

CRITICARE SYSTEMS INC /DE/  
Form 10-Q  
May 10, 2007

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 March 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  
(IRS 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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. Large accelerated filer \_\_\_\_\_ Accelerated filer \_\_\_\_\_ Non-accelerated filer X

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 March 31, 2007: Voting  
Common Stock, 12,301,071 shares.

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CRITICARE SYSTEMS, INC.  
CONSOLIDATED BALANCE SHEETS  
MARCH 31, 2007 AND JUNE 30, 2006

(UNAUDITED)

	March 31, 2007	June 30, 2006
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 4,038,871	\$ 3,793,781
Accounts receivable, less allowance for doubtful accounts of \$586,388 and \$829,700, respectively	5,642,413	6,187,351
Other receivables	349,740	591,008
Short-term note receivable	50,000	50,000
Inventories	8,326,103	9,464,037
Prepaid expenses	199,524	227,606
<b>Total current assets</b>	<b>18,606,651</b>	<b>20,313,783</b>
Property, plant and equipment - net	2,287,258	2,452,314
License rights and patents - net	57,730	62,981
Long-term note receivable	87,500	150,000
Total other assets	145,230	212,981
<b>TOTAL ASSETS</b>	<b>\$ 21,039,139</b>	<b>\$ 22,979,078</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 3,002,653	\$ 5,408,746
<b>Accrued liabilities:</b>		
Compensation and commissions	740,128	914,889
Product warranties	370,000	425,000
Obligations under capital lease	72,616	68,205
Other	130,133	174,667
<b>Total current liabilities</b>	<b>4,315,530</b>	<b>6,991,507</b>
<b>LONG-TERM LIABILITIES:</b>		
Obligations under capital lease	78,799	133,826
Other long-term obligations	—	659
<b>Total long-term liabilities</b>	<b>78,799</b>	<b>134,485</b>
<b>TOTAL LIABILITIES</b>	<b>4,394,329</b>	<b>7,125,992</b>
<b>STOCKHOLDERS' EQUITY:</b>		
Preferred stock - \$.04 par value, 500,000 shares authorized no shares issued or outstanding	—	—
Common stock - \$.04 par value, 15,000,000 shares authorized, 12,399,631 and	495,985	495,925

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12,398,131 shares issued, and 12,301,071 and 12,291,454 shares outstanding, respectively		
Additional paid-in capital	26,261,311	26,156,864
Common stock held in treasury at cost (98,560 and 106,677 shares, respectively)	(360,693)	(375,813)
Retained earnings (accumulated deficit)	(9,723,059)	(10,436,794)
Other comprehensive income (loss)	(28,734)	12,904
Total stockholders' equity	16,644,810	15,853,086
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 21,039,139</b>	<b>\$ 22,979,078</b>

See notes to consolidated financial statements.

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CRITICARE SYSTEMS, INC.  
CONSOLIDATED STATEMENTS OF INCOME  
NINE MONTHS ENDED MARCH 31, 2007 AND 2006

(UNAUDITED)

	2007	2006
NET SALES	\$ 23,790,883	\$ 24,254,956
COST OF GOODS SOLD	14,376,860	14,653,789
GROSS PROFIT	9,414,023	9,601,167
OPERATING EXPENSES:		
Sales and marketing	4,284,603	5,005,091
Research, development and engineering	1,813,672	1,913,355
Administrative	2,699,106	2,450,762
Total	8,797,381	9,369,208
INCOME FROM OPERATIONS	616,642	231,959
OTHER INCOME (EXPENSE):		
Interest expense	(11,303)	(15,360)
Interest income	94,983	66,999
Other (expense) income	13,414	452,740
Total	97,094	504,379
INCOME BEFORE INCOME TAXES	713,736	736,338
INCOME TAX PROVISION	—	—



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**Compensation of Named Executive Officers**

The following table sets forth for the year ended December 31, 2006 the compensation reportable for the named executive officers, as determined by SEC rules.

**Summary Compensation Table**

Name and Principal Position	Year	Salary	Bonus	Stock Awards(1)	Option Awards(1)	All Other Compensation	Total
<b>Jeffrey P. Bezos</b> Chief Executive Officer	2006	\$ 81,840	\$	\$	\$	\$ 1,200,000(2)	\$ 1,281,840
<b>Thomas J. Szkutak</b> SVP and Chief Financial Officer	2006	150,000	450,000(3)	1,255,700		2,993(4)	1,858,693
<b>Richard L. Dalzell</b> SVP and Chief Information Officer	2006	211,502		1,615,718	1,642,614		3,469,834
<b>Diego Piacentini</b> SVP, International Retail	2006	175,000		1,512,893	404,748	55,905(5)	2,148,546
<b>Jeffrey A. Wilke</b> SVP, North America Retail	2006	155,000		1,818,005	404,748	3,162(4)	2,380,915

(1) Represents the dollar amount recognized for financial statement reporting purposes with respect to fiscal year 2006 in accordance with FAS 123(R). Estimates of forfeitures related to service-based vesting conditions have been disregarded. The fair value of each award is recognized as an expense over the service period using the accelerated method under FAS 123(R). Assumptions made in the valuation of stock and option awards are discussed, respectively, in Note 1, *Stock-Based Compensation*, in Item 8, Financial Statements and Supplementary Data, in the Company's 2006 and 2005 Annual Reports on Form 10-K.

(2) Represents the approximate incremental cost of security arrangements for Mr. Bezos in addition to security arrangements provided at business facilities and for business travel. The Company believes that all Company-incurred security costs are reasonable and necessary

and for the Company's benefit.

- (3) Represents a signing bonus. See Employment Arrangements.
- (4) Represents the value of shares of common stock contributed by the Company under the Company's 401(k) plan.
- (5) Represents expatriation benefits, including a cost of living and housing allowance in the amount of \$40,829 and tax reimbursement in connection with such benefits in the amount of \$15,076. See Employment Arrangements.

