

Edgar Filing: CRITICARE SYSTEMS INC /DE/ - Form 10-Q

CRITICARE SYSTEMS INC /DE/
Form 10-Q
November 14, 2002

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, 2002

OR

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

For the transition period from _____ to _____

Commission file number 0-16061

CRITICARE SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware

39-1501563

(State or other jurisdiction
of incorporation or organization)

(IRS Employer Identification No.)

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

Number of shares outstanding of each class of the registrant's classes of common stock as of September 30, 2002: Class A Common Stock 11,204,024 shares.

Edgar Filing: CRITICARE SYSTEMS INC /DE/ - Form 10-Q

CRITICARE SYSTEMS, INC.
CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2002 AND JUNE 30, 2002

(UNAUDITED)

	September 30, 2002

ASSETS	
CURRENT ASSETS:	
Cash and cash equivalents	\$ 4,066,578
Accounts receivable, less allowance for doubtful accounts of \$300,000 . . .	5,179,578
Investments	1,544,221
Other receivables	345,391
Inventories	7,373,860
Prepaid expenses	455,482

Total current assets	18,965,110
Property, plant and equipment - net	2,271,978
License rights and patents - net	89,237

TOTAL	\$ 21,326,325
	=====
LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Accounts payable	\$ 2,426,183
Accrued liabilities:	
Compensation and commissions	764,103
Product warranties	253,000
Other	614,405
Current maturities of long-term debt	-

Total current liabilities	4,057,691
LONG-TERM DEBT, less current maturities	-
OTHER LONG-TERM OBLIGATIONS	44,792
STOCKHOLDERS' EQUITY:	
Preferred stock	-
Common stock - \$.04 par value, 15,000,000 shares authorized, 11,204,024, and 11,199,524 shares issued and outstanding, respectively . .	448,161
Additional paid-in capital	23,358,274
Common stock held in treasury (135,101 and 100,890 shares, respectively) . .	(428,762)
Subscriptions receivable	(225,000)
Retained earnings (accumulated deficit)	(7,479,152)
Cumulative translation adjustment	6,100
Unrealized gain on investments	1,544,221

Total stockholders' equity	17,223,842

TOTAL	\$ 21,326,325
	=====

See notes to consolidated financial statements.

CRITICARE SYSTEMS, INC.
CONSOLIDATED INCOME STATEMENTS
THREE MONTHS ENDED SEPTEMBER 30, 2002 AND 2001

(UNAUDITED)

	2002	2001
	-----	-----
NET SALES	\$ 6,304,347	\$ 5,489,137
COST OF GOODS SOLD.	3,907,000	3,677,701
	-----	-----
GROSS PROFIT.	2,397,347	1,811,436
OPERATING EXPENSES:		
Marketing	1,326,960	1,600,355
Research, development and engineering	628,940	587,083
Administrative.	957,229	660,778
	-----	-----
Total	2,913,129	2,848,216
LOSS FROM OPERATIONS.	(515,782)	(1,036,780)
OTHER INCOME (EXPENSE):		
Interest expense.	(91,533)	(62,676)
Interest income	15,865	33,044
Other income.	299,799	4,577
	-----	-----
Total	224,131	(25,055)
LOSS BEFORE INCOME TAXES.	(291,651)	(1,061,835)
INCOME TAX PROVISION.	-	-
	-----	-----
NET LOSS.	\$ (291,651)	\$ (1,061,835)
	=====	=====
NET LOSS PER COMMON SHARE:		
Basic	\$ (0.03)	\$ (0.10)
Diluted	\$ (0.03)	\$ (0.10)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING:		
Basic	11,072,682	10,733,029
Diluted	11,072,682	10,733,029

See notes to consolidated financial statements.

CRITICARE SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
THREE MONTHS ENDED SEPTEMBER 30, 2002 AND 2001

(UNAUDITED)

Edgar Filing: CRITICARE SYSTEMS INC /DE/ - Form 10-Q

	2002	2001
	-----	-----
OPERATING ACTIVITIES:		
Net loss	\$ (291,651)	\$ (1,061,835)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation	228,655	246,045
Amortization	1,750	1,751
Provision for doubtful accounts	-	75,000
Provision for obsolete inventory	364,000	-
Gain on sale of Immtech stock	(241,746)	-
Gain on sale of building	(41,208)	-
Changes in assets and liabilities:		
Accounts receivable	302,374	799,112
Other receivables	156,957	1,337
Inventories	(568,513)	(660,432)
Prepaid expenses	(2,135)	47,408
Accounts payable	94,687	(946,993)
Accrued liabilities	117,731	(279,871)
	-----	-----
Net cash provided by (used in) operating activities.	120,901	(1,778,478)
INVESTING ACTIVITIES:		
Purchases of property, plant and equipment, net. . .	(306,073)	(90,526)
Proceeds from sale of Immtech stock	241,746	-
Proceeds from sale of building	3,795,164	-
	-----	-----
Net cash provided by (used in) investing activities.	3,730,837	(90,526)
FINANCING ACTIVITIES:		
Retirement of long-term debt	(3,197,125)	(20,575)
Repurchase of Company common stock	(121,359)	-
Proceeds from issuance of common stock	9,986	5,171
	-----	-----
Net cash (used in) financing activities.	(3,308,498)	(15,404)
EFFECT OF EXCHANGE RATE CHANGES ON CASH.	268	-
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	543,508	(1,884,408)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	3,523,070	3,362,104
	-----	-----
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 4,066,578	\$ 1,477,696
	=====	=====

