MERGE HEALTHCARE INC
Form 10-K
March 16, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2010

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number 0-29486

MERGE HEALTHCARE INCORPORATED
(Exact name of Registrant as specified in its charter)

Delaware	39-1600938
(State or other jurisdiction of incorporation or organization)	(I. R. S. Employer Identification No.)

200 East Randolph Street, 24th Floor
Chicago, Illinois 60601-6436
(Address of principal executive offices, including zip code)
(Registrant's telephone number, including area code) (312) 565-6868
Securities registered under Section 12(b) of the Exchange Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $0.01 par value per share	The NASDAQ Global Select Market

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

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes o No x

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes o No x

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filers", and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filer x Non-accelerated filer o Smaller reporting company o

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No x

The aggregate market value for the Registrant's voting and non-voting common equity held by non-affiliates of the Registrant as of June 30, 2010, based upon the closing sale price of the Common Stock on June 30, 2010, as reported on The NASDAQ Global Select Market, was approximately $149,538,562. Shares of Common Stock held by each officer and director and by each person who owns ten percent or more of the outstanding Common Stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares outstanding of the Registrant's common stock, par value $0.01 per share, as of March 10, 2011: 84,259,176

DOCUMENTS INCORPORATED BY REFERENCE

Certain of the information required by Part III is incorporated by reference from the Registrant's Proxy Statement for its 2011 Annual Meeting of Shareholders.

INDEX

Index

PART I

This Annual Report on Form 10-K and other written or oral statements made by us or on our behalf may include forward-looking statements that reflect our current views with respect to future events and future financial performance. Certain statements in this Annual Report on Form 10-K are "forward-looking statements." You can identify these forward-looking statements by our use of the words "believes," "anticipates," "forecasts," "projects," "could," "plans," "expects," "may," "will," "would," "intends," "estimates" and similar expressions, whether in the negative or affirmative. We wish to caution you that any forward-looking statements made by us or on our behalf are subject to uncertainties and other factors that could cause such statements to be wrong. We cannot guarantee that we actually will achieve these plans, intentions or expectations. Actual results or events could differ materially from the plans, intentions and expectations disclosed in the forward-looking statements that we make and we cannot guarantee future results, levels of activity, and/or performance. We do not assume any obligation to update or revise any forward-looking statements that we make, whether as a result of new information, future events or otherwise.

Factors that may impact forward-looking statements include, among others, the risks and other matters set forth in the section entitled "Item 1A Risk Factors" in this Annual Report on Form 10-K. Although we have attempted to list comprehensively these important factors, we also wish to caution investors that other factors may prove to be important in the future in affecting our business and operating results. New factors emerge from time to time, and it is not possible for us to predict all of these factors, nor can we assess the impact each factor or combination of factors may have on our business.

Item 1.BUSINESS

Overview

Merge Healthcare Incorporated and its subsidiaries or affiliates (collectively Merge, we, us, or our) is an enterprise image provider dedicated to healthcare information technology (IT) solutions. We develop software solutions that automate healthcare data and diagnostic workflow to create a more comprehensive electronic record of the patient experience. Our solutions are designed to help solve some of the toughest challenges in health information exchange today, such as the incorporation of medical images and diagnostic information into broader healthcare IT applications, the interoperability of proprietary software solutions, advanced clinical tools like computer aided detection (CAD), the profitability of outpatient imaging practices in the face of declining reimbursement and the ability to improve the efficiency and cost effectiveness of our customers' businesses.

We are a Delaware corporation that was founded in 1987. Our principal executive offices are located at 200 East Randolph Street, 24th Floor, Chicago, Illinois, 60601-6436, and our telephone number there is (312) 565-6868. Our website address, which we use to communicate important business information, can be accessed at: www.merge.com. We make our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports available free of charge on or through this website as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission (SEC). Materials we file with or furnish to the SEC may also be read and copied at the SEC's Public reference Room at 100 F Street, NE, Washington, D.C. 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. Also, the SEC Internet site (www.sec.gov) contains reports, proxy and information statements, and other information that we file electronically with the SEC.

Our products, ranging from standards-based development toolkits to fully integrated clinical applications, have been used by healthcare providers worldwide for over 20 years. Our solutions optimize processes for healthcare organizations ranging in size from single-doctor practices to health systems, for the sponsors of clinical trials, for the medical device industry, for the healthcare commerce system and for consumers of healthcare. These solutions are

licensed by more than 1,500 hospitals; 4,000 clinics and labs, 250 healthcare equipment manufacturers and 70% of the top pharmaceutical companies.

Merge primarily generates revenue from the sale of perpetual software licenses, upgrading and/or renewing those licenses, hardware, professional services and maintenance. Except for maintenance, these contract elements comprise the majority of non-recurring revenue. Our backlog of non-recurring revenue was approximately $49.0 million as of December 31, 2010. Maintenance, which we renew annually with our customer base, is the primary component of recurring revenues. Recurring revenue also includes software licenses sold through contracts that are annually renewed and recognized ratably over the annual period and recorded as software revenue, revenues derived from SaaS offerings which are recorded as professional services revenue and Electronic Data Interchange (EDI) revenues which are recognized based on monthly transactional volumes. In 2010, recurring revenue exceeded 65% of total net sales. The following table presents our consolidated revenues by category, as a percentage of total revenues:

Index

	Years Ended December 31,		
	2010	2009	2008
Net sales:			
Software and other	30.2 %	49.4 %	48.6 %
Professional services	16.5 %	17.7 %	15.1 %
Maintenance and EDI	53.3 %	32.9 %	36.3 %
Total net sales	100.0 %	100.0 %	100.0 %

Healthcare IT Industry

We believe there are several factors that will be favorable for the global healthcare IT industry over the next decade. The broad recognition that healthcare IT is essential to help control healthcare costs and improve quality contributed to the inclusion of healthcare IT incentives in the American Recovery and Reinvestment Act (ARRA). The ARRA and accompanying Health Information Technology for Economic and Clinical Health (HITECH) provisions include more than $35 billion in incentives which reward providers who use certified electronic health records (EHRs) in a meaningful way. These incentives are contributing to increased demand for healthcare IT solutions and services in the United States. In addition, we believe long-term revenue growth opportunities outside the United States remain significant because other countries are also focused on controlling healthcare spending while improving the efficiency and quality of care that is delivered, and many of these countries recognize healthcare IT as an important piece of the solution to these issues.

We believe that an EHR can only be considered meaningful if imaging data is included. As providers adopt EHRs, we believe the need for solutions such as our iConnect platform, which offers connectivity, access to the image and interoperability between providers and other healthcare constituents will be critical. Imaging continues to be a critical component of healthcare delivery across the continuum of care. Increasing physician awareness and utilization of imaging as a standard of care to aid in patient diagnosis (including its use as a preventive screening method), as well as an increased availability of diagnostic imaging equipment in medical centers and hospitals, has fueled the growth of the diagnostic imaging industry. In addition, U.S. demographic trends and the opportunity for greater international adoption of medical imaging should provide the basis for long-term, sustainable growth in imaging volumes. Merge is well positioned to benefit from this expected increase in demand due to its large footprint in United States hospitals and physician practices and its proven ability to deliver value to its clients. Based on information from Frost & Sullivan and our own research, we believe the global market for imaging software and services, healthcare IT interoperability solutions, digital pathology and imaging in clinical trials is $6.5 billion annually.

We believe that we have positioned ourselves to provide value added solutions and services to our customers amidst potential changes in industry standards and regulations. We believe the fundamental value proposition of healthcare IT remains strong and that the industry will likely benefit as healthcare providers and governments continue to recognize that these solutions and services contribute to safer, more efficient healthcare.

Merge Growth Strategy

Our strategy is to be a leading provider of integrated, global healthcare IT solutions and services that improve the exchange of healthcare information. Our business strategy is anchored by the breadth and depth of our solutions and services, our proven ability to deliver value, and, the success of our customers. We believe the growth drivers for Merge are the importance of imaging, the opportunity around Meaningful Use of EHRs, and the need for interoperability. Imaging continues to be a critical component of healthcare delivery across the continuum of care. We believe it has become abundantly clear that an electronic medical record can only be considered meaningful

if imaging data is included.

A core strength that has led to our strong market position is our proven ability to innovate, which has driven consistent expansion of solutions and services and entry into new markets. We currently own approximately 70 patents issued in various jurisdictions and we continue to expand our IP portfolio. Our award-winning portfolio of technologies is used across a wide variety of clinical specialties in addition to being an increasingly important component of clinical trials. For example, our iConnect platform offers hospitals, imaging centers and Health Information Exchanges the ability to create information exchanges within their environment and with other entities. As providers adopt electronic health records, we believe the need for solutions that offer connectivity and interoperability between providers and other healthcare constituents will be a new multi-billion dollar opportunity for which Merge is uniquely positioned to compete.

We will also look to expand through strategic acquisitions that will allow us to further expand our addressable market and customer base. We believe that our acquisitions in 2010 and 2009 have allowed us to expand our product offering as well as provide greater penetration into existing market segments. As a result of these acquisitions, we have extended our addressable market to include other specialties, such as solutions for the orthopaedics and laboratory markets and have increased the depth of our solution portfolio for existing customers and new prospects to include additional automation capabilities via patient kiosks.

Index

We have an opportunity to grow revenues by cross-selling products to existing customers as only a small percent currently have more than one of our solutions. This is supported by the fact that no customer accounted for more than 10% of our net sales in the last three years. With the benefit of a broad customer base and several product lines undergoing ongoing innovation, we also believe that we are well-positioned to continue to leverage technologies into new segments where customers see value. For example, as providers adopt EHRs and seek to qualify for Meaningful Use incentives, our vendor-neutral archiving and web-based image access products will help providers facilitate Meaningful Use and accountable care initiatives.

We believe our strengths position us well to gain market share in the United States during a period of expected strong demand driven by the HITECH provisions of ARRA and the nation's focus on improving the efficiency and quality of healthcare. We also have a strong brand, as evidenced by our popular eFilm Workstation that has over 100,000 downloads. Also, Merge has already sold products in more than 50 countries. Thus, we believe that we have a good opportunity to gain market share outside of the United States.

Our Product Portfolio

We provide a broad range of products and services to our customers, including:

- Image Interoperability Platform

  - iConnect. This interoperability and connectivity platform offers hospitals, imaging centers, Integrated Delivery Networks and Health Information Exchanges the ability to create information exchanges within their environments and with other entities. This platform provides access to imaging and diagnostic data across disparate sites, geographies, specialties and providers. This solution enables providers to expedite care, reduce duplicate exams, consolidate infrastructure and limit the expenses associated with moving, managing and storing diagnostic content and results.

- Clinical and Financial Information Systems

  - Digital Imaging Solutions: Picture Archiving and Communication Systems (PACS), specialty workstations and related applications manage the image workflow of a medical enterprise. PACS can be used by any medical imaging provider at a hospital or outpatient imaging site. We offer PACS solutions for general image review and management, specialty solutions for cardiology, orthopaedics, mammography and oncology, and add-on modules like referring physician portals and critical test results reporting. We also offer the popular eFilm Workstation for general radiology reading and CADstream workstations for specialty reading of magnetic resonance imaging (MRI) breast, liver and prostate studies.

  - Clinical information systems. These systems provide a complete electronic record of a medical procedure across a variety of specialties – including Merge OrthoEMR for orthopaedics Merge Anesthesia Information Management System for surgery, and Merge RIS for radiology.

  - Revenue Cycle Management. We offer software and services for the revenue cycle management of physician practices. These solutions can be used across a number of physician specialties, but our solutions are most commonly used by radiology practices, imaging centers and billing services

- Software Development Toolkits, Technologies and Platforms.

  - Merge toolkits, technologies and platforms provide software developers with the necessary resources to assist in the timely development of new products and enhance existing products. They can be used by any original equipment

manufacturer (OEM), medical device manufacturer, RIS/PACS vendor or general healthcare IT vendor. We offer development toolkits in the basic standards of medical imaging and information interoperability, as well as advanced toolkits and unfinished applications for specialized medical image review and distribution.

- Hosted Software Solutions for Clinical Trial Data Management.

o We provide hosted software solutions for the collection, aggregation, analysis, reporting and overall management of clinical trials information. These solutions can be sold to sponsors of clinical trials, including pharmaceutical companies, contract research organizations (CRO) or imaging core labs. Our solutions include electronic data capture (EDC), interactive voice/web response (IVR/IWR) and electronic patient reported outcomes (ePRO) software and devices.

Index

Competition

The healthcare IT and imaging markets in which we participate are highly competitive, rapidly evolving and subject to rapid technological change. However, we believe that there is no single company that competes against our entire product portfolio.

Our principal competitors in the healthcare solutions and services market include: General Electric Company (Healthcare), McKesson Corporation, Cerner Corporation, Philips, Carestream, and Agfa, each of which offers software solutions that compete with a portion of our product portfolio. Almost all of these competitors are substantially larger or have more experience and market share than Merge in their respective markets. We also partner with certain of these companies to resell our products.