**Employment Arrangements**

*Diego Piacentini.* Mr. Piacentini's 2000 employment offer letter provided for an initial annual salary of \$175,000. Mr. Piacentini's employment is for no specified length of time. As additional consideration for entering into a confidentiality, noncompetition and invention assignment agreement with the Company, the Company paid Mr. Piacentini \$400,000 in February 2000, in accordance with his employment offer letter. Mr. Piacentini's employment offer letter also provides for certain repatriation benefits, including a cost of living and housing allowance.

*Thomas J. Szkutak.* Mr. Szkutak's 2002 employment offer letter provided for an initial annual salary of \$150,000. Mr. Szkutak's employment is for no specified length of time. Mr. Szkutak received a signing bonus in the amount of \$2,400,000, payable in equal monthly installments of \$50,000 commencing October 2002 through September 2006. The Company also granted Mr. Szkutak a restricted stock unit award as described in the Outstanding Equity Awards at 2006 Fiscal Year End table.



The following table supplements the disclosure in the Summary Compensation Table with respect to stock awards made to the named executive officers in 2006.

**Grants of Plan-Based Awards in Fiscal Year 2006**

Name	Grant Date	All Other Stock Awards: Number of Shares of Stock or Units (#)(1)	Grant Date Fair Value of Stock Awards(2)
<b>Jeffrey P. Bezos</b>			
<b>Thomas J. Szkutak</b>			
Restricted Stock Unit Award	4/5/06	74,898(3)	\$ 2,756,995
<b>Richard L. Dalzell</b>			
Restricted Stock Unit Award	4/5/06	173,979(4)	6,404,167
<b>Diego Piacentini</b>			
Restricted Stock Unit Award	4/5/06	175,930(5)	6,475,983
<b>Jeffrey A. Wilke</b>			
Restricted Stock Unit Award	4/5/06	215,048(6)	7,915,917

- (1) Represents shares subject to restricted stock unit awards that vest as set forth in the footnotes below. The Company has the ability to impose additional vesting conditions designed to qualify these awards as tax-deductible compensation under Section 162(m)(4)(c) of the Code.
- (2) Represents the aggregate grant date fair value of restricted stock unit awards received in fiscal year 2006, computed in accordance with FAS 123(R). Fair value is determined based on the number of shares granted multiplied by the average of the high and the low trading price of Amazon.com common stock on the grant date without regard to the fact that the grants vest over a number of years. The holder of the restricted stock unit award does not have any voting, dividend or other ownership rights in the shares of common stock subject to the award unless and until the award vests and the shares are issued.
- (3) Vests as to 18,725 shares on May 15, 2010, 18,724 shares on August 15, 2010, 18,725 shares on November 15, 2010 and 18,724 shares on February 15, 2011, assuming continued employment.
- (4) Vests as to 14,744 shares on May 15, 2008, 14,743 shares beginning August 15, 2008 and each quarter thereafter through February 15, 2009, 14,431 shares on May 15, 2009, 14,430 shares beginning August 15, 2009 and each quarter thereafter through February 15, 2010, 14,322 shares on May 15, 2010 and 14,321 shares beginning August 15, 2010 and each quarter thereafter through February 15, 2011, assuming continued employment.
- (5) Vests as to 13,345 shares beginning May 15, 2008 and each quarter thereafter through February 15, 2009, 15,871 shares on May 15, 2009, 15,870 shares beginning August 15, 2009 and each quarter thereafter through February 15, 2010, 14,768 shares on May 15, 2010 and 14,767 shares beginning August 15, 2010 and each quarter thereafter through

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February 15, 2011, assuming continued employment.

- (6) Vests as to 8,335 shares beginning May 15, 2008 and each quarter thereafter through November 15, 2008, 8,334 shares on February 15, 2009, 15,140 shares beginning May 15, 2009 and each quarter thereafter through November 15, 2009, 15,139 shares on February 15, 2010, 30,288 shares on May 15, 2010, 30,287 shares on August 15, 2010, 30,288 shares on November 15, 2010 and 30,287 shares on February 15, 2011, assuming continued employment.

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**Outstanding Equity Awards at Fiscal Year-End and Equity Awards Realized in 2006**

The following table sets forth information concerning the outstanding options and stock awards held at December 31, 2006 by the named executive officers.

**Outstanding Equity Awards at 2006 Fiscal Year End**

Name	Option Awards				Stock Awards	
	Number of Securities Underlying Unexercised Options(#)		Option Exercise Price(\$)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested(#)	Market Value of Shares or Units of Stock That Have Not Vested\$(1)
	Exercisable	Unexercisable				
<b>Jeffrey P. Bezos</b>						
<b>Thomas J. Szkutak</b>						
RSUs					289,183(2)	\$ 11,411,161
<b>Richard L. Dalzell</b>						
Stock Option(3)	400,000	100,000	\$ 71.28	3/26/09		
Stock Option(4)	7,500		30.88	7/27/10		
Stock Option(5)		249,998	8.55	4/4/11		
RSUs					198,706(6)	7,840,939
<b>Diego Piacentini</b>						
Stock Option(7)		281,260	7.93	9/6/11		
RSUs					200,657(8)	7,917,925
<b>Jeffrey A. Wilke</b>						
Stock Option(7)	149,394	281,260	7.93	9/6/11		
RSUs					259,146(9)	10,225,901

(1) Reflects the closing market price of Amazon.com common stock on December 29, 2006, \$39.46, multiplied by the number of restricted stock units that were not vested as of December 31, 2006.

(2) Reflects shares of Amazon.com common stock subject to: (a) a restricted stock unit award for 500,000 shares, the unvested portion of which vests as to 71,430 shares on each of October 1, 2007 and October 1, 2008 and 71,425 shares on October 1, 2009, assuming continued employment and (b) a restricted stock unit award for 74,898 shares vesting as disclosed in footnote 3 to the Grants of Plan-Based Awards in Fiscal Year 2006 table above.

(3) Nonqualified stock option for 500,000 shares, the unvested portion of which vests as to 100,000 shares on November 8, 2007, assuming continued employment.