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,

Edgar Filing: CRITICARE SYSTEMS INC /DE/ - Form 10-Q

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 2001 financial statements have been reclassified to conform to the 2002 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, 2002 and June 30, 2002, respectively:

	September 30, 2002	June 30, 2002
	-----	-----
Component parts	\$ 3,508,213	\$3,549,397
Work in process	588,243	499,950
Finished units	4,587,404	4,031,456
	-----	-----
Total inventories	8,683,860	8,080,803
Less: reserve for obsolescence	1,310,000	946,000
	-----	-----
Net inventory	\$ 7,373,860	\$7,134,803

3. INVESTMENTS

In July and August of 2002 the Company sold a total of 50,000 shares of its Immtech International, Inc. ("Immtech") common stock and realized a gain of \$241,746. The Company held 406,374 shares of Immtech stock, which was trading at \$3.80 per share, on September 30, 2002. The market value of these shares could change substantially due to overall market risk.

5

4. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following:

	September 30, 2002	June 30, 2002
	-----	-----
Land and building	\$ -	\$ 4,525,000
Machinery and equipment	2,066,005	2,007,322
Furniture and fixtures	827,046	809,277
Construction in progress	-	116,798
Leasehold improvements	202,984	-
Demonstration and loaner monitors . .	1,582,222	1,616,766

Edgar Filing: CRITICARE SYSTEMS INC /DE/ - Form 10-Q

Production tooling	3,463,156	3,425,117
	-----	-----
Property, plant and equipment - cost	8,141,413	12,500,280
Less: accumulated depreciation. . .	5,869,436	6,517,220
	-----	-----
Property, plant and equipment - net.	\$ 2,271,977	\$ 5,983,060

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

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 actions 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 substantially complete and no additional compliance issues have arisen as a result of the factual investigation. A report setting forth the findings from the internal audit is being completed. 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. 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 Bureau of Industry and Security ("BIS") and the Treasury's Office of Foreign Asset Control ("OFAC"). Although there is no assurance, based upon a review of the internal audit to date and precedents, the Company believes a negotiated settlement of any violations will not have a material adverse effect on the operations of the Company. At this time, the Company cannot determine whether any monetary fines would have a material adverse effect on its financial condition. The Company does not believe that the evidence 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 to the BIS, OFAC and, possibly, other agencies will serve to mitigate any potential adverse consequences that otherwise might accrue.

CRITICARE SYSTEMS, INC.
Management's Discussion and Analysis of
Results of Operations and Financial Condition
Three Months Ended September 30, 2002 and 2001

RESULTS OF OPERATIONS

Edgar Filing: CRITICARE SYSTEMS INC /DE/ - Form 10-Q

Net sales for the three months ended September 30, 2002 increased 14.9% from the same period in the prior year. The higher sales were driven by a 14.3% increase in the number of units sold and a 6.8% increase in the average sales price per unit for the same three month period in the prior year. The higher average per unit sales price in the current period was mainly mix driven, as sales of the Company's higher priced 8100 vital signs monitors and Vitalview central stations increased 33.6% over the same period in the prior year. Sales were down significantly in the prior year due mainly to the events of September 11th which adversely affected sales in September 2001 and basically eliminated sales from one of the Company's largest domestic trade shows that opened on September 12, 2001. This trade show was held in October in the current fiscal year and is expected to contribute to strong sales in the Company's fiscal second quarter ending December 31, 2002. See "Forward-Looking Statements."

The gross profit percentage of 38.0% for the three months ended September 30, 2002 was five percentage points higher than the same period in the prior year. The higher sales volume in the current period resulted in a better utilization of fixed manufacturing costs and improved margins approximately three percentage points. In addition, due to the outsourcing of the majority of the Company's products, approximately \$140,000 of fixed costs that had previously been classified as manufacturing expenses were more appropriately included in administrative expenses in the current period ended September 30, 2002 and improved margins.

Operating expenses for the three months ended September 30, 2002 increased only 2.3%, or \$64,913, from the same period in the prior year, despite the reclassification in the current period of approximately \$140,000 of fixed costs to administrative expenses discussed above. In addition, the Company's legal and consulting expenses in the current period were almost \$141,000 higher than the prior year due mostly to the internal review being conducted by the Company of its import and export procedures. The \$296,451 increase in administrative expenses in the current period was almost entirely offset by a \$273,395 reduction in marketing expenses from the same period in the prior year, driven mainly by lower expenses in international marketing and customer service.

