

PRO DEX INC  
Form 10-K  
September 27, 2013

Table of Contents

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

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.  
For the fiscal year ended June 30, 2013

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 000-14942

PRO-DEX, INC.

(Exact name of registrant as specified in its charter)

Colorado  
(State or other  
jurisdiction of  
incorporation or  
organization)

84-1261240  
(I.R.S. Employer  
Identification No.)

2361 McGaw Avenue,  
Irvine, California 92614  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number: (949) 769-3200

Securities registered under Section 12(b) of the Exchange Act:

| Title of each class        | Name of each exchange on which registered |
|----------------------------|---|
| Common Stock, no par value | NASDAQ Capital Market                     |

Securities registered under Section 12(g) of the Exchange Act:

None.

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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  No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

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

As of December 31, 2012, the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the closing sales price on the Nasdaq Capital Market was \$5,273,281. For the purpose of this calculation, shares owned by officers, directors and 10% stockholders known to the registrant have been deemed to be owned by affiliates. This determination of affiliate status is not a determination for other purposes.

As of August 31, 2013, 3,343,988 shares of the registrant's no par value common stock were outstanding.

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DOCUMENTS INCORPORATED BY REFERENCE: Part III of this report incorporates by reference certain information from the registrant's definitive proxy statement (the "Proxy Statement") for its 2013 Annual Meeting of Shareholders. The Proxy Statement will be filed with the U.S. Securities and Exchange Commission within 120 days after the end of the fiscal year to which this report relates.

Table of Contents

PRO-DEX, INC.  
TABLE OF CONTENTS

PART I

|                |                                  |    |
|----------------|----------------------------------|----|
| <u>Item 1</u>  | <u>Business</u>                  | 3  |
| <u>Item 1A</u> | <u>Risk Factors</u>              | 7  |
| <u>Item 1B</u> | <u>Unresolved Staff Comments</u> | 11 |
| <u>Item 2</u>  | <u>Description of Property</u>   | 11 |
| <u>Item 3</u>  | <u>Legal Proceedings</u>         | 12 |
| <u>Item 4</u>  | <u>Mine Safety Disclosures</u>   | 12 |

PART II

|                |   |    |
|----------------|---|----|
| <u>Item 5</u>  | <u>Market For Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | 12 |
| <u>Item 6</u>  | <u>Selected Financial Data</u>  | 13 |
| <u>Item 7</u>  | <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>                        | 13 |
| <u>Item 7A</u> | <u>Quantitative and Qualitative Disclosures About Market Risk</u>   | 18 |
| <u>Item 8</u>  | <u>Financial Statements and Supplementary Data</u>  | 18 |
| <u>Item 9</u>  | <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>                         | 18 |
| <u>Item 9A</u> | <u>Controls and Procedures</u>  | 18 |
| <u>Item 9B</u> | <u>Other Information</u>  | 19 |

PART III

|                |   |    |
|----------------|---|----|
| <u>Item 10</u> | <u>Directors, Executive Officers and Corporate Governance</u>   | 19 |
| <u>Item 11</u> | <u>Executive Compensation</u>   | 19 |
| <u>Item 12</u> | <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u> | 19 |
| <u>Item 13</u> | <u>Certain Relationships and Related Transactions, and Director Independence</u>                      | 19 |
| <u>Item 14</u> | <u>Principal Accountant Fees and Services</u>   | 19 |

PART IV

|                |  |    |
|----------------|--|----|
| <u>Item 15</u> | <u>Exhibits, Financial Statement Schedules</u> | 19 |
|----------------|--|----|

Table of Contents

PART I

FORWARD-LOOKING STATEMENTS MAY PROVE INACCURATE

This report contains forward-looking statements within the meaning of federal securities laws. Forward-looking statements are not based on historical facts but instead reflect the Company's expectations, estimates or projections concerning future results or events. These statements generally can be identified by the use of forward-looking words or phrases such as "believe," "expect," "anticipate," "may," "could," "intend," "intent," "belief," "estimate," "project," "forecast," "will," "should" or similar words or phrases. These statements are not guarantees of performance and are inherently subject to known and unknown risks, uncertainties and assumptions that are difficult to predict and could cause actual results, performance or achievements to differ materially from those expressed or indicated by those statements. The Company cannot assure you that any of its expectations, estimates or projections will be achieved.

Forward-looking statements included in this report are only made as of the date of this report and the Company disclaims any obligation to publicly update any forward-looking statement to reflect subsequent events or circumstances.