Other competitors focus on only a very specific portion of the market that we address or against specific products we sell. For example, there are 30 other companies in the North American PACS market, according to Frost and Sullivan. These companies include imaging equipment original equipment manufacturers, former film companies and healthcare IT companies. Our CAD solutions for breast, liver and/or prostate cancer diagnostic support compete with iCAD, InVivo (Philips), Sentinelle and Hologic. Our eClinical solutions and services are in a highly competitive market led by Phase Forward (recently acquired by Oracle) and Medidata. Our OEM technologies most often compete with internal development departments. Our OEM toolkits face a limited number of competitors, and we believe we are the only vendor to provide a combined Digital Imaging and Communications in Medicine (DICOM) and Health Level 7 (HL7) toolkit.

In addition, we expect that major software information systems companies, large information technology consulting service providers and system integrators, start-up companies, managed care companies and others specializing in the healthcare industry may offer competitive software solutions or services. The pace of change in the healthcare IT market is rapid and there are frequent new software solutions or service introductions, enhancements and evolving industry standards and requirements. We believe that the principal competitive factors in this market include the breadth and quality of solution and service offerings, the stability of the solution provider, the quality, features and performance of the products, the ongoing support for the systems and the potential for enhancements and future compatible software solutions.

Employees

As of December 31, 2010, we had approximately 750 employees world-wide. Competition for technical personnel in the industry in which we compete is intense. We believe that our future success depends in part on our continued ability to hire, assimilate, and retain qualified personnel.

Software Development

We commit significant resources to developing new health information system solutions. As of the end of 2010, approximately 175 of our employees were engaged in research and development activities. Total expenditures for the development and enhancement of our software solutions were approximately $20.1 million, $10.7 million and $13.2 million during 2010, 2009 and 2008, respectively.

Our products, ranging from standards-based development toolkits to fully integrated clinical applications, have been used by healthcare providers worldwide for over 20 years. Our software solutions follow industry standards such as DICOM, which ensures that images from any DICOM-compliant modality can be displayed, moved and stored within a standard set of guidelines and HL7, which provides standards for the movement of other health information file formats. In addition, Merge participates in Integrating the Healthcare Enterprise (IHE), an organization dedicated to

developing standard profiles for health information exchange. Our long-time involvement with the standards committees and continuous development of products like our DICOM and HL7 toolkits have enabled Merge to stay closely tied to industry innovation. As discussed above, continued investment in research and development remains a core element of our strategy. This will include ongoing enhancement of our core solutions and development of new solutions and services.

Sales, Marketing and Distribution

Sales to large health systems typically take more than nine months, while the sales cycle is often shorter when selling to smaller hospitals and imaging centers. In order to ramp up our sales and market presence, we began aggressively hiring sales and marketing personnel in the fourth quarter of 2010. As of the end of 2010, approximately 100 of our employees were engaged in sales and marketing activities. Our executive sales and marketing management is located at our Innovation Center in Chicago, Illinois, while our sales team is deployed across the United States and globally.

We employ quota based sales teams which specialize in particular solutions and services. In addition, we have sales teams dedicated to establishing and maintaining VAR and distributor relationships globally. Where feasible, we have concentrated inside and telesales staff in one location in order to bring economies of scale in management and process. Our sales teams are complemented by a staff of lead generation and marketing employees. These teams have the benefit of online tools and resources that streamline and track the sales process.

Index

Our marketing efforts are mainly electronic, utilizing our website and our extensive email database of eStore customers for our communication campaigns, as well as our website for online communities and certain social media. In addition, we participate in the major industry trade shows for our respective product lines. We also have an active User Group for our U.S. customers.

Financial Information about Segments

For financial information regarding our single segment business as well as our geographic areas of operation, refer to Item 8, “Note 1 – Basis of Presentation and Significant Accounting Policies” and “Note 15 – Segment Information and Concentrations of Risk” of this Annual Report on Form 10-K.

Item 1A.RISK FACTORS

Discussion of our business and operating results included in this annual report on Form 10-K should be read together with the risk factors set forth below. They describe various risks and uncertainties to which we are or may become subject. These risks and uncertainties, together with other factors described elsewhere in this report, have the potential to affect our business, financial condition, results of operations, cash flows, strategies or prospects in a material and adverse manner. New risks may emerge at any time, and we cannot predict those risks or estimate the extent to which they may affect financial performance. We undertake no obligation to update or revise the statements.

Our Business could be Harmed by Adverse General Economic and Market Conditions which could Lead to Reduced Spending on Information Technology Products.

Our markets have been negatively affected by the global macroeconomic downturn. As our business expands globally, we are increasingly subject to the risks arising from adverse changes in domestic and global economic and political conditions. Economic growth in the U.S. and other countries has slowed since the second half of 2008, which caused our customers to delay or reduce information technology purchases. As a result of slowing global economic growth, the credit market crisis, declining consumer and business confidence, shifts in consumer spending patterns, increased unemployment, reduced levels of capital expenditures, fluctuating commodity prices, bankruptcies and other challenges currently affecting the global economy, our clients might experience deterioration of their businesses, cash flow shortages and difficulty obtaining financing. If economic conditions in the U.S. and other countries were to deteriorate, customers may delay or reduce purchases. This could result in reductions in sales of our products, longer sales cycles, slower adoption of new technologies and increased price competition. In addition, weakness in the end-user market could negatively affect the cash flow of our OEM and VAR customers who could, in turn, delay paying their obligations, which would increase our credit risk exposure and cause a decrease in operating cash flows. Also, if OEM and VAR customers experience excessive financial difficulties and/or insolvency, and we are unable to successfully transition end-users to purchase products from other vendors or directly from us, sales could decline significantly. Any of these events would likely harm our business, results of operations and financial condition.

Disruption in Credit Markets and World-Wide Economic Changes may Adversely Affect our Business, Financial Condition, and Results of Operations.

Disruptions in the financial and credit markets may adversely affect our business and financial results. The tightening of credit markets may reduce the funds available to our customers to buy our products and services. It may also result in customers extending the length of time in which they pay and in our having higher customer receivables with increased default rates. General concerns about the fundamental soundness of domestic and foreign economies may also cause customers to reduce their purchases, even if they have cash or if credit is available to them.

We have a Substantial Amount of Indebtedness, which could Impact our Ability to Obtain Future Financing or Pursue our Growth Strategy.

We have substantial indebtedness. As of December 31, 2010, we had approximately $200.1 million of indebtedness, including $200 million aggregate principal amount of 11.75% Senior Secured Notes due 2015 (Notes) that we issued in connection with the acquisition of AMICAS.

Our high level of indebtedness could have important consequences to you and significant adverse effects on our business, including the following:

- We must use a substantial portion of our cash flow from operations to pay interest on our indebtedness, which will reduce the funds available to us for operations and other purposes;

Index

- Our ability to obtain additional financing for working capital, capital expenditures, acquisitions or general corporate purposes may be impaired;

- Our high level of indebtedness could place us at a competitive disadvantage compared to our competitors that may have proportionately less indebtedness;

- Our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate may be limited; and

- Our high level of indebtedness may make us more vulnerable to economic downturns and adverse developments in our business.

The indenture governing our Notes contains, and the instruments governing any indebtedness we may incur in the future may contain, restrictive covenants that impose significant operating and financial restrictions, including restrictions on our ability to take actions that we believe may be in our interest. The indenture, among other things, limits our ability to:

- Incur additional indebtedness and issue preferred stock;
- Pay dividends on or make distributions in respect of capital stock;
- Make investments or certain other restricted payments;
- Place limits on dividends and enter into other payment restrictions affecting certain subsidiaries;
- Enter into transactions with stockholders or affiliates;
- Create or incur liens;
- Enter into certain sale-leaseback transactions;
- Guarantee indebtedness;
- Merge, consolidate or sell substantially all of our assets; and
- Issue or sell stock of certain subsidiaries.

Our failure to comply with these covenants could result in an event of default which, if not cured or waived, could result in the acceleration of all or a portion of our outstanding indebtedness, which would have a material adverse effect on our business, financial condition and results of operations.

Payments on our Indebtedness will Require a Significant Amount of Cash. Our Ability to Meet our Cash Requirements and Service our Indebtedness is Impacted by Many Factors that are Outside of our Control.

We expect to obtain the funds to pay our expenses and to pay the amounts due under the Notes primarily from our operations. Our ability to meet our expenses and make these payments thus depends on our future performance, which will be affected by financial, business, economic and other factors, many of which we cannot control. Our business may not generate sufficient cash flow from operations in the future and our currently anticipated growth in revenue and cash flow may not be realized, either or both of which could result in our being unable to repay

indebtedness, including the Notes, or to fund other liquidity needs. If we do not have sufficient cash resources in the future, we may be required to refinance all or part of our then existing indebtedness, sell assets or borrow more money. We cannot assure you that we will be able to accomplish any of these alternatives on terms acceptable to us or at all. In addition, the terms of existing or future debt agreements may restrict us from adopting any of these alternatives. Our failure to generate sufficient cash flow or to achieve any of these alternatives could materially adversely affect the value of the notes and our ability to pay the amounts due under the notes. See the section captioned "Liquidity and Capital Resources" in the Management's Discussion and Analysis of Financial Condition and Results of Operations incorporated herein by reference.

Our Future Capital Needs are Uncertain and our Ability to Access Additional Financing may be Negatively Impacted by the Volatility and Disruption of the Capital and Credit Markets and Adverse Changes in the Global Economy.

Our capital requirements in the future will depend on many factors, including:

- Acceptance of and demand for our products;
- The extent to which we invest in new technology and product development;
- The costs of developing new products, services or technologies;
- Our interest and principal payment obligations;

Index

- The number and method of financing of acquisitions and other strategic transactions; and
- The costs associated with the growth of our business, if any.

We must continue to enhance and expand our product and service offerings in order to maintain our competitive position, satisfy our working capital obligations and increase our market share. We have in the past required substantial capital infusions. For example, in June 2008, we borrowed $20.0 million from Merrick RIS, LLC (Merrick RIS), an affiliate of Merrick Ventures, LLC (Merrick Ventures), in exchange for a $15.0 million senior secured term note (which was repaid in full on November 18, 2009) and 21,085,715 shares of our common stock. Our ability to incur additional indebtedness in the future may be difficult or on disadvantageous terms. We currently do not have a credit facility and such a facility may be difficult to obtain in the future given the amount of indebtedness that we incurred in connection with our acquisition of AMICAS and future market conditions. Unless we can achieve cash flow levels sufficient to support our operations, we may require additional borrowings or the sale of debt or equity securities, sale of non-strategic assets, or some combination thereof, to provide funding for our operations. Our ability to borrow in the future is dependent upon our ability to manage business operations and generate sufficient cash flows to service such indebtedness. If we are unable to generate sufficient working capital or obtain alternative financing, we may not be able to borrow or otherwise obtain additional funds to finance our operations when needed, our financial condition and operating results would be materially adversely affected.

If adverse global economic conditions persist or worsen, we could experience a decrease in cash flows from operations and may need additional financing to fund operations. Due to the existing uncertainty in the capital markets (including debt, private equity, venture capital and traditional bank lending), access to additional debt or equity may not be available on acceptable terms or at all. If we cannot raise funds on acceptable terms when necessary, we may not be able to develop or enhance products and services, execute our business plan, take advantage of future opportunities or respond to competitive pressures or unanticipated customer requirements.

Healthcare Industry Consolidation could Impose Pressure on our Software Prices, Reduce our Potential Client Base and Reduce Demand for our Software.

Many hospitals and imaging centers have consolidated to create larger healthcare enterprises with greater market power. If this consolidation trend continues, it could reduce the size of our potential customer base and give the resulting enterprises greater bargaining power, which may lead to erosion of the prices for our software. In addition, when hospitals and imaging centers combine, they often consolidate infrastructure, and consolidation of our customers could erode our revenue base.

We may Experience Significant Fluctuations in Revenue Growth Rates and Operating Results.

We may not be able to accurately forecast our growth rate. We base expense levels and investment plans on sales estimates and review all estimates on a quarterly basis. Many of our expenses and investments are fixed and we may not be able to adjust spending quickly enough if sales are lower than expected.

Our revenue growth may not be sustainable and our percentage growth rates may decrease or fluctuate significantly. Our revenue and operating profit growth depends on the continued growth of demand for our products and services offered through us or our OEM and VAR customers, and our business is affected by general economic and business conditions worldwide. A softening of demand, whether caused by changes in customer preferences or a weakening of the U.S. or global economies, may result in decreased revenue or growth.

