Fiscal Year 2014 Q4 and Full-Year Financial Results Conference Call Transcript
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Operator: Greetings. Welcome to the Pro-Dex Fiscal 2014 Fourth Quarter and Full-Year Financial Results conference call. At this time, all participants are in a listen-only mode. A brief question and answer session will follow the formal presentation. (Operator instructions.) As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Hal Hurwitz, CEO of Pro-Dex. Thank you. Please begin.

Hal Hurwitz, Chief Executive Officer, Pro-Dex, Inc.: Thank you, Roya, and thank you all for joining us to review the results for the fiscal 2014 fourth quarter and full-year ended June 30, 2014. On today's call I will provide a synopsis of our operating results as well as some comments. Then, as Roya mentioned, we will open up the call for your questions.

Before beginning, however, I ask our participants and listeners to note that the comments made on this call may include statements that are forward-looking within the meaning of securities laws. These forward-looking statements may include, without limitation, statements related to anticipated industry trends and the company's plans, products, prospects, and strategies, both preliminary and projected. Actual results or trends could differ materially. We undertake no obligation to revise forward-looking statements in light of new information or future events.

For more information please refer to the risk factors discussed in the Company's Form 10-K for the year ended June 30, 2014 to be filed with the SEC today, as well as to the Form 8-K filed with the SEC today along with the attached press release issued today, all of which can be obtained from the SEC or by visiting our website at www.Pro-Dex.com. Now let's cover the quarter's results.

Net sales for the three months ended June 30, 2014 increased $492,000, or 18%, to $3.2 million from $2.7 million for the three months ended June 30, 2013 due primarily to an increase of $746,000 in medical device product and repair revenues from our largest customer, partially offset by an aggregate decrease in sales of $349,000 to two former customers. The growth in sales to our largest customer arose from the resumption of product delivery orders from this customer in December 2013 following the customer's suspension of such orders from March through November 2013, ostensibly to relieve an inventory buildup of our products.

Gross profit for the three months ended June 30, 2014 increased $366,000, or 65%, to $931,000 compared to $565,000 for the year ago period, primarily as the result of the increase sales volume between periods. Also contributing to the growth in gross profit were decreases of $113,000 in inventory and warranty charges and $137,000 in accruals recorded for anticipated losses from the fixed price development services portion of certain contracts. The decrease in these charges and accruals also contributed to an increase in gross margin as a percentage of sales which rose to 29% for the three months ended June 30, 2014 from 21% for the corresponding period in 2013.

Operating expenses, which include selling, general and administrative, and research and development expenses, for the quarter ended June 30, 2014 decreased 24% to $958,000 from $1.3 million in the prior year's corresponding quarter, reflecting primarily the effect of our continued cost reduction efforts.

Income from continuing operations for the quarter ended June 30, 2014 was $27,000 compared to a loss from continuing operations of $680,000 in the corresponding quarter in 2013. Net income for the quarter ended June 30, 2014 was $23,000, or $0.01 per share, compared to a net loss of $673,000, or $0.20 per share, for the corresponding quarter in 2013.

Turning to the full fiscal year results, sales for the year ended June 30, 2014 decreased $1.4 million, or 12%, to $10.8 million from $12.2 million for the year ended June 30, 2013. Contributing to this reduction were decreases from fiscal 2013 to 2014 of (a), $491,000 in sales to our largest customer arising from the effects of the suspension of product delivery orders during the first five months of fiscal 2014; (b), $428,000 in repair revenues from our former largest customer from whom we expect no future revenue; and (c), $204,000 in sales of our motion control product line.

Gross profit for the year ended June 30, 2014 decreased $750,000, or 20%, to $3 million from $3.7 million for fiscal 2013 due primarily to the reduced sales volume in fiscal 2014 and to a $141,000 increase from fiscal 2013 to 2014 of accruals to record anticipated losses from the fixed priced development services portion of certain contracts; partially offset by a $480,000 decrease from fiscal 2013 to 2014 in inventory and warranty charges. Gross margin as a percentage of sales declined three percentage points from 30% in fiscal 2013 to 27% in fiscal 2014. Contributing to this decline were the increased accruals related to the product development contracts and to under absorption of overhead due to the reduced sales volume in fiscal 2014, partially offset by the lower inventory and warranty charges.