- (4) Nonqualified stock option for 150,000 shares and fully vested.
  
- (5) Nonqualified stock option for 1,400,000 shares, the unvested portion of which vests as to 62,499 shares on February 8, 2007, 62,500 shares on May 11, 2007, 62,499 shares on August 8, 2007 and 62,500 shares on November 8, 2007, assuming continued employment. The difference between the aggregate closing price of Amazon.com common stock of \$39.46 on December 29, 2006 and the aggregate exercise price of the unvested portion of this option was \$7,727,438.
  
- (6) Reflects shares of Amazon.com common stock subject to: (a) a restricted stock unit award for 8,662 shares that vests as to 2,165 shares on August 15, 2008, 2,166 shares on November 15, 2008, 2,165 shares on February 15, 2009, and 2,166 shares on May 15, 2009, assuming continued employment, (b) a restricted stock unit award for 16,065 shares that vests as to 3,013 shares on August 15, 2008, 3,012 shares beginning November 15, 2008 and each quarter thereafter through May 15, 2009 and 1,004 shares beginning August 15, 2009 and each quarter thereafter through May 15, 2010, assuming continued employment; and

(c) a restricted stock unit award for 173,979 shares vesting as disclosed in footnote 4 to the Grants of Plan-Based Awards in Fiscal Year 2006 table above.

(7) Nonqualified stock option for 1,225,000 shares, the unvested portion of which vests as to 56,252 shares beginning February 14, 2007 and each quarter thereafter through February 14, 2008, assuming continued employment. The difference between the aggregate closing price of Amazon.com common stock of \$39.46 on December 29, 2006 and the aggregate exercise price of the unvested portion of this option was \$8,868,128.

(8) Reflects shares of Amazon.com common stock subject to: (a) a restricted stock unit award for 8,662 shares that vests as to 2,165 shares on May 15, 2008, 2,166 shares on August 15, 2008, 2,165 shares on November 15, 2008 and 2,166 shares on February 15, 2009, assuming continued employment; (b) a restricted stock unit award for 16,065 shares that vests as to 3,013 shares on May 15, 2008, 3,012 shares beginning August 15, 2008 and each quarter thereafter through February 15, 2009 and 1,004 shares beginning May 15, 2009 and each quarter thereafter through February 15, 2010, assuming continued employment; and (c) a restricted stock unit award for 175,930 shares vesting as disclosed in footnote 5 to the Grants of Plan-Based Awards in Fiscal Year 2006 table above.

(9) Reflects shares of Amazon.com common stock subject to: (a) a restricted stock unit award for 17,324 shares that vests as to 4,331 shares beginning May 15, 2008 and each quarter thereafter through February 15, 2009, assuming continued employment; (b) a restricted stock unit award for 26,774 shares that vests as to 5,020 shares on May 15, 2008 and August 15, 2008, 5,019 shares on November 15, 2008 and February 15, 2009 and 1,674 shares beginning May 15, 2009 and each quarter thereafter through February 15, 2010, assuming continued employment; and (c) a restricted stock unit award for 215,048 shares vesting as disclosed in footnote 6 to the Grants of Plan-Based Awards in Fiscal Year 2006 table above.

The following table sets forth information concerning option exercises and stock awards that vested during the last fiscal year by or for the named executive officers.

**Options Exercised and Stock Vested in 2006**

Name	Option Awards		Stock Awards	
	Number of Shares Acquired on Exercise(#)	Value Realized upon Exercise\$(1)	Number of Shares Acquired on Vesting(#)	Value Realized on Vesting\$(2)
Jeffrey P. Bezos		\$		\$
Thomas J. Szkutak			71,430	2,205,044
Richard L. Dalzell	312,502	10,300,066	20,000	701,400
Diego Piacentini	225,008	6,758,893	20,000	730,600
Jeffrey A. Wilke	193,744	5,988,429	20,000	730,600

(1) Amount is the difference between the market price (closing price) of Amazon.com common stock at the time of exercise and the exercise price of the options.

(2) Amount is the number of shares of stock or units vesting multiplied by the market price (closing price) of Amazon.com common stock on the vesting date.

**Potential Payments Upon Termination of Employment or Change-In-Control**

*Termination and Change-in-Control Agreements or Arrangements*

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The Company does not have arrangements with any of its named executive officers providing for additional benefits or payments in connection with a termination of employment, change in job responsibility or change-in-control. Upon termination of employment for any reason other than for cause, as defined in the 1997 Plan, a named executive officer may exercise vested stock options within three months of termination (unless the term of the vested stock option expires before that time), but all unvested restricted stock units and unvested

options expire on the date of termination. In the event of termination for cause, all vested stock options would automatically terminate as well, unless the plan administrator determines otherwise.

*Change-in-Control Provisions of 1997 Plan*

In the event of (i) the merger or consolidation of the Company in which it is not the surviving corporation pursuant to which shares of common stock are converted into cash, securities or other property (other than a merger in which holders of common stock immediately before the merger have the same proportionate ownership of the capital stock of the surviving corporation immediately after the merger), (ii) the sale, lease, exchange or other transfer of all or substantially all of the Company's assets (other than a transfer to a majority-owned subsidiary), or (iii) the approval by the holders of common stock of any plan or proposal for the Company's liquidation or dissolution (each a Corporate Transaction), the Leadership Development and Compensation Committee will determine whether provisions will be made in connection with the Corporate Transaction for the assumption of stock-based awards under the 1997 Plan or the substitution of appropriate new awards covering the stock of the successor corporation or an affiliate of the successor corporation. If the Leadership Development and Compensation Committee determines that no such assumption or substitution will be made, vesting of outstanding awards under the 1997 Plan will automatically accelerate so that such awards become 100% vested and exercisable immediately before the Corporate Transaction. On a hypothetical basis, assuming the Leadership Development and Compensation Committee had made such a determination in a Corporate Transaction that closed on December 31, 2006, the dollar value of the stock-based awards held by named executive officers that would have vested based on the closing price of Amazon.com common stock of \$39.46 on December 29, 2006 is set forth in the Outstanding Equity Awards at 2006 Fiscal Year End table and the footnotes thereto.