Numerous factors could cause the Company's actual results and events to differ materially from those expressed or implied by forward-looking statements, including, without limitation: loss of a significant customer, entry of new and stronger competitors, capital availability, unexpected costs, compliance with contractual obligations, failure to capitalize upon access to new customers, marketplace delisting, the ramifications of industry consolidation of medical products manufacturers, dealers and distributors, managed health care, market acceptance and support of new products, cancellation of existing contracts, customer "in house" production of products previously designed by and/or acquired from the Company, maintaining favorable supplier relationships, the Company's ability to engage qualified human resources as needed, regulatory compliance, general economic conditions and other factors described under Item 1A (Risk Factors) of this report. This list of factors is illustrative, but by no means exhaustive. All forward-looking statements should be evaluated with the understanding of their inherent uncertainty.

Item 1. Business

Company Overview

Pro-Dex, Inc. ("Company," "Pro-Dex", "we," "our," "us"), with operations in Irvine, California and Beaverton, Oregon, designs and produces powered surgical and dental instruments and motion control products used in the medical, factory automation and scientific research industries.

Our products are found in hospitals, dental offices, medical engineering labs, scientific research facilities and high-tech manufacturing operations around the world. In addition to Pro-Dex, the names Micro Motors and Oregon Micro Systems are used for marketing purposes as brand names.

Our principal headquarters are located at 2361 McGaw Avenue, Irvine, California 92614 and our phone number is 949-769-3200. Our Internet address is [www.pro-dex.com](http://www.pro-dex.com). Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, amendments to those reports and other certain 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 100 F Street, N.E., 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) and company specific information at [www.sec.gov/edgar/searchedgar/companysearch.html](http://www.sec.gov/edgar/searchedgar/companysearch.html).

In February 2012, we sold our fractional horsepower motor product line, operating under the name Pro-Dex Astromec ("Astromec") and located in Carson City, Nevada, to a third party. As a result of the sale, this product line has been classified as a discontinued operation in conformity with applicable accounting guidance. Accordingly, unless otherwise indicated, Astromec's results have been reported as discontinued operations and removed from all financial discussions of continuing operations, including the Consolidated Financial Statements and Notes, beginning on page 21 of this report.

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

**Pro-Dex 2013 Annual Report | 3**

Table of Contents

## Description of Business

The majority of our revenue is derived from designing, developing and manufacturing powered instruments for the medical and dental industries and motion control software and hardware for industrial and scientific applications. The proportion of total sales by customer type is as follows:

|                      | 2013                 |      | 2012      |      |
|----------------------|----------------------|------|-----------|------|
|                      | Dollars in thousands |      |           |      |
| Medical              | \$ 7,970             | 65%  | \$ 13,177 | 76%  |
| Industrial           | 2,594                | 21%  | 2,699     | 16%  |
| Dental               | 1,092                | 9%   | 968       | 6%   |
| Government and other | 593                  | 5%   | 413       | 2%   |
| Total sales          | \$ 12,249            | 100% | \$ 17,257 | 100% |

Our medical device products utilize proprietary designs developed by us primarily under exclusive development and supply agreements and are manufactured in our Irvine, California facility, as are our dental products. Our medical device products are sold primarily to original equipment manufacturers and our dental products are sold primarily to dental product distributors. In our Beaverton, Oregon facility, we design and manufacture embedded multi-axis motion controllers which are sold to distributors or original equipment manufacturers in the automation and research industries. The proportion of total sales by facility is as follows:

|             | 2013                 |      | 2012      |      |
|-------------|----------------------|------|-----------|------|
|             | Dollars in thousands |      |           |      |
| Irvine      | \$ 10,531            | 86%  | \$ 15,271 | 89%  |
| Beaverton   | 1,718                | 14%  | 1,986     | 12%  |
| Total sales | \$ 12,249            | 100% | \$ 17,257 | 100% |

In fiscal year 2013, our top 20 customers accounted for 81% of our sales, compared to 88% in fiscal year 2012. In fiscal year 2013, our current largest customer accounted for 46% of our sales with our next largest customer accounting for 6% of our sales. This compares to fiscal year 2012, when our two largest customers accounted for 72% of our sales, with our former largest customer accounting for 39% of our sales and our current largest customer accounting for 33% of our sales. Some of our significant customers include Smith and Nephew, Medtronic, Sullivan Schein and Thermo Fisher Scientific. In many cases, including our largest customers, disclosure of customer names is prohibited by confidentiality agreements with such entities.

