PRO DEX INC
Form 10-Q
November 08, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended

SEPTEMBER 30, 2018

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 registrant as specified in its charter)

COLORADO	**84-1261240**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

2361 McGaw Avenue, Irvine, California 92614

(Address of principal executive offices and zip code)

(949) 769-3200

(Registrant's telephone number, including area code)

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 þ No ¨

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company, and emerging growth company in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer þ	Smaller reporting company þ
	Emerging growth company ¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

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

Indicate the number of shares outstanding of each of the registrant s classes of common stock outstanding as of the latest practicable date: 4,227,845 shares of common stock, no par value, as of November 6, 2018.

PRO-DEX, INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2018

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PRO-DEX, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except share amounts)

		September 30, 2018		June 30, 2018
ASSETS				
Current Assets:				
Cash and cash equivalents	$	8,315	$	5,188
Investments		3,398		2,220
Accounts receivable, net of allowance for doubtful accounts of $1 and $14 at September 30, 2018 and at June 30, 2018, respectively		3,624		2,955
Deferred costs		82		32
Inventory		4,565		4,393
Notes receivable		1,189		1,176
Prepaid expenses and other current assets		421		269
Total current assets		21,594		16,233
Equipment and leasehold improvements, net		2,148		1,755
Intangibles, net		134		140
Deferred income taxes, net		1,220		1,678
Notes receivable, net of current portion		30		43
Other assets		68		68
Total assets	$	25,194	$	19,917
LIABILITIES AND SHAREHOLDERS EQUITY				
Current Liabilities:				
Accounts payable	$	1,197	$	1,083
Accrued expenses		1,055		1,266
Deferred revenue		70		31
Note payable and capital lease obligations		583		35
Income taxes payable				123
Total current liabilities		2,905		2,538

Deferred rent		112		97
Notes and capital leases payable, net of current portion		4,450		6
Total non-current liabilities		4,562		103
Total liabilities		7,467		2,641
Shareholders equity:				
Common shares; no par value; 50,000,000 shares authorized; 4,249,548 and 4,331,089 shares issued and outstanding at September 30, 2018 and June 30, 2018, respectively		18,639		19,835
Accumulated other comprehensive income (loss)		145		(153)
Accumulated deficit		(1,057)		(2,406)
Total shareholders equity		17,727		17,276
Total liabilities and shareholders equity	$	25,194	$	19,917

The accompanying notes are an integral part of these condensed consolidated financial statements.

PRO-DEX, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

(Unaudited)

(In thousands, except share and per share amounts)

	Three Months Ended September 30, 2018		2017	
Net sales	$	6,916	$	5,162
Cost of sales		4,189		3,302
Gross profit		2,727		1,860
Operating (income) expenses:				
Selling expenses		33		87
General and administrative expenses		565		504
Gain on disposal of equipment		(7)		(12)
Research and development costs		408		407
Total operating expenses		999		986
Operating income		1,728		874
Other income (expense):				
Interest and miscellaneous income		74		18
Interest expense		(20)		(2)
Total other income		54		16
Income before income taxes		1,782		890
Provision for income taxes		433		262
Net income	$	1,349	$	628
Other comprehensive income (loss), net of tax:				
Unrealized gain (loss) from marketable equity investments, net of taxes		298		(109)
Comprehensive income	$	1,647	$	519
Basic and diluted income per share:				
Net income	$	0.31	$	0.15
Weighted average common shares outstanding:				
Basic		4,330,636		4,150,099
Diluted		4,372,893		4,189,724
Common shares outstanding		4,249,548		4,348,292

The accompanying notes are an integral part of these condensed consolidated financial statements.

PRO-DEX, INC.

CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

For the Three Months Ended September 30, 2018 and 2017

(Unaudited)

(In thousands, except share data)

	Common Shares Number of Shares	Common Shares Amount	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total
Balance at June 30, 2017	4,025,193	$ 17,704	$ 33	$ (4,027)	$ 13,710
Net income				628	628
Net change in unrealized gain (loss) from marketable equity investments, net of taxes			(109)		(109)
ESPP shares issued	3,099	16			16
Share-based compensation		3			3
Shares issued under ATM[(1)]	320,000	2,027			2,027
Balance at September 30, 2017	4,348,292	$ 19,750	$ (76)	$ (3,399)	$ 16,275
Balance at June 30, 2018	4,331,089	$ 19,835	$ (153)	$ (2,406)	$ 17,276
Net income				1,349	1,349
Net change in unrealized gain (loss) from marketable equity investments,			298		298

net of taxes					
ESPP shares issued	1,820	10			10
Share-based compensation		10			10
Shares issued in connection with performance award vesting	40,000				
Shares withheld from common stock issued to pay employee payroll taxes	(15,273)	(101)			(101)
Shares repurchases	(108,088)	(1,115)			(1,115)
Balance at September 30, 2018	4,249,548	$ 18,639	$ 145	$ (1,057)	$ 17,727

(1) Of the proceeds raised from the ATM shares issued during fiscal 2018, $142,000 were accounted for as a reduction of prepaid expenses.

