CRITICARE SYSTEMS INC /DE/
Form 10-K
September 28, 2007

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

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS
PURSUANT TO SECTIONS 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

(Mark One)

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

For the fiscal year ended June 30, 2007

[ ] 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	39-1501563
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. 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

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Voting Common Stock, $.04 par value (together with associated Preferred Stock Purchase Rights)	American Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes [ ] No [X]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.
Yes [ ] No [X]

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

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

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 Exchange Act Rule 12b-2. (Check one)

Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [X]

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

Yes [ ] No [X]

The aggregate market value of the voting common stock held by nonaffiliates of the registrant as of December 29, 2006 (the last business day of the registrant’s most recently completed second fiscal quarter) was $35,549,668. Shares of voting common stock held as of December 29, 2006 by any person who was an executive officer or director of the Registrant as of December 29, 2006 has been excluded from this computation because such persons may be deemed to be affiliates. This determination of affiliate status is not a conclusive determination for other purposes.

On August 31, 2007, there were 12,318,219 shares of the registrant's $.04 par value voting common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Annual Meeting of the Stockholders of the Registrant to be held November 27, 2007 are incorporated by reference into Part III of this report.

As used in this report, the terms "we," "us," "our," "Criticare" and the "Company" mean Criticare Systems, Inc. and its subsidiaries, unless the context indicates another meaning, and the term "common stock" means our common stock, par value $0.04 per share.

Special Note Regarding Forward-Looking Statements

A number of the matters and subject areas discussed in this report that are not historical or current facts deal with potential future circumstances and developments. These include anticipated product introductions, expected future financial results, liquidity needs, financing ability, management's or the Company's expectations and beliefs and similar matters discussed in this report. These statements may be identified by the use of forward-looking words or phrases such as "anticipate," "believe," "could," "expect," "intend," "may," "hope," "plan," "potential," "should," "estimate," "predict," "continue," "future," "will," "would" or the negative of these terms or other words of similar meaning. Such forward-looking statements are inherently subject to known and unknown risks and uncertainties. Our actual results and future developments could differ materially from the results or developments expressed in, or implied by, these forward-looking statements. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, but are not limited to, those described under the caption "Risk Factors" in Item 1A of this report. We undertake no obligation to make any revisions to the forward-looking statements contained in this filing or to update them to reflect events or circumstances occurring after the date of this filing.

PART I

Item 1. BUSINESS.

Criticare designs, manufactures and markets vital signs and gas monitoring instruments and related noninvasive sensors used to monitor patients in many healthcare environments. Since a patient's oxygen, anesthetic gas and carbon dioxide levels can change dramatically within minutes, causing severe side effects or death, continuous monitoring of these parameters is increasing. The Company's monitoring equipment improves patient safety by delivering accurate, comprehensive and instantaneous patient information to the clinician. The Company's products also allow hospitals to contain costs primarily by substituting cost-effective reusable pulse oximetry sensors for disposable sensors, controlling the use of costly anesthetics and increasing personnel productivity.

To meet the needs of end-users in a wide variety of patient environments, the Company has developed a broad line of patient monitors which combine one or more of its patented or other proprietary technologies, for monitoring oxygen saturation, carbon dioxide and anesthetic agents, with standard monitoring technologies that provide electrocardiogram ("ECG"), invasive and noninvasive blood pressures, temperature, heart rate and respiration rate. The Company's VitalView telemetry system allows one nurse to monitor up to sixteen patients simultaneously from a convenient central location. This allows hospitals to move out of the intensive care unit those patients that require continuous monitoring, but do not need all of an intensive care unit's extensive and costly personnel and equipment resources. In fiscal 2006, the Company released a new, next generation portable vital signs monitor (VitalCare™ 506N3) and a new, next generation portable multi-parameter vital signs monitor (nGenuity 8100E).

Criticare is implementing several business initiatives as part of its strategy to develop and distribute products for highly technical, growth oriented niche markets. Management believes that in order to be successful, marketing, distribution and sales partnerships in these areas are required. That effort has resulted in the execution of a number of agreements with original equipment manufacturers ("OEMs"). To capitalize on these business initiatives, modules and stand-alone monitors were developed and marketed for specific OEM customers. The Company views OEM agreements as a complementary component to our strategy to develop products for highly technical niche markets, and the OEM business has been a significant driver of the Company’s growth.

The first of these initiatives involves monitoring products for anesthesia gases. In fiscal 2003, the Company introduced an anesthesia monitoring product line for sale both under the Criticare brand name and for sale to OEMs. Production shipments to our newest OEM partner, Fukuda Denshi, Inc. of Japan, began in August 2007. A second initiative is the development of a highly specialized monitoring system for medical imaging applications in an MRI environment. In 2003, Criticare entered into an agreement with an OEM, Medrad, Inc. ("Medrad"), to jointly develop and exclusively sell a highly specialized medical monitoring product to Medrad. In July 2004, Criticare shipped the initial prototypes of this monitoring product to Medrad and production shipments began in January 2005. Sales to Medrad have grown quickly and Medrad has become the Company's largest customer in fiscal 2007, fiscal 2006 and fiscal 2005. Following the acquisition, in July 2004, of Alaris Medical Systems, Inc. ("Alaris"), a long-time OEM customer, by Cardinal Health, Inc., the third initiative was implemented to develop an Acute Care distribution network in the U.S. to sell to markets previously served through Alaris. Following such acquisition, Cardinal Health exited the vital signs monitor business and signed a transition agreement with the Company, which enabled our new Acute Care distribution network the opportunity to sell to the former Alaris customer base. In conjunction with the transition agreement, in September 2005, we introduced a new portable vital signs monitor for the Acute Care market. Sales for the Acute Care market during fiscal 2007 and fiscal 2006 have approached the largest revenue year Criticare experienced under the Alaris OEM agreement and greatly exceeded our expectations.

According to the guidance set by Statement of Financial Accounting Standards No. 131, the Company operates in one business segment in the healthcare environment. The chief operating decision maker does not utilize segmented financial statements in making decisions about resource allocation because the business activities that generate revenue do not have expenses specifically associated with them. Therefore, no segment data is disclosed in the notes to the financial statements in Item 8. However, the Company's customer base is differentiated by region (see note 10 in the notes to the financial statements in Item 8 for an analysis of sales by geographic area).

The Company was incorporated under the laws of the State of Delaware in October 1984.

Products

Criticare markets a broad range of vital signs and gas monitoring products designed to address the needs of a variety of end-users in different patient environments. Criticare's monitors display information graphically and numerically. Many of the Company’s new products, as well as those in development, focus on anesthesia related monitoring, as management believes this is a high growth area with relatively few competitors. All Criticare monitors incorporate adjustable visual and audible alarms to provide reliable patient-specific warnings of critical conditions, and most of the Company's monitors record up to 60 hours of trend data. Criticare monitors are available with printer capability to provide permanent records of patient data.

VitalCare™ 506N3 Portable Vital Signs Monitors. The Portable Vital Signs Monitor provides maximum versatility and cost effectiveness in a small, compact, portable, full-featured vital signs monitor configured to meet specific clinical needs. The unit is available in multiple configurations, with a choice of Criticare or Nellcor oximetry, ComfortCuff™ noninvasive blood pressure and temperature (either FILAC FasTemp™ or Alaris TurboTemp). This unit is ideal for spot checking or continuously monitoring patients' vital signs.

nGenuity 8100E Multi Parameter Vital Signs Monitors. The full-featured Multi Parameter Vital Signs Monitor combines ECG, ComfortCuff™ noninvasive blood pressure, DOX™ digital oximetry, heart rate, temperature, respiration rate, and nurse call interface for a complete vital signs monitor for physician offices, clinics, transport and hospital applications. Optional features include arrhythmia and ST analysis and an integrated printer.

Poet™ Plus 8100 Vital Signs Monitors. The full-featured CSI 8100 Vital Signs Monitor provides maximum flexibility for hospital, transport and outpatient care settings. The unit's custom configurations include ECG, ComfortCuff™ noninvasive blood pressure, DOX™ digital oximetry, heart rate, temperature, respiration rate, and nurse call interface. Optional features include CO_2, CO_2/O_2 and invasive blood pressure monitoring and an integrated printer. The 8100 is well suited for busy departments that require basic vital signs monitoring to conscious sedation.

Poet™ IQ 8500 and Poet™ IQ2 8500Q Anesthetic Gas Monitors. The Poet™ IQ 8500 gas monitor is used in conjunction with the Poet™ Plus 8100 Vital Signs Monitor to provide a unique combination of leading edge vital signs technology and anesthesia gas monitoring in a compact, modular system. The Poet™ IQ2 8500Q Gas Monitor provides leading edge anesthesia gas monitoring in a compact stand alone monitor. The operating systems of both monitors consist of an integrated, solid state module based upon a proprietary infrared technology developed by Criticare. The operating systems automatically monitor up to five anesthetic agents plus nitrous oxide, oxygen, and carbon dioxide. The systems also utilize a unique, disposable water trap component that is proprietary to the Company. These products are marketed as configurable systems for applications by OEMs and as Criticare branded products. The systems' reliable performance, ease of use, flexible design, and affordable cost make them the ideal monitoring solutions for anesthesia applications in hospitals and surgical centers.

Model 503DX and 504DX Pulse Oximeters. Criticare's complete line of pulse oximeters meets the needs of virtually all clinical environments, including: adult, pediatric and neonatal intensive care units, operating rooms, emergency rooms, nursing homes, physicians' offices and ambulances. The line is designed to provide accuracy and convenience at a competitive cost to the end-user.

VitalView™ Central Monitoring Station. The VitalView central station makes it possible for one nurse or technician to monitor up to sixteen patients simultaneously. The VitalView can receive, display and store data from a wide variety of Criticare monitors and patient-borne multiple parameter telemetry devices for continuous, comprehensive vital signs monitoring. In addition, the VitalView can be used as a wireless device or hardwired and has ST and arrhythmia analysis capabilities.

Pulse Oximetry Sensors. Criticare has designed proprietary, noninvasive sensors that can be used on any patient, from a premature infant to a full-grown adult. Criticare's line of reusable pulse oximetry sensors offers users significant cost savings compared to disposables. Criticare's reusable sensors generally last longer than the one-year warranty period and are easily and inexpensively cleaned between uses. Criticare's reusable sensors include a finger sensor for routine applications and a multisite sensor for increased placement flexibility. The multisite sensor is fully immersible, allowing for sterilization between patients. The Company also sells a range of disposable sensors designed for single use in cases where the facility would prefer to use a patient charge disposable product.

WaterChek™/Chek-Mate Filter System. The Company's patented, disposable Water Chek system separates a patient's respiratory secretions from a breath sample before it enters the gas monitor for analysis. The Company's proprietary, disposable Chek-Mate filter enhances the removal of moisture from the sample, while preventing cross-contamination. This system allows the monitor to operate effectively regardless of humidity or patient condition. The self-sealing feature also protects the healthcare provider from potential contamination.

Marketing and Sales

Domestic Sales. At August 31, 2007, the Company's domestic sales force consisted of three employees and 54 independent dealers. The Company's sales force and independent dealers market the Company's vital signs monitors and pulse oximeters primarily to surgery centers, dental and physician offices, and nursing homes.

The Company sells some of its higher-end monitors (anesthetic agent monitors and VitalView central stations) to domestic hospitals. With the development of an Acute Care distribution network, the Company is working to achieve a significant presence in U.S. hospitals that generally purchase medical equipment through large group purchasing organizations (GPOs). These GPOs contract large medical equipment suppliers who can provide not only medical monitors, but also other medical equipment and service needs (such as CT scanners and MRI equipment). In addition, Cardinal Health and Criticare signed a transition agreement which enabled Criticare’s new Acute Care distribution network the opportunity to sell to the former Alaris customer base. Alaris, formerly the Company’s largest customer, was acquired by Cardinal Health in 2004, and Cardinal Health subsequently made the decision to exit from vital signs monitor sales activities, since those products no longer fit within its core business strategy.

Criticare is implementing several business initiatives as part of its strategy to develop products for highly technical, growth oriented niche markets. Management believes that in order to be successful, marketing and sales partnerships in these areas are required. That effort resulted in the execution of a number of OEM agreements.

To capitalize on these business initiatives, the Company began to focus on selling to OEMs with the hiring of a senior manager, in 1999, to lead this effort. Modules and stand-alone monitors were developed and marketed for specific OEM customers. The Company views OEM agreements as a critical component to our strategy to develop products for highly technical niche markets, and the OEM business has been a significant driver of the Company's growth with net sales of $7.3 million or 23.3% of total net sales in fiscal 2007, $6.8 million or 21.7% of total net sales in fiscal 2006 and $6.1 million or 22.9% of total net sales in fiscal 2005. In particular, sales of the Company's newly developed anesthesia products and a highly specialized monitoring system for medical imaging applications are expected to continue to be mainly for new OEM partners. In July 2004, Criticare shipped the initial prototypes of this monitoring product to Medrad. Medrad, the Company's OEM partner for medical imaging applications**,** was the Company's largest customer in fiscal 2007, 2006, and 2005, accounting for net sales of approximately $6.3 million in fiscal 2007, which represented 20.0% of the Company's total net sales in fiscal 2007.

International Sales. One of the Company's principal marketing strategies has been to target international markets, particularly Europe, Latin America and the Pacific Rim countries. During fiscal 2007, Criticare sold its products, principally to hospitals, in over 71 countries through over 93 independent dealers.

