund	177,917	* *	2,492,618
	Principal Lifetime 2050 Fund	31,743	* *	431,072
	Principal Lifetime Strategic Income Fund	17,081	* *	202,233
	Vanguard Total Stock Market Index Fund	82,082	* *	2,801,453
	Collective Investment Trusts:			
*	Putnam S&P 500 Index Fund	342,453	* *	13,400,169
*	Putnam Stable Value Fund	11,228,718	* *	5,418

Operating costs and expenses:				
Sales and marketing		1,655		1,694
Product research and development		753		482
General and administrative		1,318		912
Depreciation and amortization		199		189
Total operating costs and expenses		3,925		3,277
Operating income		3,147		2,141
Other income (expense):				
Interest expense				(5)
Interest income		120		54
Other, net		(43)		3
Total other income		77		52
Income before income taxes		3,224		2,193
Income tax expense		1,128		839
Net income	$	2,096	$	1,354
Net income per share - basic	$	0.16	$	0.10
Weighted average number of shares of Common Stock outstanding - basic		13,208,370		12,886,780
Net income per share - diluted	$	0.15	$	0.10

Weighted average number of shares of Common Stock outstanding - diluted	13,992,241	13,752,543

See accompanying notes to consolidated financial statements.

MERGE TECHNOLOGIES INCORPORATED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(in thousands)

	Three Months Ended March 31,	
	2005	**2004**
Cash flows from operating activities:		
Net income	$ 2,096	$ 1,354
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,005	827
Amortization of discount on note assumed in merger		4
Provision for doubtful accounts receivable, net of recoveries	70	11
Deferred income taxes	911	782
Change in assets and liabilities, net of acquisitions:		
Accounts receivable	(1,233)	118
Inventory	8	(17)
Prepaid expenses	(561)	(160)
Accounts payable	642	(241)
Accrued wages	(587)	(108)
Other accrued liabilities	(144)	(110)
Deferred revenue and billings in excess of revenues	290	(386)
Other	(31)	69
Net cash provided by operating activities	2,466	2,143
Cash flows from investing activities:		
Acquisitions, net of cash acquired	(6,808)	
Purchases of property and equipment	(428)	(191)
Capitalized software development	(880)	(958)
Net cash used in investing activities	(8,116)	(1,149)
Cash flows from financing activities:		
Proceeds from exercise of stock options	144	238
Proceeds from employee stock purchase plan	11	19
Net cash provided by financing activities	155	257
Effect of exchange rate changes on cash	(3)	(9)
Net (decrease) increase in cash	(5,498)	1,242
Cash and cash equivalents, beginning of period	28,067	16,871
Cash and cash equivalents, end of period	$ 22,569	$ 18,113
Supplemental Disclosures of Cash Flow Information:		
Cash paid for income taxes	$ 214	$ 229
Non Cash Investing and Financing Activities:		
Redemption value related to exchangeable Common Stock	$	$ 1

See accompanying notes to consolidated financial statements.

MERGE TECHNOLOGIES INCORPORATED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(in thousands)

	Three Months Ended March 31,	
	2005	**2004**
Net income	$ 2,096	$ 1,354
Accumulated other comprehensive income cumulative translation adjustment, net of income tax expense of $2 and $7	4	11
Comprehensive income	$ 2,100	$ 1,365

See accompanying notes to consolidated financial statements.

Merge Technologies Incorporated

Notes to Consolidated Financial Statements

(Unaudited and in thousands, except for share data)

(1) Basis of Presentation and Significant Accounting Policies

The accompanying unaudited consolidated financial statements have been prepared pursuant to the rules and regulations for reporting on Form 10 Q. Accordingly, certain information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements are not included herein. The interim statements should be read in conjunction with the consolidated financial statements and notes thereto included in the latest Annual Report on Form 10 K of Merge Technologies Incorporated, a Wisconsin corporation doing business as Merge eFilm, and its subsidiaries and affiliates (which we sometimes refer to collectively as we, us or our).

Our accompanying unaudited consolidated financial statements reflect all adjustments of a normal recurring nature, which are, in the opinion of management, necessary to present a fair statement of our financial position and results of operations.

(2) Goodwill and Other Intangibles

Goodwill is our only unamortizable intangible asset. In the three months ended March 31, 2005, we increased goodwill by $4,828 due to the acquisition of AccuImage Diagnostics Corp. (AccuImage). The changes in the carrying amount of goodwill in the three months ended March 31, 2005, are as follows:

Balance as of January 1, 2005	$	21,167
Goodwill related to AccuImage acquisition		4,828
Balance as of March 31, 2005	$	25,995

Our intangible assets, other than internally developed software, subject to amortization are summarized as of March 31, 2005, as follows:

	Weighted Average Remaining Amortization Period (Years)		Gross Carrying Amount		Accumulated Amortization
Purchased software	3.1	$	3,664	$	(1,376)
Customer contracts	2.9		2,023		(860)
Total	3.0	$	5,687	$	(2,236)

Amortization expense was $246 for the three months ended March 31, 2005. Estimated aggregate amortization expense for each of the next five years is as follows:

For the remaining nine months:	2005	$	844
For the year ended December 31:	2006	$	1,092
	2007	$	876
	2008	$	456
	2009	$	169

(3) Income Per Share

Basic earnings per share are computed by dividing income available to common shareholders by the weighted average number of shares outstanding. We have 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

5

the exercise of stock options with an exercise price of less than the average market price of our Common Stock. The following table sets forth the computation of basic and diluted earnings per share for the three months ended March 31, 2005 and 2004.

	Three Months Ended March 31,			
		2005		2004
Numerator:				
Net income	$	2,096	$	1,354
Accretion of redemption value related to exchangeable shares				(1)
Allocation of income to exchangeable shares				(1)
Numerator for net income per shares basic and diluted	$	2,096	$	1,352
Denominator:				
Weighted average number of shares of Common Stock outstanding		13,208,370		12,886,780
Effect of stock options		783,871		865,763
Denominator for net income per share diluted		13,992,241		13,752,543
Net income per share basic	$	0.16	$	0.10
Net income per share diluted	$	0.15	$	0.10

For the three months ended March 31, 2005 and 2004, options to purchase 19,000 shares and 323,500 shares, respectively, of our Common Stock had exercise prices greater than the average market price of the shares of Common Stock.

