

CRITICARE SYSTEMS INC /DE/
Form 10-Q
February 07, 2008

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended December 31, 2007

OR

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

For the transition period from _____ to _____

Commission file number -1-31943

CRITICARE SYSTEMS, INC
(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

39-1501563
(I.R.S. Employer Identification No.)

20925 Crossroads Circle, Suite 100, Waukesha, Wisconsin
(Address of Principal Executive Offices)

53186
(Zip Code)

Registrant's telephone number including area code (262) 798-8282

N/A

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

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

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

Large accelerated filer _____

Accelerated filer _____

Non-accelerated filer _____

Smaller reporting company X

(Do not check if smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2).

Yes _____ No

Number of shares outstanding of each class of the registrant's classes of common stock as of December 31, 2007: Voting Common Stock, 12,336,695 shares.

CRITICARE SYSTEMS, INC.
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2007 AND JUNE 30, 2007

(UNAUDITED)

| ASSETS | December 31, 2007 | June 30, 2007 |
|--|----------------------|----------------------|
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 6,373,909 | \$ 4,635,823 |
| Accounts receivable, less allowance for doubtful accounts of \$360,000 and \$497,638, respectively | 6,527,816 | 5,991,999 |
| Other receivables | 227,580 | 251,950 |
| Short-term note receivable | 100,000 | 50,000 |
| Inventories | 8,149,284 | 8,177,523 |
| Prepaid expenses | 308,604 | 219,859 |
| Total current assets | 21,687,193 | 19,327,154 |
| Property, plant and equipment – net | 2,225,992 | 2,190,389 |
| License rights and patents – net | 52,479 | 55,980 |
| Long-term note receivable | 62,500 | 75,000 |
| Total other assets | 114,979 | 130,980 |
| TOTAL ASSETS | \$ 24,028,164 | \$ 21,648,523 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | \$ 4,189,909 | \$ 3,826,834 |
| Accrued liabilities: | | |
| Compensation and commissions | 1,182,503 | 836,720 |
| Product warranties | 352,000 | 349,000 |
| Other | 110,335 | 191,389 |
| Obligations under capital lease | 76,115 | 74,148 |
| Total current liabilities | 5,910,862 | 5,278,091 |
| LONG-TERM LIABILITIES: | | |
| Obligations under capital lease | 63,715 | 59,678 |
| Total long-term liabilities | 63,715 | 59,678 |
| TOTAL LIABILITIES | 5,974,577 | 5,337,769 |
| STOCKHOLDERS' EQUITY: | | |
| Preferred stock - \$.04 par value, 500,000 shares authorized no shares issued or outstanding | – | – |
| Common stock - \$.04 par value, 15,000,000 shares authorized, 12,427,255 and 12,409,631 shares issued, and 12,336,695 and 12,313,321 shares outstanding, | 497,090 | 496,385 |

respectively

| | | |
|--|----------------------|----------------------|
| Additional paid-in capital | 26,429,966 | 26,338,267 |
| Common stock held in treasury at cost (90,560 and 96,310 shares, respectively) | (345,791) | (356,502) |
| Retained earnings (accumulated deficit) | (8,420,884) | (10,088,767) |
| Other comprehensive income (loss) | (106,794) | (78,629) |
| Total stockholders' equity | 18,053,587 | 16,310,754 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 24,028,164 | \$ 21,648,523 |

See notes to consolidated financial statements.

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CRITICARE SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF INCOME
SIX MONTHS ENDED DECEMBER 31, 2007 AND 2006

