

CRITICARE SYSTEMS INC /DE/
Form 10-Q
November 13, 2003

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 September 30, 2003

OR

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

For the transition period from _____ to _____

Commission file number -0-16061

CRITICARE SYSTEMS, INC.
(Exact name of registrant as specified in its charter)

Delaware

39-1501563

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification Number)

20925 Crossroads Circle, Suite 100, Waukesha, Wisconsin 53186
(Address of principal executive offices) (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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes ___ No X

Number of shares outstanding of each class of the registrant's classes of common stock as of September 30, 2003:
Class A Common Stock 11,075,269 shares.

CRITICARE SYSTEMS, INC.
CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2003 AND JUNE 30, 2003

(UNAUDITED)

ASSETS	September 30, 2003	June 30, 2003
CURRENT ASSETS:		
Cash and cash equivalents	\$ 3,866,322	\$ 3,716,446
Accounts receivable, less allowance for doubtful accounts of \$300,000	5,502,349	5,627,198
Other receivables	454,885	553,147
Inventories	6,277,910	6,347,208
Prepaid expenses	364,817	340,934
Total current assets	16,466,283	16,584,933
Property, plant and equipment net	2,065,034	2,093,408
License rights and patents net	82,236	83,986
TOTAL ASSETS	\$ 18,613,553	\$ 18,762,327
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 2,425,979	\$ 2,272,953
Accrued liabilities:		
Compensation and commissions	870,381	850,034
Product warranties	353,729	312,000
Other	282,669	254,470
Total current liabilities	3,932,758	3,689,457
OTHER LONG-TERM OBLIGATIONS	34,654	38,662
TOTAL LIABILITIES	3,967,412	3,728,119
STOCKHOLDERS' EQUITY:		

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Preferred stock - \$.04 par value, 500,000 shares authorized no shares issued or outstanding	---	---
Common stock - \$.04 par value, 15,000,000 shares authorized, 11,204,024 shares issued, and 11,075,269 and 11,073,832 outstanding, respectively	448,161	448,161
Additional paid-in capital	23,361,230	23,360,244
Common stock held in treasury (128,755 and 130,192 shares, respectively)	(416,941)	(419,618)
Subscriptions receivable	(225,000)	(225,000)
Retained earnings (accumulated deficit)	(8,517,827)	(8,126,097)
Cumulative translation adjustment	(3,482)	(3,482)
	<u> </u>	<u> </u>
Total stockholders' equity	14,646,141	15,034,208
	<u> </u>	<u> </u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 18,613,553	\$ 18,762,327
	<u> </u>	<u> </u>

See notes to consolidated financial statements.

2

CRITICARE SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
THREE MONTHS ENDED SEPTEMBER 30, 2003 AND 2002

(UNAUDITED)

	2003	2002
	<u> </u>	<u> </u>
NET SALES	\$ 6,372,417	\$ 6,304,347
COST OF GOODS SOLD	3,798,010	3,907,000
	<u> </u>	<u> </u>
GROSS PROFIT	2,574,407	2,397,347
OPERATING EXPENSES:		
Sales and marketing	1,507,446	1,326,960
Research, development and engineering	600,593	628,940
Administrative	901,258	957,229
	<u> </u>	<u> </u>
Total	3,009,297	2,913,129
LOSS FROM OPERATIONS	(434,890)	(515,782)
OTHER INCOME (EXPENSE):		
Interest expense		(91,533)

Interest income	9,739	15,865
Other income	33,421	299,799
	<u> </u>	<u> </u>
Total	43,160	224,131
LOSS BEFORE INCOME TAXES	(391,730)	(291,651)
INCOME TAX PROVISION		
	<u> </u>	<u> </u>
NET LOSS	\$ (391,730)	\$ (291,651)
	<u> </u>	<u> </u>
NET LOSS PER COMMON SHARE		
Basic and diluted	\$ (0.04)	\$ (0.03)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING:		
Basic and diluted	11,074,738	11,072,682

See notes to consolidated financial statements.

3

CRITICARE SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
THREE MONTHS ENDED SEPTEMBER 30, 2003 AND 2002

(UNAUDITED)

	2003	2002
	<u> </u>	<u> </u>
OPERATING ACTIVITIES:		
Net loss	\$ (391,730)	\$ (291,651)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation	143,178	228,655
Amortization	1,750	1,750
Provision for doubtful accounts	2,352	
Provision for obsolete inventory	95,000	364,000
Gain on sale of Immtech stock		(241,746)
Gain on sale of building		(41,208)
Changes in assets and liabilities:		
Accounts receivable	122,497	544,245
Other receivables	98,262	(84,914)
Inventories	(43,842)	(568,513)
Prepaid expenses	(23,883)	(2,135)
Accounts payable	153,026	94,687

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Accrued liabilities	86,267	117,731
Net cash provided by operating activities	242,877	120,901
INVESTING ACTIVITIES:		
Purchases of property, plant and equipment, net	(96,664)	(306,073)
Proceeds from sale of Immtech stock		241,746
Proceeds from sale of building		3,795,164
Net cash (used in) provided by investing activities	(96,664)	3,730,837
FINANCING ACTIVITIES:		
Retirement of long-term debt		(3,197,125)
Repurchase of Company common stock		(121,359)
Proceeds from issuance of common stock	3,663	9,986
Net cash provided by (used in) financing activities	3,663	(3,308,498)
EFFECT OF EXCHANGE RATE CHANGES ON CASH		268
NET INCREASE IN CASH AND CASH EQUIVALENTS	149,876	543,508
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	3,716,446	3,523,070
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 3,866,322	\$ 4,066,578

See notes to consolidated financial statements.

