

PRO DEX INC  
Form 10QSB  
November 14, 2005

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-QSB**

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**  
**For the quarterly period ended September 30, 2005**

**OR**

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. For the**  
**transition period from \_\_\_\_\_ TO \_\_\_\_\_.**

**Commission File Number 0-14942**

**PRO-DEX, INC.**

**(Exact name of small business issuer as specified in its charter)**

**Colorado**  
**(State or Other Jurisdiction of  
Incorporation or Organization)**

**84-1261240**  
**(IRS Employer Identification No.)**

**151 E. Columbine Avenue, Santa Ana, California 92707**  
**(Address of Principal Executive Offices)**

**Issuer's telephone number: 714-241-4411**

Indicate by check mark whether the Registrant (1) has filed all reports required by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding twelve 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 ninety days. Yes  No

Indicate the number by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
Yes  No

Indicate the number of shares outstanding of each of the Registrant's classes of Common Stock outstanding as of the latest practicable date:  
9,504,912 shares of Common Stock, no par value, as of November 1, 2005.

Transitional Small Business Disclosure Format: Yes  No

**Item 1. Financial Statements****PRO-DEX, INC. and SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS**

	<i>September 30, 2005</i> <i>(unaudited)</i>	<i>June 30, 2005</i> <i>(audited)</i>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 2,893,000	\$ 2,584,000
Accounts receivable, net of allowance for doubtful accounts of \$120,000 at September 30 and \$100,000 at June 30	2,892,000	3,521,000
Inventories, net	3,317,000	3,145,000
Prepaid expenses	239,000	66,000
Income tax receivable	-	96,000
Deferred income taxes	586,000	519,000
Total current assets	9,927,000	9,931,000
Equipment and leasehold improvements, net	1,106,000	1,156,000
Other assets:		
Goodwill	1,110,000	1,110,000
Deferred income taxes	541,000	541,000
Other	20,000	18,000
Total other assets	1,671,000	1,669,000
Total assets	\$ 12,704,000	\$ 12,756,000
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 826,000	\$ 1,158,000
Accrued expenses	397,000	472,000
Income taxes payable	100,000	13,000
Total current liabilities	1,323,000	1,643,000
Long-term liabilities	-	-
Total liabilities	1,323,000	1,643,000
Commitments and contingencies		
Shareholders' equity:		
Common shares; no par value; 50,000,000 shares authorized; 9,454,912 shares issued and outstanding September 30, 2005, 9,449,396 shares issued and outstanding June 30, 2005,	15,940,000	15,933,000
Accumulated deficit	(4,559,000)	(4,820,000)
Total shareholders' equity	11,381,000	11,113,000
Total liabilities and shareholders' equity	\$ 12,704,000	\$ 12,756,000

*See notes to consolidated financial statements.*

**PRO-DEX, INC. and SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**Three months ended September 30 (unaudited)**

	2005	2004
Net sales	\$ 3,763,000	\$ 3,332,000
Cost of sales	2,072,000	1,472,000
Gross profit	1,691,000	1,860,000
Operating expenses:		
Selling	255,000	200,000
General and administrative expenses	586,000	544,000
Research and development costs	442,000	418,000
Total operating expenses	1,283,000	1,162,000
Income from operations	408,000	698,000
Other income (expense):		
Royalty income	11,000	40,000
Other income (expense)	(6,000)	39,000
Interest income (expense)	22,000	(7,000)
Total	27,000	72,000
Income before provision for income taxes	435,000	770,000
Provision for income taxes	173,000	308,000
Net income	\$ 262,000	\$ 462,000
Net Income per share:		
Basic	\$ 0.03	\$ 0.05
Diluted	\$ 0.03	\$ 0.05
Weighted average shares outstanding - basic	9,452,780	8,863,902
Weighted average shares outstanding - diluted	10,046,745	9,470,127

*See notes to consolidated financial statements.*

**PRO-DEX, INC. and SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**Three months ended September 30 (unaudited)**

	2005	2004
Cash Flows from Operating Activities:		
Net Income	\$ 262,000	\$ 462,000
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	105,000	84,000
Bad debt expense	20,000	5,000
Reserve for obsolete inventory	71,000	29,000
Stock based compensation	-	6,000
Deferred taxes	(67,000)	-
Changes in:		
Decrease in accounts receivable	609,000	278,000
(Increase) in inventories	(242,000)	(372,000)
(Increase) in prepaid expenses	(173,000)	(190,000)
(Increase) in other assets	(2,000)	(30,000)
(Decrease) in accounts payable and accrued expenses	(408,000)	(232,000)
Increase (decrease) in income taxes receivable/payable	183,000	(22,000)
Net Cash provided by Operating Activities	358,000	18,000
Cash Flows From Investing Activities:		
Purchases of equipment and leasehold improvements	(55,000)	(47,000)
Net Cash (used in) Investing Activities	(55,000)	(47,000)
Cash Flows from Financing Activities:		
Principal payments on long-term shareholder borrowings	-	(17,000)
Proceeds from option exercise	6,000	73,000
Net Cash provided by Financing Activities	6,000	56,000
Net Increase in Cash and Cash Equivalents	309,000	27,000
Cash and Cash Equivalents, beginning of period	2,584,000	2,070,000
Cash and Cash Equivalents, end of period	\$ 2,893,000	\$ 2,097,000
	<i>Supplemental Information</i>	
Cash payments for interest	\$ -	\$ 7,000
Cash payments for income taxes	\$ 55,000	\$ 331,000

*See notes to consolidated financial statements.*

**PRO-DEX, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Basis of Presentation**

The accompanying unaudited consolidated financial statements of Pro-Dex, Inc. ("We", "us", "our", "Pro-Dex" or the "Company") have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-QSB and Regulation S-B. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. These financial statements should be read in conjunction with the audited financial statements presented in our Annual Report for the fiscal year ended June 30, 2005. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. The results of operations for such interim periods are not necessarily indicative of the results that may be expected for the full year. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-KSB for the year ended June 30, 2005.