(4) Stock Based Compensation

We maintain three stock based employee compensation plans and one director option plan. We apply the provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*, as amended (SFAS No. 123), 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 allows entities to continue to apply the provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB Opinion No. 25) and provide pro forma disclosures as if the fair-value-based method defined in SFAS No. 123 had been applied.

We have elected to continue to apply the provisions of APB Opinion No. 25 in accounting for our plans. All stock options under the plans have been granted at exercise prices of not less than the market value at the date of grant, and as a result, no compensation expense has been recorded under APB Opinion No. 25. Had we determined compensation cost based on the fair value at the grant date under SFAS No. 123, our net income would have been decreased in the three months ended March 31, 2005 and 2004, to the pro forma amounts indicated below:

	Three Months Ended March 31,			
		2005		2004
Net income, as reported	$	2,096	$	1,354
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax benefits		(196)		(182)
Pro forma net income	$	1,900	$	1,172
Earnings per share:				

Basic as reported	$	0.16	$	0.10
Basic pro forma	$	0.14	$	0.09
Diluted as reported	$	0.15	$	0.10
Diluted pro forma	$	0.14	$	0.09

(5) Acquisitions

On January 28, 2005, we acquired all of the outstanding capital stock of AccuImage in an all cash transaction. The total purchase price for the acquisition is $7,001. AccuImage has been in the business of the development, marketing and support of software for advanced visualization, analysis and management of medical imaging data from medical imaging modalities.

We paid a significant premium above the fair value of AccuImage s tangible net assets principally because we determined that AccuImage s software development ability and advanced visualization products. As we look to the future, we foresee the need to expand our software product offerings to healthcare institutions and imaging centers to include advanced visualization tools.

An escrow of $1,000 of the purchase price was established as a reserve for 24 months, which will terminate on January 28, 2007, against any claims regarding breaches of representations and warranties as well as adjustments to the net asset value of the AccuImage balance sheet at the date of closing.

The acquisition was accounted for using the purchase method of accounting. The accompanying consolidated statements of operations include the results of operations for AccuImage since the acquisition date, January 28, 2005. The amount allocated to purchased and developed software and customer relationships are being amortized over a five (5) year period. The estimated asset lives were determined based on projected future economic benefits and expected life cycles of the technologies and customer relationships. The amount assigned to goodwill is not being amortized, but will be tested for impairment annually or under certain circumstances that may indicate a potential impairment. The following is a summary of purchase consideration for the acquisition of AccuImage:

Form of Consideration		**Fair Value**
Cash	$	5,848
Debt assumed and paid		1,012
Transaction costs		141
Total consideration	$	7,001

The following table represents the allocation of the total purchase consideration for the purchase of AccuImage. The allocation of the purchase consideration is based in part upon an independent valuation.

		Fair Value
Assets acquired	$	1,043
Purchased and developed technologies		763
Customer relationships		80
Goodwill		4,828
Deferred tax asset		676
Liabilities assumed		(1,401)
Debt assumed and paid		1,012
Total consideration	$	7,001

The $4,828 assigned to goodwill in the acquisition will not be deductible for federal income tax purposes.

(6) Recent Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 123(R), *Share-Based Payment*, (SFAS No. 123(R)) to be effective for interim or annual periods beginning after June 15, 2005. On April 14, 2005, the Securities and

Exchange Commission amended the compliance dates to require SFAS No.123(R) to be effective for fiscal years beginning after June 15, 2005. SFAS No. 123(R) supersedes APB Opinion No. 25 and requires all share-based payments to employees, including grants of employee stock options, to be recognized as an operating expense in the statement of operations. The cost will be recognized over the requisite service period based on fair values measured on the respective grant dates. We will adopt the new standard using the modified prospective transition method, which permits recognition of expense on or after the effective date for the portion of outstanding awards for which the requisite service has not yet been rendered. The adoption of SFAS 123(R) will result in additional expense being recorded beginning in 2006 related to our share-based employee compensation programs.

In March 2005, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations*, which is an interpretation of FASB Statement No. 143, *Accounting for Asset Retirement Obligations*. The interpretation requires a liability for the fair value of a conditional asset retirement obligation be recognized if the fair value of the liability can be reasonably estimated. The interpretation is effective for fiscal years ending after December 15, 2005. The interpretation is not expected to have a material impact on our results of operations or financial position.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Special Note on Forward-Looking Statements

Certain statements in this report that are not historical facts constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). Discussions containing such forward-looking statements may be included herein in the material set forth under *Management s Discussion and Analysis of Financial Condition and Results of Operations,* as well as within this report generally. In addition, when used in this report, the words: *believes, intends, anticipates, expects* and similar expressions are intended to identify forward-looking statements. These statements are subject to a number of risks and uncertainties, including, among others and in addition to those listed under *Factors That May Affect Future Results of Operations, Financial Condition or Business*, our lack of consistent profitability, fluctuations in operating results, credit and payment risks associated with end-user sales, involvement with rapidly developing technology in highly competitive markets, short product life cycles, acquisition and development of new technologies, dependence on major customers, expansion of our international sales effort, broad discretion of management and dependence on key personnel, risks associated with product liability and product defects, risks of loss associated with potential infringement of our products or services on the intellectual property rights of others, costs of complying with government regulation, changes in external competitive market factors which might impact trends in our results of operations, unanticipated working capital and other cash requirements, general changes in the industries in which we compete, and various other competitive factors that may prevent us from competing successfully in the marketplace. Actual results could differ materially from those projected in the forward-looking statements. We undertake no obligation to publicly release the result of any revisions to these forward-looking statements that may be made to reflect any future events or circumstances. Our actual results and the timing of certain events may differ materially from those reflected in the forward-looking statements. The following discussion should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere in this report.

Overview

We are a leading provider of Picture Archiving and Communications Systems (PACS), and Radiology Information System (RIS) software to imaging centers, specialty clinics, small and medium sized hospitals, and of PACS component and connectivity technologies to many Original Equipment Manufacturers (OEMs) throughout the world. We also are a leader in the development in the industry standard network communications protocol known as Digital Imaging Communications in Medicine (DICOM) technology, which defines the standard configuration for digital imaging used in the medical and healthcare industry. DICOM is used by virtually all OEMs building modalities for healthcare.