(UNAUDITED)

| | 2007 | 2006 |
|--|---------------|---------------|
| NET SALES | \$ 19,359,091 | \$ 16,669,334 |
| COST OF GOODS SOLD | 11,737,599 | 10,132,140 |
| GROSS PROFIT | 7,621,492 | 6,537,194 |
| OPERATING EXPENSES: | | |
| Sales and marketing | 3,363,808 | 2,887,549 |
| Research, development and engineering | 1,245,030 | 1,199,694 |
| Administrative | 1,554,322 | 1,882,345 |
| Total | 6,163,160 | 5,969,588 |
| INCOME FROM OPERATIONS | 1,458,332 | 567,606 |
| OTHER INCOME (EXPENSE): | | |
| Interest expense | (7,045) | (7,889) |
| Interest income | 106,080 | 62,661 |
| Foreign currency exchange gain | 45,848 | 73,931 |
| Other (expense) income | 64,668 | (12,700) |
| Total | 209,551 | 116,003 |
| INCOME BEFORE INCOME TAXES | 1,667,883 | 683,609 |
| INCOME TAX PROVISION | — | — |
| NET INCOME | \$ 1,667,883 | \$ 683,609 |
| NET INCOME PER COMMON SHARE: | | |
| Basic | \$ 0.14 | \$ 0.06 |
| Diluted | \$ 0.13 | \$ 0.06 |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING: | | |
| Basic | 12,320,152 | 12,295,483 |
| Diluted | 12,363,717 | 12,362,820 |

See notes to consolidated financial statements.

CRITICARE SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF INCOME
THREE MONTHS ENDED DECEMBER 31, 2007 AND 2006

(UNAUDITED)

| | 2007 | 2006 |
|--|---------------|--------------|
| NET SALES | \$ 10,221,365 | \$ 8,462,740 |
| COST OF GOODS SOLD | 6,045,253 | 5,046,620 |
| GROSS PROFIT | 4,176,112 | 3,416,120 |
| OPERATING EXPENSES: | | |
| Sales and marketing | 1,701,138 | 1,591,173 |
| Research, development and engineering | 694,557 | 557,411 |
| Administrative | 827,399 | 1,026,117 |
| Total | 3,223,094 | 3,174,701 |
| INCOME FROM OPERATIONS | 953,018 | 241,419 |
| OTHER INCOME (EXPENSE): | | |
| Interest expense | (3,991) | (3,770) |
| Interest income | 61,320 | 28,936 |
| Foreign currency exchange gain | 13,519 | 73,677 |
| Other income | 5,375 | 10,471 |
| Total | 76,223 | 109,314 |
| INCOME BEFORE INCOME TAXES | 1,029,241 | 350,733 |
| INCOME TAX PROVISION | — | — |
| NET INCOME | \$ 1,029,241 | \$ 350,733 |
| NET INCOME PER COMMON SHARE: | | |
| Basic | \$ 0.08 | \$ 0.03 |
| Diluted | \$ 0.08 | \$ 0.03 |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING: | | |
| Basic | 12,322,825 | 12,297,193 |
| Diluted | 12,359,351 | 12,357,641 |

See notes to consolidated financial statements.

CRITICARE SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
SIX MONTHS ENDED DECEMBER 31, 2007 AND 2006

(UNAUDITED)

| | 2007 | 2006 |
|---|---------------------|---------------------|
| OPERATING ACTIVITIES: | | |
| Net income | \$ 1,667,883 | \$ 683,609 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 207,307 | 253,126 |
| Amortization | 3,501 | 3,501 |
| Share based compensation | 36,625 | 56,545 |
| Provision for doubtful accounts | 4,187 | 1,674 |
| Provision for obsolete inventory | 152,168 | 102,000 |
| Changes in assets and liabilities: | | |
| Accounts receivable | (540,874) | 156,569 |
| Other receivables | (13,130) | 54,688 |
| Inventories | (6,829) | 1,198,237 |
| Prepaid expenses | (88,745) | 108,318 |
| Accounts payable | 363,075 | (2,259,859) |
| Accrued liabilities | 260,681 | (76,742) |
| Net cash provided by operating activities | 2,045,849 | 281,666 |
| INVESTING ACTIVITIES: | | |
| Purchases of property, plant and equipment, net | (343,280) | (115,982) |
| Net cash used in investing activities | (343,280) | (115,982) |
| FINANCING ACTIVITIES: | | |
| Retirement of obligations under capital lease | (31,843) | (33,391) |
| Proceeds from issuance of common stock | 66,490 | 19,325 |
| Net cash provided by (used in) financing activities | 34,647 | (14,066) |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH | 870 | 1,898 |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 1,738,086 | 153,516 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 4,635,823 | 3,793,781 |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | \$ 6,373,909 | \$ 3,947,297 |
| SUPPLEMENTAL CASH FLOW INFORMATION: | | |
| Cash paid for: | | |
| Income taxes paid-net | \$ 6,025 | \$ 9,325 |
| Interest | \$ 7,045 | \$ 7,889 |
| Fixed assets purchased with capital lease | \$ 44,895 | -- |