**Inventories**

Inventories are stated at the lower of cost (the first-in, first-out method) or market and consist of the following:

	September 30, 2005 (unaudited)	June 30, 2005
Raw Materials	\$ 1,299,000	\$ 1,421,000
Work in process	621,000	409,000
Development costs under contract	179,000	132,000
Finished goods	1,579,000	1,473,000
Total	\$ 3,678,000	\$ 3,435,000
Reserve for slow moving items	(361,000)	(290,000)
Total inventories, net	\$ 3,317,000	\$ 3,145,000

**GOODWILL**

On July 1, 2002 we adopted SFAS No. 142 "Goodwill and Other Intangible Assets." SFAS No. 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142.

In accordance with the requirements of SFAS No. 142, we performed impairment tests and recorded no impairment charges in fiscal years ended June 30, 2004 or 2005. We prepare our annual impairment testing on April 1 of each year. During the quarter ended September 30, 2005, management determined that there were no events or circumstances which have occurred that would indicate an impairment of the goodwill had occurred.

**Net INCOME per share**

The following table reconciles the weighted average shares outstanding for basic and diluted net income per share for the periods indicated (unaudited).

	Three Months Ended September 30,	
	2005	2004
Net income	\$ 262,000	\$ 462,000
Basic net income per common share:		
Weighted average number of common shares outstanding	9,452,780	8,863,902
Basic net income per common share	\$ 0.03	\$ 0.05
Diluted net income per share:		
Weighted average of common shares outstanding	9,452,780	8,863,902
Effect of potentially dilutive securities (options)	548,916	456,033
Effect of potentially dilutive securities (warrants)	45,049	72,064
		(convertible Preferred Shares)
		-
		78,129
		Weighted average number of common and shares -
		Diluted
		10,046,745
		9,470,128
		Diluted net income per common share
		\$
		0.03
		\$
Effect of potentially dilutive securities		0.05

**CREDIT FACILITY**

In October 2003, our then existing credit facility with Wells Fargo Business Credit Inc. was refinanced with a more favorable facility by Wells Fargo Bank, N.A. (Wells Fargo) for borrowings up to the lesser of \$2,000,000 or the total of our eligible accounts receivable. The credit facility expired in October 2004. Its terms required monthly interest payments at the prime rate or LIBOR (one month to three months) plus 2.75% based on outstanding borrowings, with no minimum interest charge. The outstanding borrowings under the credit facility were secured by all assets of, and guaranteed by the Company.

In October 2004, the credit facility with Wells Fargo was renewed again with a more favorable facility for borrowings up to \$2,000,000. The credit facility expired in October 2005 and its terms required monthly interest payments at the prime rate of interest (6.75% at September 30, 2005); or LIBOR plus 2.50% (6.36% (one month) to 6.57% (three months) at September 30, 2005), based on outstanding borrowings with no minimum interest charge. The outstanding borrowings are secured by all assets of and guaranteed by the Company. There was no outstanding balance under the terms of this credit facility as of September 30, 2005. The total eligible borrowing capacity at September 30, 2005 was \$2,000,000.

There are certain financial and non-financial covenants that we must meet to be in compliance with the terms of the October 2004 Wells Fargo credit facility. At September 30, 2005, we were in compliance with all such covenants.

### **Income Taxes**

Deferred income taxes are provided on a liability method whereby deferred tax assets and liabilities are recognized for temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. We have tax credit carry forwards totaling \$176,000 for State tax purposes that do not expire and can be carried forward indefinitely until fully utilized.

Significant management judgment is required in determining our provision for income taxes and the recoverability of our deferred tax asset. It is based on our estimates of future taxable income by jurisdiction in which we operate and the period over which our deferred tax assets will be recoverable. In the event that actual results differ from these estimates or we adjust these estimates in future periods, we may need to establish a valuation allowance which could result in a tax provision up to the carrying value of our deferred tax assets.

## STOCK OPTIONS

During the quarter ended September 30, 2005, the Company granted 45,000 Common Stock Options under the Director's Plan exercisable at an average per share price of \$3.16 (fair market value \$1.18 per option) and 120,000 Common Stock Options under the Employee's Plan exercisable at an average per share price of \$2.85 (fair market value \$1.22 per option).

The fair market value of each grant is estimated at the grant date using the Black-Scholes option-pricing model with the following weighted-average assumptions: no dividend rate for all years; price volatility of 35% to 42%, risk-free interest rate of approximately 3.7% to 4.2%; and expected lives of five years.

	Three Months Ended September 30,	
	2005	2004
Net income as reported:	\$ 262,000	\$ 462,000
Add stock-based employee compensation expense included in reported net income, net of related tax effects (Deduct) total stock-based employee and director compensation expense determined under fair value based method for all awards, net of related tax effects	(8,000)	(15,000)
Pro-forma net income:	\$ 254,000	\$ 447,000
Basic earnings per share:		
As reported	\$ 0.03	\$ 0.05
Pro-forma	\$ 0.03	\$ 0.05
Diluted earnings per share:		
As reported	\$ 0.03	\$ 0.05
Pro-forma	\$ 0.03	\$ 0.05

## PREFERRED STOCK

In January 2005, 78,129 Preferred Stock shares representing 100% of all Preferred stock shares outstanding were converted to 78,129 shares of Common Stock, leaving no Preferred Stock shares outstanding. We received no cash proceeds from the conversion.

## SUBSEQUENT EVENTS

On October 31, 2005, the credit facility with Wells Fargo was renewed again for borrowings up to \$2,000,000. The credit facility expires in October 2006 and its terms require monthly interest payments at the prime rate of interest (6.75% at September 30, 2005); or LIBOR plus 2.50% (6.36% (one month) to 6.57% (three months) at September 30, 2005), based on outstanding borrowings with no minimum interest charge. The outstanding borrowings are secured by all assets of and guaranteed by the Company. The total eligible borrowing capacity at November 14, 2005 was \$2,000,000.



There are certain financial and non-financial covenants that we must meet to be in compliance with the terms of the credit facility. At November 14, 2005, we were in compliance with all such covenants.