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**SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS**

The following table sets forth information concerning the Company's equity compensation plans as of December 31, 2006:

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted-average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans
Equity compensation plans approved by shareholders	18,963,309(1)	\$ 19.49(2)	100,417,694(3)
Equity compensation plans not approved by shareholders	2,990,461	13.86	18,750,084
<b>Total</b>	<b>21,953,770(4)</b>	<b>18.72</b>	<b>119,167,778</b>

- (1) Includes 14,559,027 shares issuable pursuant to restricted stock unit awards, which awards may be granted only under the Company's shareholder-approved 1997 Plan. There is no exercise price associated with a restricted stock unit award.
- (2) Calculation excludes shares subject to restricted stock unit awards.
- (3) For the fiscal years 2001 through 2010, the maximum number of shares issuable pursuant to the 1997 Plan is increased as of the first day of each fiscal year of the Company by an amount equal to (a) the lesser of (i) 4% of the outstanding common stock as of the end of the immediately preceding fiscal year, and (ii) 15 million shares, or (b) a lesser amount as determined by the Leadership Development and Compensation Committee.
- (4) Excludes 14,917 shares of common stock issuable upon exercise of stock options having a weighted average exercise price of \$2.40 that are outstanding under stock option plans assumed by the Company as a result of acquisitions.

*Equity Compensation Plans Not Approved By Security Holders.* The Board adopted the 1999 Nonofficer Employee Stock Option Plan (the "1999 Plan") to enable the grant of nonqualified stock options to employees, consultants, agents, advisors and independent contractors of the Company and its subsidiaries who are not officers or Directors of the Company. Restricted stock units, the Company's primary form of stock-based compensation since 2002, are not granted from the 1999 Plan. The 1999 Plan has not been approved by the Company's shareholders. The Leadership Development and Compensation Committee is the administrator of the 1999 Plan, and as such determines all matters relating to options granted under the 1999 Plan, including the selection of the recipients, the size of the grants and the conditions to vesting and exercisability. The Leadership Development and Compensation Committee has delegated authority to make grants under the 1999 Plan to another committee of the Board and to certain officers of the Company, subject to specified limitations on the size and terms of such grants. A maximum of 40 million shares of common stock were reserved for issuance under the 1999 Plan.



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### **CERTAIN RELATIONSHIPS AND RELATED PERSON TRANSACTIONS**

An employee of Amazon.com who shares the same household as Brian Valentine, an executive officer of the Company, earns an annual salary of approximately \$120,000 and was granted restricted stock unit awards in 2006 consistent with awards provided to other Company employees of the same level with similar responsibilities.

The Company owns 13.7% of the stock of drugstore.com and under the terms of a voting agreement has the right to designate a nominee for election to the drugstore.com board of directors. The Company has designated Geoff Entress to serve on the drugstore.com board. Mr. Entress is a principal of Madrona Venture Group, L.L.C. ( Madrona ), a venture capital firm in which Amazon.com director Tom Alberg is a managing director. While the Company and Madrona are not affiliates, in exchange for Mr. Entress' agreement to serve as the Company's designated nominee, the Company has agreed to indemnify Mr. Entress and Madrona from losses, claims, damages, liabilities or expenses incurred as a result of Mr. Entress' service as a director of drugstore.com, subject to certain limits and only to the extent not covered by any indemnification or insurance provided by or on behalf of drugstore.com.

Two brothers of Kal Raman, a former executive officer of the Company, are employees of the Company and earn annual salaries of approximately \$130,000 and \$111,000, respectively. They also have been awarded signing bonuses and restricted stock unit grants consistent with bonuses and grants provided to other Company employees of the same level with similar responsibilities.

The Audit Committee reviews and, as appropriate, approves and ratifies transactions that qualify for disclosure under Item 404(a) of Regulation S-K of the Securities Exchange Act of 1934.

### **SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE**

To the Company's knowledge, based solely on a review of the copies of such reports furnished to the Company and written representations that no other reports were required, the Company believes that during the year ended December 31, 2006, its officers, directors and greater-than-10% shareholders timely filed all reports required by Section 16(a).

### **EXPENSES OF SOLICITATION**

The accompanying proxy is solicited by and on behalf of the Board of Directors, and the cost of such solicitation will be borne by the Company. Georgeson Shareholder Communications, Inc. will distribute proxy materials to beneficial owners, may solicit proxies by personal interview, mail, telephone, and electronic communications, and will request brokerage houses and other custodians, nominees, and fiduciaries to forward soliciting material to the beneficial owners of the common stock held on the record date by such persons. The Company will pay Georgeson Shareholder Communications \$5,000 for its proxy solicitation services and will reimburse Georgeson Shareholder Communications for payments made to brokers and other nominees for their expenses in forwarding solicitation materials. Solicitations also may be made by personal interview, telephone, and electronic communications by directors, officers and other employees of the Company without additional compensation.

### **OTHER MATTERS**

As of the date of this Proxy Statement, there are no other matters that the Company intends to present, or has reason to believe others will present, at the Annual Meeting. If, however, other matters properly come before

the Annual Meeting, the accompanying proxy authorizes the persons named as proxies or their substitutes to vote on such matters as they determine appropriate.

#### **PROPOSALS OF SHAREHOLDERS**

Proposals of shareholders to be considered for inclusion in the Proxy Statement and proxy card for the 2008 Annual Meeting pursuant to Rule 14a-8 under the Securities Exchange Act of 1934 must be submitted in writing to the Secretary of the Company, Amazon.com, 1200 12<sup>th</sup> Avenue South, Suite 1200, Seattle, WA 98144-2734, and must be received by 11:59 p.m. Pacific time on Saturday, December 29, 2007. The submission of a shareholder proposal does not guarantee that it will be included in the Company's Proxy Statement.