See notes to consolidated financial statements.

CRITICARE SYSTEMS, INC.
Condensed Notes to Consolidated Financial Statements
(Unaudited)

1. Basis of Presentation

The accompanying unaudited financial statements have been prepared by Criticare Systems, Inc. (the "Company") pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and, in the opinion of the Company, include all adjustments necessary for a fair statement of results for each period shown. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such SEC rules and regulations. The Company believes that the disclosures made are adequate to prevent the financial information given from being misleading. It is suggested that these financial statements be read in conjunction with the financial statements and notes thereto included in the Company's latest annual report and previously filed Form 10-K. The three and six month results represent past performance, and are not necessarily indicative of results for an entire year. Certain amounts from the fiscal 2007 financial statements have been reclassified to conform to the fiscal 2008 presentation.

2. Inventory Valuation

Inventory is stated at the lower of cost or market, with cost determined on the first-in, first-out method. Components of inventory consisted of the following at December 31, 2007 and June 30, 2007, respectively:

| | December 31, 2007 | June 30, 2007 |
|--------------------------------|----------------------|------------------|
| Component parts | \$ 3,084,555 | \$ 2,507,293 |
| Work in process | 1,094,435 | 1,106,885 |
| Finished units | 4,497,294 | 4,938,345 |
| Total inventories | 8,676,284 | 8,552,523 |
| Less: reserve for obsolescence | 527,000 | 375,000 |
| Net inventory | \$ 8,149,284 | \$ 8,177,523 |

3. Property, Plant and Equipment

Property, plant and equipment consist of the following:

| | December 31, 2007 | June 30, 2007 |
|--------------------------------------|----------------------|------------------|
| Machinery and equipment | \$ 3,656,814 | \$ 3,415,501 |
| Furniture and fixtures | 896,137 | 946,668 |
| Leasehold improvements | 342,031 | 290,084 |
| Production tooling | 2,406,312 | 2,389,507 |
| Demonstration and loaner monitors | 1,939,707 | 2,025,924 |
| Property, plant and equipment – cost | 9,241,001 | 9,067,684 |
| Less: accumulated depreciation | (7,015,009) | (6,877,295) |
| Property, plant and equipment - net | \$ 2,225,992 | \$ 2,190,389 |

4. Stock Options

The Company has adopted the fair value recognition provisions of SFAS No. 123 (R), "Share-Based Payment". Under the modified prospective method of adoption selected by the Company, compensation cost recognized is the same as that which would have been recognized had the recognition provisions of SFAS No. 123 been applied from its original effective date. Stock-based employee compensation expense included in reported net income totaled \$27,486 and \$27,078 for the three months ended December 31, 2007 and 2006, respectively. Stock-based employee compensation expense included in reported net income totaled \$36,625 and \$56,545 for the six months ended December 31, 2007 and 2006, respectively.

The Company did not grant any options for the three and six months ended December 31, 2007. The fair value of stock options used to compute net income per share is the estimated fair value at the grant date using the Black-Scholes option-pricing model. The assumptions used when calculating the option-pricing model include the expected volatility of Criticare's common stock at 51.0%, the risk-free interest rate of 4.73%, the expected option life of 9.00 years and the forfeiture rate of option grants at 0%.