On October 31, 2005, we entered into an Asset Purchase Agreement (the "Purchase Agreement") with IntraVantage, Inc., a Delaware corporation ("IntraVantage"), whereby the Company purchased from IntraVantage certain of IntraVantage's assets related to IntraVantage's dental products business, including all of IntraVantage's intellectual property rights (the "Intellectual Property" and, collectively with the other purchased assets, the "Assets"). The purchase price for the Assets comprised of the following consideration:

- \$226,087 in cash paid to IntraVantage on October 31, 2005;
- \$893,271 in cash paid to IntraVantage's bank on October 31, 2005 as full payoff and release of all of IntraVantage's credit obligations with such bank; and
- \$400,000 to IntraVantage in annual installments of \$100,000 in cash payable on each of October 31, 2006, 2007, 2008 and 2009.

As further inducement for IntraVantage to enter into the Purchase Agreement, Pro-Dex also entered into an Exclusive License Agreement and a Royalty Agreement with IntraVantage in conjunction with the October 31, 2005 closing of the Purchase Agreement. The Exclusive License Agreement grants to IntraVantage an exclusive, worldwide, irrevocable, royalty-free and perpetual license to use the acquired Intellectual Property in any non-dental related field of use. The Royalty Agreement requires that the Company pay to IntraVantage certain royalty payments on revenues generated from future sales of products by the Company which fall within the scope of, incorporate, are a modification of or are substantially derived from one or more of the patents included in the Intellectual Property.

Also in conjunction with the closing of the Purchase Agreement, the Company agreed to terminate a supply agreement between the Company and IntraVantage, along with all amendments thereto. Pursuant to this termination, IntraVantage shall return to the Company certain products previously delivered to IntraVantage under the supply agreement in exchange for the Company issuing to IntraVantage a credit memo equal to the full value of outstanding IntraVantage invoices related to the supply agreement.

Pro-Dex will be reversing approximately \$300,000 in previously recorded sales to IntraVantage during the second fiscal quarter of 2006, sales that relate to product which was returned to Pro-Dex at the close of the transaction. Pro-Dex will also reduce its open order backlog by approximately \$900,000 to eliminate all orders currently in place from IntraVantage. Additionally, this adjustment is not expected to unfavorably impact bottom-line earnings during the second quarter and the remainder of the year as the impact on profit was previously addressed through increased reserves for accounts receivable during the fourth quarter of fiscal 2005 and the first quarter of fiscal year 2006.

## **Item 2. Management's Discussion and Analysis or Plan of Operations**

### **COMPANY OVERVIEW**

The following discussion and analysis provides information that the Company's management believes is relevant to an assessment and understanding of our results of operations and financial condition for each of the three month periods ended September 30, 2004 and 2005, respectively. This discussion should be read in conjunction with the Consolidated Financial Statements and the Notes thereto included elsewhere in this Report. This Report contains certain forward-looking statements and information. The cautionary statements included herein should be read as being applicable to all related forward-looking statements wherever they may appear. Our actual future results could differ materially from those discussed herein. Our critical accounting policies relate to inventory valuation for slow moving items, impairment of goodwill, and recoverability of deferred income taxes.



Except for the historical information contained herein, the matters discussed in this Quarterly Report on Form 10-QSB, including discussions of our product development plans, business strategies and market factors influencing our results, are forward-looking statements that involve certain risks and uncertainties. Actual results may differ from those anticipated by us as a result of various factors, both foreseen and unforeseen, including, but not limited to, our ability to continue to develop new products and increase systems sales in markets characterized by rapid technological evolution, consolidation within our target marketplace and among our competitors, and competition from larger, better capitalized competitors. Many other economic, competitive, governmental and technological factors could impact our ability to achieve our goals. Interested persons are urged to review the risks described herein, as well as in our other public disclosures and filings with the Securities and Exchange Commission.

Pro-Dex, Inc. is a Colorado corporation that was chartered in 1978, and specializes in bringing speed-to-market in the development and manufacture of technology-based solutions that incorporate embedded motion control and miniature rotary drive systems. We design and manufacture products serving the medical, dental, factory automation and scientific research markets. Our strategic value proposition is to get customers to market faster, at a lower total cost and with a higher quality product. Products that we have developed and manufactured are used in hospitals, dental offices, medical engineering labs, scientific research facilities and high tech manufacturing operations around the world. Until June 30, 2004, Pro-Dex had a "holding company" legal structure. In the fiscal year ended June 30, 2004, we eliminated the Company's holding company structure and terminated the separate legal status of our then operating subsidiaries, Micro Motors, Inc. ("Micro Motors") headquartered in Santa Ana, California and Oregon Micro Systems, Inc. ("OMS") headquartered in Beaverton, Oregon, through the merger of each such subsidiary into the Company. As a result, we no longer operate as a holding company but as one integrated business operating in two locations providing a broad range of systems solutions to our customers. The company names of Micro Motors® and Oregon Micro Systems® continue to be used for marketing purposes as brand names.

Pro-Dex's principal headquarters are located at 151 E. Columbine Avenue, Santa Ana, California 92707 and our phone number is 714-241-4411. Our Internet address is [www.pro-dex.com](http://www.pro-dex.com). Our annual reports on Form 10-KSB, quarterly reports on Form 10-QSB, current reports on Form 8-K, amendments to those reports and other Securities and Exchange Commission ("SEC") filings, are available free of charge through our website as soon as reasonably practicable after such reports are electronically filed with, or furnished to, the SEC. In addition, our Code of Ethics and other corporate governance documents may be found on our website at the Internet address set forth above. Our filings with the SEC may also be read and copied at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at [www.sec.gov](http://www.sec.gov).

### **Description of Business**

The majority of our revenue is derived from designing, developing and manufacturing electric, air, and battery powered rotary drive systems for the medical device and dental industries, and motion control software and hardware for industrial and scientific applications. The Company also distributes its own line of pneumatic and electric dental hand pieces sold under the Micro Motors name utilizing a network of independent sales representatives across North America. A large part of the revenue growth of the Company has been driven by developing and selling numerous private label rotary drive systems for use in dental, cranial, spinal, arthroscopic and orthopedic surgery. Other revenue sources include designing and manufacturing miniature pneumatic motors and motion control systems for industrial applications in the automotive, aerospace, apparel and entertainment industries.