We have no plans to discontinue the sales relationships with our existing significant customers and have no knowledge of them discontinuing their sales relationship with us, except that in December 2009 our then-largest customer (the "Customer") informed us that it was in the process of developing, and planned to eventually manufacture, its own surgical devices that were functionally comparable to the products we provided to the Customer at that time. We had been the Customer's exclusive manufacturer of these products since they were developed.

Through May 2012, we provided the Customer with two products and continue to provide repair services for both products. Sales to the Customer for the years ended June 30, 2013 and 2012 were as follows:

|          | 2013 | 2012         |
|----------|------|--------------|
| Products | —    | \$ 5,010,000 |

|                      |            |              |
|----------------------|------------|--------------|
| Non-warranty repairs | \$ 722,000 | 1,700,000    |
| Total                | \$ 722,000 | \$ 6,710,000 |

The Customer indicated that its plan was to limit repair requests from us to those units covered by our product warranty. Although the warranty period for such units has since lapsed and we continue to receive non-warranty repair orders from the Customer, there is no assurance that the Customer will continue to place such repair orders with us, in which case non-warranty repair revenue would decline to zero or a negligible amount.

We continue to implement the steps of a strategic plan, the objectives of which are to sustain business with our largest customer, identify and capture additional revenue opportunities and concurrently reduce operating costs not critical to revenue growth. There can be no assurance, however, as to either the timing or success of achieving these objectives, which, during any period not achieved, may cause a prolonged material and adverse impact on our business.

The majority of the raw materials and components used to manufacture our products are purchased from various suppliers and are available from several sources. Precipart Corporation, Tyco Precision Interconnect, Danaher and Transicoil are examples of key suppliers. We have no exclusive arrangements with any of our suppliers, but in several instances only one supplier is used for certain high-value purchased components. In most of such instances, secondary suppliers have been identified for utilization, although it is likely that transition delays would be incurred. We consider our

## Table of Contents

relationships with our suppliers and manufacturers to be good. We do not intend to terminate any such relationship at this time, nor does management have knowledge that any supplier or manufacturer intends to terminate its relationship with us.

Our commitment to product design, manufacturing and quality systems are supported by our compliance with several regulatory agency requirements and standards. Our Beaverton facility is certified to ISO 9001:2008. In our Irvine facility, we hold a U.S. FDA Establishment Registration and a State of California Device Manufacturing License (Dept of Public Health Food and Drug Branch). In addition, our Irvine facility is certified to ISO 13485:2003, Medical Device Directive 93/42/EEC – Annex II, and Canadian Medical Device Conformity Assessment System.

At June 30, 2013, we had a backlog of \$6.7 million. We have experienced, and may continue to experience, variability in our new order bookings due to various reasons, including, but not limited to, the timing of major new product launches and customer-planned inventory builds. However, we do not typically experience seasonal fluctuations in our shipments and revenues.

## Competition

The markets for products in the industries served by our customers 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 medical device and motion control related companies. As a provider of outsourced services, we also compete with our customers' own internal development and manufacturing groups. Competitive pressures and other factors, such as new product or new technology introductions by us, our customers' internal development and manufacturing departments, or our competitors, may result in price or market share erosion that could have a material adverse effect on 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 targeting the same customers.

## Research and Development

We conduct research and development activities to both maintain and improve our market position. Our research and development effort involves the design and manufacture of products that perform specific applications for our existing and prospective customers. Our research and development activities are focused on:

expanding our knowledge base in the medical device and motion control industries to solidify our products with current customers and expand our customer base;

advancing applicable technologies; and

enhancing our product lines.

In certain instances we may share research and development costs with our customers by billing for non-recurring engineering services. Fees received for non-recurring engineering services represented 2% and 1% of our revenue in fiscal 2013 and 2012, respectively. During 2013, we entered into certain development and supply contracts, the



development portions of which are in progress and provide for billable non-recurring engineering service fees. Such fees are recognized as revenue generally upon successful completion of the non-recurring engineering services, which we believe will occur in 2014 and 2015, although such successful completion cannot be assured. In addition, we intend to pursue additional revenue-generating development projects. Accordingly, we believe that non-recurring engineering fees could represent a greater share of our revenue in the future.

During the years ended June 30, 2013 and 2012, we incurred research and development expenses amounting to \$1,790,000 and \$2,068,000, respectively, which costs exclude \$370,000 and \$10,000 in 2013 and 2012, respectively, that were, or will be, shared with our customers through billings for non-recurring engineering services.

#### Employees

At June 30, 2013, we had 67 full-time employees, comprised of 59 employees in Irvine and 8 in Beaverton. At June 30, 2012, we had 74 full-time employees. This decrease is due primarily to reductions-in-force implemented in Irvine in June 2013 as part of strategic plan to reduce expenses.