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

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

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

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

Our July 2003 acquisition of RIS Logic allowed us to become one of the first providers of integrated RIS/PACS solutions in our target markets. We saw this as a growing need of our target market. The integrated RIS/PACS solution positions us to fundamentally own the technology necessary to run an imaging center by having PACS deliver filmless workflow and a RIS deliver paperless workflow.

Our January 2005 acquisition of AccuImage allowed us to provide advanced visualization product offerings to healthcare institutions and imaging centers. In addition, it will allow us to become one of the first providers of integrated visualization solutions offered on other than on a stand alone workstation basis, which we see as a growing need of our target market.

Significant Events in the Three Months Ended March 31, 2005

During the three months ended March 31, 2005, we continued to focus on a core set of strategic and operational objectives designed to reinforce our market leading position as a RIS/PACS solution provider and achieve our financial goals. We continue to see accelerating interest from our target market for a comprehensive workflow solution from a single, trusted healthcare software solutions provider. We have remained consistent in our focus on imaging centers, small to medium size hospitals, and specialty clinics, including a growing target market of orthopedic groups and neurosurgery centers.

During the three months ended March 31, 2005, we successfully added direct sales staff and now have 25 employees focused on direct sales activities. We continued our focus on building long term partnerships with national imaging center chains. Radiologix, Inc., an imaging center corporation with 76 centers, is utilizing our RIS/PACS solution as a key strategy to accelerate their workflow. Radiologix, Inc. successfully implemented FUSION RIS/PACS in its Northeast region, and will next focus on moving toward full digital workflow in its San Francisco region. We realized further market share gains in the RIS/PACS market by adding 18 new FUSION customers, bringing our total FUSION RIS, PACS or RIS/PACS customer base to 213 customers across 425 healthcare facilities. We developed an inside sales strategy in the three months ended March 31, 2005, designed to enhance the workflow of our current customer base by identifying add on software module opportunities and RIS/PACS version upgrades that will enhance their workflow. This strategy will become increasingly important as we expand both our installed base of RIS, PACS and RIS/PACS solutions and the additional portfolio of solutions, add on software modules and clinical software applications that can be cross sold to these customers.

The leadership and operational tactics deployed during the quarter ended September 30, 2004 in our OEM/VAR group continue to yield strong results. We continue to see strength and diversity in our OEM/VAR business, including the development of our European VARs that resell our FUSION PACS solution.

During the three months ended March 31, 2005, our product innovation group released new software that continues to deliver on our promise to accelerate our customers productivity. We strengthened the capabilities of our core FUSION RIS/PACS software by releasing a new version that provides advanced business workflow capabilities, including accounts receivable, collections and cash management, which improve our customers financial performance.

Following the closing of our AccuImage acquisition in January 2005, we focused on two key initiatives: the integration of AccuImage advanced visualization software capabilities into our RIS/PACS product suite and the sale of AccuImage software applications to our OEM market. We also began selling AccuImage software applications to FUSION PACS customers, and we are in the process of integrating the AccuImage advanced visualization features into the FUSION PACS and RIS/PACS workflow. We have also made steady progress on integrating AccuImage software into eFilm Workstation that will allow us to deliver value added products to our thousands of eFilm Workstation customers via our eCommerce channel.

In January 2005, we announced the signing of a definitive agreement to merge in an all stock transaction with Cedara Software Corp. (Cedara), a leading independent developer of medical software technologies for the global healthcare market. We will issue either 0.587 shares of our Common Stock, or 0.587 shares of a newly created class of Canadian exchangeable shares for each share of Cedara common stock. The transaction is subject to approval by shareholders of each company, which is scheduled for May 24, 2005, regulatory approvals and other customary closing conditions.

Results of Operations

(in thousands, except for share data)

Three Months Ended March 31, 2005 Compared to the Three Months Ended March 31, 2004

The following table sets forth selected, unaudited consolidated financial data for the periods indicated, expressed as a percentage of net sales.

	Three Months Ended March 31,			
	2005		2004	
Net sales	100	%	100	%
Cost of sales	33		37	
Gross profit	67		63	
Operating costs and expenses:				
Sales and marketing	16		20	
Product research and development	7		6	
General and administrative	12		10	

Depreciation and amortization	2		2	
Total operating costs and expenses	37		38	
Operating income	30		25	
Total other income, net	1		1	
Income before income taxes	31		26	
Income tax expense	11		10	
Net income	20	%	16	%

Net Sales

Net sales consist of sales made directly to healthcare facilities, the professional services associated with those sales and sales made to OEM/VARs, net of estimated product returns. The following table sets forth net sales component data.

	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004	% Change
Direct sales	$ 4,107	$ 3,673	12%
As a percentage of total net sales	39%	42%	
Professional services	$ 3,392	$ 2,481	37%
As a percentage of total net sales	32%	29%	
OEM/VARs	$ 3,002	$ 2,483	21%
As a percentage of total net sales	29%	29%	
Total net sales	$ 10,501	$ 8,637	22%

Direct sales consist of software and purchased component revenue recognized in FUSION PACS, RIS and RIS/PACS sales to healthcare facilities and imaging centers. The $434 increase in direct sales in the three months ended March 31, 2005 compared to the three months ended March 31, 2004 is attributed to revenue recognized on FUSION RIS, PACS and RIS/PACS sales.

Net sales from the professional services group increased $911 in the three months ended March 31, 2005 compared to the three months ended March 31, 2004. The net sales growth from the professional services group is due to the growth in sales made directly to healthcare facilities and imaging centers, where such sales are accompanied by installation services and service contracts. We anticipate net sales from the professional services group to continue to grow as part of the overall growth in sales made directly to healthcare facilities and imaging centers.

Net sales to OEM/VARs and dealers increased $519 in the three months ended March 31, 2005 compared to the three months ended March 31, 2004. This is attributed to the fact that the three months ended March 31, 2004 sales were lower than normal due to the long term OEM component business with one customer reaching the end of its contractual life in the quarter and unusually low sales from European VARs.