Most of the Company's international order processing, invoicing, collection and customer service functions are handled directly from the Company's headquarters in Waukesha, Wisconsin. Criticare believes demand for the Company's products in international markets is primarily driven by cost containment concerns, and increased interest in using quality patient monitoring products for improved patient outcomes.

In fiscal 2007, 34.0% of Criticare's net sales, or $10.7 million, was attributable to international sales, of which 53.4% was from sales in Europe and the Middle East, 11.6% was from sales to Pacific Rim countries and 35.0% was from sales to Canada and Central and South America. In fiscal 2006 and 2005, 40.1% and 43.5%, respectively, of Criticare's net sales were attributable to international sales. Other than inventory and accounts receivable for the Company's branch office in India totaling approximately $0.4 million, there are no material identifiable assets of the Company located in foreign markets. The Company primarily sells its products in United States dollars and is therefore not subject to currency risks other than currency fluctuations from its operation in India; however, an increase in the value of the United States dollar relative to foreign currencies could make the Company's products less price competitive in those markets. In addition, significant devaluation of certain foreign currencies could adversely affect the collectibility of accounts receivable from international customers. The Company analyzes this risk before making shipments to countries it views as unstable.

Service, Support and Warranty. Criticare believes that customer service is a key element of its marketing program. At August 31, 2007, the Company had a customer service and technical support staff of 19 people at its Waukesha, Wisconsin facility. Customer service support is available 24 hours a day, seven days a week, in which numerous customers' technical problems are resolved over the telephone. The customer service staff also provides periodic training and education of the direct sales force who in turn provide training to the dealers and end-users.

Criticare's monitors and sensors are generally warranted against defects for one year. If a problem develops with a Criticare product while under warranty, the Company typically provides a replacement unit until the product can be repaired at the Company's facility. The Company offers extended warranties and service contracts on all of its monitors.

Manufacturing

Historically, Criticare had manufactured and assembled its products internally, principally at the Company's facility in Waukesha, Wisconsin. Due mainly to pricing pressures on monitoring systems worldwide, in fiscal 2001 the Company entered into an agreement with two offshore contract manufacturing firms located in Taiwan and Ireland, respectively, that exclusively manufacture medical devices in a regulated environment. During fiscal 2005, the Company ended the supply agreement with the contract manufacturing firm in Ireland. The contract manufacturing firm in Taiwan also has manufacturing capabilities in China. A portion of Criticare's production has been transitioned to China to continue to receive favorable pricing. The Company works closely with this firm to maintain product quality and reliability. This firm performs the same rigorous quality control testing at its facilities that Criticare had done in the past at its own facility. With the majority of the Company's manufacturing outsourced as of the end of calendar 2001, Criticare concentrates on product enhancements and new product development, customer service, and increased involvement with its OEM customers. The Company manufactures and assembles all proprietary medical devices and "made in the USA" requirements at the Company's facility in Waukesha, Wisconsin. In addition, the Company continues limited production of new products internally during the development phase and for a short period after commercial introduction until production can be effectively transitioned to offshore manufacturers.

Any inability of the offshore manufacturer to deliver products on a timely basis could have a material adverse effect on the Company. However, the manufacturer has the ability to produce the Company's products in Taiwan and China. Therefore, the Company is not totally reliant on a single plant or single source to supply product. This factor, combined with the Company's ability to continue to manufacture at its headquarters in Waukesha, Wisconsin, reduces the Company's risk of supply interruption.

The Company has achieved certification under the International Organization for Standardization's (ISO) standard 13485:2003. The offshore contract manufacturing firm has achieved certification under ISO's standards 13485 and 2000. See "Regulation."

Research, Development and Engineering

Criticare has focused its research, development and engineering expenditures on products designed to meet identified market demands. The Company seeks to apply its expertise in gas monitoring, vital signs monitoring, and related sensor technology to develop new products and adapt existing products for new markets. At August 31, 2007, the Company had an in-house research, development and engineering staff of 18 people. The Company's research, development and engineering expenditures were $2.4 million in fiscal 2007, $2.4 million in fiscal 2006 and $2.6 million in fiscal 2005.

Research and development efforts for fiscal 2007 focused on the development and release our next generation full featured vital signs monitor, our design of a high quality, reasonably featured and low cost portable vital signs monitor, and an upgrade to the portable multi-parameter vital signs monitor to provide a option with CO2. Research and development efforts for fiscal 2006 focused on the development and release our next generation portable multi-parameter vital signs monitor (nGenuity 8100E), our next generation portable vital signs monitor (VitalCare™ 506N3), and an upgrade to the MRI monitor to provide additional technological enhancements. Research and development efforts for fiscal 2005 focused on the development and release of the Veris MRI compatible vital signs monitor.

Competition

The markets for the Company's products are highly competitive. Many of Criticare's competitors, including the principal ones described below, have greater financial resources, more established brand identities and reputations, longer histories in the medical equipment industry and larger direct and more experienced sales forces than Criticare. In these respects, such companies have a competitive advantage over Criticare. In addition, internationally there are many in-country manufacturers that supply duty and tariff-free low cost monitors that make it difficult for the Company to be price competitive in these countries.

The Company competes primarily on the basis of product features, the quality and value of its products (i.e., their relative price compared to performance features provided), and the effectiveness of its sales and marketing efforts. The Company believes that its principal competitive advantages are provided by its focus on cost containment, provided in part by its outsourcing a large portion of its manufacturing, its patented and other proprietary technology and software for noninvasive, continuous monitoring of oxygen, anesthetic gases, carbon dioxide and noninvasive blood pressure, the efficiency and speed of its research and development efforts, and its established international presence.

The Company believes that the worldwide anesthetic agent and carbon dioxide monitor markets are comparatively fragmented, with Datex/Ohmeda, a subsidiary of General Electric Company, Andros Incorporated, and Dräger Medical as the principal competitors. The market for vital signs monitors includes competitors such as General Electric Company, Dräger Medical, Datascope Corp., Philips Electronics, Welch Allyn Inc., Mindray Medical International Limited, CAS Medical Systems, Inc., Nihon Kohden Corporation and Spacelabs Medical, Inc., a subsidiary of OSI Systems, Inc. Internationally, the market for vital signs monitors includes the competitors mentioned above, as well as in-country manufacturers that supply low cost monitors that are not required to comply with the rigorous regulations of the U.S. Food and Drug Administration ("FDA").

Regulation

As a manufacturer of medical diagnostic equipment, the Company is regulated by the FDA and similar foreign governmental agencies. In producing its products, the Company must comply with a variety of regulations, including the good manufacturing practices regulations of the FDA. In addition, it is subject to periodic inspections by the FDA. If the FDA believes that its legal requirements have not been fulfilled, it has extensive enforcement powers, including the ability to ban or recall products from the market and to prohibit the operation of manufacturing facilities. The Company believes its products comply with applicable FDA regulations in all material respects. In addition, the Company received ISO 9002 certification on April 29, 1993, ISO 9001 certification on July 8, 1994 and ISO 13485:2003 certification on January 16, 2006.

Under the Federal Food, Drug and Cosmetic Act, all medical devices are classified as Class I, Class II or Class III, depending upon the level of regulatory control to which they will be subjected. Class III devices, which are the most highly controlled devices, are subject to premarket approval by the FDA prior to commercial distribution in the United States.

The Company's current products have not been subject to the FDA's comprehensive Class III premarket approval requirements, but are generally subject to premarket notification requirements. If a new device is substantially equivalent to a device that did not require premarket approval, premarket review is satisfied through a procedure known as a "510(k) submission," under which the applicant provides product information supporting its claim of substantial equivalence. The FDA may also require that it be provided with clinical trial results showing the device's safety and efficacy.

The Company believes that the products it is currently developing generally will be eligible for the 510(k) submission procedure and, therefore, will not be subject to lengthy premarket approval procedures. However, these products are still being developed and there can be no assurance that the FDA will determine that the products may be marketed without premarket approval.

Criticare seeks, where appropriate, to comply with the safety standards of Underwriters' Laboratories and the Canadian Standards Association and the standards of the European Union. To date, the Company has not experienced significant regulatory expense or delay in the foreign markets in which it sells its products. Industry and professional groups such as the American Society of Anesthesiologists, to the extent they have the power to mandate certain practices or procedures as part of their profession's standard of care, are also a source of indirect regulation of the Company's business.

Patents and Trademarks

The Company believes one of its principal competitive advantages is provided by its patented and other proprietary technology including its sensor technology, infrared specific anesthetic gas monitoring technology, UltraSync signal processing software and disposable respiratory secretion filter system. The Company has 20 issued U.S. patents and 1 U.S. patent pending. The Company's U.S. patents expire between 2007 and 2022. Criticare also has 14 issued foreign patents and 9 foreign patent applications pending. There is no assurance that any patents held or secured by the Company will provide any protection or commercial or competitive benefit to the Company. There is also no assurance that the Company's products will not infringe upon patents held by others. The Company is the owner of United States trademark registrations for "CRITICARE", "POET", "POET IQ", "MPT", "REMOTEVIEW", "MICROVIEW", "VITALVIEW", "SCHOLAR", and "WATERCHEK".

The Company also relies upon trade secret protection for certain of its proprietary technology. Although the Company requires all employees to sign confidentiality agreements, no assurance can be given that such agreements can be effectively enforced or that others will not independently develop substantially equivalent proprietary information and techniques or otherwise gain access to or disclose the Company's trade secrets.

Employees

At August 31, 2007 Criticare, had 95 employees in the U.S., including 18 in research, development and engineering, 19 in customer service and support, 27 in manufacturing and operations, 14 in administration, 9 in sales and marketing, and 8 in quality control. Criticare also utilizes four international country managers that work as independent contractors to support its international sales efforts. The Company also has an operation in India with 3 employees.

Many of the Company's technical employees are highly skilled. The Company believes that its continued success depends in part on its ability to continue to attract qualified management, marketing and technical personnel. None of the Company's employees are subject to a collective bargaining agreement. The Company believes that its relations with its employees are good.

Backlog

Criticare's backlog on June 30, 2007 and 2006 was $4,789,244 and $5,260,197, respectively. The backlog is driven by the extended delivery schedule from Medrad, which totaled $1,170,546 as of June 30, 2007 and $4,100,984 as of June 30, 2006. Criticare generally delivers its products out of inventory when specified by the customer. The Company does not believe that its backlog at any date is indicative of its future sales.

Item 1A. RISK FACTORS

An investment in our common stock is subject to risks inherent in our business, including the risks described below. The risks described below are not the only risks we face. Additional risks that we do not yet know of or that we currently think are immaterial may also impair our business operations. If any of the events or circumstances described in the following risks actually occur, our business, financial condition or results of operations could be materially adversely affected. In such cases, the trading price of our common stock could decline.

Risks Related to Our Business

Our net sales and profitability depend on our ability to conceive, design and market new products.

The introduction of new products is critical to our growth strategy. Our future success will depend in large part upon our ability to conceive, design, and market new products and upon market acceptance of our existing and future products. Any significant delays in the introduction of, or the failure to introduce, new products or additions to our existing product lines or the failure of our existing or future products to maintain or receive market acceptance could have a material adverse effect on our net sales and profitability.

Our future success will depend on our ability to compete effectively in our industry.

The medical equipment industry is highly competitive. Many of our competitors have greater financial and other resources, more established brand identities and reputations, greater development capabilities, more experience in testing products and obtaining regulatory approvals, and larger and more experienced sales forces than us. In these respects, such companies have a competitive advantage over us. In addition, internationally there are many in-country manufacturers that supply duty and tariff-free low cost monitors that make it difficult for us to be price competitive in these countries. The medical equipment market is also experiencing increasing customer concentration, due to the emergence of large purchasing groups, which can increase the barriers for a small company such as Criticare. If we cannot compete successfully in the future, our net sales and profitability will likely decline.

Our business may be adversely affected by the highly regulated environment in which we operate.

Our products are subject to regulation by the United States Food and Drug Administration and comparable foreign governmental authorities. These regulations can be burdensome and may:

substantially delay or prevent the introduction of new products;
materially increase the costs of any new product introductions;
interfere with or require cessation of product manufacturing and marketing; and
result in product recalls.

Additionally, adoption of new regulations or modifications to applicable regulations could harm our business. Some of the legislative and regulatory changes may benefit us and our competitors; other changes, however, could have a material adverse effect on our business, financial condition and results of operation and/or provide an advantage to certain of our competitors.

Since we sell product in foreign markets, we are subject to foreign currency and other international business risks that could adversely affect our operating results.

International sales account for a significant portion of our total net sales each fiscal year. We expect that international sales will continue to constitute a significant portion of our business. Although our net sales are primarily denominated in United States dollars and are not subject to significant currency risks, an increase in the value of the United States dollar relative to foreign currencies in our international markets could make our products less price competitive in such markets. Our international sales are subject to the risks inherent in doing business abroad, including:

complications in complying with the laws and policies of the United States and foreign governments affecting foreign trade, including duties, quotas, taxes and export controls;
unexpected changes in international regulatory requirements and tariffs;
difficulties in staffing and managing foreign operations;
political or economic changes, especially in developing nations; and
price controls and other restrictive actions by foreign governments.

Any of these risks might disrupt sales of our products, increase our expenses or decrease our revenues.