Other income for the three months ended September 30, 2002 increased \$249,186 from the same period in the prior year. The recognition of a \$241,746 gain on the sale of 50,000 shares of the Company's Immtech International, Inc. stock and a \$41,208 gain on the sale of the Company's building were the main contributors to the higher other income recognition. These gains were partially offset by a \$28,857 increase in interest expense in the current period, as two months of interest expense on the Company's mortgage on the facility and the prepayment penalty on the early retirement of the debt during the three months ended September 30, 2002 were greater than three months of interest expense incurred on the mortgage during the three months ended September 30, 2001.

The higher sales for the three months ended September 30, 2002, combined with the improved gross profit performance and an increase in other income more than offset the slightly higher operating expenses, resulting in a \$291,651 loss that was significantly lower than the \$1,061,835 loss recognized for the same period in the prior year.

7

LIQUIDITY AND CAPITAL RESOURCES

The Company has strengthened its balance sheet significantly at September 30, 2002 when compared to September 30, 2001. The Company has increased its cash balance by more than \$2.5 million over the last twelve months to \$4,066,578 at

Edgar Filing: CRITICARE SYSTEMS INC /DE/ - Form 10-Q

September 30, 2002 from \$1,477,696 at September 30, 2001. In addition, the Company's balance sheet at September 30, 2002 is now debt free due to the sale of the Company's building on August 30, 2002. The Company sold its building in Waukesha, Wisconsin, leased back approximately 62% of the its square footage, and used the proceeds from the sale to retire \$3,182,160 of debt on the balance sheet on the date of sale. 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. This transaction also increased the Company's cash position by approximately \$500,000 and was the main contributor to the Company's \$543,508 increase in cash from its balance of \$3,523,070 at June 30, 2002. In addition to strengthening the balance sheet, the reduction in square footage and the elimination of interest expense on the mortgage is expected to increase annual cash flows by almost \$150,000 (see "Forward Looking Statements").

Other significant events impacting cash flows for the three months ended September 30, 2002 included the sale of 50,000 shares of its Immtech International, Inc. stock in July and August of 2002 that resulted in the recognition of a realized gain of \$241,746. The Company held 406,374 shares of Immtech stock after the sale of these shares, which was trading at \$3.80 per share on September 30, 2002. Also, in accordance with the authorized buyback of up to 500,000 shares of the Company's common stock by the Board of Directors in the third quarter of fiscal 2002, the Company purchased 35,100 shares of stock at a cost of \$121,359 in the first quarter of fiscal 2003. The Company has now acquired a total of 76,223 shares of its common stock under this approved stock buyback.

The Company believes all capital and liquidity requirements for the remainder of fiscal 2003 will be satisfied by cash generated from operations and its current cash balances. The Company's \$4,000,000 line of credit expires in November 2002, but is expected to be extended with terms consistent with the current agreement. At September 30, 2002 there were no borrowings outstanding under this line of credit

FORWARD LOOKING STATEMENTS

A number of the matters and subject areas discussed herein 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 herein. The discussions of such matters and subject areas are qualified by the inherent risk and uncertainties surrounding future expectations generally, and also may materially differ from the Company's actual future experience.

The Company's business, operations and financial performance are subject to certain risks and uncertainties which could result in material differences in actual results from management's or the Company's current expectations. These risks and uncertainties 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.

Edgar Filing: CRITICARE SYSTEMS INC /DE/ - Form 10-Q

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, and the Company's ability to reduce costs by eliminating excess capacity at its principal facility.

CONTROLS AND PROCEDURES

Within 90 days prior to the date of 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 Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective. 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.

There have been no significant changes in the Company's internal controls or in other factors that could significantly affect the internal controls subsequent to the date the Company completed its evaluation.

9

PART II - OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K.

(a) 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 Rights Agreement (incorporated by reference to the Company's Current Report on Form 8-K filed on April 18, 1997).
- 10.1 Employment Agreement, dated as of May 18, 2000, between the Company and Joseph P. Lester.

(b) Reports on Form 8-K: None in the quarter ended September 30, 2002.

10

SIGNATURES

Edgar Filing: CRITICARE SYSTEMS INC /DE/ - Form 10-Q

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: November 14, 2002

BY /s/ Michael J. Sallmann

Michael J. Sallmann
Vice President - Finance
(Chief Accounting Officer and
Duly Authorized Officer)

11

CERTIFICATIONS

I, Emil H. Soika, President and Chief Executive Officer of Criticare Systems, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Criticare Systems, Inc.

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report.

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

(a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

(b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

(c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date.

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

Edgar Filing: CRITICARE SYSTEMS INC /DE/ - Form 10-Q

(a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls.

6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ Emil H. Soika

Emil H. Soika
President and Chief Executive Officer

12

CERTIFICATIONS

I, Michael J. Sallmann, Vice President - Finance and Secretary of Criticare Systems, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Criticare Systems, Inc.

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report.

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

(a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

(b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

(c) presented in this quarterly report our conclusions about the

Edgar Filing: CRITICARE SYSTEMS INC /DE/ - Form 10-Q

effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date.

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

(a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls.

6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ Michael J. Sallmann

Michael J. Sallmann
Vice President - Finance and Secretary