Operating expenses, which include selling, general and administrative and research and development expenses, for the year ended June 30, 2014 decreased 33% to $3.8 million from $5.6 million in fiscal 2013 reflecting primarily the effects of our continued cost reduction efforts. Also contributing to the decrease were nonrecurring charges of $190,000 incurred in fiscal 2013 in connection with the contested election of directors at our January 2013 Annual Meeting of Shareholders.

Loss from continuing operations for the year ended June 30, 2014 was $651,000 compared to a loss from continuing operations of $1.9 million for fiscal 2013. Net loss for the year ended June 30, 2014 was $488,000 or $0.14 per share compared to a net loss of $1.8 million or $0.54 per share for fiscal 2013.

During the year ended June 30, 2014 we used $329,000 of cash in operating activities compared to the use of $1.3 million of cash in operating activities in fiscal 2013. This improvement results primarily from the corresponding improvement in results of operations in fiscal 2014 relative to 2013, and to the liquidation through sales in fiscal 2014 of a buildup of our inventory that occurred in late fiscal 2013. These factors were partially offset by an increase in accounts receivable from fiscal year end 2013 to year end 2014, which corresponded to the sales increase in the fourth quarter of fiscal 2014 relative to the corresponding period in 2013.

With all of this said, now some brief commentary. One year ago I stated that our goal was to restore Pro-Dex to profitability and positive cash flow from operations. Today, it is evident we have not yet achieved that goal, but we believe that we are well along the path to achieving it.

Fiscal 2014 brought its challenges. We endured a nearly complete suspension of product delivery orders from our largest customer for the first five months of the year. We experienced unanticipated delays in completing two large product development projects involving new designs and technological applications for the markets to be served, and a major contract manufacturing customer encountered delays of its own in completing its product development. As a result revenue recognition was deferred, fixed manufacturing overhead costs were not fully absorbed, and losses on the development projects were incurred.

Even with these challenges, the right-sizing of our cost footprint over the past 18 months contributed to improved financial results in each quarter of fiscal 2014 relative to the corresponding quarters of fiscal 2013, and we finished fiscal 2014 with an essentially break-even, albeit profitable, fourth quarter. This focus on cost control as well as on inventory and other balance sheet expenditure controls contributed to positive cash flow from operating activities for both the third and fourth quarters of fiscal 2014. For these results I thank the Pro-Dex employees for their continued hard work and commitment.

In addition, I am pleased to report that in July 2014 our largest customer issued a purchase order for the manufacture and delivery of $3.5 million of products through December 2015, which will commence upon our fulfillment of the customer's current purchase orders that call for shipments between now and December 2014. In addition, the two product development projects that I've described are nearing completion, which we believe will occur during our second fiscal quarter ending December 31, 2014 and which we believe will be followed in subsequent quarters during fiscal 2015 by the aforementioned contract manufacturing project.

Finally, I will comment briefly on the Form 8-K we filed with the Securities and Exchange Commission this past July regarding our potential $225,000 acquisition of a northern California-based manufacturing company. We have been, and continue to be, open to considering transactions that make financial sense for Pro-Dex. Regarding the potential acquisition described in July's Form 8-K, I can report only that our due diligence procedures are underway, but that no assurance can be given as to the successful completion of that transaction.

I am now happy to invite any questions you might have with regard to the quarter and full-year results or on our business operations. To that end, I'll turn the call back over to Roya for Q&A.

<u>Operator:</u> Thank you. We will now be conducting a question and answer session. (Operator instructions.) Our first question comes from the line of Matthew Melchione, a private investor. Please proceed with your question.