Our reliance on offshore contract manufacturing makes our business susceptible to numerous risks that could affect our profitability.

In response to pricing pressure, in fiscal 2001 we entered into agreements for offshore contract manufacturing. We completed the transition of the offshore production of substantially all of our established product lines at the end of calendar 2001. Currently, our offshore manufacturing is handled by a contract manufacturing firm in Taiwan that also has manufacturing capabilities in China. Any inability of the offshore manufacturer to deliver products on a timely basis could have a material adverse effect on us.

Our reliance on offshore contract manufacturing will subject us to numerous risks, including the following:

economic and political instability in the countries where the contract manufacturing firms are located;
restrictive actions by foreign governments;
the laws and policies of the United States affecting the importation of goods (including duties, quotas and taxes);
production delays and cost overruns;
quality control; and
foreign trade and tax laws.

We depend on a major customer for a significant portion of our sales.

In fiscal 2007, our largest customer accounted for net sales of approximately $6.3 million, which represented 20.0% of our total net sales. We also had a receivable balance with this customer of approximately $1.6 million as of June 30, 2007, which represented 27.7% of our total receivables as of that date. An adverse change in our relationship with or the financial viability of our largest customer could have a material adverse effect on our net sales and profitability.

As a manufacturer and marketer of medical equipment, we could experience product liability claims.

The nature of our products may expose us to significant product liability risks. Although, we maintain product liability insurance, we can make no assurance that we will be able to maintain this insurance on acceptable terms or that the insurance will provide adequate coverage against product liability claims. A successful product liability claim against us in excess of our insurance coverage could be extremely damaging to us. Even if a product liability claim is without merit, the claim could harm our reputation and divert management's attention and resources from our business.

Our success depends on our ability to protect our intellectual property.

We rely on our patented and other proprietary technology including:

our sensor technology;
infrared specific anesthetic gas monitoring technology;
UltraSync signal processing software; and
disposable respiratory secretion filter system.

The actions taken by us to protect our proprietary rights may not be adequate to prevent imitation of our products, processes or technology. We can not assure you that:

our proprietary information will not become known to competitors;
others will not independently develop substantially equivalent or better products that do not infringe on our intellectual property rights; or
others will not challenge or assert rights in, and ownership of, our patents and other proprietary rights.

Health care cost containment programs could adversely affect our domestic sales.

The cost of a significant portion of medical care in the United States is funded by government or other insurance programs. Additional limits imposed by such programs on health care cost reimbursements may further impair the ability of hospitals and other health care providers to purchase equipment such as our products and could reduce our domestic sales.

Our controls and procedures may be ineffective.

Our management regularly reviews and updates our internal control over financial reporting, disclosure controls and procedures, and corporate governance policies and procedures. We are in the process of documenting and testing our internal control procedures in order to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act, which will require annual management assessments of the effectiveness of our internal control over financial reporting beginning with our annual report for fiscal 2008 and annual attestation reports by our independent auditors addressing the effectiveness of our internal control over financial reporting beginning with our annual report for fiscal 2009. We expect our efforts to achieve initial compliance with these provisions will require a significant commitment of management resources and will result in significant additional expenses over the next two fiscal years. We may not be able to achieve and maintain effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act by the required deadlines. Further, any system of controls, no matter how well designed and operated, is based partly on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of our controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on our business, results of operations, and financial condition.

Risks Related to an Investment in our Common Stock

The trading price of our common stock has been volatile and investors in our common stock may experience substantial losses.

The market price of our common stock has experienced significant volatility from time to time. There may be volatility in the market price of our common stock due to factors that may or may not relate to our performance. The trading price of our common stock could decline or fluctuate in response to a variety of such factors, including:

the timing of announcements by us or our competitors concerning significant acquisitions, financial performance or the introduction of new innovative products or services;
fluctuation in our quarterly operating results;
fluctuations in demand for our products;
fluctuations in interest rates;
substantial sales of our common stock; or
general stock market or other economic conditions.

You may be unable to sell your stock at or above your purchase price.

Various restrictions in our certificate of incorporation and by-laws, our rights plan and Delaware law could prevent or delay a change in control of us which is not supported by our Board of Directors.

Provisions of our certificate of incorporation and by-laws may make it more difficult for a third party to gain control or acquire us without the consent of our board of directors, even if such a transaction may be perceived as beneficial to our stockholders. These provisions include a Board of Directors divided into three classes of directors serving staggered terms of three years each.

Each currently outstanding share of our common stock includes, and each newly issued share of our common stock will include, one preferred share purchase right. The rights are attached to and trade with the shares of common stock and generally are not exercisable. The rights will become exercisable the tenth business day after a person or group acquires 20% or more of our common stock or makes an offer to acquire 30% or more of our common stock. When exercisable, each right entitles the holder to purchase for $25, subject to adjustment, 1/100th of a share of preferred stock for each share of common stock owned. The rights have anti-takeover effects and generally will cause substantial dilution to a person or group that attempts to acquire control of us without conditioning the offer on either redemption of the rights or amendment of the rights to prevent this dilution. The rights could have the effect of delaying or preventing a change of control. The rights are scheduled to expire on March 27, 2017.

We are also subject to Section 203 of the Delaware General Corporation Law which prohibits a merger, consolidation, asset sale or other similar business combination between Criticare and any stockholder of 15% or more of our common stock for a period of three years after the stockholder acquires 15% or more of our common stock, unless (1) the transaction is approved by our board of directors before the stockholder acquires 15% or more of our common stock, (2) upon completing the transaction the stockholder owns at least 85% of our common stock outstanding at the commencement of the transaction, or (3) the transaction is approved by our board of directors and the holders of 66 2/3% of our common stock excluding shares of our common stock owned by the stockholder.

Item 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

Item 2. PROPERTIES.

In August 2002, the Company leased approximately 37,000 square feet of a building in Waukesha, Wisconsin to serve as the Company’s headquarters, warehouse, manufacturing, research and development and service facility. The lease originally was to expire on August 30, 2007, but the Company exercised its option to extend the lease for an additional three years so that the lease now expires on August 31, 2010. The Company currently leases approximately 32,000 square feet, with rent currently totaling $23,545 per month. The Company has also leased approximately 8,800 square feet of a building near the Company's headquarters to serve as an additional warehouse facility. This lease expires on August 31, 2010, with rent totaling $4,925 per month for the term of the lease.

Item 3. LEGAL PROCEEDINGS.

In the normal course of business Criticare may be involved in various legal proceedings from time to time. Criticare does not believe it is currently involved in any claim or action the ultimate disposition of which would have a material adverse effect on the Company.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year ended June 30, 2007.

PART II

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

The Company's common stock trades on the American Stock Exchange under the symbol “CMD”. As of June 30, 2007, there were approximately 183 holders of record of the common stock. The Company has never paid dividends on its common stock and has no plans to pay cash dividends in the foreseeable future. The following table shows the high and low closing prices of the Company's common stock as reported by the American Stock Exchange for the periods indicated.

	Years Ended June 30,			
	2007		2006	
Quarter Ended:	High	Low	High	Low
September 30	$ 4.25	$ 2.79	$ 5.34	$ 4.14
December 31	$ 4.25	$ 2.94	$ 5.15	$ 4.62
March 31	$ 3.83	$ 3.11	$ 5.30	$ 4.55
June 30	$ 3.81	$ 3.20	$ 5.09	$ 3.58

ItemSELECTED FINANCIAL DATA. 6.

The following table sets forth selected financial data with respect to the Company for each of the periods indicated, which should be read along with our consolidated financial statements and the notes to those statements and with “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

	Years Ended June 30,				
	2007	2006	2005	2004	2003
Net sales	$ 31,431,810	$ 31,350,919	$ 26,781,627	$ 28,591,481	$ 28,562,943
Net income (loss)	348,027	212,118	(422,245)	(2,100,573)	(938,596)
Net income (loss) per common share--					
basic and diluted	$ 0.03	$ 0.02	$ (0.04)	$ (0.19)	$ (0.08)
Average shares outstanding--					
basic	12,299,411	12,069,060	11,514,786	11,240,685	11,071,735
diluted	12,332,296	12,256,431	11,514,786	11,240,685	11,071,735
Stockholders' equity	$ 16,310,754	$ 15,853,086	$ 14,209,140	$ 13,789,300	$ 15,034,208
Long-term obligations	59,678	134,485	210,592	286,417	38,662
Working capital	14,049,063	13,322,276	12,339,332	11,756,441	12,895,476
Total assets	21,648,523	22,979,078	19,060,473	19,542,341	18,762,327

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

The following discussion is intended to provide an analysis of our financial condition and results of operations and should be read in conjunction with our financial statements and the notes to our financial statements included in Item 8 of this report. The discussion also includes forward-looking statements. As indicated on the cover page of this report under "Special Note Regarding Forward-Looking Statements," undue reliance should not be placed on forward-looking statements.

Overview

Criticare designs, manufactures and markets vital signs and gas monitoring instruments and related noninvasive sensors used to monitor patients in many healthcare environments. The Company sells its products both in the U.S. and in international markets to customers such as hospitals, surgery centers, dental and physicians offices, and nursing homes. Criticare is implementing several business initiatives as part of its strategy to develop and distribute products for highly technical, growth oriented niche markets. Management believes that in order to be successful, marketing and sales partnerships in these areas are required. That effort resulted in the execution of a number of OEM agreements.

Criticare is implementing several new business initiatives as part of its strategy to develop and distribute products for highly technical growth oriented niche markets. To capitalize on these business initiatives, modules and stand-alone monitors were developed and marketed for specific OEM customers. The Company views OEM agreements as a critical component to our strategy to develop products for highly technical niche markets, and the OEM business has been a significant driver of the Company’s growth with net sales of $7,335,059 or 23.3% of total net sales in fiscal 2007, $6,814,623 or 21.7% of total net sales in fiscal 2006 and $6,132,122 or 22.9% of total net sales in fiscal 2005.

The first of these initiatives involves monitoring products for anesthesia gases. In fiscal 2003, the Company introduced an anesthesia monitoring product line for sale both under the Criticare brand name and for sale to OEMs. Production shipments to our newest OEM partner, Fukuda Denshi, Inc. of Japan, began in August 2007. A second initiative is the development of a highly specialized monitoring system for medical imaging applications in an MRI environment. In 2003, Criticare entered into an agreement with Medrad to jointly develop and exclusively sell a highly specialized medical monitoring product to Medrad. In July 2004, Criticare shipped the initial prototypes of this monitoring product to Medrad and production shipments began in January 2005. Medrad was the Company's largest customer in fiscal 2007, 2006 and 2005, accounting for 20.0%, 16.5% and 11.6%, respectively, of the Company's net sales in those fiscal years. Following the acquisition, in July 2004, of Alaris Medical Systems, Inc., a long-time OEM customer, by Cardinal Health, Inc., the third initiative was implemented to develop an Acute Care distribution network in the U.S. to sell to markets and group purchasing organizations (GPO's) previously served through Alaris. Following such acquisition, Cardinal Health exited the vital signs monitor business and signed a transition agreement with the Company, which enabled our new Acute Care distribution network the opportunity to sell to the former Alaris customer base. In conjunction with the transition agreement, in September 2005, we introduced a new portable vital signs monitor for the Acute Care market. Sales for the Acute Care market totaled approximately $3.16 million during fiscal 2007 and $3.49 million during the introduction year of fiscal 2006. This key initiative will remain ongoing as the Company works to obtain and maintain tier I and tier II GPO contracts which will allow the net sales for the Acute Care network to exceed the largest revenue year Criticare experienced under the Alaris OEM agreement.

The Company posted total net sales of $7,640,927 for the fourth quarter of fiscal 2007, which were 7.7% higher than the $7,095,962 in net sales for the same period of fiscal 2006, principally due to the strong OEM and international sales in fiscal 2007. The Company reported a net loss of $(365,709) for the fourth quarter of fiscal 2007 as compared to a net loss of $(524,220) for the fourth quarter for fiscal 2006. For the full year, the Company had total net sales of $31,431,810 in fiscal 2007 compared to net sales of $31,350,919 in fiscal 2006. Additionally, for the second consecutive year the Company posted net income, with net income of $348,027 in fiscal 2007 compared to net income of $212,118 in fiscal 2006.

Results of Operations

The following table sets forth, for the periods indicated, certain items from the Company's Consolidated Statements of Operations expressed as percentages of net sales.