Our net sales and operating results will also fluctuate for many other reasons, including due to risks described elsewhere in this section and the following:

- Demand for our software solutions and services;
- Our sales cycle;
- Economic cycles;
- The level of reimbursements to our end-user customers from government sponsored healthcare programs (principally, Medicare and Medicaid);
- Accounting policy changes mandated by regulating entities;
- Delays due to customers' internal budgets and procedures for approving capital expenditures, by competing needs for other capital expenditures and the deployment of new technologies and personnel resources;
- Our ability to retain and increase sales to existing customers, attract new customers and satisfy our customers' demands;
- Our ability to fulfill orders;
- The introduction of competitive products and services;

Index

- Price decreases;
- Changes in the usage of the Internet and eCommerce, including in non-U.S. markets;
- Changes to regulatory approval processes and/or requirements;
- Timing, effectiveness and costs of expansion and changes in our systems and infrastructure;
- The outcomes of legal proceedings and claims involving us; and
- Variations in the mix of products and services offered by us.

Delays in the expected sales or installation of our software may have a significant impact on our anticipated quarterly revenues and, consequently, our earnings since a significant percentage of expenses are relatively fixed. Additionally, we sometimes depend, in part, upon large contracts with a small number of customers to meet sales goals in any particular quarter. Delays in the expected sales or installation of solutions under these large contracts may have a significant impact on our quarterly net sales and consequently our earnings, particularly because a significant percentage of expenses are fixed.

The Length of our Sales and Implementation Cycles may Adversely Affect our Operating Results.

We have experienced long sales and implementation cycles. How and when to implement, replace, expand or substantially modify medical imaging management software, or to modify or add business processes, are major decisions for our end-user target market. The sales cycle for our software ranges from six to 18 months or more from initial contact to contract execution. Our end-user implementation cycle has generally ranged from three to nine months from contract execution to completion of implementation. During the sales and implementation cycles, we will expend substantial time, effort and resources preparing contract proposals, negotiating the contract and implementing the software, and may not realize any revenues to offset these expenditures. Additionally, any decision by our customers to delay or cancel purchases or the implementation of our software may adversely affect net sales.

We Operate in Competitive Markets, which may Adversely Affect our Market Share and Financial Results.

Some of our competitors are focused on sub-markets within targeted industries, while others have significant financial and information-gathering resources with recognized brands, technological expertise and market experience. We believe that competitors are continuously enhancing their products and services, developing new products and services and investing in technology to better serve the needs of their existing customers and to attract new customers.

We face competition in specific industries and with respect to specific offerings. We may also face competition from organizations and businesses that have not traditionally competed with us, but that could adapt their products and services to meet the demands of our customers. Increased competition may require us to reduce the prices of our offerings or make additional capital investments that would adversely affect margins. If we are unable or unwilling to do so, we may lose market share in target markets and our financial results may be adversely affected.

We face Aggressive Competition in Many Areas, and our Business will be Harmed if we Fail to Compete Effectively.

The markets for medical imaging solutions are highly competitive and subject to rapid technological change. We may be unable to maintain our competitive position against current and potential competitors. Many of our current and potential competitors have greater financial, technical, product development, marketing and other resources, and we may not be able to compete effectively with them. In addition, new competitors may emerge and our system and

software solution offerings may be threatened by new technologies or market trends that reduce the value of our solutions.

We often compete with our OEM customers' own internal software engineering groups. The size and competency of these groups may create additional competition.

The development and acquisition of additional products, services and technologies, and the improvement of our existing products and services, require significant investments in research and development. For example, our current product candidates are in various stages of development and may require significant further research, development, pre-clinical or clinical testing, regulatory approval and commercialization. If we fail to successfully sell new products and update existing products, our operating results may decline as existing products reach the end of their commercial life cycles.

Index

If We Are Unable to Successfully Identify or Effectively Integrate Acquisitions, our Financial Results may be Adversely Affected.

We have in the past and may in the future acquire and make investments in companies, products or technologies that we believe complement or expand our existing business and assist in quickly bringing new products to market. In addition to the acquisition of AMICAS, in 2009 we completed two significant acquisitions, etrials Worldwide, Inc. on July 20, 2009, and Confirma, Inc. on September 1, 2009. There can be no assurance that we will be able to identify suitable candidates for successful acquisitions at acceptable prices. In addition, our ability to achieve the expected returns and synergies from past and future acquisitions and alliances depends in part upon our ability to integrate the offerings, technology, administrative functions, and personnel of these businesses into our business in an efficient and effective manner. We cannot predict whether we will be successful in integrating acquired businesses or that our acquired businesses will perform at anticipated levels. In addition, our past and future acquisitions may subject us to unanticipated risks or liabilities, or disrupt operations and divert management's attention from day-to-day operations. In addition, we may use our capital stock to acquire acquisition targets, which could be dilutive to the existing stockholders and cause a decline in the price of our common stock.

In making or attempting to make acquisitions or investments, we face a number of risks, including risks related to:

- Identifying suitable candidates, performing appropriate due diligence, identifying potential liabilities and negotiating acceptable terms;
- Reducing our working capital and hindering our ability to expand or maintain our business, if acquisitions are made using cash;
- The potential distraction of our management, diversion of our resources and disruption to our business;
- Retaining and motivating key employees of the acquired companies;
- Managing operations that are distant from our current headquarters and operational locations;
- Entering into industries or geographic markets in which we have little or no prior experience;
- Competing for acquisition opportunities with competitors that are larger or have greater financial and other resources than us;
- Accurately forecasting the financial impact of a transaction;
- Assuming liabilities of acquired companies, including existing or potential litigation related to the operation of the business prior to the acquisition;
- Maintaining good relations with the customers and suppliers of the acquired company; and
- Effectively integrating acquired companies and achieving expected synergies.

In addition, any acquired business, products or technologies may not generate sufficient revenue and net income to offset the associated costs of such acquisitions, and such acquisitions could result in other adverse effects.

Moreover, from time to time, we may enter into negotiations for the acquisition of businesses, products or technologies but be unable or unwilling to consummate the acquisitions under consideration. This can be expensive

and could cause significant diversion of managerial attention and resources.

Our Acquisitions could Trigger Certain Provisions Contained in Agreements Between Third Parties and Acquired Companies that could Permit Such Parties to Terminate that Agreement.

The companies we acquire may be a party to agreements that permit a counter-party to terminate an agreement or receive payments because the acquisition would cause a default or violate an anti-assignment, change of control or similar clause in such agreements. If this happens, we may have to seek to replace that agreement with a new agreement or make additional payments under such agreements. However, we may be unable to replace a terminated agreement on comparable terms or at all. Depending on the importance of such agreement to the acquired business, the failure to replace a terminated agreement on similar terms or at all, and requirements to pay additional amounts, may increase our costs of operating the acquired business or prevent us from operating the acquired business.

We have Incurred and may Continue to Incur Significant Costs Associated with Acquisition Activities.

In the years ended December 31, 2010 and 2009, we incurred $9.7 million and $1.2 million of acquisition related costs, respectively. All such direct acquisition costs are expensed as incurred by us. In addition, we often are required to incur charges to operations in the quarters following an acquisition to reflect costs associated with integrating acquired companies. We may incur additional material charges in subsequent quarters associated with acquisitions. We anticipate that our acquisition activities will require significant cash outflows directly related to completing acquisitions as well as costs related to integration efforts. If the benefits of an acquisition do not exceed the costs of integrating the businesses, our financial results may be adversely affected.

Index

A Portion of our Business Relies Upon a Network of Independent Contractors and Distributors Whose Actions could have an Adverse Effect on our Business.

We obtain some critical information from independent contractors. In addition, we rely on a network of VAR's and distributors to sell our offerings in locations where we do not maintain a sales office or sales team. These independent contractors and distributors are not our employees. As a result, we have limited ability to monitor and direct their activities. The loss of a significant number of these independent contractors or dealers could disrupt our sales, marketing and distribution efforts. Furthermore, if any actions or business practices of these individuals or entities violate our policies or procedures or otherwise are deemed inappropriate or illegal, we could be subject to litigation, regulatory sanctions or reputation damage, any of which could adversely affect our business and require us to terminate relationships with them.

Our Investments in Technology may not be Sufficient and may not Result in an Increase in our Revenues or Decrease in our Operating Costs.

As the technological landscape continues to evolve, it may become increasingly difficult for us to make timely, cost-effective changes to our offerings in a manner that adequately differentiates them from those of our competitors. We cannot provide any assurance that our investments have been or will be sufficient to maintain or improve our competitive position or that the development of new or improved technologies and products by our competitors will not have a material adverse effect on our business.

Our Performance and Future Success Depends on our Ability to Attract, Integrate and Retain Qualified Technical, Managerial and Sales Personnel.

We are dependent, in part, upon the services of our senior executives and other key business and technical personnel. We do not currently maintain key-man life insurance on our senior executives. The loss of the services of any of our senior executives or key employees could have a material adverse effect on our business. Our commercial success will depend upon, among other things, the successful recruiting and retention of highly skilled technical, managerial and sales personnel with experience in similar business activities. Competition for the type of highly skilled individuals that we seek is intense. We may not be able to retain existing key employees or be able to find, attract and retain skilled personnel on acceptable terms.

We may not be Able to Adequately Protect our Intellectual Property Rights or may be Accused of Infringing Intellectual Property Rights of Third Parties.

We regard our trademarks, service marks, copyrights, patents, trade secrets, proprietary technology and similar intellectual property as critical to our success. We rely on trademark, copyright and patent law, trade secret protection and confidentiality and/or license agreements with employees, customers and others to protect our proprietary rights. Effective intellectual property protection may not be available in every country in which our products and services are made available. We also may not be able to acquire or maintain appropriate intellectual property rights in all countries where we do business.

We may not be able to discover or determine the extent of any unauthorized use of our proprietary rights. Third parties that license our proprietary rights also may take actions that diminish the value of these rights. Such claims, whether or not meritorious, may result in the expenditure of significant financial and managerial resources, injunctions against us or the payment of damages. We may need to obtain licenses from third parties who allege that we have infringed on their rights, but such licenses may not be available on terms acceptable to us or at all. In addition, we may not be able to obtain or utilize on favorable terms, or at all, licenses or other rights with respect to intellectual property we do not own in providing services under commercial agreements. These risks have been amplified by the

increase in third parties whose sole or primary business is to assert such claims.

We also rely on proprietary know how and confidential information and employ various methods, such as entering into confidentiality and non-compete agreements with our current employees and with certain third parties to whom we have divulged proprietary information to protect the processes, concepts, ideas and documentation associated with our solutions. Such methods may not afford sufficient protection, and we may not be able to protect trade secrets adequately or ensure that other companies would not acquire information that we consider proprietary.

We have Foreign Exchange Rate Risk.

Our international operating results are exposed to foreign exchange rate fluctuations. While the functional currency of most of our international operations is the U.S. Dollar, certain account balances are maintained in the local currency. Upon remeasurement of such accounts or through normal operations, results may differ materially from expectations, and we may record significant gains or losses on the remeasurement of such balances. As we expand international operations, our exposure to exchange rate fluctuations may increase.

Index

We may not be Successful in our Efforts to Expand into International Markets.

Our international activities are significant to our revenues and profits, and we plan to further expand internationally. In 2010, our international revenues were $14.4 million, or about 10% of total revenues. We have relatively little experience operating in these or future markets and may not benefit from any first-to-market advantages or otherwise succeed. It is costly to establish, develop and maintain international operations and websites and promote our brand internationally. Our international operations may not be profitable on a sustained basis.

In addition to risks described elsewhere in this section, our international sales and operations are subject to a number of risks, including:

- Local economic and political conditions;
- Foreign government regulation of healthcare and government reimbursement of health services;
- Local restrictions on sales or distribution of certain products or services and uncertainty regarding liability for products and services;
- Local import, export or other business licensing requirements;
- Local limitations on the repatriation and investment of funds and foreign currency exchange restrictions;
- Shorter payable and longer receivable cycles and the resultant negative impact on cash flow;
- Local laws and regulations regarding data protection, privacy, network security and restrictions on pricing;
- Difficulty in staffing, developing and managing foreign operations as a result of distance, language and cultural differences;
- Different employee/employer relationships and the existence of workers' councils and labor unions;
- Laws and policies of the U.S. and other jurisdictions affecting trade, foreign investment, loans and taxes; and
- Geopolitical events, including war and terrorism.

If our New and Existing Products, Including Product Upgrades, and Services do not Achieve and Maintain Sufficient Market Acceptance, our Business, Financial Condition, Cash Flows, Revenues, and Operating Results could Suffer.

The success of our business depends and will continue to depend in large part on the market acceptance of:

- Our existing products and services;
- Our new products and services, and
- Enhancements to existing products, support and services.

There can be no assurance that customers will accept any of these products, product upgrades, support or services. In addition, even if customers accept these products and services initially, we cannot assure you that they will continue to purchase our products and services at levels that are consistent with, or higher than, past quarters. Customers may significantly reduce their relationships with us or choose not to expand their relationship with us. In addition, any pricing strategy that we implement for any of our products, product upgrades, or services may not be economically

viable or acceptable to our target markets. Failure to achieve or to sustain significant penetration in our target markets with respect to any of these products, product upgrades, or services could have a material adverse effect on our business.