In addition, the Company's Bylaws include advance notice provisions that require shareholders desiring to bring nominations for directors or other business before an annual shareholders meeting to do so in accordance with the terms of the advance notice provisions regardless of whether the shareholder seeks to include such matters in the Proxy Statement pursuant to Rule 14a-8. These advance notice provisions require that, among other things, shareholders give timely written notice to the Secretary of the Company regarding such nominations or other business and otherwise satisfy the requirements set forth in the Bylaws. To be timely, a shareholder who intends to present nominations or a proposal at the 2008 Annual Meeting of Shareholders other than pursuant to Rule 14a-8 must provide written notice of the nominations or other business they wish to propose to the Secretary no earlier than Sunday, March 16, 2008, and no later than Tuesday, April 15, 2008. However, in the event the 2008 Annual Meeting of Shareholders is to be held on a date that is more than 30 days before or more than 60 days after June 14, 2008, then such notice must be received not earlier than the 90th day prior to the date of the 2008 Annual Meeting of Shareholders, and not later than the later to occur of (i) the 60th day prior to the date of such annual meeting, or (ii) the tenth day following the day on which notice of the date of such annual meeting was mailed or public disclosure was made. If a shareholder fails to meet these deadlines and fails to satisfy the requirements of Rule 14a-4 under the Securities Exchange Act of 1934, the Company may exercise discretionary voting authority under proxies it solicits to vote on any such proposal as it determines appropriate.

The Company reserves the right to reject, rule out of order or take other appropriate action with respect to any proposal that does not comply with these and other applicable requirements.

#### **HOUSEHOLDING; AVAILABILITY OF ANNUAL REPORT ON FORM 10-K AND PROXY STATEMENT**

A copy of the Company's combined Annual Report to Shareholders and Annual Report on Form 10-K for the year ended December 31, 2006 (the 2006 Annual Report), accompanies this Proxy Statement. If you and others who share your mailing address own common stock in street name, meaning through a bank or brokerage firm or other nominee, you may have received a notice that your household will receive only one annual report and proxy statement from each company whose stock is held in such accounts. This practice, known as householding, is designed to reduce the volume of duplicate information and reduce printing and postage costs. Unless you responded that you did not want to participate in householding, you were deemed to have consented to it, and a single copy of this Proxy Statement and the 2006 Annual Report have been sent to your address. Each shareholder will continue to receive a separate voting instruction form.

If you would like to revoke your consent to householding and in the future receive your own set of proxy materials or if your household is currently receiving multiple copies of the proxy materials and you would like in the future to receive only a single set of proxy materials at your address, please contact Household Department by mail at 51 Mercedes Way, Edgewood, NY 11717, or by calling 1-800-542-1061, and indicate your name, the name of each of your brokerage firms or banks where your shares are held, and your account



numbers. The revocation of a consent to householding will be effective 30 days following its receipt. You will also have an opportunity to opt in or opt out of householding by following the instructions on your voting instruction form or by contacting your bank or broker.

**If you would like an additional copy of the 2006 Annual Report or this Proxy Statement, these documents are available in digital form for download or review by visiting Financial Documents at [www.amazon.com/ir](http://www.amazon.com/ir). Alternatively, we will promptly send a copy to you upon request by mail to Investor Relations, Amazon.com, Inc., P.O. Box 81226, Seattle, WA 98108-1226, or by calling 1-800-426-6825.**

If you own shares in street name, you can also register to receive all future shareholder communications electronically, instead of in print. This means that the annual report, proxy statement, and other correspondence will be delivered to you via e-mail. Holders in street name can register for electronic delivery at <http://www.icsdelivery.com/amzn>. Electronic delivery of shareholder communications helps save your company money by reducing printing and postage costs.

**SUMMARY OF THE 1997 STOCK INCENTIVE PLAN**

**Description of the 1997 Plan**

The 1997 Plan provides a means whereby employees, directors, officers, consultants, agents, advisors and independent contractors of the Company may be granted stock awards, ISOs or nonqualified stock options ( NSOs ) to acquire shares of Common Stock. Subject to adjustment required in the event of any recapitalization of the Company, the numbers of shares available for issuance under the 1997 Plan as amended will be as described above.

The Leadership Development and Compensation Committee of the Company's Board of Directors is the plan administrator for the 1997 Plan. The plan administrator is authorized to make awards of Common Stock on such terms and conditions and subject to such restrictions, if any (whether based on performance standards, periods of service or otherwise) as the plan administrator may determine. Restrictions may include repurchase or forfeiture rights in favor of the Company.

The number of shares available for issuance is subject to an annual increase, beginning on the first day of the Company's fiscal year, equal to (i) the lesser of (a) 4% of the outstanding common shares as of the end of the immediately preceding fiscal year and (b) 15,000,000 shares or (ii) a lesser amount determined by the plan administrator; provided that any shares from any such increases in previous years that are not actually issued will be added to the aggregate number of shares available for issuance under the 1997 Plan. The number of shares available for grant under the 1997 Plan is also increased by any shares that are subject to outstanding grants under the Company's 1994 Stock Option Plan and that again become available for grant under the Prior Plan in accordance with its terms. Shares subject to awards granted under the 1997 Plan that have lapsed or terminated may again become subject to awards granted under the plan. As of March 31, 2007, 115,020,765 shares remained available for grant under the 1997 Plan. As of that date, approximately 18,296,023 shares were subject to outstanding grants under the 1997 Plan, of which 3,823,660 represent outstanding options and 14,472,363 represent outstanding restricted stock units and stock awards. Information regarding the number of awards held by each of our directors and named executive officers that were granted under the 1997 Plan is set forth on page 6 and 17 of this proxy statement, and all directors and executives as a group hold options covering 1,799,169 shares and restricted stock units and stock awards covering 2,974,471 shares. On March 30, 2007, the average of the high and low sale prices of the Common Stock was \$39.83 per share, as reported by the Nasdaq National Market.