	Percentage of Net Sales Years Ended June 30,		
	2007	**2006**	**2005**
Net sales	100.0%	100.0%	100.0%
Cost of goods sold	62.5	61.6	60.9
Gross profit	37.5	38.4	39.1
Operating expenses:			
Sales and marketing	19.1	22.2	21.2
Research, development and engineering	7.6	7.5	9.8
Administrative	10.9	10.1	10.8
Total	37.6	39.8	41.8
Loss from operations	(0.1)	(1.4)	(2.7)
Interest expense	0.0	(0.1)	(0.1)
Interest income	0.4	0.3	0.2
Foreign currency exchange gain (loss)	0.5	(0.3)	0.5
Other income	0.3	2.2	0.5
Income (loss) before income taxes	1.1	0.7	(1.6)
Income tax provision	--	--	--
Net income (loss)	1.1%	0.7%	(1.6)%

Fiscal Year Ended June 30, 2007 Compared to June 30, 2006

Net sales increased $80,891 to $31,431,810 for fiscal 2007 compared to $31,350,919 for fiscal 2006. The increase resulted from a 5.3% increase in the average sales price per unit, which was partially offset by a 3.9% decrease in accessory sales and a 1.0% decrease in the number of units shipped in the current year. The increased sales were driven by a $1,093,031 increase in domestic alternate care sales and a $520,436 increase in OEM sales, which were partially offset by a $1,027,626 decrease in international sales and a $335,453 decrease in acute care sales during fiscal 2007. OEM sales in fiscal 2007 were $7,335,000 and represented 23.3% of total net sales, compared to $6,815,000 (21.7% of total net sales) in fiscal 2006. The OEM sales of $6,290,137 to Medrad in fiscal 2007, for medical imaging applications, increased $1,110,258 from fiscal 2006. The increased domestic alternate care sales was due to a number of factors, including Criticare’s release of our next generation portable multi-parameter vital signs monitor and the initial order to replace all vital signs monitors in over 50 domestic plasma collection centers. International sales were lower than expected, due in large part to a $1,874,000 partial shipment of an order from the ministry of health of the Republic of Iraq which shipped in the fourth quarter of fiscal 2007, but which did not meet all the strict criteria for revenue recognition in accordance with SAB No. 104. Due to the size and risks associated with a contract of this nature, the Company obtained a confirmed letter of credit to secure payment. As a result, while the order met the revenue recognition criteria of ensuring collectibility, the terms of the letter of credit

did not allow the transfer of title to occur until after June 30, 2007. The majority of this sale will be included in the first quarter results for fiscal 2008.

The gross profit percentage of 37.5% realized in fiscal 2007 decreased from the 38.4% generated in the prior year. Margins decreased in the current year as the positive effect of a slight change in product mix was offset the continued upward shift in fixed overhead costs to meet the increased quality and production demands of our OEM customers and the increased overhead costs associated with manufacturing start-up costs related to our new portable multi-parameter vital signs monitor.

Charges to cost of goods sold for potentially obsolete inventory totaled $ 167,144 in fiscal 2007 compared to $56,622 in fiscal 2006. Inventory considered obsolete will be disposed of and removed from Criticare's warehouse during fiscal 2008.

Operating expenses for the year ended June 30, 2007 decreased $672,357 from fiscal 2006 due mainly to a decrease of $941,355 in sales and marketing expenses, which was partially offset by an increase of $257,165 in administrative expenses. The increase of $257,165 in administrative expenses was due to the $451,564 of expenses incurred during the year in connection with the two consent solicitation actions initiated by BlueLine Partners and the subsequent settlement of those actions in the third quarter. The decrease of $941,355 in sales and marketing expenses was due mainly to a $528,709 decrease in bad debt expenses from the reserve established in fiscal 2006 of a portion of the receivable due from one of our distributors with no corresponding reserve in fiscal 2007, a $135,676 decrease in India operation expenses, a $112,695 decrease in commissions earned and a $83,178 decrease in advertising and trade show expenses for the year ended June 30, 2007. In fiscal 2006, the Company reserved a portion of the receivable due from the distributor referred to in the previous sentence, in the amount of $529,700. Due to a reduction in the receivable from the distributor, the reserve has been reduced to $227,638 as of June 30, 2007.

Total other income for the fiscal year ended June 30, 2007 decreased $273,525 from fiscal 2006. This decrease was mainly due to the $300,000 received pursuant to a patent license agreement in fiscal 2006 with no corresponding income in fiscal 2007, and a decrease of $295,400 in royalty income partially offset by an increase of $41,395 in interest income and a foreign currency exchange gain of $171,361 in fiscal 2007 related to the Company's operation in India, which had a foreign currency exchange loss of $(108,225) in fiscal 2006.

Loss from operations of $(38,055) for the year ended June 30, 2007 decreased $409,434 as compared to a loss from operations of $(447,489) for the same period in fiscal 2006, which was the result of a decrease of $672,357 in operating expenses and a decrease in gross profit of $262,923. The decreased loss from operations was partially offset by the decrease in other income of $273,525, resulting in net income of $348,027 for the year ended June 30, 2007 as compared to net income of $212,118 for fiscal 2006.

Fiscal Year Ended June 30, 2006 Compared to June 30, 2005

Net sales increased $4,569,292 to $31,350,919 for fiscal 2006 compared to $26,781,627 for fiscal 2005. The increase resulted from a 3.5% increase in the number of units shipped, a 11.7% increase in the average sales price per unit and a 6.5% increase in accessory sales in the current year. The increased sales were in part the result of $3,492,754 in acute care sales, which are a successful result of Criticare's business initiative to develop an acute care distribution network in the U.S. to sell to markets previously served through Alaris. Additionally, the increased sales were driven by a $827,941 increase in international sales and a $682,501 increase in OEM sales, which were partially offset by a $1,025,778 decrease in domestic alternate care sales during fiscal 2006. The international sales increased despite a $357,972 reduction of sales in India during fiscal 2006. The OEM sales of $5,179,879 to Medrad, for medical imaging applications, was partially offset by reduced sales of $2,034,468 to Alaris, formerly our largest OEM customer, during fiscal 2006. The decrease in domestic alternate care sales was due to a number of factors, including Criticare's movement to exit the defibrillator market due to the continued trend of direct sales by defibrillator manufacturers rather than through an establish distribution network, the postponed sales of patient monitors awaiting the release of our next generation portable multi-parameter vital signs monitor and the overall maturation of the oral surgery market. OEM sales in fiscal 2006 were $6,815,000 and represented 21.7% of total net sales, compared to $6,132,000 (22.9% of total net sales) in fiscal 2005.

The gross profit percentage of 38.4% realized in fiscal 2006 decreased from the 39.1% generated in the prior year. The margins decreased in the current period as the positive effect of a slight change in product mix was offset by the adverse effect of increased overhead costs associated with the manufacturing start-up costs related to our new portable vital signs monitor and the portable multi-parameter vital signs monitor, the replacement of a key supplier and with an upward shift in the fixed overhead costs to meet the increased quality and production demands of our OEM customers.

Charges to cost of goods sold for potentially obsolete inventory totaled $56,622 in fiscal 2006 compared to $281,003 for fiscal 2005. Inventory considered obsolete will be disposed of and removed from Criticare's warehouse during fiscal 2007.

Operating expenses for the year ended June 30, 2006 increased $1,293,377 from fiscal 2005 as an increase of $1,279,806 in sales and marketing and $271,193 in administrative expenses was partially offset by a $257,622 reduction in research, development and engineering expenses. The increase of $1,279,806 in sales and marketing expenses was due mainly to a $354,918 increase in the commissions earned due to increased sales and a $148,113 increase in India operation expenses, combined with a $98,277 increase in advertising, trade shows and sales promotion and a $19,154 increase in license fees spending for the year ended June 30, 2006. In addition, due to the political climate currently in Mexico and the age of the receivable, we have reserved a portion of a receivable from one of our distributors in the amount of $529,700, which has significantly increased our sales and marketing expenses. Administrative expenses increased by $271,193 mainly due to an increase of $316,096 in compensation expenses of which $172,988 was recognized in conjunction with stock options under SFAS 123(R), an increase of $38,406 in license fees and an increase of $37,500 in board of director fees, which was partially offset by a $99,211 reduction in legal fees and a $26,506 reduction in recruiting fees. The increase in operating expenses was partially offset by a decrease of $257,622 in research, development and engineering expenses. In the first quarter of fiscal 2005, Criticare received funding of $125,000 from our largest OEM customer to jointly develop a highly specialized monitoring system for medical imaging applications, which reduced the research, development and engineering expenses for the year ended June 30, 2005 as compared to the year ended June 30, 2006.

Total other income for the fiscal year ended June 30, 2006 increased $355,657 from fiscal 2005. This increase was mainly due to the $300,000 received pursuant to a patent license agreement, an increase of $136,297 in royalty income and an increase of $36,120 in interest income, partially offset by a foreign currency exchange loss of $(108,225) related to the Company’s operation in India, which had a foreign currency exchange gain of $131,885 in fiscal 2005.

The $1,572,083 and $355,657 increase in gross profit and total other income, respectively, partially offset by the increased operating expenses of $1,293,377, resulted in net income of $212,118 for the year ended June 30, 2006 as compared to a net loss of $(422,245) for fiscal 2005.

Critical Accounting Policies

The Company's discussion and analysis of its financial condition and results of operations are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to bad debts, sales returns, inventories, and warranty obligations. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. The Company believes the following accounting policies require its more significant judgments and estimates used in the preparation of its financial statements.

Revenue Recognition

Revenues and the costs of products sold are recognized as the related products are shipped or installed, if there are significant installation costs. Revenue is recognized in accordance with SAB No. 104, when all four elements for revenue recognition have been met. This revenue recognition policy is utilized for shipment of product to customers including both distributors and end-users.

Estimating Allowances for Doubtful Accounts and Sales Returns

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. Management analyzes specific accounts receivable as well as historical bad debts, customer concentrations, customer credit-worthiness, current economic trends, foreign currency movements, and changes in its customer payment terms when evaluating the allowance for doubtful accounts. If the financial condition of any of the Company's customers were to deteriorate, resulting in impairment of their ability to make payments, additional allowances may be required.

The Company also maintains a sales returns reserve in order to estimate potential future product returns related to current period revenue. Management analyzes historical returns, current economic trends, changes in customer demand, and acceptances of the Company's products when evaluating the adequacy of the sales returns reserve. Significant management judgments and estimates must be made and used in connection with establishing the sales returns reserve in any accounting period. Material differences may result in the timing of the Company's revenue if management made different judgments or utilized different estimates.

Valuation of Inventories

Inventories are stated at the lower of cost or market, with cost determined on the first-in, first-out method. The Company maintains a reserve for obsolete inventory that it utilizes to write down inventories for estimated obsolescence or unmarketable inventory equal to the difference between the carrying value of the inventory and the estimated market value. The Company determines the adequacy of the obsolescence reserve by considering historical annual usage of component parts and finished goods as well as assumptions about market conditions and forecasted demand. When items are physically disposed of the amounts are written off against the reserve. If future product demand is lower than expected or if market conditions are less favorable than those projected by the Company, additional charges to increase the obsolescence reserve may be required.

During fiscal 2007, the reserve for obsolete inventory was increased $15,000 to $375,000 at June 30, 2007 due to normal variations in the inventory mix. During fiscal 2006, the reserve for obsolete inventory was decreased $78,300 to $360,000 at June 30, 2006 due mainly to the disposal of obsolete inventory that had been reserved for in prior years.

Product Warranty

The Company provides for the estimated cost of product warranties at the time products are shipped based upon its historical experience providing warranty coverage. The Company's warranty obligations are affected by product failure rates, material usage and service delivery costs incurred in correcting a product failure. If actual product failure rates, material usage or service delivery costs differ from current projections, revisions to the estimated warranty reserve would be required.

Liquidity and Capital Resources

As of June 30, 2007, the Company had a cash balance of $4,635,823 as compared with its fiscal 2006 year-end cash balance of $3,793,781. The Company has continued to maintain a bank debt free balance sheet.

With the Company's return to profitability, Criticare has been able to increase its cash position by an aggregate of $896,998 over the last three fiscal years. Non-cash expenses consisting primarily of depreciation expense, share based compensation expense as a result of SFAS 123(R), provision for obsolete inventory and provision for doubtful accounts decreased the Company's profitability by an aggregate of $3,379,846 over the last three fiscal years, but did not impact the Company's cash flows. Over the last three fiscal years, the Company has been able to fund $1,192,915 of capital spending primarily with $2,147,192 of cash provided by the exercise of stock options over that period.

In fiscal 2007, $1,255,824 of cash was generated from operations. This increase in cash was primarily driven by a combination of the reduction of the inventory, which was increased in fiscal 2006 due to the release of the next generation portable multi-parameter vital signs monitor, and the profitability of the Company. The cash generated from operations was partially offset by capital spending of $407,473 and $11,493 of cash used in financing activities. In fiscal 2007, $62,655 of cash was generated from the issuance of 11,500 shares of common stock upon the exercise of stock options. In fiscal 2006, $1,213,677 of cash was generated from the issuance of 473,045 shares of common stock upon the exercise of stock options, most of which were scheduled to expire in less than one year. This cash partially offset the $408,544 of cash used in operations and the $669,275 of capital spending in fiscal 2006. Cash used in operations in fiscal 2006 was primarily driven by the inventory investment in the new, next generation portable multi-parameter vital signs monitor. In fiscal 2005, $688,724 of cash was generated from the issuance of 280,337 shares of common stock upon the exercise of stock options and an additional $131,250 of cash was generated from the issuance of 70,000 shares of common stock upon the exercise of stock warrants, most of which were scheduled to expire in less than one year. This cash partially offset the $726,064 of cash used in operations and the $116,167 of capital spending in fiscal 2005.

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

The following table summarizes the Company's contractual cash obligations at June 30, 2007 in the categories set forth below, and the effect such obligations are expected to have on its liquidity and cash flow in future fiscal periods:

	Total	2008	2009	2010	2011	2012 and Thereafter
Operating leases	$ 1,187,990	$ 378,597	$ 383,459	$ 365,270	$ 60,664	--
Capital leases	145,200	82,560	52,140	10,500	--	--
Contract Mfg obligations	350,000	350,000	--	--	--	--
Other long-term obligations	5,476	5,476	--	--	--	--
Total contractual obligations	$ 1,688,666	$ 816,633	$ 435,599	$ 375,770	$ 60,664	--

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

The Company has a demand line of credit facility with a commercial bank with interest payable monthly at 25 basis points below the bank's reference rate. The Company had no borrowings outstanding under this bank facility at June 30, 2007, 2006 and 2005. Due historically to the lack of need to borrow from this credit facility and due to the Company's current cash position, the Company is not subject to financial risk on this obligation if interest rates in the market change significantly.