Cost of Sales

Cost of sales consists of purchased components and service costs associated with net sales, and amortization of purchased and developed software and acquired customer relationships. The following table sets forth cost of sales data.

	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004	% Change
Software and other	$ 989	$ 1,115	(11)%
Services and maintenance	1,634	1,466	11%

Amortization		806		638	26%
Total cost of sales	$	3,429	$	3,219	7%

The cost of software and other includes purchased components included in software and hardware sales to our customers. The cost of software and other decreased $126 in the three months ended March 31, 2005 compared to the three months ended March 31, 2004, as a result of greater software only FUSION PACS, RIS and RIS/PACS sales with associated revenue recognized during the three months ended March 31, 2005.

The cost of professional services and maintenance increased $168 in the three months ended March 31, 2005 compared to $1,466 in the three months ended March 31, 2004. The increase is due to the required growth in headcount to install and maintain ongoing service and support for direct sales customers. In addition, we reassigned several presales and technical staff to the professional services group in the three months ended March 31, 2004 to keep pace

with the increased installation demand. As such, only a portion of their time is captured in the three months ended March 31, 2004 compared to 100% of their time for the three months ended March 31, 2005.

Amortization of purchased and developed software increased $168 in the three months ended March 31, 2005 compared to the three months ended March 31, 2004. As a percentage of net sales, amortization of purchased and developed software remained relatively consistent at 8% in the three months ended March 31, 2005 compared to 7% in the three months ended March 31, 2004. The dollar increase in the three months ended March 31, 2005 is a result of the commencement of amortization on software available for general release and the amortization of the intellectual property and customer relationships obtained in the acquisition of AccuImage in January 2005.

Gross Profit

Gross profit increased 31% to $7,072 in the three months ended March 31, 2005 from $5,418 in the three months ended March 31, 2004. As a percentage of net sales, gross profit increased to 67% of net sales in the three months ended March 31, 2005 compared to 63% in the three months ended March 31, 2004. The increase in gross profit as a percentage of sales is primarily due to the greater percentage of software only sales in the three months ended March 31, 2005.

Sales and Marketing

Sales and marketing expense decreased 2% to $1,655 in the three months ended March 31, 2005 from $1,694 in the three months ended March 31, 2004. Sales and marketing expense for the three months ended March 31, 2005 as a percentage of sales decreased to 16% compared to 20% in the three months ended March 31, 2004. The 4% decrease as a percentage of sales is the result of increased sales.

Product Research and Development

Research and development expense as a percentage of net sales increased slightly to 7% in the three months ended March 31, 2005 compared to 6% in the three months ended March 31, 2004. Research and development expense increased 56% to $753 in the three months ended March 31, 2005 from $482 in the three months ended March 31, 2004. Capitalization of software development costs decreased $78 to $880 in the three months ended March 31, 2005, from $958 in the three months ended March 31, 2004. We will continue with the development of FUSION™ application modules and further integration of our FUSION RIS/PACS technologies during 2005. The increase in research and development expense as a percentage of sales is primarily attributed to engineering costs associated with our AccuImage acquisition in January 2005 and costs associated with our continued investment in our quality assurance efforts.

General and Administrative

General and administrative as a percentage of net sales increased slightly to 12% in the three months ended March 31, 2005 compared to 10% in the three months ended March 31, 2004. General and administrative expense increased 44% to $1,318 in the three months ended March 31, 2005 from $912 in the three months ended March 31, 2004. General and administrative expense includes costs for information systems, accounting, administrative support, management personnel, bad debt expenses and general corporate matters. The $406 increase is primarily attributed to increased costs associated with continued compliance with the Sarbanes Oxley Act of 2002, costs for recruiting efforts and building infrastructure to support our growth.

Depreciation and Amortization

Depreciation and amortization expense as a percentage of net sales remained constant at 2% in the three months ended March 31, 2005 and March 31, 2004. Depreciation and amortization expense increased $10 to $199 in the three months ended March 31, 2005 from $189 in the three months ended March 31, 2004. Depreciation and amortization is assessed on capital equipment and intangible assets with estimable useful lives. This excludes the amortization of capitalized software and customer relationships, which is a component of cost of sales.

Other Income, Expense

Our interest expense decreased to zero in the three months ended March 31, 2005 compared to $5 in the three months ended March 31, 2004, while interest income was $120 in the three months ended March 31, 2005 compared to $54 in the three months ended March 31, 2004. The increase in interest income is directly attributed to our increased cash and cash equivalent balance, as well as increased interest rates on our cash balance during the three months ended March 31, 2005 compared to March 31, 2004. Other expense, net, was $43 in the three months ended March 31, 2005 compared to other income, net, of $3 in the three months ended March 31, 2004. The other expense, net, for the three months ended March 31, 2005 is primarily attributed to unrealized and realized foreign exchange losses on foreign currency receivables and cash held in our Nuenen, Netherlands branch, where the functional currency is the United States Dollar (U. S. Dollar).

Income Taxes

We recorded income tax expense of $1,128 in the three months ended March 31, 2005 and $839 in the three months ended March 31, 2004. Our consolidated effective tax rate for 2005 is estimated at 35%.

Liquidity and Capital Resources

(in thousands, except for share data)

Operating Cash Flows

Cash provided by operating activities was $2,466 in the three months ended March 31, 2005 compared to $2,143 in the three months ended March 31, 2004. Our positive operating cash flow in the three months ended March 31, 2005 was due primarily to net income of $2,096, depreciation and amortization expense of $1,005 and an increase in accounts payable of $642, offset by a $1,163 increase in accounts receivable and a $731 decrease in other accrued liabilities.

The total days sales outstanding in the three months ended March 31, 2005 increased to 108 days compared to 86 days in the three months ended March 31, 2004.

Although we have recorded income tax expense using a 35% effective income tax rate in 2005, the cash flow impact is expected to be less, due to tax benefits associated with utilizing net operating losses, tax credits and tax deductions associated with certain stock option exercises or disqualifying dispositions of Common Stock associated with stock options.

Investing Cash Flows

Cash used by investing activities was $8,116 in the three months ended March 31, 2005, due to cash outflows for the acquisition of AccuImage of $6,808, net of cash acquired, capitalized software development costs of $880, and purchases of capital equipment of $428. We expect to continue to invest in software development projects to increase sales.