5. Income Taxes

No income tax provision has been made in the consolidated statements of income due to federal and state net operating loss carry forwards that will be utilized to offset taxable income earned. At December 31, 2007, the Company had federal net operating loss carry forwards of approximately \$17,301,000 (which expire from 2008 through 2027) and state net operating loss carry forwards of approximately \$10,187,000 (which expire from 2008 through 2021) available to offset future taxable income. The Company has recorded a valuation allowance to offset the related deferred income tax assets arising from these net operating loss carry forwards due to the uncertainty of realizing the benefits of these assets in future years.

The Company and one of its subsidiaries file income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, on July 1, 2007. As a result of the implementation of Interpretation 48, the Company did not recognize an increase in the liability for unrecognized tax benefits. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

| | | |
|--|----|----|
| Balance at July 1, 2007 | \$ | 0 |
| Additions based on tax positions related to the current year | | -- |
| Additions for tax positions of prior years | | -- |
| Reductions for tax positions of prior years | | -- |
| Settlements | | -- |
| Balance at December 31, 2007 | \$ | 0 |

The Company recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. As of December 31, 2007, the Company had not accrued for any payments of interest and penalties.

6. Line of Credit Facility

At December 31, 2007, the Company had a \$2,000,000 demand line of credit facility with a commercial bank to meet its short-term borrowing needs. Borrowings against the line were payable on demand with interest payable monthly at the bank's reference rate, less 0.25% (7.00% as of December 31, 2007). As of December 31, 2007 and June 30, 2007, there were no borrowings against the line. Borrowings under the line of credit facility are collateralized by substantially all assets of the Company. The credit facility has covenants, which require minimum income or liquidity levels. The Company was in compliance with the covenants at December 31, 2007.

7. Net Income Per Common Share

Basic net income per share is computed using the weighted average number of common shares outstanding during the periods. Diluted net income per share is computed using the weighted average number of common and dilutive common equivalent shares outstanding during the periods. Additionally, antidilution occurs when the exercise price of the option is higher than the average market price of the common stock. The diluted weighted average common shares outstanding would be higher by 142,750 shares for the three and six months ended December 31, 2007 and by 80,000 shares for the three and six months ended December 31, 2006 without this anti-dilutive impact.

CRITICARE SYSTEMS, INC.
Management's Discussion and Analysis of
Results of Operations and Financial Condition
Six Months Ended December 31, 2007 and 2006

Results of Operations

The Company had record net sales of \$19,359,091 for the six months ended December 31, 2007, which increased 16.1% from \$16,669,334 for the same period in fiscal 2007. The record net sales drove income from operations of \$1,458,332 for the six months ended December 31, 2007, which increased 156.9% from \$567,606 for the same period in fiscal 2007. These served to drive the increased net income for the Company to \$1,667,883 for the six months ended December 31, 2007, which was 144.0% higher than \$683,609 for the same period in fiscal 2007. A 24.8% increase in the average unit sales price and a 10.6% increase in the accessory sales were partially offset by a 4.9% reduction in number of units shipped, due to variations in the product mix, in the current period. The increased sales were driven by increases of \$2,370,720 in OEM sales and \$2,137,850 in international sales, which were partially offset by a \$1,036,630 decrease in domestic alternate care sales and a \$786,546 decrease in domestic acute care sales. The OEM sales increase was driven by sales to Medrad, which increased \$1,637,295 to \$4,641,258, and due to the start of the production shipments to our newest OEM partner, Fukuda Denshi, Inc. of Japan. The increase in international sales was due in large part to the partial shipment of an order to the ministry of health of the Republic of Iraq of \$1,520,257 and a 171.3% growth in the number of units shipped to the international market for Criticare's multi-parameter vital signs monitor (nGenuity 8100E). The decrease in domestic alternate care sales was due to a large order to replace vital signs monitors in domestic plasma collection centers shipped in the first quarter of fiscal 2007 with no corresponding sales in fiscal 2008. The decrease in domestic acute care sales in fiscal 2008 was anticipated as the Company capitalized on opportunities within the market during fiscal 2007 to participate in bid requests without institutional contract requirements.

The gross profit percentage of 39.4% for the six months ended December 31, 2007 increased slightly from 39.2% for the same period in fiscal 2007. The increased margins in the current period were mainly due to the small variations in the product mix.