<Q – Matthew Melchione>: Hi, Harold. Thank you for taking my question. Congratulations on finishing the year strong. I have a few questions. The first one is about can we consider this quarter to be somewhat of a run rate for the operations now? Is this kind of stabilized as far as revenue, kind of thing similar without the production contract coming through? Is the cost base about where you want it to be?

<A - Harold Hurwitz, CEO>: Matt, first, thanks for your comments on this quarter. Because we are very much still a project-based entity, and as I mentioned we don't look for manufacturing to start on our two large development projects until later in this calendar year, I don't know that I can say that we can yet call this a run rate for future quarters, but we're definitely getting there.

<Q – Matthew Melchione>: All right. Thanks. Then, just quickly on the purchase order from the largest customer, are you happy with the volume that that's going through and that contract, and how does that look compared to the prior year?

<A - Harold Hurwitz, CEO>: We are happy with it. Our customer has actually now run short of product, at least that's what we've been told, so that's good news. We are very pleased with the PO.

<Q – Matthew Melchione>: That's great to hear. Lastly, could you speak anymore about how these product development projects are going? What are you looking at for this quarter? Is there going to be, hopefully, some sort of a system that's plugged in at this quarter? Will revenue then follow in the following quarters? How should we approach this as investors?

<A - Harold Hurwitz, CEO>: The product development projects are going nicely. We've emerged substantially through the development phase. We're into a testing phase now so we're not completely through the development phase, but it is an accomplishment to say that we're into the test phase now. The answer to the latter part of your question is yes. We expect that we will be through the development phase of those projects late in this calendar year, which would be our second fiscal quarter, so that our expectation is that meaningful manufacturing revenues likely would be on the other side of New Year’s. There's some chance that some manufacturing revenues would occur in December, but I think that it's a more realistic and reasonable expectation to say that it will occur in the quarter beginning January 1.

<Q – Matthew Melchione>: All right. I appreciate that. Then I have just one last question about the 8-K filing in regards to considering a possible full manufacturing company operation. I'm just wondering how potentially it may make sense with Pro-Dex [indiscernible] provide traditional manufacturing capacity? Does it align well with these product developments contracts? If you could provide any sort of color. I understand if you're doing a due diligence now it may not be anything you can speak to, but if you could provide some additional information.

<A - Harold Hurwitz, CEO>: Sure. I'll be happy to. The particular transaction that we're looking at, as well as some others, provides us with nearer-term and shorter sales cycle revenues. As I've commented on, and as my predecessors have commented on for many years now, the sales cycle in the medical device space is a very long one. As we have a two-tiered approach with respect to business development as we go after the larger ticket, higher margin revenues represented by the medical device projects, those need to be supported by a solid foundation of shorter sales cycle recurring on a regular basis revenue, which I think will make my answer to your first question about run rate an easier one in future quarters. That's really our objective with these small acquisitions.

<Q – Matthew Melchione>: That's good to hear. This isn't just simply buying pure assets. You're actually looking to have reasonable operational revenue from the entities as well.

<A - Harold Hurwitz, CEO>: That's correct. I would remind you that this particular acquisition, as an example, is a small one; at $225,000 of purchase price you can appreciate that it's a small entity, but it does have a good run rate, a good positive cash flow, and a good customer list, which is our primary interest.

<Q – Matthew Melchione>: All right. That's all the questions I have. I really appreciate you taking the time and I wish you luck on the remainder of the calendar year.

<A - Harold Hurwitz, CEO>: Okay. Thank you very much.

Operator: Thank you. (Operator instructions.) We have no further questions in queue at this time. I would like to hand the floor back over to our host for closing remarks.

<A - Harold Hurwitz, CEO>: Thank you, Roya, and thank you, everyone, for joining us today. All of us at Pro-Dex appreciate your interest, your time and your support of the company. We look forward to speaking with you in November when we report our fiscal year 2015 first quarter financial results. Have a good day.