Financing Cash Flows

Cash provided by financing activities was $155 in the three months ended March 31, 2005. We received net proceeds of $144 from employee and director stock option exercises and $11 from purchases of our Common Stock by employees under our employee stock purchase plan.

Total outstanding commitments at March 31, 2005 were as follows:

Contractual Obligations	**Total**	**Less than 1 Year**	**1 3 Years**	**4 6 Years**	**7 10 Years**
Operating Leases	$ 4,561	$ 535	$ 1,544	$ 1,790	$ 692

In November 2003, we negotiated a new unsecured revolving line of credit agreement with our bank, increasing our line to $15 million from $5 million effective November 21, 2003, and maturing December 31, 2006. 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. At March 31, 2005, the loan s interest rate was 5.0%. No amounts were outstanding on the line of credit as of March 31, 2005.

In April 2005, we moved to our new principal facility in Milwaukee, Wisconsin, which has approximately 22,000 square feet and is leased through April 2011. The payments due under this new lease are reflected in the above contractual obligations schedule. We did not incur material moving expenses associated with the new facility and do not anticipate a material write off in the second quarter related to leasehold improvements or fixed asset disposals.

In connection with the merger of Cedara, we expect to incur substantial out of pocket expenses to complete the transaction. At March 31, 2005, we had incurred approximately $663 in merger related costs, which are included in other assets on our balance sheet.

We do not have any other significant long term obligations, contractual obligations, lines of credit, standby letters of credit, standby repurchase obligations or other commercial commitments.

We believe that existing cash, together with the availability under our revolving line of credit and future cash flows from operations will be sufficient to execute our business plan in 2005. However, any projections of future cash inflows and outflows are subject to uncertainty. In 2005, it may be necessary to raise additional capital for activities necessary to meet our business objectives or our long term liquidity needs. If it is determined that additional capital is needed, it may be raised by selling additional equity or raising debt from third party sources. The sale of additional equity or convertible debt securities could result in dilution to current stockholders. In addition, debt financing, if available, could involve restrictive covenants, which could adversely affect operations. There can be no assurance that any of these financing alternatives, including raising additional capital, will be available in amounts or on terms acceptable to us.

Critical Accounting Policies

Our consolidated financial statements are impacted by the accounting policies used and the estimates and assumptions made by management during their preparation. Critical accounting policies in which management makes significant estimates are revenue recognition, accounts receivable, software capitalization, goodwill and intangible asset valuation, other long lived assets and income taxes.

Revenue Recognition

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

For software arrangements, we recognize revenue according to the American Institute of Certified Public Accountants (AICPA) Statement of Position No. 97 2, *Software Revenue Recognition,* and related amendments (SOP No. 97 2). SOP No. 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, pursuant to Statement of Position No. 98 9, *Modification of SOP No. 97 2, Software Revenue Recognition, With Respect to Certain Transactions.* Under the residual method, revenue is recognized in a multiple element arrangement when vendor-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. We allocate 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, we determine the fair value of the maintenance portion of the arrangement based on the

renewal price of the maintenance offered to customers, 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 undelivered elements 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 sales of RIS and from RIS/PACS solutions, where professional services are considered essential to the functionality of the solution sold, is recognized on the percentage of completion method, as prescribed by AICPA Statement of Position 81 1, *Accounting for Performance on Construction Type and Certain Production Type Contracts*. Percentage of completion is determined by the input method based upon the amount of labor hours expended compared to the total estimated amount of labor hours to complete the project. Total estimated labor hours is based on management s best estimate of the total amount of time it takes to complete a project. These estimates require the use of judgment. A significant change in one or more of these estimates could affect the profitability of one or more of our contracts. We review our contract estimates periodically to assess revisions in contract values and estimated labor hours expended and reflect changes in estimates in the period that such estimates are revised under the cumulative catch up method.

Revenue from sublicenses sold on an individual basis and computer software licenses is recognized upon shipment provided that evidence of an arrangement exists, delivery has occurred and risk of loss has 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.

Our policy is to allow returns when we have preauthorized the return. Based on our historical experience of a limited number of returns and our expectation that returns, if any, will be insignificant, we have provided for an allowance for specific potential items only.

Allowance for Doubtful Accounts

Our accounts receivable balance is reported net of an allowance for bad debts. We determine collection risk and record allowances for bad debts based on the aging of accounts and past transaction history with customers. 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.

Software Capitalization

Software capitalization commences when management determines that projects have achieved technological feasibility. Management s determination that a project has achieved technological feasibility does not ensure that the project can be commercially salable. Amounts capitalized include direct labor and estimates of overhead attributable to the projects. The useful lives of capitalized software projects are assigned by management, based upon the expected life of the software. Management also estimates the realizability of capitalized values based on projections of future net operating cash flows through the sale of products related to each capitalized project. If we determine in the future that the value of capitalized software cannot be recovered, a write down of the value of the capitalized software to its recoverable value may be required. If the actual achieved revenues are lower than our estimates or the useful life of a project is shorter than the estimated useful life, the

asset may be deemed to be impaired and, accordingly, a write down of the value of the asset or a shorter amortization period may be required.

Other Long Lived Assets

Other long term assets, including property and equipment, and other intangibles, are amortized over their expected lives, which are estimated by management. Management also makes estimates of the impairment of long term assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If the actual useful life of a long term asset is shorter than the useful life estimated by us, the assets may be

deemed to be impaired and, accordingly, a write down of the value of the assets or a shorter amortization period may be required.

Goodwill and Other Intangible Assets

Effective January 1, 2002, we adopted Statement of Financial Accounting Standards (SFAS), SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142). SFAS No. 142 requires that goodwill and indefinite lived intangible assets be reviewed for impairment annually, or more frequently if impairment indicators arise. Our policy provides that goodwill and indefinite lived intangible assets will be reviewed for impairment as of December 31 of each year. In calculating potential impairment losses, we evaluated the fair value of goodwill and intangible assets by estimating the expected present value of their future cash flows. The future cash flows are based upon management s assumptions about future sales activity and market acceptance of our products. If these assumptions change, we may be required to write down the carrying value of the asset to a revised amount.