All years relating to financial data herein shall refer to fiscal years ending June 30, unless indicated otherwise.

Company-funded research and development supports the development of generic rotary drive and motion control platforms. We then seek customer-funded projects to customize these platforms to specific customer requirements. Company-funded research and development projects are generally expected to convert to customer-funded projects within six to eighteen months. Company funded project costs are expensed as incurred. In the three months ended September 30, 2005, \$442,000 was expensed; an increase of \$24,000 from the \$418,000 expensed in the three months ended September 30, 2004.

For customer-funded development projects, costs are capitalized and recognized as a cost of sales when specific deliverables within the development contracts are produced, matching the costs to the revenue. In the three months ended September 30, 2005, \$4,000 was recognized as cost of sales, compared to \$37,000 recognized as cost of sales in the three months ended September 30, 2004, reflecting a decrease in development fees billable during the quarter.

Customer-funded research and development provided \$19,000 in revenue in the three months ended September 30, 2005, and \$149,000 in revenue in the three months ended September 30, 2004, reflecting a decrease in development fees billable during the quarter. The results of customer-funded development work are intended to provide long-term exclusive manufacturing agreements and provide the customer with the retention of the intellectual property developed. The identity of the customer is generally protected by a non-disclosure agreement.

The Company's revenue is derived from four main customer types. The proportion of Pro-Dex total sales to each customer type is noted in the table below:

	Q1 FY	Q1 FY	FY	FY	FY
% of Total Sales	2006	2005	2005	2004	2003
Dental	29%	23%	24%	32%	43%
Medical	43%	33%	42%	41%	28%
Industrial	19%	31%	26%	18%	19%
Government research and other	9%	12%	8%	9%	10%

Medical product sales represent the manufacture of products which utilize proprietary designs developed by the Company under exclusive design and supply agreements. Our dental products are sold to original equipment manufacturers and dental product distributors. An independent dealer network was engaged in 2003 to market our own branded line of dental products in a more effective manner. We also design and manufacture embedded multi-axis motion controllers used to regulate the motion of servo and stepper motors, predominantly for the factory automation and medical analysis equipment industries. The controllers support the platforms for PCI, VME, ISA, and cPCI busses as well as stand-alone requirements. In addition, we make and sell pneumatic motors for industrial applications that are marketed directly to end-users and through industrial supply distributors. The increase in the percentage of sales of medical products is a direct result of the shift in the focus of our research and development efforts away from dental products and toward our capabilities in the medical product market.

Our commitment to quality manufacturing is demonstrated by our many independently verified certifications for maintaining quality processes and products. We hold the following certifications: ISO 9001:2000, ISO 13485 revised 1998, and Medical Device Directive 93\42\EEC Annex II company.

At the present time, we are generally able to fill orders within sixty (60) days. At September 30, 2005, we had a backlog, including orders for delivery beyond 60 days, of \$7.6 million compared with a backlog of \$4.3 million at September 30, 2004 and \$7.9 million at June 30, 2005. We expect to ship most of our backlog in 2006 and the remainder in 2007. The increased backlog compared to September 30, 2004 is due to an increase in new purchase orders in the last year from new and existing customers. We do not typically experience seasonal fluctuations in our new order bookings, but may experience variability in our new order bookings due to the timing of major new product launches. Similarly, we do not typically experience seasonal fluctuations in our shipments and revenues.

We sell our products using several methods; selling directly to the customer, selling directly to original equipment manufacturers and selling through a network of high technology and dental product distributors within North America. Internationally, the Company has sales agreements with foreign distributors or sells through the domestic subsidiaries of foreign customers.

### **CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS**

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States (GAAP). The preparation of our financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures. We base our estimates on historical experience and 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 significant accounting policies that are believed to be the most critical to fully understanding and evaluating the reported financial results include inventory valuations for slow moving items, impairment of goodwill, and the recovery of deferred income tax assets.

We determine our inventory value at the lower of cost (first-in, first-out method) or market value and calculate a reserve for slow moving items to reflect a reduced marketability for the item. The reserve is calculated by comparing the quantity of the item on hand with our prior 12-month sales history. If inventory on hand for a specific part exceeds an estimated 24 months of usage, between 20% and 100% of its value may be included in the inventory reserve. The actual percentage reserved depends on the total quantity on hand, its sales history, and expected near term sales prospects.

On July 1, 2002 the Company adopted SFAS No. 142 "Goodwill and Other Intangible Assets." SFAS No. 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142. In accordance with the requirements of SFAS No. 142, we have recorded no impairment charge in 2004 or 2005. We prepare our annual impairment testing on April 1 of each year.

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating the actual current tax liabilities together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within the consolidated balance sheet. The most significant tax assets are future deductions from the amortization of intangibles over the next ten years. Tax assets also result from net operating losses and research and development tax credits. We must then assess the likelihood that the deferred tax assets will be recovered from future taxable income and, to the extent we believe that recovery is not likely, a valuation allowance must be established. To the extent we establish a valuation allowance or increase or decrease this allowance in a period, the impact will be included in the tax provision in the statement of operations.



Significant management judgment is required to determine our provision for income taxes and the recoverability of the deferred tax asset. It is based on estimates of future taxable income by jurisdiction in which the Company operates and the period over which the deferred tax assets will be recoverable. In the event that actual results differ from these estimates or we adjust these estimates in future periods, a valuation allowance may need to be established which could result in a tax provision equal to the carrying value of the deferred tax assets.

**Results of Operations****For the Three-Month periods ended September 30, 2005 and 2004**

The following table sets forth for the periods indicated the percentage of net revenues represented by each item in our Consolidated Statements of Income.