The accompanying notes are an integral part of these condensed consolidated financial statements.

PRO-DEX, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 1,349	$ 628
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	88	153
Share-based compensation	10	3
Gain on disposal of equipment	(7)	(12)
Deferred income tax	404	66
Bad debt expense (recovery)	(13)	
Changes in operating assets and liabilities:		
Accounts receivable and other receivables	(655)	1,284
Deferred costs	(50)	12
Inventory	(172)	(427)
Prepaid expenses and other assets	(152)	89
Accounts payable, accrued expenses and deferred rent	(82)	(744)
Deferred revenue	39	(1)
Income taxes payable	(123)	10
Net cash provided by operating activities	636	1,061
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of equipment	(477)	(139)
Purchases of investments	(824)	(297)
Increase in notes receivable		(1,150)
Decrease (increase) in intangibles	1	(8)
Proceeds from disposal of equipment	7	12
Net cash used in investing activities	(1,293)	(1,582)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payments on capital lease and notes payable	(10)	(14)
Borrowings from Minnesota Bank & Trust	5,000	
Payment of employee payroll taxes on net issuance of common stock	(101)	
Proceeds from shares issued under ATM, net of commissions and fees		2,169
Proceeds from ESPP Contributions	10	16

Repurchases of common stock		(1,115)		
Net cash provided by financing activities		3,784		2,171
Net increase in cash and cash equivalents		3,127		1,650
Cash and cash equivalents, beginning of period		5,188		4,205
Cash and cash equivalents, end of period	$	8,315	$	5,855

The accompanying notes are an integral part of these condensed consolidated financial statements.

PRO-DEX, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - CONTINUED

(Unaudited)

(In thousands)

	Three Months Ended September 30,			
	2018		2017	
Supplemental disclosures of cash flow information:				
Noncash investing and financing activity:				
Value of shares issued to employees under performance awards	$	266	$	
Cash paid during the period for:				
Interest	$	20	$	2
Income taxes, net of refunds	$	299	$	118

The accompanying notes are an integral part of these condensed consolidated financial statements.

PRO-DEX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of Pro-Dex, Inc. (we , us , our , Pro-Dex the Company) have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q and Regulation S-K. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. These financial statements should be read in conjunction with the consolidated financial statements presented in our Annual Report on Form 10-K for the fiscal year ended June 30, 2018. 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 our Annual Report on Form 10-K for the year ended June 30, 2018.

Recent Accounting Standards

In February 2016, the FASB issued ASU 2016-02, (Topic 842) Leases . The objective of this update is to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. This ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those annual periods and is to be applied utilizing a modified retrospective approach. While we are still in the process of evaluating the effect of adoption on our consolidated financial statements and are currently assessing our leases, we expect the adoption will lead to a material increase in the assets and liabilities recorded on our consolidated balance sheet.

Recently Adopted Accounting Standards

Effective July 1, 2018, we adopted new revenue recognition guidance issued by the FASB related to contracts with customers. Under ASU 2014-09, (Topic 606) Revenue From Contracts with Customers, we recognize revenue from the sales of products and services by applying the following steps: (1) identify the contract with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to each performance obligation in the contract; and (5) recognize revenue when each performance obligation is satisfied. We utilized the modified retrospective method of adoption and there was no impact on our financial statements as a result of adopting Topic 606 for the three months ended September 30, 2018. We primarily sell finished products and recognize revenue at point of sale or delivery and the timing of revenue recognition has not changed with the adoption of the new guidance. However, we also perform services when we are engaged to design a product for a customer and there is more judgment involved in determining the amount and timing of revenue recognition under those types of contracts. In order to disclose the amount of revenue related to these services, where more judgment is required, we have added NRE & Prototypes to our net sales table included under Management s Discussion and Analysis of Financial Condition and Results of Operations of this report, which had previously been reflected in Medical device and services.

Reclassifications

We have reclassified the gain on disposal of equipment to operating income (expense) from other income (expense) as prescribed by GAAP. This reclassification has no impact on our net income. We have also reclassified the tax effect of unrealized gain (loss) from marketable equity investments from a separate line item to deferred income taxes on the statement of cash flows. This reclassification has no impact on our net increase or decrease in cash, but properly reflects this change in net cash provided by or used in operating activities instead of investing activities.

NOTE 2. DESCRIPTION OF BUSINESS

We specialize in the design, development and manufacture of autoclavable, battery-powered and electric, multi-function surgical drivers and shavers used primarily in the orthopedic and maxocranial facial markets. We have patented adaptive torque-limiting software and proprietary sealing solutions which appeal to our customers, primarily medical device distributors. We also manufacture and sell rotary air motors to a wide range of industries.

Our Fineline Molds division (Fineline), acquired in fiscal 2015, manufactured plastic injection molding for a variety of industries. As disclosed in our Form 8-K filed with the SEC on May 30, 2018, we sold substantially all of the assets of Fineline on May 23, 2018. Management reviewed ASU 2014-08 Reporting Discontinued Operations and Disposals of Components of an Entity and concluded that the sale of Fineline does not require treatment as a discontinued operation because it was not a material part of our operations.