Income Taxes

As part of the process of preparing our consolidated financial statements, we are required to estimate income taxes in each of the jurisdictions in which we operate. This process involves estimating our current tax rate together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities. Significant management judgment is required in determining our provision for income taxes, deferred tax assets and liabilities. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income, and to the extent that we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance or increase or decrease this allowance in a period, we must include the tax effect within the tax provision in the statement of operations. Significant management judgment is required in determining our provision for income taxes, deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets.

Recent Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 123(R), *Share-Based Payment*, to be effective for interim or annual periods beginning after June 15, 2005. On April 14, 2005, the Securities and Exchange Commission amended the compliance dates to require SFAS No.123(R) to be effective for fiscal years beginning after June 15, 2005. SFAS No. 123(R) supersedes APB Opinion No. 25 and requires all share-based payments to employees, including grants of employee stock options, to be recognized as an operating expense in the statement of operations. The cost will be recognized over the requisite service period based on fair values measured on the respective grant dates. We will adopt the new standard using the modified prospective transition method, which permits recognition of expense on or after the effective date for the portion of outstanding awards for which the requisite service has not yet been rendered. The adoption of SFAS 123(R) will result in additional expense being recorded beginning in 2006 related to our share-based employee compensation programs.

In March 2005, the FASB issued Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations*, which is an interpretation of FASB Statement No. 143, *Accounting for Asset Retirement Obligations*. The interpretation requires a liability for the fair value of a conditional asset retirement obligation be recognized if the fair value of the liability can be reasonably estimated. The interpretation is effective for fiscal years ending after December 15, 2005. The interpretation is not expected to have a material impact on our results of operations or financial position.

Material Off Balance Sheet Arrangements

We have no material off balance sheet arrangements.

17

We have no material off balance sheet arrangements.

Factors That May Affect Future Results of Operations, Financial Condition or Business

Quarterly Operating Results May Vary Our quarterly operating results have varied in the past and may continue to vary in future periods. Quarterly operating results may vary for a number of reasons, including accounting policy changes mandated by regulating entities (including, but not limited to, any accounting policy change concerning the expensing of options), demand for our software solutions and services, our sales cycle, and other factors described in this section and elsewhere in this report. As a result of healthcare industry trends and the market for our RIS, PACS or RIS/PACS solutions, a large percentage of our revenues are generated by the sale and installation of systems sold directly to healthcare institutions. The sale may be subject to delays due to customers internal budgets and procedures for approving capital expenditures and by competing needs for other capital expenditures and deploying new technologies or personnel resources. Delays in the expected sale or installation of these contracts may have a significant impact on our anticipated quarterly revenues and consequently our earnings, since a significant percentage of our expenses are relatively fixed.

In addition, software revenue from sales of PACS solutions is generally recognized at the time of shipment to our customers. Software revenue from sales of RIS and RIS/PACS solutions are recognized on the percentage of completion method as the installation services are performed. As a result, significant changes in the sales mix of our FUSION™ solutions may have an impact on our quarterly revenues and consequently, our earnings.

Stock Price May Be Volatile The trading price of our Common Stock may be volatile. The market for our Common Stock may experience significant price and volume fluctuations in response to a number of factors including actual or anticipated quarterly variations in operating results, rumors about our performance or software solutions, changes in expectations of future financial performance or changes in estimates of securities analysts, governmental regulatory action, healthcare reform measures, client relationship developments, changes occurring in the securities markets in general and other factors, many of which are beyond our control. As a matter of policy, we do not generally comment on rumors.

Furthermore, the stock market in general, and the market for software, healthcare and technology companies in particular, has experienced volatility that often has been unrelated to the operating performance of particular companies. These broad market and industry fluctuations may adversely affect the trading price of our Common Stock, regardless of actual operating performance.

Changes in the Healthcare Industry The healthcare industry is highly regulated and is subject to changing political, economic and regulatory influences. For example, the Health Insurance Portability and Accountability Act of 1996 (HIPAA) has impacted the healthcare industry by requiring identifiers and standardized transactions/code sets and necessary security and privacy measures in order to ensure the protection of patient health information. These factors affect the purchasing practices and operation of healthcare organizations. Federal and state legislatures have periodically considered programs to reform the United States of America healthcare system at both the federal and state level and to change healthcare financing and reimbursement systems. These programs may contain proposals to increase governmental involvement in healthcare, lower reimbursement rates or otherwise change the environment in which healthcare industry participants operate. Healthcare industry participants may respond by reducing their

investments or postponing investment decisions, including investments in our software solutions and services.

Significant Competition The market for RIS, PACS and RIS/PACS systems is competitive and subject to technological change. We believe that the principal competitive factors in this market include the breadth and quality of system and software solution offerings, the stability of the systems provider, the features and capabilities of the information system, the ongoing support for the system and the potential for enhancements and future compatible software solutions. Certain of our competitors have greater financial, technical, product development, marketing and other resources than us and some of our competitors offer software solutions that we do not offer.

Dependence on Key Employees Our continued success will depend to a significant degree upon the efforts and abilities of our senior management, in particular, Richard A. Linden, our President and Chief Executive Officer. We carry key man life insurance in the amount of $5 million on Richard A. Linden and $2 million on Scott T. Veech, our

Chief Financial Officer. We do not carry key man life insurance on any other of our officers or directors. The loss of the services of any of these persons could have a material adverse effect on us.

Government Regulation We are subject to regulation by the United States of America Food and Drug Administration (FDA). If our software solutions are deemed to be actively regulated medical devices by the FDA, we could be subject to more extensive requirements governing pre and post marketing requirements. Complying with these FDA regulations could be time consuming and expensive. It is possible that the FDA may become more active in regulating computer software that is used in healthcare.

In addition, we remain subject to periodic FDA inspections and there can be no assurances that we will not be required to undertake additional actions to comply with the Federal Food, Drug and Cosmetic Act (Act) and any other applicable regulatory requirements. Any failure by us to comply with the Act and any other applicable regulatory requirements could have a material adverse effect on our ability to continue to manufacture and distribute our software solutions. The FDA has many enforcement tools including recalls, seizures, injunctions, civil fines and/or criminal prosecutions. Any of the foregoing could have a material adverse effect on our business, results of operations or financial condition.