The Company's net sales are primarily denominated in United States dollars, except for a small amount of net sales from the Company's operations in India which are denominated in Indian rupees. As a result, part of the Company's accounts receivable are denominated in rupees and translated into U.S. dollars for financial reporting purposes. A 10% change in the exchange rate of the U.S. dollar with respect to the Indian rupee would not have a material adverse effect on the Company's financial condition or results of operations for the fiscal year ended June 30, 2007. The Company does not use any hedges or other derivative financial instruments to manage or reduce exchange rate risk.

ItemFINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.
8.

FINANCIAL STATEMENTS

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

ASSETS (Note 6)	2007	2006
CURRENT ASSETS:		
Cash and cash equivalents (Notes 1 and 10)	$ 4,635,823	$ 3,793,781
Accounts receivable, less allowance for doubtful accounts of $497,638 and $829,700, respectively (Note 1)	5,991,999	6,446,637
Other receivables (Note 1)	251,950	331,722
Short-term note receivable (Note 1)	50,000	50,000
Inventories (Notes 1 and 2)	8,177,523	9,464,037
Prepaid expenses	219,859	227,606
Total current assets	19,327,154	20,313,783
PROPERTY, PLANT AND EQUIPMENT (Note 1):		
Machinery and equipment	3,415,501	3,157,328
Furniture and fixtures	946,668	952,193
Leasehold improvements	290,084	243,604
Demonstration and loaner monitors	2,025,924	1,997,844
Production tooling	2,389,507	2,294,360
Property, plant and equipment – cost	9,067,684	8,645,329
Less accumulated depreciation	6,877,295	6,193,015
Property, plant and equipment – net	2,190,389	2,452,314
OTHER ASSETS:		
License rights and patents – net (Notes 1 and 3)	55,980	62,981
Long-term note receivable (Note 1)	75,000	150,000
Total other assets	130,980	212,981
TOTAL ASSETS	$ 21,648,523	$ 22,979,078

See notes to consolidated financial statements.

LIABILITIES AND STOCKHOLDERS' EQUITY	2007	2006
CURRENT LIABILITIES:		
Accounts payable	$ 3,826,834	$ 5,408,746
Accrued liabilities:		
Compensation and commissions	836,720	914,889
Product warranties (Notes 1 and 4)	349,000	425,000
Other	191,389	174,667
Obligations under capital lease (Note 12)	74,148	68,205
Total current liabilities	5,278,091	6,991,507
LONG-TERM LIABILITIES:		
Obligations under capital lease, less current portion (Note 12)	59,678	133,826
Other long-term obligations	--	659
Total long-term liabilities	59,678	134,485
COMMITMENTS AND CONTINGENCIES (Notes 7, 9 and 12)		
TOTAL LIABILITIES	5,337,769	7,125,992
STOCKHOLDERS' EQUITY (Notes 1 and 8):		
Preferred stock - $.04 par value, 500,000 shares authorized, no shares issued or outstanding	--	--
Common stock - $.04 par value, 15,000,000 shares authorized, 12,409,631 and 12,398,131 shares issued, and 12,313,321 and 12,291,454 outstanding, respectively	496,385	495,925
Additional paid-in capital	26,338,267	26,156,864
Common stock held in treasury (96,310 and 106,677 shares, respectively)	(356,502)	(375,813)
Retained earnings (accumulated deficit)	(10,088,767)	(10,436,794)
Cumulative translation adjustment	(78,629)	12,904
Total stockholders' equity	16,310,754	15,853,086
TOTAL LIABILITIES AND STOCKHOLDERS’ EQUITY	$ 21,648,523	$ 22,979,078

See notes to consolidated financial statements.

CRITICARE SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
YEARS ENDED JUNE 30, 2007, 2006 AND 2005

	2007	2006	2005
NET SALES (Notes 1, 10 and 11)	$ 31,431,810	$ 31,350,919	$ 26,781,627
COST OF GOODS SOLD	19,652,167	19,308,353	16,311,144
GROSS PROFIT	11,779,643	12,042,566	10,470,483
OPERATING EXPENSES:			
Sales and marketing (Note 1)	6,008,956	6,950,311	5,670,505
Research, development and engineering (Note 1)	2,374,345	2,362,512	2,620,134
Administrative (Note 9)	3,434,397	3,177,232	2,906,039
Total	11,817,698	12,490,055	11,196,678
LOSS FROM OPERATIONS	(38,055)	(447,489)	(726,195)
OTHER (EXPENSE) INCOME:			
Interest expense (Note 12)	(14,354)	(19,820)	(28,848)
Interest income	136,225	94,830	58,710
Foreign currency exchange gain (loss) (Note 1)	171,361	(108,225)	131,885
Other income (Note 14)	92,850	692,822	142,203
Total	386,082	659,607	303,950
INCOME (LOSS) BEFORE INCOME TAXES	348,027	212,118	(422,245)
INCOME TAX PROVISION (Notes 1 and 5)	--	--	--
NET INCOME (LOSS)	$ 348,027	$ 212,118	$ (422,245)
NET INCOME (LOSS) PER COMMON SHARE (Note 1):			
Basic and diluted	$ 0.03	$ 0.02	$ (0.04)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING (Note 1):			
Basic	12,299,411	12,069,060	11,514,786
Diluted	12,332,296	12,256,431	11,514,786

See notes to consolidated financial statements.

CRITICARE SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
YEARS ENDED JUNE 30, 2007, 2006 AND 2005

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Common Stock Treasury Shares	Common Stock Treasury Cost	Retained Earnings (Accumulated Deficit)	Cumulative Translation Adjustment	Total Stockholders' Equity
Balance, June 30, 2004	11,574,749	$ 462,990	$ 23,965,900	124,728	$ (409,439)	$ (10,226,667)	$ (3,482)	$ 13,789,302
Net loss						(422,245)		(422,245)
Cumulative translation adjustment							(4,630)	(4,630)
Comprehensive income/(loss)								(426,875)
Exercise of options	280,337	11,213	677,511					688,724
Exercise of warrants	70,000	2,800	128,450					131,250
Employee common stock purchased from treasury			4,134	(12,135)	22,605			26,739
Balance, June 30, 2005	11,925,086	$ 477,003	$ 24,775,995	112,593	$ (386,834)	$ (10,648,912)	$ (8,112)	$ 14,209,140
Net income						212,118		212,118
Cumulative translation adjustment							21,016	21,016
Comprehensive income/(loss)								233,134
Exercise of options	473,045	18,922	1,194,755					1,213,677
Stock-based employee compensation			172,988					172,988
Employee common stock purchased from treasury			13,126	(5,916)	11,021			24,147
Balance, June 30, 2006	12,398,131	$ 495,925	$ 26,156,864	106,677	$ (375,813)	$ (10,436,794)	$ 12,904	$ 15,853,086
Net income						348,027		348,027

Cumulative translation adjustment							(91,533)	(91,533)
Comprehensive income/(loss)								256,494
Exercise of options	11,500	460	32,873					33,333
Stock-based employee compensation			138,519					138,519
Employee common stock purchased from treasury			10,011	(10,367)	19,311			29,322
Balance, June 30, 2007	12,409,631	$ 496,385	$ 26,338,267	96,310	$ (356,502)	$ (10,088,767)	$ (78,629)	$ 16,310,754

See notes to consolidated financial statements.

CRITICARE SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2007, 2006 AND 2005

	2007	2006	2005
OPERATING ACTIVITIES:			
Net income (loss)	$ 348,027	$ 212,118	$ (422,245)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation	457,440	650,142	588,559
Amortization	7,001	7,002	7,002
Share based compensation	138,519	172,988	--
Provision for doubtful accounts	(44,221)	559,206	87,695
Provision for obsolete inventory	167,144	56,622	281,003
Note receivable	--	(200,000)	--
Changes in assets and liabilities:			
Accounts receivable	402,143	(158,411)	(445,243)
Other receivables	154,772	313,757	(285,673)
Inventories	1,331,328	(4,392,330)	197,563
Prepaid expenses	7,747	27,498	109,271
Accounts payable	(1,581,913)	2,375,187	(203,846)
Accrued liabilities	(132,163)	(32,323)	(640,150)
Net cash provided by (used in) operating activities	1,255,824	(408,544)	(726,064)
INVESTING ACTIVITIES:			
Purchases of property, plant and equipment, net	(407,473)	(669,275)	(116,167)
Net cash used in investing activities	(407,473)	(669,275)	(116,167)
FINANCING ACTIVITIES:			
Retirement of obligation under capital lease	(74,148)	(68,205)	(57,712)
Proceeds from issuance of common stock	62,655	1,237,824	846,713
Net cash (used in) provided by financing activities	(11,493)	1,169,619	789,001
EFFECT OF EXCHANGE RATE CHANGES ON CASH	5,184	21,016	(4,630)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	842,042	112,816	(57,860)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	3,793,781	3,680,965	3,738,825
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 4,635,823	$ 3,793,781	$ 3,680,965
SUPPLEMENTAL CASH FLOW INFORMATION:			
Cash paid for:			
Income taxes paid—net	$ 10,547	$ 3,910	$ 2,506
Interest	14,355	19,820	26,596

See notes to consolidated financial statements.

NOTES TO FINANCIAL STATEMENTS

CRITICARE SYSTEMS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2007, 2006 AND 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business -- Criticare Systems, Inc. designs, manufactures and markets patient monitoring equipment and related accessories to the health care community worldwide and is headquartered in Waukesha, Wisconsin. The Company sells domestically primarily to oral and stand-alone general surgery centers and hospitals through regional sales managers and a dealer network. Internationally, the Company sells mainly to hospitals through country managers and a worldwide dealer network. In addition, the Company sells modules and stand-alone monitors worldwide to original equipment manufacturers (“OEMs”).

Principles of Consolidation -- The consolidated financial statements include the accounts of Criticare Systems, Inc. and its wholly owned subsidiaries (the "Company"). All significant intercompany accounts and transactions have been eliminated.

Cash Equivalents -- The Company considers all investments with purchased maturities of less than three months to be cash equivalents.

Accounts Receivable and Allowance for Doubtful Accounts -- Accounts receivable are customer obligations due under normal trade terms. The Company sells its products to distributors, OEMs, and end users in medical facilities such as hospitals, surgery centers, nursing homes, and physician offices. The Company performs continuing credit evaluations of its customers’ financial condition, and although it generally does not require collateral, letters of credit may be required from customers in certain circumstances.

Management reviews accounts receivable on a monthly basis to determine if any receivables will potentially be uncollectible. The Company includes any accounts receivable balances that are determined to be uncollectible, along with a general reserve, in its overall allowance for doubtful accounts. The general reserve in the allowance for doubtful accounts is calculated based upon the accounts receivable balance and the historical effectiveness of Criticare’s collection of those receivables. The general reserve as of June 30, 2007 and 2006 is $70,000 and $100,000, respectively. After all attempts to collect a receivable have failed, the receivable is written off against the allowance. Based on the information available, the Company believes its allowance for doubtful accounts as of June 30, 2007 and 2006 is adequate. However, actual write-offs might exceed the recorded allowance.

Inventories -- Inventories are stated at the lower of cost or market, with cost determined on the first-in, first-out method.

Other Receivables -- Other receivables as of June 30, 2007 and 2006 consist mainly of tender deposits in the amount of $116,458 and $130,880, respectively, bank guarantees in the amount of $26,725 and $28,917, respectively.

Note Receivable -- Note receivable as of June 30, 2007 and 2006 is the result of the grant of a non-exclusive license with quarterly payments ending January 1, 2010. This license agreement is treated, for accounting purposes, as a non-interest bearing note. The future maturities of the note receivable are $50,000 in each of the fiscal years 2008 and 2009 and $25,000 in 2010. The balance of the short-term note on each of June 30, 2007 and 2006 was $50,000. The balance of the long-term note on June 30, 2007 and 2006 respectively, was $75,000 and $150,000.

Property, Plant and Equipment -- Property, plant and equipment is recorded at cost. Each member of the Company's sales force is provided with demonstration monitors to assist them in their sales efforts. The Company also has loaner monitors which are used to temporarily replace a customer's unit when it is being repaired or upgraded. Depreciation is provided over the estimated useful lives of the assets. The estimated useful lives of other property and equipment are as follows:

Classification	Estimated Useful Lives
Machinery and equipment	5–7 years
Furniture and fixtures	5 years
Leasehold improvements	4–5 years
Demonstration and loaner monitors	4 years
Production tooling	5–7 years

The Company periodically assesses the recoverability of long-lived assets, including property and equipment and intangibles, subject to amortization, in accordance with the Statement of Financial Accounting Standards No. 144, “Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of” (“SFAS No. 144”), when indications of potential impairment exist. The amount of any impairment is calculated as the shortfall of the estimated fair market value from the carrying value of the related asset. Management considers such factors as current operating results, trends, and future prospects, in addition to other economic factors in performing this analysis. No such impairments exist at June 30, 2007 and 2006. As of July 1, 2005, in accordance with the Statement of Financial Accounting Standards No. 86, Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed” (“SFAS No. 86”), the Company will accumulate and amortize the software costs on a product-by product basis after the technological feasibility of the product has been established. Amortization of the costs will be equal to the straight-line amortization of the costs over the estimated economic life of the product. As of June 30, 2007 and 2006, the Company had capitalized $108,720 of software costs. Amortization of $21,744 and $10,872 was recorded in fiscal 2007 and fiscal 2006, respectively.