Not more than 4,500,000 shares of common stock may be made subject to awards under the 1997 Plan to any individual in the aggregate in any one fiscal year of the Company, except that the Company may make additional one-time grants of up to 18 million shares to newly hired or newly promoted individuals. The maximum number of shares that may be issued pursuant to options that are intended to qualify as incentive stock options ( ISOs ) will be 251,025,075 shares. The share limitations described in this and the preceding paragraph will be proportionately adjusted by the plan administrator in the event that a stock dividend, stock split, spin-off, combination or exchange of shares, recapitalization, merger, consolidation, distribution to shareholders other than a normal cash dividend, or other change in the Company's corporate or capital structure results in the Company's outstanding shares (or any securities exchanged therefore or received in their place) being exchanged for a different number or class of securities of the Company or of any other corporation or new, different or additional securities of the Company or of any other corporation being received by the holders of shares of Common Stock of the Company.

Subject to the terms of the 1997 Plan, the plan administrator is authorized to make awards of restricted stock units, restricted stock and other awards of Common Stock or denominated in units of Common Stock, in each case on such terms and conditions and subject to such restrictions, if any as the plan administrator shall determine. The terms of such awards may be

based on continuous service with the Company or the achievement

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of performance goals specified by the plan administrator. The plan administrator may in its discretion waive the forfeiture period and any other terms, conditions or restrictions on any such award, except that the plan administrator may not adjust performance goals for any such award intended to be exempt under Section 162(m) of the Code in such a manner as would increase the amount otherwise payable to a participant.

Subject to the terms of the 1997 Plan, the plan administrator determines the terms and conditions of stock options granted under the plan, including the exercise price of options granted under the plan. The 1997 Plan provides that the plan administrator must establish an exercise price for ISOs that is not less than the fair market value per share at the date of grant. Each ISO must expire within ten years of the date of grant. However, if ISOs are granted to persons owning more than 10% of the voting stock of the Company, the 1997 Plan and the tax laws pertaining to ISOs provide that the exercise price may not be less than 110% of the fair market value per share at the date of grant.

The option exercise price may be paid in cash or by check, by tendering shares of Common Stock that the optionee has owned for at least six months, by a broker-assisted cashless exercise, by any combination of the foregoing, or with such other consideration as the plan administrator may permit. Unless otherwise established by the plan administrator, the term of each option is ten years from the date of grant, except that if ISOs are granted to persons owning more than 10% of the Company's voting stock, the term may not exceed five years. Unless otherwise provided by the plan administrator, options granted under the 1997 Plan vest over five years, at a rate of 20% per year for two years, then an additional 5% for each three months of employment completed thereafter.

No stock award or option may be transferred by the optionee other than by will or the laws of descent or distribution, except for certain transfers that may be permitted by the plan administrator. Unless otherwise established by the plan administrator, an optionee whose relationship with the Company or any related corporation ceases for any reason (other than termination for cause, retirement, death or disability, as such terms are defined in the 1997 Plan) may exercise options, to the extent vested on the date of termination, in the three-month period following such cessation (unless such options terminate or expire sooner by their terms). In the event the optionee is terminated for cause, the options terminate upon the first notification to the optionee of such termination. In the event the optionee retires, dies or becomes permanently and totally disabled, options vested as of the date of retirement, death or disability may be exercised prior to the earlier of the option's specified expiration date and one year from the date of the optionee's retirement, death or disability.

In the event of a Corporate Transaction (as defined in the 1997 Plan), the plan administrator will determine whether provisions will be made in connection with the Corporate Transaction for the assumption of the options under the 1997 Plan or substitution of appropriate new options covering the stock of the successor corporation or an affiliate of the successor corporation. If the plan administrator determines that no such assumption or substitution will be made, each outstanding option under the 1997 Plan will automatically accelerate so that it will become 100% vested and exercisable immediately before the Corporate Transaction.

The 1997 Plan does not have a fixed expiration date. No ISOs may be granted under the 1997 Plan, however, more than ten years after the later of (i) the plan's adoption by the Board and (ii) the adoption by the Board of any amendment to the plan that constitutes the adoption of a new plan for purposes of Section 422 of the Code.

#### **Federal Income Tax Consequences**

The material U.S. federal income tax consequences to the Company and to any person granted a stock award or an option under the 1997 Plan who is subject to taxation in the United States under existing applicable provisions of the Code and underlying Treasury Regulations are substantially as follows. The following summary does not address state, local or foreign tax consequences and it is based on present law and regulations as in effect as of the date hereof.

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**NSOs.** No income will be recognized by an optionee upon the grant of an NSO. Upon the exercise of an NSO, the optionee will recognize taxable ordinary income in an amount equal to the excess of the fair market value at the time of exercise of the shares acquired over the exercise price. Upon a later sale of those shares, the optionee will have capital gain or loss equal to the difference between the amount realized on such sale and the tax basis of the shares sold. Furthermore, this capital gain or loss will be long-term capital gain or loss if the shares are held for more than one year before they are sold. If payment of the option price is made entirely in cash, the tax basis of the shares will be equal to their fair market value on the exercise date (but not less than the exercise price), and the shares' holding period will begin on the day after the exercise date.

If the optionee uses already-owned shares to pay the exercise price of an NSO in whole or in part, the transaction will not be considered to be a taxable disposition of the already-owned shares. The optionee's tax basis and holding period of the already-owned shares will be carried over to the equivalent number of shares received upon exercise. The tax basis of the additional shares received upon exercise will be the fair market value of the shares on the exercise date (but not less than the amount of cash, if any, used in payment), and the holding period for such additional shares will begin on the day after the exercise date.

**ISOs.** No income will be recognized by an optionee upon the grant of an ISO. The rules for the tax treatment of an NSO also apply to an ISO that is exercised more than three months after the optionee's termination of employment (or more than 12 months thereafter in the case of permanent and total disability, as defined in the 1997 Plan).