Operating expenses for the six months ended December 31, 2007 increased \$193,572 from the same period in fiscal 2007 due mainly to an increase of \$476,259 in sales and marketing expenses, which was partially offset by a decrease of \$328,023 in administrative expenses. The increase of \$476,259 in sales and marketing expenses was driven by a \$383,853 increase in commissions earned which included commissions earned by the Company's dealer of \$263,140 for the partial shipment of the order to the ministry of health of the Republic of Iraq, a \$21,538 increase in travel expenses and a \$13,089 increase in advertising and trade show expenses for the six months ended December 31, 2007. Administrative expenses decreased by \$328,023 as \$362,693 of expenses were incurred during the first six months of fiscal 2007 in connection with the BlueLine consent solicitation with no corresponding expense in fiscal 2008, more than offsetting increased expenses of \$35,793 relating to the Company's preparation for compliance with Section 404 of the Sarbanes-Oxley Act.

Total other income for the six months ended December 31, 2007 increased \$93,548 from the same period in fiscal 2007. This increase was mainly driven by increased interest income of \$43,419 and increased royalty income of \$25,200 received during the period.

Income from operations of \$1,458,332 for the six months ended December 31, 2007 increased \$890,726 as compared to income from operations of \$567,606 for the same period in fiscal 2007, which was the result of a \$1,084,298 increase in gross profit combined with increased operating expenses of \$193,572. The increase in income from operations together with an increase in other income of \$93,548, resulted in an increase in net income of \$984,274 to net income of \$1,667,883 for the six months ended December 31, 2007 as compared to net income of \$683,609 for the

same period in fiscal 2007.

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CRITICARE SYSTEMS, INC.
Management's Discussion and Analysis of
Results of Operations and Financial Condition
Three Months Ended December 31, 2007 and 2006

Results of Operations

Record quarterly net sales of \$10,221,365 for the three months ended December 31, 2007 increased 20.8% from \$8,462,741 for the same period in fiscal 2007. The record net sales drove income from operations of \$953,018 for the three months ended December 31, 2007, which increased 294.8% from \$241,419 for the same period in fiscal 2007. These served to drive the increased net income for the Company to \$1,029,241 for the three months ended December 31, 2007, which was 193.5% higher than \$350,733 for the same period in fiscal 2007. A 28.5% increase in the average unit sales price and an 5.5% increase in the accessory sales were partially offset by a 1.9% reduction in number of units shipped, due to variations in the product mix, in the current period. The increased sales were driven by a \$1,815,546 increase in OEM sales and a \$513,097 increase in international sales, which were partially offset by a \$597,034 decrease in domestic acute care sales. The increase in OEM sales was driven by sales to Fukuda Denshi, Inc. of Japan and Medrad. Medrad sales increased \$1,494,374 to \$2,930,985 for the three months ended December 31, 2007. The increase in international sales has been driven by 100.5% growth in the number of units shipped for Criticare's multi-parameter vital signs monitor (nGenuity 8100E), as the monitor, which was released in late fiscal 2006, continues to gain acceptance and momentum.

The gross profit percentage of 40.9% for the three months ended December 31, 2007 increased slightly from 40.4% for the same period in fiscal 2007. The increased margins in the current period were mainly due to the small variations in the product mix.

Operating expenses for the three months ended December 31, 2007 increased \$48,393 from the same period in fiscal 2007 due mainly to an increase of \$137,146 in research, development and engineering expenses and an increase of \$109,965 in sales and marketing expenses, which were partially offset by a decrease of \$198,718 in administrative expenses. The increase of \$137,146 in research, development and engineering expenses is mainly due to the specific cycle variations of the on-going development projects. The increase of \$109,965 in sales and marketing expenses was driven by a \$38,791 increase in commissions earned, a \$29,331 increase in advertising and trade show expenses and a \$27,922 increase in travel expenses for the three months ended December 31, 2007. Administrative expenses decreased by \$198,718 as \$271,153 of expenses were incurred during the second quarter of fiscal 2007 in connection with the BlueLine consent solicitation with no corresponding expense in fiscal 2008, more than offsetting increased expenses of \$35,793 relating to the Company's preparation for compliance with Section 404 of the Sarbanes-Oxley Act.