Achieving and sustaining market acceptance for these products, product upgrades and services is likely to require substantial marketing and service efforts and the expenditure of significant funds to create awareness and demand by participants in the healthcare industry. In addition, deployment of new or newly integrated products or product upgrades may require the use of additional resources for training our existing sales force and customer service personnel and for hiring and training additional sales and customer service personnel. There can be no assurance that the revenue opportunities for new products, product upgrades and services will justify the amounts that we spend for their development, marketing and rollout.

If we are unable to sell new and next-generation software products to healthcare providers that are in the market for healthcare information and/or image management systems, such inability will likely have a material adverse effect on our business, financial condition, cash flows, revenues and operating results, If anticipated software sales and services do not materialize, or if we lose customers or experience significant declines in orders from customers, our revenues would decrease over time due to the combined effects of attrition of existing customers and a shortfall in new client additions.

Index

If we Fail to Manage Future Growth Effectively, we may be Unable to Execute our Business Plan, Maintain High Levels of Service or Address Competitive Challenges Adequately.

We plan to expand our business. We anticipate that this expansion will require substantial management effort and significant additional investment in infrastructure, service offerings and service center expansion. In addition, we will be required to continue to improve our operational, financial and management controls and our reporting procedures. Our future growth will place a significant strain on managerial, administrative, operational, financial and other resources. If we are unable to manage growth successfully, our business will be harmed.

Litigation or Regulatory Actions could Adversely Affect our Financial Condition.

On June 1, 2009, Merge Healthcare was sued in the Milwaukee County Circuit Court, State of Wisconsin, by William C. Mortimore and David M. Noshay with respect to the separation of Mortimore's and Noshay's employment and our subsequent refusal to indemnify them with respect to litigation related to their service as officers of Merge. The plaintiffs allege that we breached their employment agreements, unreasonably refused their requests for indemnification and breached other covenants of good faith and fair dealing. The plaintiffs seek indemnification, and unspecified monetary damages. Discovery in this case is on-going. We have retained litigation counsel and intend to continue to vigorously defend this action.

In January 2010, a purported stockholder class action complaint was filed in the Superior Court of Suffolk County, Massachusetts in connection with AMICAS' proposed acquisition by Thoma Bravo, LLC (the "Thoma Bravo Merger"). A second similar action was filed in the same court in February 2010 and consolidated with the first action. In March 2010, because AMICAS had terminated the Thoma Bravo Merger and agreed to be acquired by us, the court dismissed the plaintiffs' claims as moot. Subsequently, counsel to the plaintiffs filed an application for approximately $5 million of attorneys' fees for its work on this case, which fee petition AMICAS opposed. We retained litigation counsel to defend against the fee petition. On December 23, 2010, the court awarded plaintiffs approximately $3.2 million in attorneys' fees and costs. AMICAS has filed a notice of appeal from this judgment, and the plaintiffs have cross-appealed. We previously tendered the defense in this matter to our appropriate insurers, who have provided coverage against the claims asserted against AMICAS. After receipt of the court's attorneys' fee award decision, the applicable insurer denied policy coverage for approximately $2.5 million of the fee award. We do not believe that the insurer's denial has merit and have retained counsel to contest it. We will vigorously assert all of our rights under our applicable insurance policies, which we believe cover the claims and expenses incurred by AMICAS or us in connection with the fee award. However, an adverse outcome could negatively impact our financial condition.

On February 1, 2010, Merge filed a complaint against its former CEO, Richard Linden and its former CFO, Scott Veech, in the U.S. District for the Eastern District of Wisconsin, seeking a declaration that we do not have to indemnify either Linden or Veech for liabilities they incurred in connection with SEC investigation and enforcement actions and various securities fraud and shareholder derivative litigation. Merge also seeks to recover from both defendants all costs incurred by Merge associated with defending Linden and Veech in those prior actions. On October 15, 2010, the Court concluded that it did not have subject matter jurisdiction over Merge's claims and dismissed the claims in their entirety. The Court rendered no opinion on the merits of Merge's claims. Merge believes it has numerous meritorious claims against Linden and Veech and will continue to pursue those claims. As to Scott Veech, Merge is evaluating its options against Scott Veech in Wisconsin state court. As to the former CEO, Richard Linden, on February 8, 2011, Merge filed a complaint against its former CEO, Richard Linden, in the U.S. District Court for the Eastern District of Wisconsin captioned Merge Healthcare Incorporated v. Richard Linden, Case no. 11-CV-00154/ as Merge believes that jurisdiction exists in that court vis-à-vis Linden. We have retained litigation counsel and intend to continue to vigorously prosecute this action.

In August, 2010, Merge Healthcare was sued in the Northern District of Texas by the court-appointed receiver for Stanford International Bank, Ltd. The Receiver alleges that Merge was a recipient of a fraudulent conveyance as a result of a Ponzi scheme orchestrated by Robert Stanford and Stanford International Bank, Ltd. (SIBL). Merge is not alleged to have participated in the Ponzi scheme. The Receiver's claims arise from the failed acquisition of Emageon, Inc. (Emageon) by Health Systems Solutions, Inc. (HSS) an affiliate of SIBL in February 2009, which resulted in the payment of a $9 million break-up fee by HSS, which payment is alleged to have been financed by SIBL. Merge subsequently acquired Emageon as part of our AMICAS acquisition. The Complaint seeks to recover the $9 million payment to Emageon, plus interest, costs, and attorneys' fees. We have retained litigation counsel and intend to vigorously defend this action. We have filed a motion to dismiss the complaint for failure to state a claim. That motion has been fully briefed, and we are awaiting a decision from the court. However, an adverse outcome could negatively impact our operating results and financial condition.

Index

As a result of lawsuits and regulatory matters, including the matter discussed above, we have incurred and may continue to incur substantial expenses. In addition to the matter discussed above, we are, from time to time, parties to legal proceedings, lawsuits and other claims incident to our business activities. Such matters may include, among other things, assertions of contract breach or intellectual property infringement, claims for indemnity arising in the course of our business and claims by persons whose employment has been terminated. Such matters are subject to many uncertainties and outcomes are not predictable with assurance. The defense of these actions may be both time consuming and expensive. If any of these legal proceedings were to result in an unfavorable outcome, it could have a material adverse effect on our business, financial position and results of operations.

We may be Subject to Product Liability Claims if People or Property are Harmed by the Products and Services that we Sell.

Some of the products we sell or manufacture may expose us to product liability claims relating to personal injury, death or environmental or property damage and may require product recalls or other actions. Certain third parties, primarily our customers, also sell products or services using our products. This may increase our exposure to product liability claims. Although we maintain liability insurance, we cannot be certain that coverage will be adequate for liabilities actually incurred or that insurance will continue to be available on economically reasonable terms or at all. In addition, some of our agreements with vendors and sellers do not indemnify us from product liability.

We Provide Customers with Certain Warranties that could Result in Higher Costs than Anticipated.

Software products such as ours that are used in a wide range of clinical and health information systems settings may contain a number of errors or “bugs,” especially early in their product life cycle. Our products include clinical information systems used in patient care settings where a low tolerance for errors or bugs exists. Testing of products is difficult due to the wide range of environments in which systems are installed. The discovery of defects or errors in our software products or in our implementation of integrated solutions may 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 result in delayed acceptance of, or the return of, our software products.

We Depend on Licenses from Third Parties for Rights to Some Technology we use, and if we are Unable to Continue these Relationships and Maintain our Rights to this Technology, our Business could Suffer.

Some of the technology used in our software depends upon licenses from third party vendors. These licenses typically expire within one to five years, can be renewed only by mutual consent and may be terminated if we breach the license and fail to cure the breach within a specified period of time. We may not be able to continue using the technology made available to us under these licenses on commercially reasonable terms or at all. As a result, we may have to discontinue, delay or reduce software shipments until we obtain equivalent technology, which could hurt our business. Most of our third party licenses are nonexclusive. Our competitors may obtain the same right to use any of the technology covered by these licenses and use the technology to compete directly with us. In addition, if our vendors choose to discontinue support of the licensed technology in the future or are unsuccessful in their continued research and development efforts, particularly with regard to the Microsoft Windows/Intel platform on which most of our products operate, we may not be able to modify or adapt our own software.

We are Subject to Government Regulation, Changes to which could Negatively Impact our Business.

We are subject to regulation in the U.S. by the Food and Drug Administration (FDA), including periodic FDA inspections, in Canada under Health Canada’s Medical Devices Regulations, and in other countries by corresponding regulatory authorities. We may be required to undertake additional actions in the U.S. to comply with the Federal Food, Drug and Cosmetic Act (FDCA Act), regulations promulgated under the FDCA Act, and any other applicable

regulatory requirements. For example, the FDA has increased its focus on regulating computer software intended for use in a healthcare setting. 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 activities. Complying with these regulations could be time consuming and expensive, and may include:

- Requiring us to receive FDA clearance of a pre-market notification submission demonstrating substantial equivalence to a device already legally marketed, or to obtain FDA approval of a pre-market approval application establishing the safety and effectiveness of the software;

- Requiring us to comply with rigorous regulations governing the pre-clinical and clinical testing, manufacture, distribution, labeling and promotion of medical devices; and

- Requiring us to comply with the FDCA Act regarding general controls, including establishment registration, device listing, compliance with good manufacturing practices, reporting of specified malfunctions and adverse device events.

Index

Similar obligations may exist in other countries in which we do business, including Canada. Any failure by us to comply with other applicable regulatory requirements, both domestic and foreign, could subject us to a number of enforcement actions, including warning letters, fines, product seizures, recalls, injunctions, total or partial suspensions of production, operating restrictions or limitations on marketing, refusals of the government to grant new clearances or approvals, withdrawals of marketing clearances or approvals and civil and criminal penalties.

Changes in Federal and State Regulations Relating to Patient Data could Depress the Demand for our Software and Impose Significant Software Redesign Costs.

Federal regulations under the Health Insurance Portability and Accountability Act (HIPAA) impose national health data standards on healthcare providers that conduct electronic health transactions, healthcare clearinghouses that convert health data between HIPAA compliant and non-compliant formats and health plans. Collectively, these groups are known as covered entities. The HIPAA regulations prescribe transaction formats and code sets for electronic health transactions, protect individual privacy by limiting the uses and disclosures of individually identifiable health information and require covered entities to implement administrative, physical and technological safeguards to ensure the confidentiality, integrity, availability and security of individually identifiable health information in electronic form. Although we are not a covered entity, most of our customers are, and they require that our software and services adhere to HIPAA regulations. Any failure or perceived failure of our software or services to meet HIPAA regulations could adversely affect demand for our software and services and potentially require us to expend significant capital, research and development and other resources to modify our software or services to address the privacy and security requirements of our clients.

States and foreign jurisdictions have adopted, or may adopt, privacy standards that are similar to or more stringent than the federal HIPAA privacy regulations. This may lead to different restrictions for handling individually identifiable health information. As a result, our customers may demand IT solutions and services that are adaptable to reflect different and changing regulatory requirements, which could increase our development costs. In the future, federal, state or foreign governmental authorities may impose new data security regulations or additional restrictions on the collection, use, transmission and other disclosures of health information. We cannot predict the potential impact that these future rules may have on our business; however, the demand for our software and services may decrease if we are not able to develop and offer software and services that can address the regulatory challenges and compliance obligations facing our clients.

Recently Enacted Healthcare Reform Legislation may have a Negative Impact on our Business. Among other things, Reductions in Medicare and Medicaid Reimbursement Rates for Imaging Procedures and Professional Services could Negatively Affect Revenues of our Hospital and Imaging Clinic Customers, which could Reduce our Customers' Ability to Purchase our Software and Services.

The U.S. Congress recently enacted far-reaching health system reform legislation that could have a negative impact on our business. While the impact of the legislation is difficult to predict, the legislation will increase pressure to control spending in government programs (e.g., Medicare and Medicaid) and by third party payors. The ability of customers to obtain appropriate reimbursement for imaging services they provide from these programs and payors is critical to the success of our company. Changes in the equipment utilization rate, once fully implemented, have the potential to dramatically decrease technical reimbursements for radiology procedures, and could have a particularly negative impact on hospitals and imaging clinics in rural regions of the country where utilization rates are naturally lower. A second significant potential reimbursement change relates to the Sustainable Growth Rate (SGR) component of the Medicare Physician Fee Schedule. The SGR is part of the update factor process used to set the annual rate of growth in allowed reimbursable medical expenditures, and is determined by a formula specified by Congress. Because the annual calculation of the SGR would have led to reimbursement reductions that Congress found unacceptable, Congress has interceded to delay the implementation of this statutory SGR update factor. While these changes have

provided temporary reimbursement relief to healthcare providers and us, because of the significant budgetary impacts, Congress has left the SGR formula, thereby allowing annual unimplemented payment reductions to accumulate in the Medicare statute. As a result, for 2010, if this SGR had been allowed to be implemented, it would have caused a 21.3 percent reduction in the update adjustment factor in the calculation of the Physician Fee Schedule. The Congress and Obama administration are currently considering legislation to attempt to fix or delay this problem, but the prospects for enactment remain uncertain. The changes being considered have the potential to negatively impact the professional component of reimbursement.