Upon the exercise of an ISO during employment or within three months after the optionee's termination of employment (12 months in the case of permanent and total disability), for regular tax purposes the optionee will recognize no ordinary income at the time of exercise (although the optionee will have income for alternative minimum income tax purposes at that time equal to the excess of the fair market value of the shares over the exercise price). If the acquired shares are sold or exchanged after the later of (i) one year from the date of exercise of the option and (ii) two years from the date of grant of the option, the difference between the amount realized by the optionee on that sale or exchange and the option exercise price will be taxed to the optionee as long-term capital gain or loss. If the shares are disposed of in an arms length sale before such holding period requirements are satisfied, then the optionee will recognize taxable ordinary income in the year of disposition in an amount equal to the excess of the fair market value of the shares received on the exercise date over the exercise price (or, if less, the excess of the amount realized on the sale of the shares over the exercise price), and the optionee will have short-term or long-term capital gain or loss, as the case may be, in an amount equal to the difference between (i) the amount realized by the optionee upon the disposition of the shares and (ii) the exercise price paid by the optionee increased by the amount of ordinary income, if any, so recognized by the optionee.

**Company Deduction.** In all the foregoing cases, the Company will be entitled to a deduction at the same time and in the same amount as the participant recognizes ordinary income, subject to certain limitations. Among these limitations is Section 162(m) of the Code. As discussed above, certain performance-based compensation is not subject to the Section 162(m) limitation on deductibility. Stock options and restricted stock and performance share awards can qualify for this performance-based exception if they meet the requirements set forth in Section 162(m) and Treasury Regulations promulgated thereunder. The 1997 Plan has been drafted to allow, but not require, compliance with those performance-based criteria.

April 27, 2007

**Re: Amazon.com, Inc. 2007 Annual Meeting of Shareholders**

Dear 401(k) Plan Participant:

The Amazon.com 401(k) Plan allows each plan participant to direct the voting of the shares of common stock of Amazon.com, Inc. that are held in the participant's 401(k) plan account. By following the instructions for internet or telephone voting on the enclosed proxy card, or by marking, signing and mailing the proxy card in the envelope provided, you may instruct Vanguard Fiduciary Trust Company, the trustee of the Amazon.com 401(k) Plan, how to vote the shares of the Company credited to your 401(k) plan account on the matters presented at the Company's 2007 Annual Meeting. The Plan trustee will vote as you have directed. All shares for which a proxy card was not timely received will be voted by the trustee on each matter in the same proportion as shares actually voted by participants who timely delivered proxy cards. Your proxy card will be kept confidential and will not be disclosed to the Company.

Participant proxy cards will be tabulated by the Company's transfer agent, Mellon Investor Services. To be timely, your proxy card must be received by Mellon Investor Services no later than 11:59 PM Eastern Time on June 11, 2007.

The Proxy Statement for the 2007 Annual Meeting and the Company's 2006 Annual Report can be viewed online at [www.amazon.com/ir](http://www.amazon.com/ir).

**VOTING VIA THE INTERNET OR BY TELEPHONE IS FAST AND CONVENIENT,  
AND YOUR VOTE IS IMMEDIATELY CONFIRMED AND TABULATED. USING  
THE INTERNET OR TELEPHONE HELPS SAVE YOUR COMPANY MONEY BY  
REDUCING**

**POSTAGE AND PROXY TABULATION COSTS.**

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**AMAZON.COM, INC.**

Y

**Annual Meeting of Stockholders - June 14, 2007**

**THIS PROXY IS SOLICITED BY THE BOARD OF DIRECTORS OF THE  
COMPANY**

The undersigned shareholder of Amazon.com, Inc., a Delaware corporation (the Company), hereby appoints Jeffrey P. Bezos, Thomas J. Szkutak and L. Michelle Wilson, or any one of them, with full power of substitution in each, as proxies to cast all votes that the undersigned is entitled to cast at the Annual Meeting of Stockholders (the Annual Meeting) of the Company to be held at 9:00 a.m., Pacific Time, on June 14, 2007 at the Seattle Repertory Theatre, 155 Mercer Street, Seattle, WA 98109, or any adjournment or postponement thereof, with authority to vote upon the matters set forth on the reverse side of this Proxy Card and upon such other matters as may be properly presented.

**(Continued, and to be marked, dated and signed, on the other side)**

**Address Change/Comments (Mark the corresponding box on the reverse side)**

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**Δ FOLD AND DETACH HERE Δ**

***You can now access your AMAZON.COM, INC.  
account online.***

*Access your Amazon.com, Inc. shareholder account online via Investor ServiceDirect® (ISD).*

Mellon Investor Services LLC, Transfer Agent for Amazon.com, Inc., now makes it easy and convenient to get current information on your shareholder account.

View account status

View certificate history

View book-entry information

View payment history for  
dividends

Make address changes

Obtain a duplicate 1099 tax form

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**For Technical Assistance Call 1-877-978-7778 between 9am-7pm**

**Monday-Friday Eastern Time**

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*of Mellon Investor Services LLC*

**THIS PROXY, WHEN PROPERLY EXECUTED, WILL BE VOTED IN THE MANNER DIRECTED HEREIN BY THE UNDERSIGNED SHAREHOLDER AND IN ACCORDANCE WITH THE DISCRETION OF THE PROXIES AS TO ANY OTHER MATTERS THAT ARE PROPERLY PRESENTED. UNLESS DIRECTION IS GIVEN, THIS PROXY WILL BE VOTED AS THE BOARD OF DIRECTORS RECOMMENDS BELOW:**

Please ..  
 Mark Here for Address Change  
 or  
 Comments  
**SEE REVERSE SIDE**

**THIS PROXY IS SOLICITED BY THE BOARD OF DIRECTORS**

<b>The Board of Directors recommends a vote FOR Item 1</b>	FOR	WITHHELD	<b>The Board of Directors recommends a vote FOR Item 2</b>	FOR	AGAINST	ABSTAIN
	ALL	FOR ALL				

ITEM 1 -  
 ELECTION OF  
 DIRECTORS

.. ..

ITEM 2 -  
 RATIFICATION OF  
 THE  
 APPOINTMENT  
 OF ERNST &  
 YOUNG LLP AS  
 INDEPENDENT  
 AUDITORS

.. ..