4

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. Certain amounts from the fiscal 2002 financial statements have been reclassified to conform to the 2003 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 September 30, 2003 and June 30, 2003, respectively:

	September 30, 2003	June 30, 2003
Component parts	\$ 2,981,099	\$ 2,762,803
Work in process	664,566	811,906
Finished units	4,127,245	4,172,499
Total inventories	7,772,910	7,747,208
Less: reserve for obsolescence	1,495,000	1,400,000
Net inventory	\$ 6,277,910	\$ 6,347,208

3. Investments

During fiscal 2003, the Company completely liquidated its position in its Immtech International, Inc. (Immtech) common stock. In the first quarter of fiscal 2003 ended September 30, 2002, the Company sold 50,000 shares and realized a gain of \$241,746 that was included in other income in the accompanying consolidated statement of operations. The remaining 406,374 shares of Immtech stock after this sale were sold in the second and third quarters of fiscal 2003.

5

4. Property, Plant and Equipment

Property, plant and equipment consist of the following:

	September 30, 2003	June 30, 2003
Machinery and equipment	\$ 2,308,061	\$ 2,264,697
Furniture and fixtures	919,408	919,077
Leasehold improvements	212,229	212,229
Demonstration and loaner monitors	1,253,148	1,346,459
Production tooling	3,670,314	3,617,345
Property, plant and equipment cost	8,363,160	8,359,807
Less: accumulated depreciation	6,298,126	6,266,399
Property, plant and equipment - net	\$ 2,065,034	\$ 2,093,408

On August 30, 2002, the Company sold its building in Waukesha, Wisconsin and leased back approximately 62% of the building's square footage. The building was sold for \$4,000,000 and a gain of \$41,208 was realized on the sale

after the payment of commissions and fees and the funding of \$105,396 in capitalized build out costs needed to split the building into two leasable spaces. The proceeds from the sale were used to retire the \$3,182,160 of debt on the Company's balance sheet at August 30, 2002 and increased the Company's cash position by approximately \$500,000.

5. Contingencies

The import and export rules applicable to all United States companies engaged in international business transactions contain compliance guidelines. Violations may result in civil or criminal penalties, or both, as well as the potential loss of export privileges.

On August 6, 2002, in part due to the new regulations imposed under the Sarbanes-Oxley Act, the Company initiated an internal review of its import and export procedures. On August 28, 2002, senior management of the Company became aware of previous events that may have violated United States import/export laws and regulations. Senior management of the Company immediately authorized an internal audit of these possible violations, focusing on the sale of medical equipment directly or indirectly into an embargoed country and possible marking issues.

The factual investigation pursuant to the internal audit is complete, no additional compliance issues arose, and no material marking issues were identified as a result of the investigation.

Subsequently, the Company has taken action to adopt and implement a written compliance program with respect to applicable import/export rules. The Company has also undertaken a voluntary disclosure with the relevant government agencies and has filed its completed internal audit report and all requested documents. Although there is no assurance, based upon the results of the completed internal audit and precedents, the Company believes a negotiated settlement of any violations will not have a material adverse effect on the Company. In addition, the Company does not believe that the audit result supports the denial of export privileges; however, any such penalty would have a material adverse effect on the Company's business. The Company further believes that the voluntary disclosure, along with other internal actions taken, will serve to mitigate any potential adverse consequences that otherwise might accrue.

6

6. Guarantees

Criticare Integration, Inc., a wholly owned U.S. subsidiary of the Company, was incorporated on April 8, 2003 to supply medical equipment and supplies to medical facilities in countries in the Black Sea Economic Zone (Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Romania, and the Ukraine). The Company had set up a standby letter of credit for \$300,000 on behalf of a Romanian company it is working with in connection with this new venture. The standby letter of credit served as a guarantee for a \$2,000,000 line of credit that had been extended by a large Austrian bank to the Romanian company to fund this project. The standby letter of credit was to expire on November 15, 2003. The line of credit was no longer deemed necessary to fund the project and was therefore cancelled prior to expiration. The related standby letter of credit from the Company guaranteeing the line of credit was also cancelled on October 20, 2003.

The Company also maintains a second standby letter of credit for \$300,000 on behalf of the Romanian company that serves as a guarantee to fund borrowings by the Romanian company used to set up and market this project. This standby letter of credit was to expire on November 1, 2003, but was renewed through November 1, 2004 on October 16, 2003. This standby letter of credit would only be called if the cash flows from the project were not adequate to fund these costs and the Romanian company would not be able to retire the debt. The value of this remaining guarantee that was renewed was not material to the Company's financial statements.

7. Stock Options

The Company has adopted the disclosure-only provisions of SFAS No. 123, Accounting for Stock-Based Compensation and SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. If the Company had elected to recognize compensation cost for the options granted for the three months ended September 30, 2003 and 2002, consistent with the method prescribed by SFAS No. 123, net loss and net loss per share would have been changed to the pro forma amounts indicated below:

	Three Months ended September 30	
	2003	2002