Changes related to the equipment utilization assumption and the SGR calculation could result in a reduction in software and service procurement of our customers, and have a material adverse effect on our revenues and operating results.

Index

There are a Limited Number of Stockholders who have Significant Control over our Common Stock, Allowing them to have Significant Influence over the Outcome of all Matters Submitted to Stockholders for Approval, which may Conflict with our Interests and the Interests of other Stockholders.

Our directors, officers and principal stockholders (stockholders owning 10% or more of our common stock) beneficially owned approximately 34.8 million, or 40.4%, of the outstanding shares of common stock and stock options that could have been converted to common stock at December 31, 2010, and such stockholders will have significant influence over the outcome of all matters submitted to our stockholders for approval, including the election of directors and other corporate actions. Also, on November 18, 2009, we repaid in full our $15.0 million senior secured term note from Merrick RIS, LLC (Merrick), an affiliate of Merrick Ventures, LLC (Merrick Ventures), including a prepayment penalty of $2.7 million and accrued interest of $0.4 million. As of December 31, 2010, Merrick and its affiliates owned approximately 38.1% of our Common Stock. The influence of our large stockholders could impact our business strategy and also have the effect of discouraging others from attempting us to take over, thereby increasing the likelihood that the market price of the common stock will not reflect a premium for control.

In addition, we engage from time to time in transactions with certain of our significant stockholders. In June 2008, in exchange for $20 million, we issued (i) a $15 million senior secured note payable to Merrick and (ii) 21,085,715 shares of our common stock at a price per share of $0.35 to Merrick. In November 2009, we completed a stock offering and used a portion of the proceeds to prepay in full our senior secured note due June 2010 held by Merrick, which included all amounts owed under the note of $15.0 million and an additional amount $3.1 million payable as a result of the prepayment of the note. On April 1, 2010, we entered into a Securities Purchase Agreement with Merrick, under which Merrick subscribed to purchase 10,000 shares of Series A Non-Voting Preferred Stock, par value $0.01 per share (Series A Preferred Stock) and 1,800,000 shares of common stock for an aggregate purchase price of $10,000, under the same terms and conditions as other investors, as further indicated in Note 8 of this Annual Report on Form 10-K. Merrick and its affiliates beneficially own, as of December 31, 2010, 38.1% of our outstanding common stock. Michael W. Ferro, Jr., our Chairman of the Board, and trusts for the benefit of Mr. Ferro's family members beneficially own a majority of the equity interest in Merrick. Mr. Ferro also serves as the chairman and chief executive officer of Merrick. In addition, Justin C. Dearborn, our President and a Director, served as Managing Director and General Counsel of Merrick Ventures, an affiliate of Merrick.

Our Large Stockholders may have Interests that Differ from other Stockholders.

Merrick and its affiliates beneficially own, as of December 31, 2010, 38.1% of our outstanding common stock. Michael W. Ferro, Jr., our Chairman of the Board, and trusts for the benefit of Mr. Ferro's family members beneficially own a majority of the equity interest in Merrick. Mr. Ferro also serves as the chairman and chief executive officer of Merrick. Accordingly, Mr. Ferro indirectly owns or controls all of the shares of common stock owned by Merrick. In addition, prior to joining the Company, Justin C. Dearborn, our President and a Director, served as Managing Director and General Counsel of Merrick Ventures, an affiliate of Merrick. Due to its stock ownership, Merrick has significant influence over our business, including the election of our directors.

Effective as of January 1, 2009, we entered into a consulting agreement with Merrick. Services provided by Merrick Ventures under the consulting agreement include investor relations, financial analysis and strategic planning. Effective January 1, 2010, we entered into an amendment to extend the term of the consulting agreement through December 31, 2011, and modified the payment terms from a flat fee arrangement per quarter to a per transaction or success based arrangement. The cost of this consulting agreement in 2010 and 2009 was $2.1 million and $0.5 million, respectively.

In March 2009, we entered into a value added reseller agreement with Merrick Healthcare Solutions, LLC (Merrick Healthcare). Under terms of the agreement, Merrick Healthcare purchased software licenses from us for $0.4

million. Payment of the entire balance was made on the date of the agreement. We recognized $0.4 million in revenue in 2009 related to this transaction.

In March 2010, we entered into a VAR agreement with Merrick Healthcare under which we may market, resell, or supply certain of their products and services. Under terms of the agreement, products and services will be purchased on a per unit basis from Merrick Healthcare.

On April 1, 2010, we entered into a Securities Purchase Agreement with Merrick, under which Merrick subscribed to purchase 10,000 shares of Series A Non-Voting Preferred Stock, par value $0.01 per share (Series A Preferred Stock) and 1,800,000 shares of common stock for an aggregate purchase price of $10,000, under the same terms and conditions as other investors, as further indicated in Note 8 of this Annual Report on Form 10-K.

Merrick also purchased, at the same purchase price per note as the other investors in the offering, $5.0 million of the Notes that we issued on April 28, 2010 to complete our acquisition of AMICAS.

In addition, on July 30, 2010, we acquired substantially all of the Olivia Greets assets from Merrick Healthcare for 500,000 shares of our common stock, which have a one-year trading restriction. As a result of the acquisition, all prior agreements between us and Merrick Healthcare have been terminated.

Index

As a result of these relationships, the interests of Merrick and its affiliates may differ from those of our other stockholders. Merrick Ventures and its affiliates are in the business of making investments in companies and maximizing the return on those investments. They currently have, and may from time to time in the future acquire, interests in businesses that directly or indirectly compete with certain aspects of our business or our suppliers' or customers' businesses. Merrick's significant ownership of our voting stock will enable it to influence or effectively control us.

The Market Price of our Common Stock may Decline as a Result of Acquisitions.

The market price of our Common Stock may decline after acquisitions are completed. Some of the issues that we could face are:

- The integration of an acquired business is unsuccessful or takes longer or is more disruptive than anticipated;
- We do not achieve the expected synergies or other benefits of the acquisition as rapidly or to the extent anticipated, if at all;
- The effect of the acquisition on our financial results does not meet the expectations of Merge, financial analysts or investors; or
- After the acquisition, the business does not perform as anticipated.

In connection with the acquisitions of etrials and Confirma in the third quarter of 2009, we issued 9.4 million additional shares of our Common Stock. We did not use our Common Stock as consideration for the AMICAS acquisition in April of 2010, but we did issue 7.5 million in additional shares of our Common Stock to the purchasers of our new class of Preferred Stock that funded a portion of the purchase price for the AMICAS acquisition. The increase in the number of outstanding shares of our Common Stock may lead to sales of such shares or the perception that such sales may occur, either of which may adversely affect the market price of our Common Stock.

Shares of our Common Stock Eligible for Public Sale may have a Negative Impact on the Market Price of our Common Stock, and Dilute our Stockholders' Percentage Ownership and Voting Power.

Sales of a substantial number of shares of our common stock in the public market, or the perception that these sales may occur, could cause the market price of our common stock to decline. In addition, the sale of these shares could impair our ability to raise capital, should we wish to do so, through the sale of additional common or preferred stock. As of December 31, 2010, we had 83,258,123 shares of common stock outstanding. In addition, as of December 31, 2010, we had outstanding options to purchase 7,959,110 shares of our common stock, of which 2,795,937 options were then exercisable. Future sales of shares of our common stock by existing holders of our common stock or by holders of outstanding options, upon the exercise thereof, could have a negative impact on the market price of our common stock. As additional shares of common stock become available for sale in the public market, due to the exercise of options or the issuance of shares as a result of acquisitions, the market supply of shares of common stock will increase, which could also decrease the market price.

We are unable to estimate the number of shares that may be sold because this will depend on the market price for our common stock, the personal circumstances of the sellers and other factors. Any sale of substantial amounts of our common stock or other securities in the open market may adversely affect the market price of such securities and may adversely affect our ability to obtain future financing in the capital markets as well as create a potential market overhang.

Because we do not Intend to Pay Cash Dividends, Stockholders will Benefit from an Investment in our Stock Only if it Appreciates in Value.

We currently intend to retain future earnings, if any, and do not expect to pay any cash dividends in the foreseeable future. As a result, the success of an investment in our common stock will depend upon any future appreciation in its value. There is no guarantee that our common stock will appreciate in value or even maintain the price at stockholders have purchased and will purchase shares.

The Trading Price of our Common Stock has been Volatile and may Fluctuate Substantially in the Future.

The price of our common stock has been, and may continue to be, volatile. The trading price of our common stock may continue to fluctuate widely as a result of a number of factors, some of which are not in our control, including:

- Our ability to meet or exceed the expectations of analysts or investors;
- Changes in our forecasts or earnings estimates by analysts;

Index

- Quarter-to-quarter variations in our operating results;
- Announcements regarding clinical activities or new products by us or our competitors;
- General conditions in the healthcare IT industry;
- Governmental regulatory action and healthcare reform measures, including changes in reimbursement rates for imaging procedures;
- Rumors about our performance or software solutions;
- Announcements regarding acquisitions;
- Uncertainty regarding our ability to service existing debt;
- Price and volume fluctuations in the overall stock market, which have particularly affected the market prices of many software, healthcare and technology companies; and
- General economic conditions.

In addition, the market for our common stock may experience price and volume fluctuations unrelated or disproportionate to our operating performance. These fluctuations could have a significant impact on our business due to diminished incentives for management and diminished currency for acquisitions.

Certain Provisions of our Charter and Delaware law could make a Takeover Difficult and May Prevent or Frustrate Attempts by our Stockholders to Replace or Remove our Management Team.

We have an authorized class of 1,000,000 shares of preferred stock all of which shares are undesignated except for 50,000 shares of Series A Non-Voting Preferred Stock (41,750 shares of which are issued and outstanding). Shares of our authorized but unissued preferred stock may be issued by our board of directors without stockholder approval, on such terms and with such rights, preferences and designation as the board of directors may determine. Issuance of such preferred stock, depending upon the rights, preferences and designations thereof, may have the effect of delaying, deterring or preventing a change in control of us. In addition, we are subject to provisions of Delaware corporate law which, subject to certain exceptions, will prohibit us from engaging in any “business combination” with a person who, together with affiliates and associates, owns 15% or more of our common stock for a period of three years following the date that the person came to own 15% or more of our common stock, unless the business combination is approved in a prescribed manner.

These provisions of our certificate of incorporation, and of Delaware law, may have the effect of delaying, deterring or preventing a change in control, may discourage bids for our common stock at a premium over market price and may adversely affect the market price, and the voting and other rights of the holders, of our common stock. In addition, these provisions make it more difficult to replace or remove our current management team in the event our stockholders believe this would be in our best interest and the best interests our stockholders.

Item 1B.UNRESOLVED STAFF COMMENTS

None.

Item 2.PROPERTIES

Our principal facilities are set forth in the following table:

Location	Square Footage	Annual Lease Payments (millions of $)
Chicago, Illinois	28,000	$ 0.5
Daytona Beach, Florida	36,000	0.3
Hartland, Wisconsin	81,000	0.7
Mississauga, Ontario	24,000	0.6
Morrisville, North Carolina	17,000	0.3

We actively monitor our real estate needs in light of our current utilization and projected growth. We believe that we can acquire any necessary additional facility capacity on reasonably acceptable terms within a relatively short timeframe. We devote capital resources to facility improvements and expansions as we deem necessary to promote growth and most effectively serve our customers.

Item 3.LEGAL PROCEEDINGS

On June 1, 2009, Merge Healthcare was sued in the Milwaukee County Circuit Court, State of Wisconsin, by William C. Mortimore and David M. Noshay with respect to the separation of Mortimore's and Noshay's employment and our subsequent refusal to indemnify them with respect to litigation related to their service as officers of Merge. The plaintiffs allege that we breached their employment agreements, unreasonably refused their requests for indemnification and breached other covenants of good faith and fair dealing. The plaintiffs seek indemnification, and unspecified monetary damages. Discovery in this case is on-going. We have retained litigation counsel and intend to continue to vigorously defend this action.

Index

In January 2010, a purported stockholder class action complaint was filed in the Superior Court of Suffolk County, Massachusetts in connection with AMICAS' proposed acquisition by Thoma Bravo, LLC (the "Thoma Bravo Merger"). A second similar action was filed in the same court in February 2010 and consolidated with the first action. In March 2010, because AMICAS had terminated the Thoma Bravo Merger and agreed to be acquired by us, the court dismissed the plaintiffs' claims as moot. Subsequently, counsel to the plaintiffs filed an application for approximately $5 million of attorneys' fees for its work on this case, which fee petition AMICAS opposed. We retained litigation counsel to defend against the fee petition. On December 23, 2010, the court awarded plaintiffs approximately $3.2 million in attorneys' fees and costs. AMICAS has filed a notice of appeal from this judgment, and the plaintiffs have cross-appealed. We previously tendered the defense in this matter to our appropriate insurers, who have provided coverage against the claims asserted against AMICAS. After receipt of the court's attorneys' fee award decision, the applicable insurer denied policy coverage for approximately $2.5 million of the fee award. We do not believe that the insurer's denial has merit and have retained counsel to contest it. We will vigorously assert all of our rights under our applicable insurance policies, which we believe cover the claims and expenses incurred by AMICAS or us in connection with the fee award. However, an adverse outcome could negatively impact our financial condition.