PRO-DEX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 3. COMPOSITION OF CERTAIN FINANCIAL STATEMENT ITEMS

Investments

Investments are stated at market value and consist of the following (in thousands):

	September 30, 2018	June 30, 2018
Marketable equity securities	$ 3,398	$ 2,220

Investments at September 30, 2018 and June 30, 2018 had an aggregate cost basis of $3,198,000 and $2,374,000 respectively. During the quarter ended September 30, 2018, the investments incurred unrealized gains of $353,000 (gross unrealized gains of $403,000 offset by gross unrealized losses of $50,000) and related income tax expense of approximately $55,000 recorded in other comprehensive income. At June 30, 2018, the investments included net unrealized losses of $153,000 (gross unrealized losses of $196,000 offset by gross unrealized gains of $43,000).

Of the total marketable equity securities at September 30, 2018 and June 30, 2018, $1,113,000 and $285,000, respectively, represent an investment in the common stock of Air T, Inc. Two of our Board members are also board members of Air T, Inc. and both either individually or through affiliates own an equity interest in Air T, Inc. Our Chairman, one of the two Board members aforementioned, also serves as the Chief Executive Officer and Chairman of Air T, Inc. The shares have been purchased through 10b5-1 Plans, which in accordance with our internal policies regarding the approval of related party transactions, was approved by our three Board members that are not affiliated with Air T, Inc.

Inventory

Inventory is stated at the lower of cost (first-in, first-out) or net realizable value and consists of the following (in thousands):

	September 30, 2018	June 30, 2018
Raw materials /purchased components	$ 1,942	$ 1,878
Work in process	1,387	974
Sub-assemblies /finished components	1,125	1,193
Finished goods	111	348
Total inventory	$ 4,565	$ 4,393

Intangibles

Intangibles consist of the following (in thousands):

	September 30, 2018	June 30, 2018
Covenant not to compete	$ 30	$ 30
Patent-related costs	163	164
Total intangibles	$ 193	$ 194
Less accumulated amortization	(59)	(54)
	$ 134	$ 140

The covenant not to compete relates to assets acquired in conjunction with a business acquisition. Patent-related costs consist of legal fees incurred in connection with both patent applications and a patent issuance, and will be amortized over the estimated life of the product(s) that is or will be utilizing the technology, or expensed immediately in the event the patent office denies the issuance of the patent. Since we do not know when, or if, our patent applications will be issued, the future amortization expense is not predictable.

PRO-DEX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 4. WARRANTY

The warranty accrual is based on historical costs of warranty repairs and expected future identifiable warranty expenses, and is included in accrued expenses in the accompanying consolidated balance sheets. As of September 30, 2018 and June 30, 2018, the warranty reserve amounted to $95,000 and $107,000, respectively. Warranty expenses are included in cost of sales in the accompanying consolidated statements of operations. Changes in estimates to previously established warranty accruals result from current period updates to assumptions regarding repair costs and warranty return rates, and are included in current period warranty expense.

Information regarding the accrual for warranty costs for the three months ended September 30, 2018 and 2017 are as follows (in thousands):

	As of and for the Three Months Ended September 30,			
	2018		2017	
Beginning balance	$	107	$	159
Accruals during the period		29		20
Changes in estimates of prior period warranty accruals		(15)		(20)
Warranty amortization		(26)		(13)
Ending balance	$	95	$	146

NOTE 5. NET INCOME (LOSS) PER SHARE

The Company calculates basic net income (loss) per share by dividing net income (loss) by the weighted-average number of common shares outstanding during the reporting period. Diluted income (loss) per share reflects the effects of potentially dilutive securities, which consist entirely of outstanding stock options.

The following table presents reconciliations of the numerators and denominators of the basic and diluted income (loss) per share computations. In the tables below, income (loss) amounts represent the numerator, and share amounts represent the denominator (in thousands, except per share amounts):

	Three Months Ended September 30, 2018		Three Months Ended September 30, 2017	
Basic:				
Net income	$	1,349	$	628
Weighted average shares outstanding		4,331		4,150
Basic earnings per share	$	0.31	$	0.15
Diluted:				
Net income	$	1,349	$	628
Weighted average shares outstanding		4,331		4,150
Effect of dilutive securities stock options		42		40
Weighted average shares used in calculation of diluted earnings per share		4,373		4,190
Diluted earnings per share	$	0.31	$	0.15

PRO-DEX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 6. 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.

Significant management judgment is required in determining our provision for income taxes and the recoverability of our deferred tax assets. Such determination is based primarily on our historical taxable income or loss, with some consideration given to our estimates of future taxable income or loss by jurisdictions in which we operate and the period over which our deferred tax assets would be recoverable.

As of September 30, 2018, we have accrued $467,000 of unrecognized tax benefits related to federal and state income tax matters. None of this balance is expected to reduce the Company s income tax expense if recognized.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):