License Rights and Patents -- The Company adopted SFAS 142, "Goodwill and Other Intangible Assets," during the period ended June 30, 2003 to account for its license rights and patents. License rights and patents are carried at cost and are amortized using the straight-line method over their estimated useful life as follows:

Classification	Estimated Useful Lives
License rights and patents	17 years

License rights and patents are evaluated for impairment when events or changes in circumstances indicate that the carrying amounts of the assets may not be recoverable through the estimated undiscounted future cash flows resulting from the use of these assets. When any such impairment exists, the related assets will be written down to fair value.

Revenue Recognition -- Revenues and the costs of products sold are recognized as the related products are shipped or installed, if there are significant installation costs. This revenue recognition policy is utilized for shipment of product to customers, including both distributors and end-users. Revenue is recognized, in accordance with SAB No. 104, when all four elements for revenue recognition have been met.

Shipping Costs -- Any shipping costs that are billable to the customer are included in revenue and all shipping costs are included in cost of goods sold in the accompanying consolidated statements of operations.

Product Warranties -- Estimated costs for product warranties are accrued for and charged to operations, as revenues for the related products are recognized.

Marketing Expenses -- Marketing expenses include all of the Company's sales related costs. Bad debt expense(recoveries) totaled $(44,221) , $559,206 and $87,695 in fiscal 2007, 2006 and 2005, respectively.

Advertising Costs -- Advertising costs are expensed as incurred. Advertising costs totaled $61,807, $97,460 and $68,120 for the years ended June 30, 2007, 2006 and 2005, respectively.

Research and Development Expenses -- Research and development costs are charged to operations as incurred. Such expenses totaled $2,275,053, $2,304,226 and $2,561,386 in fiscal 2007, 2006 and 2005, respectively.

Income Taxes -- The Company accounts for income taxes using an asset and liability approach. Deferred income tax assets and liabilities are computed for differences between the financial statements and tax basis of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. The Company pays income taxes in certain states that require an annual minimum tax. These taxes are included in administrative expenses in the consolidated statements of operations.

Translation of Foreign Currency -- The Company follows the translation policy as provided by Financial Accounting Standards No. 52, “Foreign Currency Translation” in translating the financial statements of its operation in India from Indian rupees to U.S. dollars. Accordingly, assets and liabilities are translated at the rate of exchange at the balance sheet date. Income and expense items are translated at the average exchange rate prevailing throughout the year. The results are shown as a component of other comprehensive income.

Net Income (Loss) Per Common Share -- Basic income (loss) per share is computed using the weighted average number of common shares outstanding during the periods. Diluted income (loss) per share is computed using the weighted average number of common and dilutive common equivalent shares outstanding during the periods. For fiscal 2007 and fiscal 2006, the number of diluted weighted average common shares outstanding would be higher by 122,750 and 28,000 shares, respectively, without this anti-dilutive impact. The basic and diluted weighted average number of common shares outstanding in the financial statements are the same in fiscal year 2005 because including a diluted calculation in a loss position would produce an anti-dilutive per share amount. The number of diluted weighted average common shares outstanding would be higher by 131,230 shares in 2005 without this anti-dilutive impact.

Stock Options -- The Company grants options to purchase Criticare Systems, Inc. common shares under stock option plans that are described more fully in Note 8. Prior to fiscal 2006, the Company had 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”. Effective July 1, 2005, the Company adopted the fair value recognition provisions of SFAS No. 123 (R), “Share-Based Payment”. Under the modified prospective method of adoption selected by the Company, compensation cost recognized in fiscal 2007 and 2006 is the same as that which would have been recognized had the recognition provisions of SFAS No. 123 been applied from its original effective date. Results for the prior year have not been restated. If the Company had elected to recognize compensation cost for the options granted during the year ended June 30, 2005, 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:

	Year Ended June 30, 2005
Net loss--as reported	$ (422,245)
Add: Stock-based employee compensation expense included in reported net loss	--
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	(211,498)
Net loss – pro forma	$ (633,743)
Basic net loss per share – as reported	$ (0.04)
Diluted net loss per share – as reported	$ (0.04)
Basic net loss per share – pro forma	$ (0.06)
Diluted net loss per share – pro forma	$ (0.06)

Fair Value of Financial Instruments -- The Company's financial instruments under SFAS No. 107 "Disclosure About Fair Value of Financial Instruments," includes cash, accounts receivable, accounts payable, borrowings under line of credit facility and long-term debt. The Company believes that the carrying amounts of these accounts are a reasonable estimate of their fair value because of the short-term nature of such instruments or, in the case of long-term debt because of interest rates available to the Company for similar obligations.

Comprehensive Income -- Comprehensive income consists of net income and foreign currency translation adjustments, and is presented in the consolidated statements of stockholders' equity.

Use of Estimates -- The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications -- Certain amounts for fiscal 2005 and fiscal 2006 have been reclassified to conform to the fiscal 2007 presentation.

2. INVENTORIES

Inventories consist of the following as of June 30:

	2007	2006
Component parts	$ 2,507,293	$ 2,605,751
Work in process	1,106,885	1,470,893
Finished units	4,938,345	5,747,393
Total inventories	8,552,523	9,824,037
Less: reserve for obsolescence	375,000	360,000
Net inventory	$ 8,177,523	$ 9,464,037

3. LICENSE RIGHTS AND PATENTS

The components of and changes in the carrying amount of license rights and patents are as follows as of June 30:

	2007	2006
License rights and patents	$ 196,777	$ 196,777
Accumulated amortization	(140,797)	(133,796)
Net license rights and patents	$ 55,980	$ 62,981

Future amortization of license and patents is as follows at June 30, 2007:

	Year ended June 30,
2008	$ 7,001
2009	7,001
2010	7,001
2011	7,001
2012	7,001
Thereafter	20,975
Total	$ 55,980

Approximately $7,000 of amortization was charged to operations in each of the fiscal years ended June 30, 2007, 2006 and 2005.

4. PRODUCT WARRANTY

The Company’s products are subject to a standard warranty of 12 months, and therefore reserves are established for the estimated future costs of repair or replacement and included in cost of sales at the time the related sale is recognized. These reserves are adjusted based on management’s best estimates of future warranty costs after considering historical and projected product failure rates and product repair costs. In the event that actual experience differs from these best estimates, changes in the Company’s warranty reserves might become necessary. The Company also sells extended warranties, which result in a deferral of revenue, amortized over the extended warranty period.

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Changes in the Company's warranty reserve for fiscal years 2007 and 2006 are as follows:

	2007	2006
Balance, beginning of year	$ 425,000	$ 452,000
Warranties issued	181,328	244,093
Settlements	(257,328)	(271,093)
Changes in estimated pre-existing warranties	--	--
Balance, end of year	$ 349,000	$ 425,000

The Company's warranty settlements for fiscal 2005 totaled $289,955.

5. INCOME TAXES

The Company accounts for income taxes using an asset and liability approach, which generally requires the recognition of deferred income tax assets and liabilities based upon the expected future income tax consequences of events that have previously been recognized in the Company's financial statements or tax returns. In addition, a valuation allowance is recognized if it is more likely than not that some or all of the deferred income tax asset will not be realized. A valuation allowance is used to offset the related net deferred income tax assets due to uncertainties of realizing the benefits of certain net operating loss and tax credit carryforwards.

The valuation allowance was decreased $268,000 in 2007 and increased $263,000 in 2006.

Significant components of the Company's deferred income tax assets and deferred income tax liabilities are as follows:

	June 30, 2007	June 30, 2006	June 30, 2005
Deferred income tax assets:			
Accounts receivable and sales allowances	$ 211,000	$ 341,000	$ 148,000
Inventory allowances	180,000	183,000	196,000
Product warranties	139,000	167,000	177,000
Other accrued liabilities	144,000	139,000	146,000
Compensation	125,000	71,000	9,000
Federal net operating loss carryforwards	5,882,000	5,958,000	6,004,000
State net operating loss carryforwards	505,000	591,000	601,000
Federal tax credit carryforwards	132,000	143,000	198,000
Excess of book over tax depreciation and amortization	269,000	258,000	116,000
Investment losses not deducted	118,000	118,000	118,000
Total deferred income tax assets	7,705,000	7,969,000	7,713,000
Deferred income tax liabilities:			
Excess of tax over book depreciation and amortization	0	0	0
Prepaid expenses	(39,000)	(38,000)	(42,000)
Total deferred income tax liabilities	(39,000)	(38,000)	(42,000)
Valuation allowance	(7,666,000)	(7,931,000)	(7,671,000)
Net deferred income taxes recognized in the	$ 0	$ 0	$ 0

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At June 30, 2007, the Company had federal net operating loss carryforwards of approximately $17,301,000 which expire in 2008 through 2027. At June 30, 2007, the Company had available for federal income tax purposes approximately $87,000 of alternative minimum tax credit carryforwards which carry forward indefinitely and approximately $45,000 of tax credit carryforwards which expire in 2009. The Company also has approximately $10,187,000 of state net operating loss carryforwards, which expire in 2008 through 2021, available to offset certain future state taxable income.

The income tax provision consists of the following:

	2007	2006	2005
Current			
Federal	$ 0	$ 0	$ 0
State	0	0	0
Total income tax provision	$ 0	$ 0	$ 0

A reconciliation of the provision for income taxes (benefit) at the federal statutory income tax rate to the effective income tax rate follows:

	2007	2006	2005
Federal statutory income tax rate	34.0%	34.0%	34.0%
State taxes net of federal benefit	5.2	5.2	5.2
Expired net operating loss and credits	26.8	25.7	0.0
Permanent items	9.8	(187.5)	49.8
Valuation adjustment	(75.8)	122.6	(89.0)
Effective income tax rate	0%	0%	0%

6. LINE OF CREDIT FACILITY

At June 30, 2007, the Company had a $2,000,000 demand line of credit facility with a commercial bank to meet its short-term borrowing needs. Borrowings against the line are payable on demand with interest payable monthly at the bank's reference rate, less 0.25% (8.00% as of June 30, 2007). As of June 30, 2007 and 2006 there were no borrowings against the line. Borrowings under the line of credit facility are collateralized by substantially all assets of the Company. The credit facility has covenants which require minimum income or liquidity levels. The Company was in compliance with the covenants at June 30, 2007.

7. CONTINGENCIES

From time to time, various lawsuits arise out of the normal course of business. These proceedings are handled by outside counsel. Currently management is not aware of any claim or action pending against the Company that would have a material adverse effect on the Company.

8.STOCKHOLDERS' EQUITY

Stock Options– At the December 1, 2005 annual meeting of the stockholders of the Company, the stockholders approved an amendment of the Criticare Systems, Inc. 2003 Stock Option Plan (the “2003 Plan”) to increase the number of shares of common stock available for future grants by 500,000 shares to 930,000 shares and to authorize grants of restricted stock and stock appreciation rights under the plan. During the annual stockholders meeting held on November 14, 2003, the Company’s stockholders approved the original 2003 Plan. This 2003 Plan replaced the 1992 Employee Stock Option Plan and the 1992 Non-Employee Stock Option Plan (collectively, the “1992 Plans”) and 179,380 reserved shares of common stock available under the 1992 Plans were moved to the 2003 Plan. The stockholders also approved 250,620 shares being available for future grants in addition to the 179,380 shares currently available, for a total of 430,000 shares authorized for issuance under the 2003 Plan. The Company also has options outstanding under two plans which existed prior to the approval of the 1992 Plans, the 1987 Employee Stock Option Plan and the 1987 Non-Employee Stock Option Plan (collectively with the 1992 Plans, the "Old Plans"). As a result of the approval of the 2003 Plan, no new stock options can be granted under the Old Plans, although the Company can regrant existing stock options under the Old Plans to extend the terms of such options. The Board of Directors has authorized in connection with these stock option plans the issuance of 3,210,620 reserved shares of common stock, of which 427,440 reserved shares remain available for future issuance at June 30, 2007. The Board of Directors increased the number of reserved shares for issuance under the Plans from 1,720,000 to 2,220,000 during 2001, from 2,220,000 to 2,460,000 during 2002, from 2,460,000 to 2,710,620 during 2003, and from 2,710,620 to 3,210,620 during 2005. The compensation cost that has been charged against income for the 2003 Plan and the Old Plans was $138,519 and $172,988 for the years ended June 30, 2007 and 2006, respectively. No income tax benefit was recognized in the income statement for share-based compensation arrangements due to the valuation allowance. The activity during 2005, 2006 and 2007 for the above plans is summarized as follows:

	Number of Shares	Stock Options Price Range	Weighted Avg. Exercise Price
Outstanding at June 30, 2004	1,429,895	$ 1.88-4.40	$ 2.75
Granted	96,000	2.25-5.13	2.97
Cancelled	(189,200)	2.88-3.75	3.16
Exercised	(280,337)	1.88-4.30	2.46
Outstanding at June 30, 2005	1,056,358	1.88-5.13	2.77
Granted	45,000	4.60-5.19	4.90
Cancelled	(84,625)	1.88-3.42	2.51
Exercised	(473,045)	1.88-4.40	2.57
Outstanding at June 30, 2006	543,688	2.25-5.19	3.17
Granted	79,000	3.36-3.76	3.61
Cancelled	(13,315)	2.25-3.60	3.00
Exercised	(11,500)	2.88-3.05	2.90
Outstanding at June 30, 2007	597,873	$ 2.51-5.19	$ 3.24

The following table summarizes the option details as of June 30, 2007:

	Shares Outstanding At June 30, 2007	Weighted Average Remaining Contractual Life-Years	Weighted Average Exercise Price	Aggregate Intrinsic Value at June 30, 2007
Options Outstanding	597,873	6.31	$ 3.24	$ 175,662
Options Exercisable	372,425	5.19	$ 3.07	$ 131,938

Option awards are granted with an exercise price equal to the market price of the Company's stock at the date of the grant; those option awards generally vest based upon 4 years of continuous service and have 5 and 10 year contractual terms for the Old Plans and 2003 Plan, respectively, as determined by the Compensation Committee of the Company's Board of Directors. Certain option awards provide for accelerated vesting if there is a change in control.