On February 1, 2010, Merge filed a complaint against its former CEO, Richard Linden and its former CFO, Scott Veech, in the U.S. District for the Eastern District of Wisconsin, seeking a declaration that we do not have to indemnify either Linden or Veech for liabilities they incurred in connection with SEC investigation and enforcement actions and various securities fraud and shareholder derivative litigation. Merge also seeks to recover from both defendants all costs incurred by Merge associated with defending Linden and Veech in those prior actions. On October 15, 2010, the Court concluded that it did not have subject matter jurisdiction over Merge's claims and dismissed the claims in their entirety. The Court rendered no opinion on the merits of Merge's claims. Merge believes it has numerous meritorious claims against Linden and Veech and will continue to pursue those claims. As to Scott Veech, Merge is evaluating its options against Scott Veech in Wisconsin state court. As to the former CEO, Richard Linden, on February 8, 2011, Merge filed a complaint against its former CEO, Richard Linden, in the U.S. District Court for the Eastern District of Wisconsin captioned Merge Healthcare Incorporated v. Richard Linden, Case no. 11-CV-00154/ as Merge believes that jurisdiction exists in that court vis-à-vis Linden. We have retained litigation counsel and intend to continue to vigorously prosecute this action.

In August, 2010, Merge Healthcare was sued in the Northern District of Texas by the court-appointed receiver for Stanford International Bank, Ltd. The Receiver alleges that Merge was a recipient of a fraudulent conveyance as a result of a Ponzi scheme orchestrated by Robert Stanford and Stanford International Bank, Ltd. (SIBL). Merge is not alleged to have participated in the Ponzi scheme. The Receiver's claims arise from the failed acquisition of Emageon, Inc. (Emageon) by Health Systems Solutions, Inc. (HSS) an affiliate of SIBL in February 2009, which resulted in the payment of a $9 million break-up fee by HSS, which payment is alleged to have been financed by SIBL. Merge subsequently acquired Emageon as part of our AMICAS acquisition. The Complaint seeks to recover the $9 million payment to Emageon, plus interest, costs, and attorneys' fees. We have retained litigation counsel and intend to vigorously defend this action. We have filed a motion to dismiss the complaint for failure to state a claim. That motion has been fully briefed, and we are awaiting a decision from the court. However, an adverse outcome could negatively impact our operating results and financial condition.

In addition to the matters discussed above, we are, from time to time, parties to legal proceedings, lawsuits and other claims incident to our business activities. Such matters may include, among other things, assertions of contract breach or intellectual property infringement, claims for indemnity arising in the course of our business and claims by persons whose employment has been terminated. Such matters are subject to many uncertainties and outcomes are not predictable with assurance. Consequently, we are unable to estimate the ultimate aggregate amount of monetary liability, amounts which may be covered by insurance or recoverable from third parties, or the financial impact with respect to these matters as of the date of this report.

19

Index

Item 4.RESERVED

PART II

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

Our Common Stock trades on The NASDAQ Global Select Market (NASDAQ). The following table sets forth for the periods indicated, the high and low sale prices of our Common Stock as reported by the NASDAQ:

Common Stock Market Prices

2010	4th Quarter	3rd Quarter	2nd Quarter	1st Quarter
High	$ 4.25	$ 3.38	$ 3.16	$ 3.44
Low	$ 2.84	$ 2.46	$ 1.92	$ 1.95

2009	4th Quarter	3rd Quarter	2nd Quarter	1st Quarter
High	$ 4.25	$ 4.78	$ 4.48	$ 1.84
Low	$ 2.93	$ 2.98	$ 1.25	$ 1.07

According to the records of American Stock Transfer & Trust Company, our registrar and transfer agent, we had 402 shareholders of record of Common Stock as of March 10, 2011.

Stock Price Performance Graph

The graph below compares the cumulative total return on our common stock with the Russell 2000 Index and the NASDAQ Computer Index (U.S. companies) for the period from December 31, 2005 to December 31, 2010. The comparison assumes that $100 was invested on December 31, 2005 in our Common Stock and in each of the comparison indices, and assumes reinvestment of dividends, where applicable. We have selected the Russell 2000 index for comparison purposes as we do not believe we can reasonably identify an appropriate peer group index. The comparisons shown in the graph below are based upon historical data. The stock price performance shown in the graph below is not indicative of, nor intended to forecast, the potential future performance of our common stock.

Index

COMPARISON OF THE 5 YEAR CUMULATIVE TOTAL RETURNS
FOR THE FIVE YEAR PERIOD ENDED DECEMBER 31, 2010

Date	Merge Healthcare Incorporated (Nasdaq: MRGE)	Nasdaq Computer Index (^IXCO)	Russell 2000 Index (^RUT)
12/30/2005	$ 100	$ 100	$ 100
12/29/2006	$ 26	$ 106	$ 117
12/31/2007	$ 5	$ 129	$ 114
12/31/2008	$ 5	$ 69	$ 74
12/31/2009	$ 13	$ 118	$ 93
12/31/2010	$ 15	$ 138	$ 116

Dividend Policy

We are prohibited from making certain dividend payments based on the terms of our Notes. We currently do not intend to declare or pay any cash dividends on our Common Stock in the foreseeable future.

Repurchases of Shares

In the third quarter of 2010 we received 8,549 shares of our Common Stock upon final settlement of an escrow account related to our acquisition of Confirma, Inc. on September 1, 2009. These shares were cancelled in the fourth quarter of 2010.

Item 6.SELECTED FINANCIAL DATA

The following selected historical financial data is qualified in its entirety by reference to, and should be read in conjunction with, our consolidated financial statements and the related notes thereto appearing elsewhere herein and Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in this Annual Report on Form 10-K.

	Years Ended December 31,				
	2010(1)	2009(2)	2008	2007	2006
	(in thousands, except for share and per share data)				
Statement of Operations Data:					
Net sales	$140,332	$66,841	$56,735	$59,572	$74,322
Operating income (loss)(3)	(8,524)	8,963	(21,697)	(171,238)	(252,087)
Income (loss) before income taxes	(25,162)	150	(23,743)	(171,808)	(249,473)
Income tax expense (benefit)	(13,646)	(135)	(60)	(240)	9,450
Net income (loss)	(11,516)	285	(23,683)	(171,568)	(258,923)
Net income (loss) available to common shareholders	(30,592)	285	(23,683)	(171,568)	(258,923)
Earnings (loss) per share:					
Basic	$(0.38)	$0.00	$(0.51)	$(5.06)	$(7.68)
Diluted	(0.38)	0.00	(0.51)	(5.06)	(7.68)
Weighted average shares outstanding:					
Basic	80,231,427	60,910,268	46,717,546	33,913,379	33,701,735
Diluted	80,231,427	62,737,821	46,717,546	33,913,379	33,701,735

	2010	2009	December 31, 2008	2007	2006
			(in thousands)		
Balance Sheet Data:					
Working capital	$28,792	$18,231	$8,254	$878	$27,101
Total assets	396,388	100,249	54,737	61,635	234,875
Long-term debt obligations	195,077	-	14,230	-	-
Shareholders' equity	104,806	68,137	8,841	24,405	189,925

(1)Includes the results of AMICAS from April 28, 2010, the date of the business combination.

(2)Includes the results of etrials and Confirma from July 20, 2009 and September 1, 2009, the respective dates of the business combinations.

(3)For the years ended December 31, 2007 and 2006, we incurred charges of $122.4 million and $214.1 million, respectively, related to the impairment of goodwill.

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

The discussion below contains "forward-looking statements. We have used words such as "believes," "intends," "anticipates," "expects" and similar expressions to identify forward-looking statements. These statements are based on information currently available to us and are subject to a number of risks and uncertainties that may cause our actual results of operations, financial condition, cash flows, performance, business prospects and opportunities and the timing of certain events to differ materially from those expressed in, or implied by, these statements. These risks, uncertainties and other factors include, without limitation, those matters discussed in Item 1A of Part I of this Annual Report on Form 10-K. Except as expressly required by the federal securities laws, we undertake no obligation to update such factors or to publicly announce the results of any of the forward-looking statements contained herein to reflect future events, developments, or changed circumstances, or for any other reason. The following discussion should be read in conjunction with our consolidated financial statements and notes thereto appearing elsewhere in this Annual Report on Form 10-K and Item 1A, "Risk Factors".

Index

Management's Discussion and Analysis is presented in the following order:

- Overview
- Revenues and Expenses
- Results of Operations
- Liquidity and Capital Resources
- Material Off Balance Sheet Arrangements
- Critical Accounting Policies

Overview

Our solutions are designed to help solve some of the toughest challenges in health information exchange today, such as the incorporation of medical images and diagnostic information into broader healthcare IT applications, the interoperability of proprietary software solutions, advanced clinical tools like computer aided detection (CAD), the profitability of outpatient imaging practices in the face of declining reimbursement and the ability to improve the efficiency and cost effectiveness of our customers' businesses. Our proven ability to innovate has driven consistent expansion of solutions and services and entry into new markets. We currently own approximately 70 patents which are used across a wide variety of clinical specialties in addition to being an increasing important component of clinical trials. We will also look to expand through strategic acquisitions that will allow us to further expand our addressable market and customer base. During the last two years, we have expanded our product offerings through the following strategic acquisitions (the first three of which we also refer to as Significant Acquisitions):

- AMICAS, Inc. (AMICAS), an image and information management solutions provider, which we acquired on April 28, 2010;
- Confirma, Inc. (Confirma), a provider of computer systems for processing and presenting data from magnetic resonance imaging (MRI) studies, which we acquired on September 1, 2009. Upon completion of the acquisition, this legal entity was renamed Merge CAD;
- etrials Worldwide, Inc. (etrials), a provider of clinical trials software and services, which we acquired on July 20, 2009. Upon completion of the acquisition, this legal entity was renamed Merge eClinical; and
- Seven other acquisitions, five of which were completed in 2010.

On April 28, 2010, we completed our acquisition of AMICAS through a successful tender offer for 37,009,990 outstanding shares of common stock of AMICAS at $6.05 per share in cash. Following the tender offer, we purchased the remaining shares pursuant to a merger of a subsidiary of Merge with and into AMICAS. Total transaction consideration was approximately $223.9 million. In addition, shortly before the completion of the acquisition, AMICAS paid cash to holders of vested, in-the-money stock options for the difference between $6.05 per share and the exercise price of such options. The holders of shares of restricted stock were paid $6.05 per share in cash. The total consideration paid to option and restricted stockholders was approximately $22.9 million. We financed the transaction with $200 million aggregate principal amount of 11.75% Senior Secured Notes due 2015 (Notes), cash already available at the two companies and proceeds of $41.8 million from the issuance of preferred and common stock. See Notes 2, 7, 8 and 11 for further information regarding these transactions.

We primarily generate revenue from the sale of perpetual software licenses, upgrading and/or renewing those licenses, hardware, professional services and maintenance. Except for maintenance, these contract elements comprise the majority of non-recurring revenue. Our backlog of non-recurring revenue was approximately $49.0 million as of December 31, 2010. Maintenance, which we renew annually with our substantial customer base, is the primary component of recurring revenues. Recurring revenue also includes software licenses sold through contracts that are annually renewed and recognized ratably over the annual period and recorded as software revenue, revenues derived from SaaS offerings which are recorded as professional services revenue and Electronic Data Interchange (EDI) revenues which are recognized based on monthly transactional volumes. We continue to generate recurring revenue annually that exceeds 65% of total net sales.

Index

Our solutions optimize processes for healthcare organizations ranging in size from single-doctor practices to health systems, for the sponsors of clinical trials, for the medical device industry, for the healthcare commerce system and for consumers of healthcare. These solutions are licensed by more than 1,500 hospitals; 4,000 clinics and labs, 250 OEM customers and 70% of the top pharmaceutical companies. We have a significant opportunity to grow revenues by expanding our solution footprint in existing customers, as only a small percent currently have more than one of our solutions. This is supported by the fact that no customer accounted for more than 10% of our net sales in any of the last three years. With the benefit of a broad customer base and several product lines undergoing ongoing innovation, we also believe that we are well-positioned to continue to leverage technologies into new segments where customers see value. For example, as providers adopt EHRs and seek to qualify for Meaningful Use incentives, our vendor-neutral archiving and web-based image access products allow us to capitalize on these opportunities. In order to take advantage of these opportunities, we began aggressively hiring sales and marketing personnel in the fourth quarter of 2010. We continue these hiring efforts today.