(In Thousands)	Three Months Ended September 30,			
	2005		2004	
Net sales:	\$ 3,763	100.0 %	\$ 3,332	100.0 %
Cost of sales	2,072	55.1 %	1,472	44.2 %
Gross Profit	1,691	44.9 %	1,860	55.8 %
Selling, general and administrative expenses	841	22.3 %	744	22.3 %
Research and development costs	442	11.7 %	418	12.5 %
Income from Operations	408	10.8 %	698	20.9 %
Net interest and other (income)	(27)	(0.7)	(72)	(2.2)
Provision for Income Taxes	173	4.6 %	308	9.2 %
Net Income	\$ 262	7.0 %	\$ 462	13.9 %

**Net Sales.** Consolidated sales increased from \$3,332,000 to \$3,763,000 (\$431,000 or 13%) for the quarter ended September 30, 2005, compared to the quarter ended September 30, 2004. Medical products continued to increase as a peryear. Shipments to dental customers increased to 29% of total sales compared to 23% for the same quarter in the prior year as new customers expanded their order volume. Sales to factory automation and industrial customers decreased to 19% from 31% for the same quarter in the prior year as shipments of legacy motion control devices were reduced. Although selective price increases and decreases were implemented in response to market conditions, the majority of the sales growth and declines for each product line is due primarily to changes in sales volume, not the effect of price changes.

**Gross Profit and Gross Profit Percentage of Sales.** Our consolidated gross profit for the quarter ended September 30, 2005 decreased 9% over the same quarter in the previous year despite an increase in sales as higher margin industrial sales were replaced by a mix of lower margin dental products. Gross profit as a percentage of sales decreased to 44.9% for the quarter ended September 30, 2005 compared to 55.8% for the quarter ended September 30, 2004, reflecting the sales product mix changes as well as new product launch manufacturing inefficiencies that offset cost improvements from prior quarters. Gross profit and gross profit percentage were as follows:

	Three Months Ended September 30,			(Decrease)
	2005	2004		
Gross Profit	\$ 1,691,000	\$ 1,860,000		-9.1 %
Gross Profit Percentage	44.9 %	55.8 %		-19.5 %

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**Selling, General and Administrative Costs (S, G&A).** S, G & A expenses increased to \$841,000 for the quarter ended September 30, 2005 from \$744,000 for the quarter ended September 30, 2004. The increase is due to increased expenses related to print advertising and promotional materials of \$30,000, increased bad debt expense of \$20,000 and increased corporate business development expenses. S, G & A costs were as follows:

	Three Months Ended September 30,		Increase
	2005	2004	
Selling	\$ 255,000	\$ 200,000	28 %
General and administrative	\$ 586,000	\$ 544,000	8 %
Total S, G&A	\$ 841,000	\$ 744,000	13 %

**Research and Development Costs.** Company-funded research and development expenses increased to \$442,000 for the quarter ended September 30, 2005 from \$418,000 for the quarter ended September 30, 2004. The increase in Company-funded research and development costs is due to higher investments in labor and travel associated with new product development. Company-funded research and development costs were as follows:

	Three Months Ended September 30,		Increase
	2005	2004	
Research and Development costs	\$ 442,000	\$ 418,000	6 %

Company-funded research and development supports the development of generic rotary drive and motion control platforms. We then seek customer-funded projects to customize these platforms to specific customer requirements. Company-funded research and development projects are generally expected to convert to customer-funded projects within six to eighteen months. Company funded project costs are expensed as incurred. In the three months ended September 30, 2005, \$442,000 was expensed; an increase of \$24,000 from the \$418,000 expensed in the three months ended September 30, 2004.

For customer-funded development projects, costs are capitalized and recognized as a cost of sales when specific deliverables within the development contracts are produced, matching the costs to the revenue. In the three months ended September 30, 2005, \$4,000 was recognized as cost of sales, compared to \$37,000 recognized as cost of sales in the three months ended September 30, 2004, reflecting the completion of new product launches this quarter.

Customer-funded research and development provided \$19,000 in revenue in the three months ended September 30, 2005, and \$149,000 in revenue in the three months ended September 30, 2004. The results of customer-funded development work are intended to provide long-term exclusive manufacturing agreements and provide the customer with the retention of the intellectual property developed. The identity of the customer is generally protected by a non-disclosure agreement.

**Operating Profit and Operating Profit Percentage of Sales.** Our consolidated operating profit for the quarter ended September 30, 2005 decreased to \$408,000 compared to operating profit of \$698,000 for the same quarter in the previous year. The decrease was due to the less profitable product sales mix given the decreased industrial product sales levels and increased operating expenses. Consequently, operating profit as a percentage of sales decreased to 10.8% for the quarter ended September 30, 2005 compared to 20.9% for the quarter ended September 30,. Operating profit and margin were as follows:

	Three Months Ended September 30,		Decrease
	2005	2004	
Operating Profit	\$408,000	\$698,000	-42%
Operating Profit Percentage	10.8%	20.9%	-48%

**Royalties and Other Income.** The Company recognized \$11,000 in royalty income in the three months ended September 30, 2005, compared to \$40,000 in the prior year's quarter.

**Interest.** Interest income was \$22,000 in the quarter ended September 30, 2005, compared to a \$7,000 expense in the prior year's quarter due to the size of Company's cash balances and current debt-free status.

**Provision for Taxes.** Our estimated effective combined federal and state tax rate on income from operations for the quarter ended September 30, 2005 was 40% and was 40% for the quarter ended September 30, 2004.

**Net Income.** Our net income for the three months ended September 30, 2005 was \$262,000 or \$0.03 per share on a basic and diluted basis, as compared to a net income of \$462,000 or \$0.05 per share on a basic and diluted basis for the three months ended September 30, 2004.

### Liquidity and Capital Resources

The following table presents selected financial information for the comparative period last year and the year ended June 30, 2005:

	As of September 30,		Year Ending
	2005	2004	June 30, 2005
Cash and cash equivalents	\$ 2,893,000	\$ 2,097,000	\$ 2,584,000
Working Capital <sup>1</sup>	\$ 8,604,000	\$ 6,267,000	\$ 8,288,000
Credit Line outstanding balance	\$ 0	\$ 0	\$ 0
Tangible book value/common share <sup>2</sup>	\$ 1.09	\$ 0.91	\$ 1.10
Number of days of sales outstanding (DSO) in accounts receivable at end of quarter <sup>3</sup>	70	57	75
	Three Months Ended September 30,		Year Ending
	2005	2004	June 30, 2005
Net cash provided by operations	\$ 358,000	\$ 18,000	\$ 557,000

<sup>1</sup> Working Capital is calculated as follows: ending current assets balance less ending current liabilities balance.