The Company has adopted the fair value recognition provisions of SFAS No. 123 (R), "Share-Based Payment". Under the modified prospective method of adoption selected by the Company, compensation cost recognized in fiscal 2007 and fiscal 2006 is the same as that which would have been recognized had the recognition provisions of SFAS No. 123 been applied from its original effective date. The fair value of stock options is the estimated fair value at the grant date using the Black Scholes option-pricing model. The fair value of each option award is estimated on the date of the grant using the Black-Scholes option-pricing model that uses the assumptions noted in the following table. Expected volatilities are based on historical volatility of the Company's stock and other factors. The Company uses historical data to estimate option exercise and employee termination within the valuation model. The expected term of options granted is derived from the analysis of the Company's historical patterns and represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the expected life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. The weighted average fair market value of the options granted during fiscal 2007, 2006 and 2005, along with the assumptions used, follows below:

	Years Ended June 30,		
	2007	**2006**	**2005**
Weighted average fair market value of options granted during the fiscal year ended June 30	$ 2.27	$ 2.90	$ 1.62
Assumptions used:			
Expected volatility	51.0%	45.0%	55.0%
Risk-free interest rate	4.73%	4.29%	3.74%
Expected option life (in years)	9.00	8.88	6.25
Dividend yield	0	0	0
Forfeiture rate	0	0	0

The total intrinsic value of the options exercised during the years ended June 30, 2007, 2006 and 2005 was $10,253, $1,132,994 and $377,138, respectively.

The following table summarizes the status of the Company's nonvested shares as of June 30, 2007, and changes during the year ended June 30, 2007:

Nonvested Shares	Number of Shares	Weighted-Average Grant Date Fair Value
Nonvested at June 30, 2006	300,699	$ 3.30
Granted	79,000	3.61
Cancelled	(5,815)	2.82
Vested	(148,436)	3.15
Nonvested at June 30, 2007	225,448	$ 3.51

As of June 30, 2007, there was $221,937 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the 2003 Plan and Old Plans. That cost is expected to be recognized over a weighted-average period of 1.40 years. The total fair value of the shares vested during the years ended June 30, 2007 and 2006 was $160,333 and $139,392, respectively.

Stock Warrants -- In February 1998, the Company executed a warrant agreement with a consultant. The warrant agreement provided for the issuance of warrants to purchase up to 150,000 shares of common stock at a price of $3.00 per share. The warrant was exercisable as to 30,000 shares upon execution of the agreement and the warrants to purchase the remaining 120,000 shares were to be exercisable if certain performance parameters were achieved by February 1999. No such parameters were achieved. These warrants expired in February 2003, but were amended. The 30,000 warrants were extended for an additional five years with an exercise price of $2.88 per share which represented the closing price of the Company's stock on the date the warrants were amended. The fair value of the extended warrants, based on the estimated fair value using the Black-Scholes pricing model, totaled $24,990 and was expensed during the year in which they were extended, fiscal 2003.

In December 2000, the Company executed another warrant agreement with the consultant. The warrant agreement provided for the issuance of warrants to purchase up to 70,000 shares of common stock at a price of $1.875 per share. The warrant vested over a four year period in four equal increments each year on the anniversary date of the warrant. The warrant was to terminate as to any shares that were unvested at the time the consultant ceased to provide consulting services to the Company. As of December 21, 2004, the warrant had fully vested. During fiscal 2005, this warrant was exercised in full to purchase 70,000 shares. The fair value of this warrant was the estimated fair value using the Black-Scholes pricing model.

Preferred Stock -- The Company's Board of Directors has the authority to determine the relative rights and preferences of any series it may establish with respect to the 500,000 shares of $.04 par value authorized preferred shares. As of June 30, 2007, no preferred stock was issued or outstanding.

On March 27, 1997, the Board of Directors of the Company declared a dividend of one preferred share purchase right (a "Right") for each outstanding share of common stock of the Company. The dividend was made on April 24, 1997 to the stockholders of record on that date to purchase Preferred Stock ("Preferred") upon the occurrence of certain events. Each share of common stock that shall become outstanding between the record date and the earliest of the distribution date, redemption date and the final expiration date shall be issued one Right. The Rights will be exercisable the tenth business day after a person or group acquires 20% of the Company's common stock, or makes an offer to acquire 30% or more of the Company's common stock. When exercisable, each right entitles the holder to purchase for $25, subject to adjustment, one-hundredth of a share of Preferred for each share of common stock owned. Each share of Preferred will be entitled to a minimum preferential quarterly dividend of $25 per share, but not less than an aggregate dividend of 100 times the common stock dividend. Each share will have 100 votes, voting together with the common stock. In the event of any merger, each share of Preferred will be entitled to receive 100 times the amount received per share of common stock. The Rights expire on March 27, 2017.

Common Stock Held in Treasury -- At June 30, 2007 and 2006, the Company held in Treasury 96,310 and 106,677 shares of common stock, respectively, shown at cost. On February 28, 2002, the Criticare Board of Directors approved the purchase in the open market of up to 500,000 shares of Criticare common stock. The Company has purchased 180,063 shares of common stock as of June 30, 2007. At June 30, 2007 and 2006, the Company held in Treasury 76,223 shares of common stock purchased in accordance with this stock buyback program.

Employee Stock Purchase Plan -- The Company has an Employee Stock Purchase Plan to provide employees of the Company with an opportunity to purchase common stock of the Company through accumulated payroll deductions. The plan allows eligible employees to purchase shares of the Company’s common stock through monthly offering periods. The purchase price for each share of common stock purchased equals 85% of the last quoted sales price of a share of the Company’s common stock as reported by the American Stock Exchange on the first day of the monthly offering period or the last day of the monthly offering period, whichever is lower. Compensation expense under this plan is immaterial. The Company is authorized to issue 500,000 shares of common stock under the plan. As of June 30, 2007, the Company had issued a total of 83,753 shares of common stock under the plan, and had 416,247 shares of common stock authorized for future issuance under the plan. The plan will terminate on July 1, 2009, unless sooner terminated by the Board of Directors.

9. EMPLOYEE BENEFIT PLAN

The Company has a 401(k) plan which covers substantially all employees. Company contributions to the plan are discretionary and determined annually by the Company's Board of Directors. The Company's contributions were approximately $103,000, $104,000 and $97,000 in 2007, 2006 and 2005, respectively.

10. BUSINESS AND CREDIT CONCENTRATIONS

Financial instruments which potentially subject the Company to concentrations of credit risk consist of cash, certificates of deposit, and accounts receivable. These financial instruments are carried at approximate fair value, less appropriate allowance, due to their short maturities.

The Company maintains cash balances which at times may exceed federally insured limits. As of June 30, 2007 and 2006, the Company held $4,692,519 and $3,764,888, respectively, in excess of federally insured limits. The Company’s management evaluates the creditworthiness of the financial institutions in which it places its cash. The Company has not experienced any losses in such accounts and does not believe it is exposed to any significant credit risk for cash accounts.

The Company is a manufacturer of medical monitors and telemetry products whose customers include hospitals and alternative health care sites throughout the world. Although the Company's products are sold primarily to health care providers, concentrations of credit risk with respect to trade accounts receivable are limited due to the Company's large number of customers, their geographic dispersion, and the Company’s credit evaluation process. Due in part to the risks involved in conducting business internationally, the Company currently coordinates substantially all international sales, distribution and credit activities through its headquarters in Waukesha, Wisconsin. Other than inventory, other receivables and accounts receivable for the Company’s operation in India totaling approximately $660,000, identifiable assets located outside of the United States are insignificant in relation to the Company's total assets. Net sales into geographic area are as follows:

	2007	2006	2005
Europe and Middle East	$ 5,712,000	$ 7,355,000	$ 7,182,000
Pacific Rim	1,240,000	1,692,000	1,787,000
Canada and Central and South America	3,747,000	3,516,000	2,689,000
Export net sales	$ 10,699,000	$ 12,563,000	$ 11,658,000
U.S. net sales	20,733,000	18,788,000	15,124,000
Total net sales	$ 31,432,000	$ 31,351,000	$ 26,782,000

Note: Sales in Europe and the Middle East have been combined above due to joint sales responsibility in these areas. No foreign country made up more than 10% of the Company’s total net sales.

11. OTHER BUSINESS CONCENTRATIONS

During 2003, the Company entered into an OEM agreement with a customer to jointly develop and exclusively sell a highly specialized medical monitoring product to the OEM. In July 2004, Criticare shipped the initial prototypes of this monitoring product to this OEM and in January 2005 production shipments began. Sales to this customer approximated $6,326,000 in fiscal 2007, $5,177,000 in fiscal 2006, and $3,100,000 in fiscal 2005, which represented 20.0%, 16.5% and 11.6%, respectively, of the Company's total net sales. The Company had a receivable balance from this customer of $1,641,260 on June 30, 2007, $939,270 on June 30, 2006, and $1,373,836 on June 30, 2005 which represented 27.7%, 15.2% and 20.1%, respectively, of the Company's total receivables as of those dates.

In fiscal 2001, the Company entered into agreements with two offshore contract manufacturing firms to supply finished products. During fiscal 2005, the Company ended the supply partnership agreement with one of the contract manufacturing firms. A summary of the purchases and outstanding payables to these two companies for the years ended June 30, 2007, 2006 and 2005 follows below:

	2007	2006	2005
Supplier I - Purchases	$ 5,648,427	$ 9,324,825	$ 6,193,106
% of total purchases	22.4%	32.3%	29.5%
Accounts payable balance	$ 1,369,312	$ 973,625	$ 610,479
% of total payables	35.8%	18.0%	20.1%

12. COMMITMENTS

The Company leases various equipment under both operating leases and a capital lease, which expire at various dates through fiscal 2011.

On January 19, 2004, the Company entered into a lease agreement for the hardware and software for a new business system. This lease has been accounted for as a capital lease in accordance with SFAS No. 13, “Accounting for Leases”. The following is an analysis of this capital lease:

	June 30, 2007	June 30,2006
Machinery and equipment	$ 333,840	$ 333,840
Less accumulated depreciation	(166,920)	(119,228)
Net	$ 166,920	$ 214,612

Depreciation expense was $47,691 in fiscal 2007, 2006 and 2005.

The Company's Waukesha building lease was to expire in August 2007, but the Company has exercised its option to extend the lease for an additional three years. The lease expires in August 2010 with the Company now leasing approximately 53% of the building's square footage. The Company has also leased an additional warehouse facility. This lease also expires in August 2010. Rent expense was $335,318 in fiscal 2007, $339,024 in fiscal 2006 and $337,281 in fiscal 2005 for the building lease and all other lease commitments.

The following is a schedule by years of the future minimum lease payments under this capital lease and future minimum rental payments required under operating leases, together with the present value of the net minimum lease payments at June 30, 2007:

Fiscal year ending June 30	Capital Lease	Operating Leases
2008	$ 82,560	$ 378,597
2009	52,140	383,459
2010	10,500	365,270
2011	--	60,664
2012 and thereafter	--	--
Total minimum lease payments	$ 145,200	$ 1,187,990
Less amount representing interest	(11,374)	
Present value of net minimum lease payments	$ 133,826	
Less current portion at June 30, 2007	74,148	
Long-term portion at June 30, 2007	$ 59,678	

During fiscal 2001, the Company entered into supply partnership agreements with two offshore contract manufacturing firms that exclusively manufacture medical devices in a regulated environment. These two firms manufacture specific products designated by the Company in accordance with formal purchase orders. The initial term of the agreements is for a period of three years and is automatically extended for additional periods of two years each, unless either party gives written notice at least sixty days prior to the end of the initial term or the then current extension term. During fiscal 2005, the Company ended the supply partnership agreement with one of the contract manufacturing firms. To ensure an adequate supply of products manufactured by the remaining contract manufacturer is maintained, the agreement with this manufacturer, requires that this firm keeps on hand in its finished goods inventories one full month of supply of all products under current purchase orders. At June 30, 2007 and 2006, a one month supply of product maintained at the firm would total approximately $350,000 and $555,000, respectively. In the event the Company would cancel a purchase order under the agreement, the Company would be required to purchase at cost all raw materials, work-in-progress and finished goods inventories for that purchase order. The total work-in-process and raw material inventories for the agreement is approximately $350,000. In addition, any property or equipment that this firm purchased specifically for the production of the Company's products would be purchased, by the Company, at mutually agreed upon prices in the event of termination of the agreement. There have not been any purchase order cancellations under this agreement.