Our Market and Challenges That We Face

We have provided a detailed assessment of the healthcare information technology market under Part I, Item 1, Healthcare IT Industry. During the period between the announcement of our bid to acquire AMICAS and the closing of the transaction, certain of our customers were uncertain regarding our go-forward corporate and product strategy, which we believe is a common issue when a public company acquires a perceived competitor. This resulted in weakness in our net sales for the second quarter of 2010. However, immediately following the closing of the acquisition, we began a proactive communication effort with customers in order to share and validate our corporate strategy and product roadmap. In addition, we realigned our business from a decentralized organizational structure into a centralized organizational structure with functional leaders. We believe that centralizing functions will have a long-term positive effect on our ability to efficiently develop products to address market needs. Based on discussions held with current and potential customers and the operating results for the third and fourth quarters of 2010, we believe that our customers understand and support our corporate and product strategies.

Revenues and Expenses

The following is a brief discussion of our revenues and expenses:

Net Sales

Net sales consist of:

- Software and other sales, net of estimated returns and allowances, including software and purchased component revenue recognized in sales to OEM customers, healthcare facilities and other healthcare providers;

- Professional services, including hosted clinical trial SaaS offerings, installation, custom engineering services, training, consulting and project management; and

    - Maintenance and EDI, including software maintenance and support and EDI revenues.

Cost of Sales

Cost of sales consists of:

- Software and other cost of sales, including purchased components and third-party royalties included in software and hardware sales to our customers;

- Professional services cost of sales, including headcount and related costs and direct third-party costs incurred in our performance of SaaS offerings, installation, custom engineering services, training, consulting and project management;

- Maintenance and EDI cost of sales, including headcount and related costs and direct third-party costs incurred to fulfill our maintenance and support obligations and to deliver EDI services; and

- Depreciation and amortization, including any impairment, for amounts assessed on capital equipment used to fulfill contract obligations as well as our purchased and developed software and backlog assets. Depreciation and amortization are recorded over the respective asset's useful life. Each quarter we test our purchased and developed software for impairment by comparing its net realizable value (estimated using undiscounted future cash flows) to the carrying value of the software. If the carrying value of the software exceeds its net realizable value, we record an impairment charge in the period in which the impairment is incurred equal to the amount of the difference between the carrying value and estimated undiscounted future cash flows.

Index

Sales and Marketing Expense

Sales and marketing expense includes the costs of our sales and marketing departments, commissions and costs associated with trade shows.

Research and Development Expense

Research and development expense consists of expenses incurred for the development of our proprietary software and technologies. The costs reflected in this category are reduced by capitalized software development costs. The amortization of capitalized software development costs and any related impairments are included in cost of sales.

General and Administrative Expense

General and administrative expense includes costs for information systems, accounting, administrative support, management personnel, bad debt expense, legal fees and general corporate matters.

Acquisition-Related Expenses

Acquisition-related expenses are costs incurred to effect business combinations, including banking, legal, accounting, valuation and other professional or consulting fees.

Trade Name Impairment, Restructuring and Other Expenses

Trade name impairment, restructuring and other expenses consist of impairment of trade names, severance to involuntarily terminated employees and relocation expenses resulting from our restructuring initiatives, loss on disposal of subsidiaries and impairment of non-cancelable building leases associated with restructuring activities.

Depreciation, Amortization and Impairment

Depreciation and amortization, including any impairment, is assessed on capital equipment, leasehold improvements and our customer relationships, trade names and non-compete agreement intangible assets. Depreciation and amortization are recorded over the respective asset’s useful life. We also record impairment of these long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable based primarily upon whether expected future undiscounted cash flows are sufficient to support recovery of the assets.

Other Income (Expense)

Other income (expense) is comprised of interest income earned on cash and cash equivalent balances, interest expense and amortization of costs and discounts incurred from borrowings. It also includes foreign exchange gains or losses on foreign currency payables and receivables at our Nuenen, Netherlands branch and at our subsidiaries located in Europe, Canada and China. In addition, we also record any other-than-temporary impairment charges recognized on our equity investments in non-public companies in other income (expense).

Results of Operations

The following have significantly impacted the results of operations for the periods discussed herein:

- Completion of the Significant Acquisitions, of which the results of operations are included in our condensed consolidated statements of operations since the respective dates of acquisition. As result of the timing of the

Significant Acquisitions, the comparability of the results of operations in the year ended December 31, 2010 differs significantly from the same period in 2009. In addition, as a result of the AMICAS transaction, we incurred significant acquisition related expenses in the year ended December 31, 2010.

- We issued $200.0 million of Notes in April 2010 as part of the financing for the acquisition of AMICAS. The Notes were issued at 97.266% of the principal amount, are due in 2015 and bear interest at 11.75% of principal (payable on May 1st and November 1st of each year). In connection with the Notes, we incurred issuance costs of $9.0 million. The year ended December 31, 2010 includes approximately eight months of interest expense and amortization of the original issuance discount and costs of the Notes.

- In November 2009, we sold 9.1 million shares of common stock in a registered direct offering for aggregate net proceeds of $25.2 million which we used to repay a then-existing $15.0 million note payable (at 13% interest). This note payable was originally issued at a discount and had issuance costs, both of which were being amortized over the life of the note payable.

- Concurrent with the acquisition of AMICAS, we completed a restructuring initiative in April 2010. We also completed a restructuring activity in July 2009 concurrent with the acquisition of etrials. Both of these initiatives assisted in providing operational rigor to a combined, larger organization and enabled us to decrease costs as a percentage of revenue (most notably general and administrative costs). The full impact of cost saving benefits of the April 2010 initiative is reflected in the operating results for the fourth quarter of 2010.

Index

Year Ended December 31, 2010 Compared to the Year Ended December 31, 2009

The following table sets forth selected, summarized, consolidated financial data for the periods indicated, as well as comparative data showing increases and decreases between the periods. All amounts, except percentages, are in thousands.

	Years Ended December 31,						Change		
	2010	%	(1)	2009	%	(1)	$	%	
Net sales:									
Software and other	$42,420	30.2	%	$33,037	49.4	%	$9,383	28.4	%
Professional services	23,175	16.5	%	11,830	17.7	%	11,345	95.9	%
Maintenance and EDI	74,737	53.3	%	21,974	32.9	%	52,763	240.1	%
Total net sales	140,332	100.0	%	66,841	100.0	%	73,491	109.9	%
Cost of sales:									
Software and other	13,762	32.4	%	3,730	11.3	%	10,032	269.0	%
Professional services	15,411	66.5	%	6,731	56.9	%	8,680	129.0	%
Maintenance and EDI	24,418	32.7	%	5,593	25.5	%	18,825	336.6	%
Depreciation, amortization and impairment	10,972	7.8	%	3,323	5.0	%	7,649	230.2	%
Total cost of sales	64,563	46.0	%	19,377	29.0	%	45,186	233.2	%
Total gross margin	75,769	54.0	%	47,464	71.0	%	28,305	59.6	%
Gross margin by net sales category (3)									
Software and other	28,658	67.6	%	29,307	88.7	%	(649)	-2.2	%
Professional services	7,764	33.5	%	5,099	43.1	%	2,665	52.3	%
Maintenance and EDI	50,319	67.3	%	16,381	74.5	%	33,938	207.2	%
Operating expenses:									
Sales and marketing	20,697	14.7	%	9,203	13.8	%	11,494	124.9	%
Product research and development	20,064	14.3	%	10,689	16.0	%	9,375	87.7	%
General and administrative	22,012	15.7	%	13,005	19.5	%	9,007	69.3	%
Acquisition-related expenses	9,674	6.9	%	1,225	1.8	%	8,449		NM(2)
Restructuring and other expenses	5,006	3.6	%	1,613	2.4	%	3,393	210.4	%
Depreciation and amortization	6,840	4.9	%	2,766	4.1	%	4,074	147.3	%
Total operating costs and expenses	84,293	60.1	%	38,501	57.6	%	45,792	118.9	%
Operating income (loss)	(8,524)	-6.1	%	8,963	13.4	%	(17,487)	-195.1	%
Other income (expense), net	(16,638)	-11.9	%	(8,813)	-13.2	%	(7,825)	88.8	%
Income (loss) before income taxes	(25,162)	-17.9	%	150	0.2	%	(25,312)		NM(2)
Income tax benefit	(13,646)	-9.7	%	(135)	-0.2	%	(13,511)		NM(2)
Net income (loss)	(11,516)	-8.2	%	285	0.4	%	(11,801)		NM(2)
Less: preferred stock dividends	19,076	13.6	%	-	0.0	%	19,076		NM(2)
	$(30,592)	-21.8	%	$285	0.4	%	$(30,877)		NM(2)

Net income (loss) available to
common shareholders

(1) Percentages are of total net sales, except for cost of sales and gross margin, which are based upon related net sales.

(2) NM denotes percentage is not meaningful.

(3) Depreciation, amortization and impairment expenses are excluded from these gross margin calculations.

Net Sales

Software and Other Sales. Total software and other sales in 2010 were $42.4 million, an increase of $9.4 million, or 28.4%, from $33.0 million in 2009, primarily due to sales arising from the Significant Acquisitions.

Professional Services Sales. Total professional services sales in 2010 were $23.2 million, an increase of $11.3 million, or 95.9%, from $11.8 million in 2009, primarily due to sales arising from the Significant Acquisitions.

Maintenance and EDI Sales. Total maintenance and EDI sales in 2010 were $74.7 million, an increase of $52.7 million, or 240.1%, from $22.0 million in 2009, primarily due to sales arising from the Significant Acquisitions.

Gross Margin

Gross Margin – Software and Other Sales. Gross margin on software and other sales was $28.7 million in 2010, a decrease of $0.6 million, or 2.2%, from $29.3 million in 2009. Gross margin as a percentage of software and other sales decreased to 67.6% in 2010 from 88.7% in 2009, due to an increase in hardware sales, which are at lower margins than software only sales, as a result of the acquisition of AMICAS. Hardware sales were 23% of software and other sales in 2010 compared to 7% in 2009. We expect gross margins on software and other sales to fluctuate depending on the mix of sales among our products.

Index

Gross Margin – Professional Services Sales. Gross margin on professional service sales was $7.8 million in 2010, an increase of $2.7million, or 52.3%, from $5.1 million in 2009. Gross margin as a percentage of professional service sales decreased to 33.5% in 2010 from 43.1% in 2009, primarily due to the impact of our Significant Acquisitions. As the majority of professional service costs are fixed, we expect gross margins going forward to fluctuate depending on billable utilization of our resources.

Gross Margin – Maintenance and EDI Sales. Gross margin on maintenance and EDI sales was $50.3 million in 2010, an increase of $34.0 million, or 207.2%, from $16.4 million in 2009. Gross margin as a percentage of maintenance and EDI sales decreased to 67.3% in 2010 from 74.5% in 2009, primarily due to the impact of the AMICAS acquisition as such services include more third party maintenance costs. Further, prior to the acquisition of AMICAS, we did not have significant EDI sales. EDI margins are typically lower than that of maintenance. We expect that our maintenance and EDI margins will be similar to 2010 going forward.

Depreciation, Amortization and Impairment. Depreciation, amortization and impairment expense increased $7.6 million, or 230.2%, to $11.0 million in 2010 from $3.3 million in 2009, primarily due to the Significant Acquisitions. The 2010 expense also includes an impairment of purchased technology of $2.3 million as a result of decisions made related to overlapping products.

Sales and Marketing

Sales and marketing expense increased $11.5 million, or 124.9%, to $20.7 million in 2010 from $9.2 million in 2009, primarily as a result of the Significant Acquisitions. As a percentage of net sales, sales and marketing increased by 0.9% to 14.7% as a result of increases in headcount and other resources in the fourth quarter of 2010. We expect that sales and marketing expenses will increase in 2011, as we will have a full year of AMICAS expenses and also as we continue to expand the sales and marketing functions to allow us to meet 2011 sales goals.

Product Research and Development

Product research and development expense increased $9.4 million, or 87.7%, to $20.1 million in 2010 from $10.7 million in 2009 primarily due to the Significant Acquisitions. As a percentage of net sales, product research and development decreased by 1.7% to 14.3% as a result of our cost saving initiatives to bring operational rigor to a larger organization. We expect that product research and development expenses will increase in 2011, as we will have a full year of AMICAS expenses and also as we continue to invest and grow this function.

General and Administrative

General and administrative expense increased $9.0 million, or 69.3%, to $22.0 million in 2010 from $13.0 million in 2009, primarily due to the Significant Acquisitions. As a percentage of net sales, general and administrative expenses decreased by 3.8% to 15.7% as a result of our cost saving initiatives to bring operational rigor to a larger organization as well as a one-time $1.3 million benefit on a negotiated settlement with former officers. We expect that general and administrative expenses will increase in 2011, as we will have a full year of AMICAS expenses in 2011.