<sup>2</sup> Tangible book value/common share is calculated as follows: (Total shareholders' equity less Goodwill) divided by (basic weighted average outstanding shares for the most recent quarter).

<sup>3</sup> DSO is calculated as follows: Ending Net Accounts Receivable balance divided by (Previous Quarter Sales divided by 91 days).

Our working capital at September 30, 2005 increased to \$8.6 million compared to \$6.3 million at September 30, 2004 and \$8.3 million at June 30, 2005. Sustained profitability contributed to the provision of cash and increased working capital for the quarter.

In October 2003, our then existing credit facility with Wells Fargo Business Credit Inc. was refinanced with a more favorable facility by Wells Fargo Bank, N.A. (Wells Fargo) for borrowings up to the lesser of \$2,000,000 or the total of our eligible accounts receivable. The credit facility expired in October 2004. Its terms required monthly interest payments at the prime rate or LIBOR (one month to three months) plus 2.75% based on outstanding borrowings, with no minimum interest charge. The outstanding borrowings under the credit facility were secured by all assets of, and guaranteed by the Company.

In October 2004, the credit facility with Wells Fargo was renewed again with a more favorable facility for borrowings up to \$2,000,000. The credit facility expired in October 2005 and its terms required monthly interest payments at the prime rate of interest (5.75% at September 30, 2005); or LIBOR plus 2.50% (6.36% (one month) to 6.57% (three months) at September 30, 2005), based on outstanding borrowings with no minimum interest charge. The outstanding borrowings are secured by all assets of, and guaranteed by the Company. There was no outstanding balance under the terms of this credit facility as of September 30, 2005. The total eligible borrowing capacity at September 30, 2005 was \$2,000,000.



There are certain financial and non-financial covenants that we must meet to be in compliance with the terms of the October 2004 Wells Fargo credit facility. At September 30, 2005, we were in compliance with all such covenants.

In September 2002, our Board of Directors authorized the repurchase on the open market of up to 500,000 shares at a share price no greater than \$1.25 of our outstanding Common Stock, subject to compliance with applicable laws and regulations. There is no requirement that we repurchase all or any portion of such shares. The maximum total value of the repurchase is not to exceed \$500,000. This repurchase is to be financed with cash generated by operations. From the inception of the repurchase authorization through the year-end date of June 30, 2003, we repurchased 75,700 shares of Common Stock for \$43,741, at an average price of \$0.58 per share. No additional shares were repurchased in fiscal year 2004, 2005, or to date during fiscal year 2006.

At September 30, 2005, we had cash and cash equivalents of \$2,893,000. We believe that our cash and cash equivalents on hand, together with cash flows from operations, if any, and amounts available under the credit facility will be sufficient to meet our working capital and capital expenditure requirements for the next twelve months.

## **SUBSEQUENT EVENTS**

On October 31, 2005, the credit facility with Wells Fargo was renewed again for borrowings up to \$2,000,000. The credit facility expires in October 2006 and its terms require monthly interest payments at the prime rate of interest (6.75% at September 30, 2005); or LIBOR plus 2.50% (6.36% (one month) to 6.57% (three months) at September 30, 2005), based on outstanding borrowings with no minimum interest charge. The outstanding borrowings are secured by all assets of and guaranteed by the Company. The total eligible borrowing capacity at November 14, 2005 was \$2,000,000.

There are certain financial and non-financial covenants that we must meet to be in compliance with the terms of the credit facility. At November 14, 2005, we were in compliance with all such covenants.

On October 31, 2005, we entered into an Asset Purchase Agreement (the "Purchase Agreement") with IntraVantage, Inc., a Delaware corporation ("IntraVantage"), whereby the Company purchased from IntraVantage certain of IntraVantage's assets related to IntraVantage's dental products business, including all of IntraVantage's intellectual property rights (the "Intellectual Property" and, collectively with the other purchased assets, the "Assets"). The purchase price for the Assets comprised of the following consideration:

- \$226,087 in cash paid to IntraVantage on October 31, 2005;
- \$893,271 in cash paid to IntraVantage's bank on October 31, 2005 as full payoff and release of all of IntraVantage's credit obligations with such bank; and
- \$400,000 to IntraVantage in annual installments of \$100,000 in cash payable on each of October 31, 2006, 2007, 2008 and 2009.

As further inducement for IntraVantage to enter into the Purchase Agreement, Pro-Dex also entered into an Exclusive License Agreement and a Royalty Agreement with IntraVantage in conjunction with the October 31, 2005 closing of the Purchase Agreement. The Exclusive License Agreement grants to IntraVantage an exclusive, worldwide, irrevocable, royalty-free and perpetual license to use the acquired Intellectual Property in any non-dental related field of use. The Royalty Agreement requires that the Company pay to IntraVantage certain royalty payments on revenues generated from future sales of products by the Company which fall within the scope of, incorporate, are a modification of or are substantially derived from one or more of the patents included in the Intellectual Property.

Also in conjunction with the closing of the Purchase Agreement, the Company agreed to terminate a supply agreement between the Company and IntraVantage, along with all amendments thereto. Pursuant to this termination, IntraVantage shall return to the Company certain products previously delivered to IntraVantage under the supply agreement in exchange for the Company issuing to IntraVantage a credit memo equal to the full value of outstanding IntraVantage invoices related to the supply agreement.

Pro-Dex will be reversing approximately \$300,000 in previously recorded sales to IntraVantage during the second fiscal quarter of 2006, sales that relate to product which was returned to Pro-Dex at the close of the transaction. Pro-Dex will also reduce its open order backlog by approximately \$900,000 to eliminate all orders currently in place from IntraVantage. Additionally, this adjustment is not expected to unfavorably impact bottom-line earnings during the second quarter and the remainder of the year as the impact on profit was previously addressed through increased reserves for accounts receivable during the fourth quarter of fiscal 2005 and the first quarter of fiscal year 2006.