Product Related Liabilities Many of our software solutions provide data for use by healthcare providers in providing care to patients. Although no such claims have been brought against us to date regarding injuries related to the use of our software solutions, such claims may be made in the future. Although we maintain product liability insurance coverage in an amount that we believe is sufficient for our business, there can be no assurance that such coverage will cover a particular claim that may be brought in the future, prove to be adequate or that such coverage will continue to remain available on acceptable terms, if at all. A successful claim brought against us, which is uninsured or underinsured, could materially harm our business, results of operations or financial condition.

Risks Associated with Our Global Operations We market, sell and service our software solutions globally. We have established offices around the world, including North America, the Netherlands and Japan. We will continue to expand our global operations and enter new global markets. This expansion will require significant management attention and financial resources to develop successful indirect global sales and support channels. Our success will depend, in part, on our ability to form relationships with local partners. For these reasons, we may not be able to maintain or increase global market demand for our software solutions.

Global operations are subject to inherent risks, and our future results could be adversely affected by a variety of uncontrollable and changing factors. These include:

greater difficulty in collecting accounts receivable and longer collection periods;

the impact of economic conditions outside of the United States of America;

changes in foreign currency exchange rates;

unexpected changes in regulatory requirements;

certification requirements;

reduced protection of intellectual property rights in some countries;

potentially adverse tax consequences;

political instability;

trade protection measures and other regulatory requirements;

service provider and government spending patterns;

natural disasters, war or terrorist acts;

poor selection of a partner in a country; and

political conditions which may threaten the safety of associates or our continued presence in foreign countries.

Concentrations Substantially all of our cash and cash equivalents are held at one financial institution located in the United States of America. Deposits held with the bank exceed the amount of insurance provided on such deposits. Generally these deposits may be redeemed upon demand and, therefore, bear minimal risk. The majority of our clients are imaging centers, hospitals and integrated delivery networks. If significant adverse macro economic factors were to impact these organizations, it could materially adversely affect us. Our access to certain software and hardware components is dependent upon single and sole source suppliers. The inability of any supplier to fulfill our supply requirements could affect future results.

New Regulations Relating to Patient Confidentiality HIPAA mandates significant changes in the legal and regulatory environment governing the provision of health benefits, the delivery of and payment for healthcare services, and the security and confidentiality of individually identifiable, protected health information in written, electronic or oral formats. The Department of Health and Human Services adopted final rules implementing HIPAA. The final rules include standards for the security of electronic health information and the privacy of a patient s medical records and became effective on February 20, 2003 and April 14, 2003, respectively. Most healthcare providers, healthcare clearinghouses and health plans (Covered Entities) are required to comply. Covered Entities are required to comply with the standards for security by April 21, 2005, and have been required to comply with the standards for privacy since April 14, 2003. Although we are not a Covered Entity, most of our customers are Covered Entities. As Covered Entities, our customers are required to flow down certain of their obligations under HIPAA to their service providers. Accordingly, we have been required to adopt different and or additional procedures. In addition, we have had increased legal expenses associated with negotiating agreements with existing and new customers to implement the new HIPAA obligations. In light of the new obligations under HIPAA, Covered Entities may be required or may choose to reevaluate their technology solutions. We may be required to invest in our products and procedures to maintain compliance. In addition, many states have passed or are evaluating local versions of HIPAA. We believe, but cannot assure, that HIPAA will not materially affect our business, results of operations or financial condition.

System Errors and Warranties Despite testing, software products as complex as those offered by us and used in a wide range of clinical and health information systems settings are likely to contain a number of errors or bugs, especially early in their product life cycle. Our products are clinical information systems used in patient care settings where a low tolerance for bugs exists. Testing of products is difficult due to the wide range of environments in which systems are installed. Due to these factors, there is no assurance that the discovery of defects or errors will not cause delays in product delivery, poor client references, payment disputes, contract cancellations, or additional expenses and

payments to rectify problems. Any of those factors may delay acceptance of products, which could have a material adverse effect upon the our business, results of operations or financial condition.

Limited Protection of Intellectual Property and Property Rights; Proprietary Technology May Be Subjected to Infringement Claims We rely upon a combination of trade secret, copyright and trademark laws, license and marketing agreements, and nondisclosure agreements to protect our proprietary information. Generally, we have not historically filed patent applications or copyrights covering our software technology. As a result, we may not be able to protect against the misappropriation of our intellectual property.

We do not believe our software products, third party software products we offer under sublicense agreements, trademarks or other proprietary rights infringe the intellectual property rights of third parties. However, there can be no assurance that third parties will not assert infringement claims against us in the future with respect to current or future software products or that any such assertion may not require us to enter into royalty arrangements or result in costly litigation.

Proprietary Technology May Be Subjected to Infringement Claims or May Be Infringed Upon We rely upon a combination of license agreements, confidentiality procedures, employee nondisclosure agreements and technical measures to maintain the confidentiality and trade secrecy of our proprietary information. We also rely on trademark and copyright laws to protect our intellectual property. We have initiated a patent program, but currently we have a very limited patent portfolio. As a result, we may not be able to protect against misappropriation of our intellectual property.

We May Be Unable to Successfully Integrate Acquisitions We may continue to acquire or make investments in complementary companies, products or technologies. Acquisitions may pose risks to the operations, including:

problems and increased costs in connection with the integration of the personnel, operations, technologies or products of the acquired companies;

unanticipated costs;

diversion of management s attention from our core business;

adverse effects on business relationships with suppliers and customers and those of the acquired company;

acquired assets becoming impaired as a result of technical advancements or worse than expected performance by the acquired company;

entering markets in which we have no, or limited, prior experience; and

potential loss of key employees, particularly those of the acquired organization.

In addition, in connection with any acquisitions or investments we could:

issue stock that would dilute existing shareholders percentage of ownership;

incur debt and assume liabilities;

obtain financing on unfavorable terms;

incur amortization expenses related to acquired intangible assets or incur large and immediate write offs;

incur large expenditures related to office closures of the acquired companies, including costs relating to termination of employees and leasehold improvement charges relating to vacating the acquired companies premises; and

reduce the cash that would otherwise be available to fund operations or to use for other purposes.