Nominees:

<b>The Board of Directors recommends a vote FOR Item 3</b>	FOR	AGAINST	ABSTAIN
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01 Jeffrey P. Bezos

02 Tom A. Alberg

03 John Seely  
 Brown

04 L. John Doerr

05 William B.  
 Gordon

06 Myrtle S. Potter

07 Thomas O.  
 Ryder

08 Patricia Q.  
 Stonesifer

ITEM 3 -  
 RE-APPROVAL OF  
 THE MATERIAL  
 TERMS OF THE  
 PERFORMANCE  
 GOALS IN THE  
 1997 STOCK  
 INCENTIVE PLAN  
 PURSUANT TO  
 SECTION 162(M)  
 OF THE  
 INTERNAL  
 REVENUE CODE

.. ..

I PLAN TO ATTEND THE MEETING ..

**Withheld for the nominees you list below:  
 (Write that nominee s name in the space  
 provided below.)**

The undersigned hereby acknowledges receipt of the Company s Proxy Statement in connection with the Annual Meeting and hereby revokes any proxy or proxies previously given.

Signature

Signature

Date

**NOTE:** Please sign as name appears hereon. Joint owners should each sign. When signing as attorney, executor, administrator, trustee or guardian, please give full title as such.

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**WE ENCOURAGE YOU TO TAKE ADVANTAGE OF INTERNET  
OR TELEPHONE VOTING, BOTH ARE AVAILABLE**

**24 HOURS A DAY, 7 DAYS A WEEK.**

**Internet and telephone voting is available through 11:59 PM Eastern Time  
the day prior to annual meeting day.**

**Your Internet or telephone vote authorizes the named proxies to vote your shares in the  
same manner**

**as if you marked, signed and returned your proxy card.**

**Internet**

<http://www.proxyvoting.com/amzn>

**Telephone**

**1-866-540-5760**

**OR**

Use the internet to vote your proxy.  
Have your proxy card in hand when  
you access the web site.

Use any touch-tone  
telephone to vote your  
proxy. Have your  
proxy card in hand  
when you call.

**If you vote your proxy by Internet or by telephone,**

**you do NOT need to mail back your proxy card.**

**To vote by mail, mark, sign and date your proxy card and**

**return it in the enclosed postage-paid envelope.**

Choose **MLink<sup>SM</sup>** for fast, easy and secure 24/7 online access to your future proxy materials, Investment plan statements, tax documents and more. Simply log on to **Investor ServiceDirect<sup>®</sup>** at [www.melloninvestor.com/isd](http://www.melloninvestor.com/isd) where step-by-step instructions will prompt you through enrollment.

**You can view the Annual Report and Proxy**

**Statement on the internet at [www.amazon.com/ir](http://www.amazon.com/ir)**

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**P** **AMAZON.COM, INC.**

**R** **Annual Meeting of Stockholders - June 14, 2007**

**O** **THIS PROXY IS SOLICITED BY THE BOARD OF DIRECTORS OF THE  
COMPANY**

**X**

**Y**

The undersigned shareholder of Amazon.com, Inc., a Delaware corporation (the Company ), hereby appoints Jeffrey P. Bezos, Thomas J. Szkutak and L. Michelle Wilson, or any one of them, with full power of substitution in each, as proxies to cast all votes that the undersigned is entitled to cast at the Annual Meeting of Stockholders (the Annual Meeting ) of the Company to be held at 9:00 a.m., Pacific Time, on June 14, 2007 at the Seattle Repertory Theatre, 155 Mercer Street, Seattle, WA 98109, or any adjournment or postponement thereof, with authority to vote upon the matters set forth on the reverse side of this Proxy Card and upon such other matters as may be properly presented.

**(Continued, and to be marked, dated and signed, on the other side)**

**Address Change/Comments (Mark the corresponding box on the reverse side)**

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**THIS PROXY, WHEN PROPERLY EXECUTED, WILL BE VOTED IN THE MANNER DIRECTED HEREIN BY THE UNDERSIGNED SHAREHOLDER AND IN ACCORDANCE WITH THE DISCRETION OF THE PROXIES AS TO ANY OTHER MATTERS THAT ARE PROPERLY PRESENTED. UNLESS DIRECTION IS GIVEN, THIS PROXY WILL BE VOTED AS THE BOARD OF DIRECTORS RECOMMENDS BELOW:**

Please  
Mark Here  
for Address ..  
Change or  
Comments  
**SEE REVERSE SIDE**

**THIS PROXY IS SOLICITED BY THE BOARD OF DIRECTORS**

<b>The Board of Directors recommends</b>	FOR ALL	WITHHELD	<b>The Board of Directors recommends a vote FOR Item 2.</b>	FOR	AGAINST	ABSTAIN
		FOR ALL				

**a vote FOR Item 1.**

ITEM 1 - ELECTION OF DIRECTORS

.. ..

ITEM 2 - RATIFICATION OF THE APPOINTMENT OF ERNST & YOUNG LLP AS INDEPENDENT AUDITORS

.. .. ..

**The Board of Directors recommends a vote FOR Item 3.**

FOR AGAINST ABSTAIN

Nominees:

01 Jeffrey P. Bezos

ITEM 3 - RE-APPROVAL OF THE MATERIAL TERMS OF THE PERFORMANCE GOALS IN THE 1997 STOCK INCENTIVE PLAN PURSUANT TO SECTION 162(M) OF THE INTERNAL REVENUE CODE

.. .. ..

02 Tom A. Alberg

03 John Seely Brown

04 L. John Doerr

05 William B. Gordon

06 Myrtle S. Potter

07 Thomas O. Ryder

08 Patricia Q. Stonesifer

**Withheld for the nominees you list below: (Write that nominee's name in the space provided below.)**

I PLAN TO ATTEND THE MEETING ..

The undersigned hereby acknowledges receipt of the Company's Proxy Statement in connection with the Annual Meeting and hereby revokes any proxy or proxies previously given.