## **Risk Factors**

### **Competition**

The markets for healthcare and factory automation industries are intensely competitive, and we face significant competition from a number of different sources. Several of our competitors have significantly greater name recognition as well as substantially greater financial, technical, product development and marketing resources than us.

We compete in all of our markets with other major healthcare and factory automation related companies. Competitive pressures and other factors, such as new product or new technology introductions by us or our competitors, may result in price or market share erosion that could have a material adverse effect on the our business, results of operations and financial condition. Also, there can be no assurance that our products and services will achieve broad market acceptance or will successfully compete with other products.

### **Fluctuation in Quarterly Operating Results**

Our revenues have fluctuated in the past, and may fluctuate in the future from quarter to quarter and period to period, as a result of a number of factors including, without limitation: the size and timing of orders from customers; the length of new product development cycles; market acceptance of new technologies; changes in pricing policies or price reductions by us or our competitors; the timing of new product announcements and product introductions by us or our competitors; the financial stability of major customers; our success in expanding our sales and marketing programs; deferrals of customer orders and deliveries; changes in our strategy; personnel changes; and general market/economic factors.

Because a significant percentage of our expenses are relatively fixed, a variation in the timing of sales can cause significant variations in operating results from quarter to quarter. As a result, we believe that interim period-to-period comparisons of our results of operations are not necessarily meaningful and should not be relied upon as indications of future performance. Further, our historical operating results are not necessarily indicative of future performance for any particular period.

Due to all of the foregoing factors, it is possible that in some future quarter(s) our operating results may be below the expectations of public market analysts and investors. In such event, the price of our Common Stock would likely be materially adversely affected.

## **Dependence on Principal Products and New Product Development**

We currently derive a substantial part of our net revenues from sales of our core healthcare and factory automation products and services. We believe that a primary factor in the market acceptance of our product and services is the value that is created for our customers by those products and services. Our future financial performance will depend in large part on our ability to continue to meet the increasingly sophisticated needs of our customers through the timely development, successful introduction and implementation of new and enhanced products and services. We have historically expended a significant percentage of our net revenues on product development and believe that significant continued product development efforts will be required to sustain our growth. Continued investment in our sales and marketing efforts will also be required to support future growth.

There can be no assurance that we will be successful in our product development efforts, that the market will continue to accept our existing products, or that new products or product enhancements will be developed and implemented in a timely manner, meet the requirements of our customers, achieve market acceptance, or operate without failure or product recall due to design or manufacturing errors. If new products or product enhancements do not achieve market acceptance, our business, results of operations and financial condition could be materially adversely affected.

## **Technological Change**

The healthcare and factory automation markets are generally characterized by rapid technological change, changing customer needs, frequent new product introductions, and evolving industry standards. The introduction of products incorporating new technologies and the emergence of new industry standards could render the Company's existing products obsolete and unmarketable. There can be no assurance that we will be successful in developing and marketing new products that respond to technological changes or evolving industry standards.

New product development requires significant research and development expenditures that are ultimately funded by sales growth. Any significant decrease in revenues or research funding could impair our ability to respond to technological advances in the marketplace and to remain competitive. If we are unable, for technological or other reasons, to develop and introduce new products in a timely manner in response to changing market conditions or customer requirements, our business, results of operations and financial condition may be materially adversely affected.

In response to increasing market demand, we are currently developing new products. There can be no assurance that we will successfully develop these new products or that these products will operate successfully, or that any such development, even if successful, will be completed concurrently with or prior to the introduction of competing products. Any such failure or delay could adversely affect our competitive position or could make our current products obsolete.

## **Litigation**

We continually face the possibility of litigation as either a plaintiff or a defendant. It is not reasonably possible to estimate the expenses, awards or damages, or the range of expenses, awards or damages, if any, that we might incur in connection with such litigation. The uncertainty associated with potential litigation may have an adverse impact on our business. In particular, such litigation could impair our relationships with existing customers and our ability to obtain new customers. Defending or prosecuting such litigation may result in a diversion of management's time and attention away from business operations, which could have a material adverse effect on our business, results of operations and financial condition.

There can be no assurance that such litigation will not result in liability in excess of our insurance coverage, that our insurance will cover such claims or that appropriate insurance will continue to be available to us in the future at commercially reasonable rates.

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### **Proprietary Technology**

We are dependent on the maintenance and protection of our intellectual property and rely on exclusive development and supply agreements, confidentiality procedures, and employee nondisclosure agreements to protect our intellectual property.

There can be no assurance that the legal protections and precautions taken by us will be adequate to prevent misappropriation of our technology or that competitors will not independently develop technologies equivalent or superior to ours. Further, the laws of some foreign countries do not protect our proprietary rights to as great an extent as do the laws of the United States and are often not enforced as vigorously as those in the United States.

We do not believe that our operations or products infringe on the intellectual property rights of others. However, there can be no assurance that others will not assert infringement or trade secret claims against us with respect to our current or future products or that any such assertion will not require us to enter into a license agreement or royalty arrangement with the party asserting the claim.

### **Ability to Manage Growth**

We have in the past experienced periods of growth that have placed, and may continue to place, a significant strain on our resources. We also anticipate expanding our overall development, marketing, sales, management and training capacity as market demand requires. In the event we are unable to identify, hire, train and retain qualified individuals in such capacities within a reasonable timeframe, such failure could have a material adverse effect on the Company.

In addition, our ability to manage future increases, if any, in the scope of our operations or personnel may depend on significant expansion of our research and development, marketing and sales, management, and administrative and financial capabilities. The ineffective management of expansion in the business could have a material adverse effect on our business, results of operations and financial condition.

### **Dependence Upon Key Personnel**

Our future performance also depends in significant part upon the continued service of our key technical and senior management personnel, many of who have been with the Company for a significant period of time. We purchased an annually renewable one-year term key man life insurance policy for our president in December 2004, but do not maintain key man life insurance on any other of our employees. Because we have a relatively small number of employees when compared to other leading companies in the same industry, our dependence on maintaining our relationship with key employees is particularly significant. We are also dependent on our ability to attract and retain high quality personnel, particularly in the areas of product development, operations management and finance.