Total other income for the three months ended December 31, 2007 decreased \$33,091 from the same period in fiscal 2007. This decrease was mainly due to a decrease in foreign currency exchange gain of \$60,158, which was partially offset by increased interest income of \$32,384 received during the quarter.

Net income of \$1,029,241 for the three months ended December 31, 2007 increased by \$678,508 as compared to net income of \$350,733 for the same period in fiscal 2007, as the result of a \$759,992 increase in gross profit and a \$48,393 decrease in operating expenses.

CRITICARE SYSTEMS, INC.
Management's Discussion and Analysis of
Results of Operations and Financial Condition

Liquidity and Capital Resources

As of December 31, 2007, the Company had a cash balance of \$6,373,909, which was \$1,738,086 higher than its balance at June 30, 2007 of \$4,635,823 and \$2,426,612 higher than its balance at December 31, 2006. The Company continues to maintain a long-term bank debt free balance sheet since August 30, 2002 when it sold its building and used the proceeds from the sale to retire the long-term bank debt on the facility.

The Company's cash position increased by \$1,738,086 for the six months ended December 31, 2007 driven by \$2,045,849 of cash provided by operating activities, which was partially offset by \$343,280 of capital expenditures. Cash provided by operations was \$2,045,849 for the six months ended December 31, 2007 as net income of \$1,667,883, an increase of \$363,075 in accounts payable, an increase of \$260,681 in accruals and depreciation of \$207,307 were partially offset by a \$540,874 increase in accounts receivable.

The Company believes all future capital and liquidity requirements will be satisfied by cash generated from operations, proceeds received from the issuance of common stock related to the exercise of stock options, and its current cash balances. No major capital equipment expenditures are expected in the Company's current fiscal year ending June 30, 2008. The Company also has a \$2,000,000 line of credit currently in place that could be utilized, if necessary. At both December 31, 2007 and June 30, 2007, there were no borrowings outstanding under this line of credit. The credit facility has covenants that require minimum income or liquidity levels. The Company was in compliance with the covenants at December 31, 2007. This line expires in June 2008.

Forward Looking Statements

A number of the matters and subject areas discussed in this report that are not historical or current facts deal with potential future circumstances and developments. These include anticipated product introductions, expected future financial results, liquidity needs, financing ability, management's or the Company's expectations and beliefs and similar matters discussed in Management's Discussion and Analysis or elsewhere in this report. These statements may be identified by the use of forward-looking words or phrases such as "anticipate," "believe," "could," "expect," "intend," "may," "hope," "plan," "potential," "should," "estimate," "predict," "continue," "future," "will," "would" or the negative of these terms or other words of similar meaning.

Such forward-looking statements are inherently subject to known and unknown risks and uncertainties. The Company's actual results and future developments could differ materially from the results or developments expressed in, or implied by, these forward-looking statements. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, but are not limited to, general economic conditions, demand for the Company's products, costs of operations, the development of new products, the reliance on single sources of supply for certain components in the Company's products, government regulation, health care cost containment programs, the effectiveness of the Company's programs to manage working capital and reduce costs, competition in the Company's markets, compliance with product safety regulations and product liability and product recall risks, risks relating to international sales and compliance with U.S. export regulations, unanticipated difficulties in outsourcing the manufacturing of the majority of its products to foreign manufacturers and risks related to foreign manufacturing, including economic and political instability, trade and foreign tax laws, production delays and cost overruns and quality control. Such uncertainties and other risks that may affect the Company's performance are discussed further in Part I, Item 1A, "Risk Factors," in the Company's Form 10-K for the year ended June 30, 2007. The Company undertakes no obligation to make any revisions to the forward-looking statements contained in this report or to update them to reflect events or circumstances occurring after the date of this report.