The failure to successfully integrate any acquisition or for acquisitions to yield expected results may negatively impact our financial condition and operating results.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk. Our cash and cash equivalents are exposed to financial market risk due to fluctuations in interest rates, which may affect our interest income. As of March 31, 2005, our cash and cash equivalents include money market funds and short term deposits totaling approximately $22.6 million, and earned interest at a weighted average rate of 2.2%. The value of the principal amounts is equal to the fair value for these instruments. Due to the relative short term nature of our investment portfolio, our interest income is vulnerable to sudden changes in market interest rates. We do not use our portfolio for trading or other speculative purposes.

Foreign Currency Exchange Risk. We have sales and expenses in Canada and Europe that are denominated in currencies other than the U. S. Dollar and as a result have exposure to foreign currency exchange risk. We do not currently enter into forward exchange contracts to hedge exposures denominated in foreign currencies or any other derivative financial instruments for trading or speculative purposes. However, in the event our exposure to foreign currency risk increases to levels that we do not deem acceptable, we may choose to hedge those exposures.

Item 4. Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of March 31, 2005, that our disclosure controls and procedures (as defined in Rules 13a 15(e) and 15d 15(e) under the Exchange Act) are effective for gathering, analyzing and disclosing the information we are required to disclose in our reports filed under the Exchange Act. There have been no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of the previously mentioned evaluation.

Internal Control Over Financial Reporting

There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a 15(f) and 15d 15(f) under the Exchange Act) during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II

Item 1. Legal Proceedings

On October 24, 2003, ScheduleQuest, Inc. filed a patent infringement lawsuit (Civil Action No. 03 5900) against us in the United States District Court for the Eastern District of Pennsylvania alleging that our RIS Logic CS Scheduling System product infringes upon their United States of America Patent No. 6,389,454 for their Multi-Facility Appointment Scheduling System product, which we acquired in connection with our RIS Logic acquisition. We cannot currently predict the outcome of the litigation or the amount of any potential loss if our defense is unsuccessful. Our merger agreement with RIS Logic contains a representation that the RIS Logic technology does not infringe others proprietary rights and 173,093 shares of our Common Stock conveyed to the former RIS Logic owners are in an escrow holdback, which has been extended to August 15, 2005, to cover any claims of breach of representation or warranty. We believe that all the claims in the lawsuit are without merit and we intend to vigorously defend against such claims. However, we cannot provide any assurances as to the outcome of this litigation or whether the escrow holdback will be adequate to satisfy any costs, expenses or losses that we may incur in connection with such litigation.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) None.

(b) Not applicable.

(c) None.

Item 3. Defaults upon Senior Securities

Not applicable.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

(a) None.

(b) None.

Item 6. Exhibits

(a) Exhibits

See Exhibit Index.

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.

	Registrant:	
	MERGE TECHNOLOGIES INCORPORATED	
May 5, 2005	By:	/s/ Richard A. Linden Richard A. Linden President and Chief Executive Officer
May 5, 2005	By:	/s/ Scott T. Veech Scott T. Veech Chief Financial Officer, Secretary and Treasurer (Principal Financial Officer and Principal Accounting Officer)

EXHIBIT INDEX

2.1	Merger Agreement by and among Merge Technologies Incorporated, RL Acquisition Corp., RIS Logic Incorporated, and the Principal Shareholders of RIS Logic Incorporated dated July 9, 2003(6)
2.2	Merger Agreement by and between Merge Technologies Incorporated, AccuImage Diagnostics Corp., ADI Acquisition Corp. and the Principal Shareholder of AccuImage Diagnostics Corp. dated November 24, 2004(8)
2.3	Merger Agreement by and between Merge Technologies Incorporated, Cedara Software Corp. and Corrida, Ltd. dated January 17, 2005(9)
3.1	Articles of Incorporation of Registrant(2), Articles of Amendment as filed on December 28, 1998(3), Articles of Amendment as filed on September 2, 1999(4), Articles of Amendment as filed on February 23, 2001(4), and Articles of Amendment as filed on August 9, 2002(7)
3.2	Amended and Restated Bylaws of Registrant as of February 3, 1998(1)
10.1	Employment Agreement entered into as of March 1, 2004, between Registrant and Richard A. Linden(7)
10.2	Employment Agreement entered into as of March 1, 2004, between Registrant and William C. Mortimore(7)
10.3	Employment Agreement entered into as of March 1, 2004, between Registrant and Scott T. Veech(7)
10.4	Employment Agreement entered into as of March 1, 2004, between Registrant and David M. Noshay(7)
10.5	1996 Stock Option Plan for Employees of Registrant dated May 13, 1996(2), as amended and restated in its entirety as of September 1, 2003(5)
10.6	1998 Stock Option Plan For Directors(1)
10.7	2003 Stock Option Plan of Registrant dated September 24, 2003, and effective July 17, 2003(5)
10.8	Loan Agreement dated as of November 21, 2003, by and between Registrant and Lincoln State Bank(7)
31.1	Certification of Chief Executive Officer Pursuant to Section 13(a) of the Securities Exchange Act of 1934
31.2	Certification of Chief Financial Officer Pursuant to Section 13(a) of the Securities Exchange Act of 1934
32	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 13(a) of the Securities Exchange Act of 1934 (Section 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002)
99.1	Code of Ethics(7)
99.2	Whistleblower Policy(7)

---

(1) Incorporated by reference from Annual Report on Form 10-KSB for the fiscal year ended December 31, 1997.
(2) Incorporated by reference from Registration Statement on Form SB-2 (No. 333-39111) effective January 29, 1998.
(3) Incorporated by reference from Quarterly Report on Form 10-QSB for the three months ended March 31, 1999.
(4) Incorporated by reference from Annual Report on Form 10-KSB for the fiscal year ended December 31, 2000.
(5) Incorporated by reference from Quarterly Report on Form 10-Q for the three months ended September 30, 2003.
(6) Incorporated by reference from Current Report on Form 8-K dated July 17, 2003.
(7) Incorporated by reference from Annual Report on Form 10-K for the fiscal year ended December 31, 2003.
(8) Incorporated by reference from Current Report on Form 8-K dated November 24, 2004.
(9) Incorporated by reference from Current Report on Form 8-K dated January 18, 2005.