A high level of employee mobility and the aggressive recruiting of skilled personnel characterize the healthcare and motion control industries. There can be no assurance that our current employees will continue to work for us. Loss of services of key employees could have a material adverse effect on our business, results of operations and financial condition. Furthermore, we may need to grant additional stock options to key employees and provide other forms of incentive compensation to attract and retain such key personnel.

### **Product Liability**

We maintain insurance to protect against claims associated with the use of our products, but there can be no assurance that our insurance coverage would adequately cover any claim asserted against us. A successful claim

brought against us in excess of our insurance coverage could have a material adverse effect on our business, results of operations and financial condition. Even unsuccessful claims could result in the expenditure of funds in litigation and management time and resources.

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There can be no assurance that we will not be subject to product liability claims, that such claims will not result in liability in excess of our insurance coverage, that our insurance will cover such claims or that appropriate insurance will continue to be available to us in the future at commercially reasonable rates. Such claims could have a material adverse affect on our business, results of operations and financial condition.

### **Accounting Matters**

We are subject to changes in and interpretations of financial accounting matters that govern the measurement of our performance. Based on our reading and interpretations of relevant guidance, principles or concepts issued by, among other authorities, the American Institute of Certified Public Accountants, the Financial Accounting Standards Board, and the United States Securities and Exchange Commission, our management believes our current sales contract terms and business arrangements have been properly reported. However, there continue to be issued interpretations and guidance for applying the relevant standards to a wide range of contract terms and business arrangements that are prevalent in the industries in which we operate. Future interpretations or changes by the regulators of existing accounting standards or changes in our business practices could result in future changes in our accounting policies and practices that could have a material adverse effect on our business, financial condition, cash flows, revenue and results of operations.

### **Internal Controls**

Any weaknesses identified in our internal controls as part of the evaluation being undertaken by us and our registered independent public accountants pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 could have an adverse effect on our business. We are in the process of evaluating and documenting our controls pursuant to Section 404 of the Sarbanes-Oxley Act. We are working toward being fully compliant with the requirements of Section 404 of the Sarbanes-Oxley Act. Failure to comply could have a material adverse affect on our business, financial condition, and our ability to remain listed as a publicly held exchange traded company.

### **Stock Option Expense**

Stock options have from time to time been an important component of the compensation packages for many of our directors and employees. We currently do not deduct the expense of director or employee stock option grants from our income. As issued on December 16, 2004, FAS 123(R) requires companies to change their accounting policies to record the value of stock options vested as an expense and a charge against earnings. We are a small business issuer and thus the rule would require that we comply at the beginning of the first fiscal year after December 15, 2005, so reports issued for dates after July 1, 2006 will reflect the change and our reported earnings will be adversely affected.

### **RECENT ACCOUNTING PRONOUNCEMENTS**

We are subject to the revised requirements of the Statement of Financial Accounting Standards ("SFAS") No. 123R "Accounting for Stock-Based Compensation" as revised in December 2004. This standard establishes the accounting standards for share-based compensation, and will apply to us in the recognition of the cost of share based awards based on the grant-date fair value of those awards. As a small business issuer, the statement is effective for us at the beginning of the first fiscal year that begins after December 15, 2005. Upon adoption of SFAS 123(R), all stock option awards to employees will be recognized as expense in the income statement, typically over any related vesting period. We will be required to adopt SFAS 123(R) in the first quarter of fiscal year 2007. We believe the impact of adopting SFAS 123(R) will be similar to the pro-forma disclosure impact presented.



## **MAJOR CUSTOMERS**

The Company had one Major Customer (defined as a customer that represents greater than 10% of the Company's total revenues) in each of the quarters ended September 30, 2004 and 2005. The 10% customer was the same customer in 2005 and 2004. Net sales to the Major Customer in 2005 amounted to \$1,374,000 and at September 30, 2005 the accounts receivable included a balance of \$1,255,000 due from this Major Customer. Net sales to the Major Customer in 2004 amounted to \$811,000 and at September 30, 2004 the accounts receivable included a balance of \$726,000 due from this Major Customer.

### **Item 3. Controls and Procedures**

The Chief Executive Officer and Chief Financial Officer (the principal executive officer and principal financial officer, respectively) conducted an evaluation of the design and operation of our "disclosure controls and procedures" (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended ("Exchange Act")). Based on that evaluation, which was conducted within 90 days of the date on which this quarterly report was filed with the Securities and Exchange Commission, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures are effective to ensure that information required to be disclosed by use in the reports filed or submitted by us under the Exchange Act is accumulated, recorded, processed, summarized and reported to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, and to allow timely decisions regarding whether or not disclosure is required.

During the quarter ended September 30, 2005, there were no changes in our internal controls over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act) that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting, except that subsequent to the ending of our second quarter of fiscal 2005, we improved the information and financial controls by consolidating our accounting and Enterprise Resource Planning system to a unified platform. This allowed us to eliminate two of the previous three accounting systems which we operated. As the systems were consolidated, many of the operating procedures and information processing steps were streamlined, reducing the opportunity for error and increasing the Company's information processing efficiency.

**PART II**

**OTHER INFORMATION**

**Item 1. Legal Proceedings**

The Company is a party to various legal proceedings incidental to its business, none of which are considered by the Company to be material at this time.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**  
None.

**Item 3. Defaults Upon Senior Securities.**  
None.

**Item 4. Submissions of Matters to a Vote of Securities Holders.**  
None.

**Item 5. Other Information.**  
None.

**Item 6. Exhibits.**

Exhibits:

31.1 Certifications of Chief Executive Officer Required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certifications of Chief Financial Officer Required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32 Certification of the Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

**SIGNATURES**

In accordance with 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.

Date: November 14, 2005

Date: November 14, 2005

PRO-DEX INC.

By: / s / Patrick Johnson

PRO-DEX INC.

By: / s / Jeffrey J. Ritchey

Patrick Johnson

Chief Executive Officer

Jeffrey J. Ritchey

Secretary and Chief Financial Officer

(Principal Financial and Accounting Officer)

**End of Filing**