Quantitative and Qualitative Disclosures about Market Risk

The Company has a demand line of credit facility with a commercial bank with interest payable monthly at 25 basis points below the bank's reference rate. The Company had no borrowings outstanding under this bank facility at December 31, 2007 and June 30, 2007. Due historically to the lack of need to borrow from this credit facility and due to the Company's current cash position, the Company is not subject to financial risk on this obligation if interest rates in the market change significantly.

The Company's net sales are primarily denominated in United States dollars, except for a small amount of net sales from the Company's operation in India denominated in Indian rupees. As a result, part of the Company's accounts receivable are denominated in rupees and translated into U.S. dollars for financial reporting purposes. A 10% change in the exchange rate of the U.S. dollar with respect to the Indian rupee would not have a material adverse effect on the Company's financial condition or results of operations for the quarter ended December 31, 2007. The Company does not use any hedges or other derivative financial instruments to manage or reduce exchange rate risk.

Controls and Procedures

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Company's Vice President - Finance, of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended). Based on this evaluation, the Company's Chief Executive Officer and Vice President - Finance concluded that, as of the end of such period, the Company's disclosure controls and procedures were effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company in reports that the Company files with or submits to the Securities and Exchange Commission. It should be noted that in designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. The Company has designed its disclosure controls and procedures to reach a level of reasonable assurance of achieving the desired control objectives and based upon the evaluation described above, the Company's Chief Executive Officer and Vice President - Finance concluded that the Company's disclosure controls and procedures were effective at reaching that level of reasonable assurance.

There was no change in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended) during the Company's most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1A. Risk Factors

There have been no material changes from the risk factors previously disclosed in Part I, Item 1A, "Risk Factors," of the Company's Form 10-K for the year ended June 30, 2007. Please refer to that section for disclosures regarding the risks and uncertainties relating to the Company's business.

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

The annual meeting of stockholders of the Company was held on November 27, 2007. The matters voted upon, including the number of votes cast for, against or withheld, as well as the number of abstentions and broker non-votes, as to each such matter were as follows:

Proposal 1: Election of five directors to serve for a one-year term ending at the 2008 annual meeting of stockholders.

| | For | Withheld |
|-----------------------|-----------|-----------|
| Jeffrey T. Barnes | 6,278,289 | 3,428,949 |
| N.C. Joseph Lai | 6,416,279 | 3,290,959 |
| William M. Moore | 9,454,646 | 252,592 |
| Robert E. Munzenrider | 9,453,246 | 253,992 |
| Emil H. Soika | 5,954,290 | 3,752,948 |

Proposal 2: Ratification of appointment of BDO Seidman, LLP as independent auditors of the Company.

| For | Against | Abstain | Broker Non-Votes |
|-----------|---------|---------|---------------------|
| 9,648,797 | 49,620 | 8,821 | 0 |

Item 6. Exhibits.

- 3.1 Restated Certificate of Incorporation of the Company (incorporated by reference to the Registration Statement filed on Form S-1, Registration No. 33-13050).
- 3.2 By-Laws of the Company (incorporated by reference to the Registration Statement filed on Form S-1, Registration No. 33-13050).
- 4.1 Specimen Common Stock certificate (incorporated by reference to the Registration Statement filed on Form S-1, Registration No. 33-13050).
- 4.2 Amended and Restated Rights Agreement, dated as of March 27, 2007, between the Company and LaSalle Bank, National Association, as rights agent (incorporated by reference to the Company's Current Report on Form 8-K filed on March 30, 2007).
- 31.1 Certification of Emil H. Soika, President and Chief Executive Officer (Principal Executive Officer) pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Joel D. Knudson, Vice President - Finance and Secretary (Principal Financial Officer) pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32* Certification of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350.

* This Exhibit is not "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended.

SIGNATURES

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

CRITICARE SYSTEMS, INC.

(Registrant)

Date: February 7, 2008

BY /s/ Joel D. Knudson

Joel D. Knudson

Vice President - Finance

(Chief Accounting Officer and

Duly Authorized Officer)