Acquisition-Related Expenses

Acquisition-related expenses are costs incurred to effect business combinations, including banking, legal, accounting, valuation and other professional or consulting fees. In 2010, we incurred $9.7 million of such expenses, primarily related to our significant acquisition of AMICAS as well as the completion of five other acquisitions. In 2009, we incurred $1.2 million of such expenses primarily related to our acquisitions of etrials and Confirma.

Restructuring and Other Expenses

Restructuring and other expenses consist primarily of severance to involuntarily terminated employees and relocation of certain employees resulting from our restructuring initiatives and abandonment of non-cancelable building leases associated with restructuring activities. In 2010, we incurred $5.0 million of such expenses primarily related to the reorganization of our business concurrent with our acquisition of AMICAS. In 2009, we incurred $1.6 million of such expenses, primarily related to the restructuring initiative announced concurrent with the acquisition of etrials and the abandonment of a portion of our leased space subsequent to the acquisition of Confirma.

Depreciation and Amortization

Depreciation and amortization expense increased $4.1 million, or 147.3%, to $6.8 million in 2010 from $2.7 million in 2009, due to depreciation and amortization on fixed assets and intangible assets acquired from Significant Acquisitions.

Index

Other Income (Expense), Net

Net other expense increased $7.8 million to $16.6 million in 2010 compared to $8.8 million of net expense in 2009. The expense in 2010 includes $16.8 million of interest expense and amortization of issuance costs and note discount associated with our $200.0 million of Notes issued to fund the AMICAS acquisition. The expense in 2009 includes an impairment charge of $3.6 million on an equity investment and $2.7 million of interest expense and amortization of issuance costs and note discount associated with a $15.0 million note payable and a $3.3 million loss on early extinguishment of the $15.0 million note payable (including a prepayment penalty of $2.7 million and write-off of $0.4 million of remaining debt issuance costs and note discount).

Income Tax Benefit

In 2010, we recorded income tax benefit of $13.6 million resulting in an effective tax rate of 54.2% compared to (90.0)% income tax benefit recorded in 2009. The tax benefit in 2010 resulted from the release of $14.1 million of valuation allowance that was previously established for the Canadian operations. Our expected effective income tax rate is volatile and may move up or down with changes in, among other items, operating income and the results of changes in tax law and regulations of the U.S. and the foreign jurisdictions in which we operate.

Year Ended December 31, 2009 Compared to the Year Ended December 31, 2008

The following table sets forth selected, summarized, consolidated financial data for the periods indicated, as well as comparative data showing increases and decreases between the periods. All amounts, except percentages, are in thousands.

	Years Ended December 31,						Change		
	2009	%	(1)	2008	%	(1)	$	%	
Net sales:									
Software and other	$ 33,037	49.4	%	$ 27,561	48.6	%	$ 5,476	19.9	%
Professional services	11,830	17.7	%	8,586	15.1	%	3,244	37.8	%
Maintenance	21,974	32.9	%	20,588	36.3	%	1,386	6.7	%
Total net sales	66,841	100.0	%	56,735	100.0	%	10,106	17.8	%
Cost of sales:									
Software and other	3,730	11.3	%	5,121	18.6	%	(1,391)	-27.2	%
Professional services	6,731	56.9	%	6,044	70.4	%	687	11.4	%
Maintenance	5,593	25.5	%	5,628	27.3	%	(35)	-0.6	%
Depreciation, amortization and impairment	3,323	5.0	%	3,279	5.8	%	44	1.3	%
Total cost of sales	19,377	29.0	%	20,072	35.4	%	(695)	-3.5	%
Total gross margin	47,464	71.0	%	36,663	64.6	%	10,801	29.5	%
Gross margin by net sales category (3)									
Software and other	29,307	88.7	%	22,440	81.4	%	6,867	30.6	%
Professional Services	5,099	43.1	%	2,542	29.6	%	2,557	100.6	%
Maintenance	16,381	74.5	%	14,960	72.7	%	1,421	9.5	%
Operating expenses:									

Sales and marketing	9,203	13.8	%	9,313	16.4	%	(110)	-1.2	%
Product research and development	10,689	16.0	%	13,240	23.3	%	(2,551)	-19.3	%
General and administrative	13,005	19.5	%	20,461	36.1	%	(7,456)	-36.4	%
Acquisition-releated expenses	1,225	1.8	%	-	0.0	%	1,225	NM(2)	
Trade name impairment, restructuring and other expenses	1,613	2.4	%	11,816	20.8	%	(10,203)	-86.3	%
Depreciation, amortization and impairment	2,766	4.1	%	3,530	6.2	%	(764)	-21.6	%
Total operating costs and expenses	38,501	57.6	%	58,360	102.9	%	(19,859)	-34.0	%
Operating income (loss)	8,963	13.4	%	(21,697)	-38.2	%	30,660	-141.3	%
Other income (expense), net	(8,813)	-13.2	%	(2,046)	-3.6	%	(6,767)	330.7	%
Income (loss) before income taxes	150	0.2	%	(23,743)	-41.8	%	23,893	NM(2)	
Income tax benefit	(135)	-0.2	%	(60)	-0.1	%	(75)	125.0	%
Net income (loss)	$ 285	0.4	%	$ (23,683)	-41.7	%	$ 23,968	NM(2)	

(1) Percentages are of total net sales, except for cost of sales and gross margin, which are based upon related net sales.

(2) NM denotes percentage is not meaningful.

(3) Depreciation, amortization and impairment expenses are excluded from these gross margin calculations.

Net Sales

Software and Other Sales. Total software and other sales in 2009 were $33.0 million, an increase of $5.4 million, or 19.9%, from $27.6 million in 2008, primarily due to the fact that sales were negatively affected in 2008 because of customer concerns with our financial viability. We believe that these concerns were alleviated with the financing transaction completed in June 2008.

Index

Professional Services Sales. Total professional service sales in 2009 were $11.8 million, an increase of $3.2 million, or 37.8%, from $8.6 million in 2008, due to $5.8 million of sales from our Merge eClinical business, which was acquired in July 2009. This increase was offset by a decrease of $2.4 million due to the decline in the number of custom engineering services projects in 2009, primarily the result of the reluctance of OEM customers to start new projects in the uncertain economic environment as well as a shift in our strategic focus towards selling software solutions to such customers.

Maintenance Sales. Total maintenance sales in 2009 were $22.0 million, an increase of $1.4 million, or 6.7%, from $20.6 million in 2008. The increase is primarily due to $1.5 million of Merge CAD maintenance sales from the date of its acquisition.

Gross Margin

Gross Margin – Software and Other Sales. Gross margin on software and other sales was $29.3 million in 2009, an increase of $6.9 million, or 30.6%, from $22.4 million in 2008. Gross margin as a percentage of software and other sales increased to 88.7% in 2009 from 81.4% in 2008, primarily due to a decrease in hardware sales, which are at a lower margin than software only sales. Hardware sales were 7% of software and other sales in 2009 compared to 17% in 2008.

Gross Margin – Professional Services Sales. Gross margin on professional services sales was $5.1 million in 2009, an increase of $2.6 million, or 100.6%, from $2.5 million in 2008, primarily due to a decrease in salaries and other related expenses (including travel and entertainment) as a result of our restructuring initiatives.

Gross Margin – Maintenance Sales. Gross margin on maintenance sales was $16.4 million in 2009, an increase of $1.4 million, or 9.5%, from $15.0 million in 2008, primarily due to a decrease in salaries and other related expenses (including travel and entertainment) as a result of our restructuring initiatives.

Depreciation, Amortization and Impairment. Depreciation, amortization and impairment expense remained consistent year over year. Amortization increased by $0.5 million in 2009 due to intangible assets from our 2009 acquisitions. This increase was offset by a $0.4 million impairment charge which was recorded in2008.

Sales and Marketing

Sales and marketing expense decreased $0.1 million, or 1.2%, to $9.2 million in 2009 from $9.3 million in 2008. Salaries, commissions and other related expenses (including travel and entertainment) remained relatively constant as decreases from 2008 restructuring and subsidiary disposal activities were offset by an increases due to 2009 acquisitions. We experienced a $0.2 million decrease in Canadian related costs due to the strengthening of the average exchange rate for the U.S dollar compared to the Canadian dollar in 2009 (primarily in the first half of 2009).

Product Research and Development

Product research and development expense decreased $2.5 million, or 19.3%, to $10.7 million in 2009 from $13.2 million in 2008. Salaries and related expenses (including travel and entertainment) and third-party costs decreased by $3.1 million due to 2008 restructuring and subsidiary disposal activities, offset by an increase of $1.1 million due to 2009 acquisitions. Also, Canadian related costs decreased $0.5 million due to strengthening of the average exchange rate for the U.S. dollar compared to the Canadian dollar.

General and Administrative

General and administrative expense decreased $7.5 million, or 36.4 %, to $13.0 million in 2009 from $20.5 million in 2008. Salaries and related expenses (including travel and entertainment) decreased by $1.1 million as decreases from 2008 restructuring and subsidiary disposal activities were partially offset by an increase due to 2009 acquisitions. In addition, legal costs decreased in 2009 by $4.4 million (2008 included a $3.0 million charge related to the settlement of a class action lawsuit), accounting and other professional fees decreased by $1.5 million and share-based compensation expense decreased in 2009 by $0.4 million.

Acquisition-Related Expenses

Acquisition-related expenses are costs incurred to effect business combinations, including banking, legal, accounting, valuation and other professional or consulting fees. In 2009, we incurred $1.2 million of such expenses related to our acquisitions.

Trade name Impairment, Restructuring and Other Expenses

In 2009, we recorded $1.6 million in trade name impairment, restructuring and other expenses, including $1.7 million in restructuring expenses related to the initiative announced in July 2009, and $0.3 million due to the abandonment of a portion of a facility leased by Merge CAD. These charges were offset by a $0.4 million reduction in expense related to updated estimates of obligations due under prior restructuring activities and other facilities previously abandoned. In 2008, we recorded $11.8 million in trade name impairment, restructuring and other expenses, including $8.7 million in restructuring charges related to the initiatives announced in February 2008 and June 2008, a $1.1 million trade name impairment charge associated with renaming our Cedara Software business unit and a $1.7 million charge associated with the disposal of our French subsidiary. We also recorded a $0.4 million charge in 2008 related to a change in estimate associated with subleasing a facility.

Index

Depreciation, Amortization and Impairment

Depreciation, amortization and impairment expense decreased $0.7 million, or 21.6 %, to $2.8 million in 2009 from $3.5 million in 2008, as a result of a $0.5 million impairment of fixed assets held for sale in 2008 and a $0.6 million decrease in depreciation due to assets being disposed of or becoming fully depreciated. These decreases are offset by an increase of $0.6 million of depreciation and amortization resulting from fixed assets and intangible assets acquired in our 2009 acquisitions.

Other Income (Expense), Net

Other income (expense), net increased by approximately $6.8 million, to $8.8 million of net expense in 2009 from $2.0 million of net expense in 2008. The net expense in 2009 is due to $2.7 million of interest expense and amortization of issuance costs and note discount associated with a $15.0 million note payable, a $3.3 million loss on early extinguishment of the $15.0 million note payable (including a prepayment penalty of $2.7 million and write-off of $0.4 million of remaining debt issuance costs and note discount) and a realized loss of $3.6 million related to the sale of an investment. These expenses were offset by a $0.5 million gain on the sale of certain patents that were no longer necessary to support our business and $0.3 million in foreign currency exchange gains. The net other expense in 2008 is primarily attributable to $1.8 million of interest expense and amortization of issuance costs and note discount associated with a $15.0 million note payable and a $1.4 million impairment charge related to the investment which was sold in 2009 , offset by $0.8 million in foreign exchange gains and $0.3 million of interest income.

Income Tax Benefit

We recorded an income tax benefit resulting in an effective tax rate of (90.0)% in 2009, compared to an effective rate of 0.3% in 2008. Our effective tax rates in 2009 and 2008 differ significantly from statutory rates primarily due to recording a valuation allowance for deferred tax assets that are not more-likely-than-not to be realized. Our expected effective income tax rate is volatile and may move up or down with changes in, among other items, operating income and the results of changes in tax law and regulations of the U.S. and the foreign jurisdictions in which we operate.

Liquidity and Capital Resources

Our cash and cash equivalents were $41.0 million at December 31, 2010, an increase of approximately $21.4 million, or 109.1%, from our balance of $19.6 million at December 31, 2009. In addition, our working capital was $28.8 million at December 31, 2010, an increase of $10.6 million, or 57.9%, from our working capital of $18.2 million at December 31, 2009.

On April 28, 2010, we completed our acquisition of AMICAS through the issuance of $200.0 million of Notes, cash already available at the two companies and proceeds of $41.8 million from the issuance of preferred and common stock.

The net increase in cash and cash equivalents during the years ended December 31, 2010, 2009 and 2008 of $20.3 million, $1.8 million and $3.6 million, respectively, is attributed to the following factors:

Index

	Year Ended December 31,		
	2010	2009	2008
	(in millions)		
Cash received from (paid for):			