13. QUARTERLY RESULTS - Unaudited

The following table contains quarterly information, which includes all adjustments, consisting only of normal recurring adjustments, that the Company considers necessary for a fair presentation.

	Quarters Ended (Unaudited)							
	June 30, 2007	March 31, 2007	Dec. 31, 2006	Sept. 30, 2006	June 30, 2006	March 31, 2006	Dec. 31, 2005	Sept. 30, 2005
	(in thousands, except per share data)							
Net sales	$ 7,641	$ 7,121	$ 8,463	$ 8,207	$ 7,096	$ 7,812	$ 8,771	$ 7,672
Gross profit	2,366	2,877	3,416	3,121	2,442	3,089	3,576	2,935
Net income (loss)	(366)	30	351	333	(524)	(8)	607	137
Net income (loss) per common share:								
—Basic and diluted	(0.03)	0.00	0.03	0.03	(0.04)	(0.00)	0.05	0.01

The Company typically receives a substantial volume of its quarterly sales orders at or near the end of each quarter. In anticipation of meeting this expected demand, the Company usually builds a significant inventory of finished products throughout each quarter. If the expected volume of sales orders is not received during the quarter, or is received too late to allow the Company to ship the products ordered during the quarter, the Company's quarterly results and stock of finished inventory can be significantly affected. During the fourth quarter of fiscal 2006, the Company reevaluated the allowance for doubtful accounts and increased the allowance by $529,700.

14. OTHER INCOME

Royalty income was $18,100, $313,500 and $177,203 for the years ended June 30, 2007, 2006 and 2005, respectively. The Company recognized $300,000 of income pursuant to a patent license agreement for the year ended June 30, 2006.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Criticare Systems, Inc.
Waukesha, Wisconsin

We have audited the accompanying consolidated balance sheets of Criticare Systems, Inc. and subsidiaries as of June 30, 2007 and 2006, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended June 30, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Criticare Systems, Inc. and subsidiaries at June 30, 2007 and 2006, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 2007, in conformity with accounting principles generally accepted in the United States of America.

/s/ BDO Seidman, LLP
Milwaukee, Wisconsin
September 24, 2007

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

Not applicable.

Item 9A. CONTROLS AND PROCEDURES.

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

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

Item 9B. OTHER INFORMATION.

Not applicable.

PART III

Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

Information regarding the executive officers and directors of the Company is incorporated herein by reference to the discussions under "Election of Directors," "Section 16(a) Beneficial Ownership Reporting Compliance," "Executive Officers," "Audit Committee Matters—Audit Committee Financial Expert" and "Corporate Governance Matters—Code of Business Ethics" in the Company's Proxy Statement for the 2007 Annual Meeting of Stockholders which will be filed on or before October 29, 2007 (the "Criticare Proxy Statement").

The Audit Committee of the Company's Board of Directors is an "audit committee" for purposes of Section 3(a)(58)(A) of the Securities Exchange Act of 1934. The members of the Audit Committee are Dr. Higgins D. Bailey, Jeffrey T. Barnes, Dr. N.C. Joseph Lai and Robert E. Munzenrider (Chairman).

Item 11. EXECUTIVE COMPENSATION.

Information regarding executive compensation is incorporated herein by reference to the discussion under "Executive Compensation" and "Director Compensation" in the Criticare Proxy Statement.

The information incorporated by reference from the "Report of the Compensation Committee" in the Criticare Proxy Statement shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except as shall be expressly set forth by specific reference in such filing.

ItemSECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED 12. STOCKHOLDER MATTERS.

Information regarding security ownership of certain beneficial owners and management is incorporated herein by reference to the discussion under "Security Ownership" in the Criticare Proxy Statement.

The following table summarizes share information for the Company’s equity compensation plans as of June 30, 2007, including the 2003 Stock Option Plan, the 1992 Employee Stock Option Plan, the 1992 Non-Employee Stock Option Plan, the 1987 Employee Stock Option Plan, the 1987 Non-Employee Stock Option Plan and the Company’s Employee Stock Purchase Plan.

Equity Compensation Plan Information

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 (excluding securities in first column)
Equity compensation plans approved by security holders	597,873 shares	$3.24 per share	843,687 shares
Equity compensation plans not approved by security holders	30,000 shares	$2.88 per share	0 shares
Total	627,873 shares	$3.22 per share	843,687 shares

As noted in the table above, the Company has issued warrants to a consultant which have not been approved by the Company's stockholders. The Company extended warrants for the purchase of 30,000 shares of Common Stock issued to the consultant expiring in February 2003 for an additional five years with an exercise price of $2.88 per share.

ItemCERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE.
13.

Information regarding review and approval of related party transactions is incorporated herein by reference to the discussion under "Corporate Governance Matters-Review and Approval of Related Person Transactions" in the Criticare Proxy Statement.

Information regarding director independence is incorporated herein by reference to the discussion under "Corporate Governance Matters-Director Independence" in the Criticare Proxy Statement.

Item 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

Information regarding the fees and services of the independent registered public accounting firm is incorporated herein by reference to the discussion under "Audit Committee Matters—Fees of Independent Registered Public Accounting Firm" in the Criticare Proxy Statement.

PART IV

ItemEXHIBITS AND FINANCIAL STATEMENT SCHEDULES
15.

(a) The following documents are filed as part of this report:

1. Financial Statements. The following consolidated financial statements of the Company are included in Item 8 of this report.

Consolidated Balance Sheets - as of June 30, 2007 and 2006.

Consolidated Statements of Operations - for the years ended June 30, 2007, 2006 and 2005.

Consolidated Statements of Stockholders' Equity - for the years ended June 30, 2007, 2006 and 2005.

Consolidated Statements of Cash Flows - for the years ended June 30, 2007, 2006 and 2005.

Notes to consolidated financial statements.

Report of Independent Registered Public Accounting Firm.

2. Financial Statement Schedules:

Report of Independent Registered Public Accounting Firm.

Financial Statement Schedule for the years ending June 30, 2007, 2006 and 2005:

Schedule Number	Description	Page
II	Valuation and Qualifying Accounts and Reserves	62

All other schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions, are inapplicable or the required information is shown in the financial statements or notes thereto, and therefore have been omitted.

3. Exhibits:

3.1 Restated Certificate of Incorporation of the Company (incorporated by reference to the Registration Statement on Form S-1, Registration No. 33-13050).

3.2 Restated By-Laws of the Company (incorporated by reference to the Company's Current Report on Form 8-K filed on March 17, 2006).

4.1 Specimen Common Stock certificate (incorporated by reference to the Registration Statement filed on Form S-1, Registration No. 33-13050).

4.2 Amended and Restated Rights Agreement, dated as of March 27, 2007, between the Company and LaSalle Bank National Association, as rights agent (incorporated by reference to the Company's Current Report on Form 8-K filed on March 27, 2007).

10.1* 2003 Stock Option Plan, as amended (and form of stock option grant agreement, stock appreciation right grant agreement and restricted stock grant agreement) (incorporated by reference to the Company's Current Report on Form 8-K filed on December 7, 2005).

10.2* 1999 Employee Stock Purchase Plan (incorporated by reference to the Company's Annual Report on Form 10-K for the year ended June 30, 1999).

10.3* 1992 Employee Stock Option Plan (incorporated by reference to the Company's Registration Statement on Form S-8, Registration No. 33-60644).

10.4* 1992 Nonemployee Stock Option Plan (incorporated by reference to the Company's Registration Statement on Form S-8, Registration No. 33-60214).

10.5* 1987 Employee Stock Option Plan (incorporated by reference to the Company's Registration Statement on Form S-8, Registration No. 33-33497).

10.6* 1987 Nonemployee Stock Option Plan (incorporated by reference to the Company's Registration Statement on Form S-8, Registration No. 33-40038).

10.7* Form of Executive Officer and Director Indemnity Agreement (incorporated by reference to the Company's Registration Statement on Form S-1, Registration No. 33-13050).

10.8* Employment Agreement of Emil H. Soika (incorporated by reference to the Company's Current Report on Form 8-K filed on September 8, 2005).

10.9* Employment Agreement of Drew M. Diaz (incorporated by reference to the Company's Annual Report on Form 10-K for the year ended June 30, 2006).

10.10 Supply Partnership Agreement, dated as of August 1, 2000, between the Company and BioCare Corporation (incorporated by reference to the Company's Annual Report on Form 10-K for the year ended June 30, 2001).

10.11* Employment Agreement of Joseph P. Lester (incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002).

10.12* Employment Agreement of Deborah A. Zane (incorporated by reference to the Company's Annual Report on Form 10-K for the year ended June 30, 2005).

10.13* Employment Agreement of Joel D. Knudson (incorporated by reference to the Company's Annual Report on Form 10-K for the year ended June 30, 2005).

10.14* Employment Agreement of Michael Larsen (incorporated by reference to the Company's Annual Report on Form 10-K for the year ended June 30, 2005).

10.15* Amendment to Employment Agreement of Emil H. Soika effective September 28, 2006 (incorporated by reference to the Company's Annual Report on Form 10-K for the year ended June 30, 2006).

10.16* Amendment to Employment Agreement of Joseph P. Lester effective September 28, 2006 (incorporated by reference to the Company's Annual Report on Form 10-K for the year ended June 30, 2006).

10.17* Amendment to Employment Agreement of Deborah A. Zane effective September 28, 2006 (incorporated by reference to the Company's Annual Report on Form 10-K for the year ended June 30, 2006).

10.18* Amendment to Employment Agreement of Joel D. Knudson effective September 28, 2006 (incorporated by reference to the Company's Annual Report on Form 10-K for the year ended June 30, 2006).

10.19* Amendment to Employment Agreement of Michael T. Larsen effective September 28, 2006 (incorporated by reference to the Company's Annual Report on Form 10-K for the year ended June 30, 2006).

21 Subsidiaries.

23.1 Consent of BDO Seidman, LLP.

24 Power of Attorney (incorporated by reference to the signature page hereof).

31.1 Certification of Emil H. Soika, President and Chief Executive Officer (Principal Executive Officer) pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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

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

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* Management contract or compensatory plan or arrangement.

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

(b) Exhibits.

The response to this portion of Item 15 is submitted as a separate section of this report.

(c) Financial Statement Schedules.

The response to this portion of Item 15 is submitted as a separate section of this report.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

By /s/ Emil H. Soika
Emil H. Soika, President
and Chief Executive Officer

Date: September 27, 2007

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Emil H. Soika and Joel D. Knudson, and each of them, as his true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or any of them, or their or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Emil H. Soika	President, Chief Executive Officer	September 27, 2007
Emil H. Soika	and Director (Principal Executive Officer)	
/s/ Joel D. Knudson	Vice President-Finance and Secretary	September 27, 2007
Joel D. Knudson	(Principal Financial and Accounting Officer)	

/s/ N.C. Joseph Lai N.C. Joseph Lai, Ph.D.	Director	September 27, 2007
/s/ Jeffrey T. Barnes Jeffrey T. Barnes	Director	September 27, 2007
/s/ Robert E. Munzenrider Robert E. Munzenrider	Director	September 27, 2007
/s/ William M. Moore William M. Moore	Director	September 27, 2007

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Criticare Systems, Inc.
Waukesha, Wisconsin

The audits referred to in our report dated September 24, 2007 relating to the consolidated financial statements of Criticare Systems, Inc., which is contained in Item 8 of this Form 10-K included the audit of the financial statement schedule listed in Item 15. This financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion on this financial statement schedule based upon our audits.

In our opinion, such financial statement schedule presents fairly, in all material respects, the information set forth therein.

/s/ BDO Seidman, LLP
Milwaukee, Wisconsin
September 24, 2007

SCHEDULE II

CRITICARE SYSTEMS, INC.

VALUATION AND QUALIFYING ACCOUNTS
FOR THE YEARS ENDED JUNE 30, 2007, 2006 AND 2005

Column A Description	Column B Balance at Beginning of Period	Column C Charged to Costs and Expenses	Column D Deductions	Column E Balance at End of Period
YEAR ENDED JUNE 30, 2005:				
Allowance for doubtful accounts	$ 260,000	$ 87,695	$ 47,695	$ 300,000
Reserve for sales returns and allowances	$ 77,945	$ --	$ --	$ 77,945
Reserve for obsolete inventory	$ 610,000	$ 281,003	$ 452,703	$ 438,300
YEAR ENDED JUNE 30, 2006:				
Allowance for doubtful accounts	$ 300,000	$ 559,206	$ 29,506	$ 829,700
Reserve for sales returns and allowances	$ 77,945	$ --	$ 37,945	$ 40,000
Reserve for obsolete inventory	$ 438,300	$ 56,622	$ 134,922	$ 360,000
YEAR ENDED JUNE 30, 2007:				
Allowance for doubtful accounts	$ 829,700	$ (44,221)	$ 287,841	$ 497,638
Reserve for sales returns and allowances	$ 40,000	$ --	$ --	$ 40,000
Reserve for obsolete inventory	$ 360,00	$ 167,144	$ 152,144	$ 375,000