None of our employees are a party to any collective bargaining agreements with us. We consider our relationships with our employees to be good.

#### Government Regulations

The manufacture and distribution of medical and dental devices are subject to state and federal requirements set forth by various agencies, including state dental boards and the U.S. Food and Drug Administration (“FDA”). The

## Table of Contents

statutes, regulations, administrative orders, and advisories that affect our businesses are complex and subject to diverse, often conflicting, interpretations. While we make every effort to maintain full compliance with all applicable laws and regulations, we are unable to eliminate an ongoing risk that one or more of our activities or devices may at some point be determined to be non-compliant. The penalties for non-compliance could range from an administrative warning to termination of a portion of our business. Furthermore, even if we are subsequently determined to have fully complied with applicable laws or regulations, the costs to achieve such a determination and the intervening loss of business could adversely affect or result in the cessation of a portion of our business. A change in such laws or regulations at any time may have an adverse effect on our operations.

The FDA regulates all medical devices into one of three classes (Class I, II or III) based on the level of control necessary to assure the safety and effectiveness of the device. The surgical instrumentation we manufacture is generally classified into Class I, and our dental instrumentation is generally classified into Class II. The FDA has broad enforcement powers to recall and prohibit the sale of products that do not comply with federal regulations, and to order the cessation of non-compliant processes. No claim has been made to date by the FDA regarding any of our products or processes. Nevertheless, as is common in the industry, certain of our products and processes have been the subject of routine governmental reviews and investigations.

The total cost of providing health care services has been and will continue to be subject to review by governmental agencies and legislative bodies in the major world markets, including the United States, which are faced with significant pressure to lower health care costs. The Patient Protection and Affordable Care Act signed into law in March 2010 (the "Healthcare Act") imposes a 2.3% excise tax on sales of certain medical devices, some of which we produce, that we may be unable to recover through price increases to our customers.

We believe that our business is conducted in a manner consistent with Environmental Protection Agency ("EPA") and other agency regulations governing disposition of industrial waste materials.

While we believe that our products and processes fully comply with applicable laws and regulations, we are unable to predict the outcome of any investigation or review which may be undertaken in the future with respect to our products or processes.

Management believes that each of our facilities has manufacturing systems and processes that are based on established Quality Management System standards. In addition, we believe that our Irvine facility is compliant with applicable Good Manufacturing Practices promulgated by the FDA, and is, with our Beaverton facility, also compliant with applicable ISO standards set forth by the International Organization for Standardization.

### Patents, Trademarks, and Licensing Agreements

We hold patents relating to multi-axis motion controllers and miniature rotary drive products. Our patents have varying expiration dates. The near term expiration of the patents, if any, is not expected to cause any change in our revenue-generating operations as the revenue from the products associated with those patents is not material.

We have no reason to believe that our activities infringe upon the intellectual property of any third party. With respect to our own patents, we have no reason to believe that our patents are invalid and we believe that at least some of our patents cover certain aspects of our products. While we are unaware of any reason that would cause us to assert or defend a claim of patent infringement, any such assertion or defense could materially and adversely affect our business and results of operations due to the costs involved.

We have certain federally registered trademarks relating to our products, including OMS-EZ®, Pro-Dex® and OMS®, along with a number of other common law trademarks.

We have not entered into any franchising agreements. We have not granted nor do we hold any third-party licenses having terms under which we earn revenue or incur expense in material amounts.

**6 | Pro-Dex 2013 Annual Report**

Table of Contents

Item 1A. RISK FACTORS

A substantial portion of our revenue is derived from a single customer such that if we were to lose that customer, it would have a material adverse effect on our business, financial condition and results of operations.

In fiscal year 2013, our top 20 customers accounted for 81% of our sales, with our largest customer accounting for 47% of our sales. The loss of our largest customer, or the loss of any other significant customer, would severely impact us, including having a material adverse effect on our business, financial condition, cash flows, revenue and results of operations.

Our failure to manage contracting sales levels could harm us by having a material adverse effect on our business and results of operations.

Over the past two fiscal years our total sales have contracted from \$27.1 million in 2011 to \$12.2 million in 2013 . We continue to implement the steps of a strategic plan, the objectives of which are to identify and capture additional revenue opportunities and concurrently reduce operating costs not critical to revenue growth. There can be no assurance, however, as to either the timing or success of achieving these objectives, which, during any period not achieved, may cause us to experience a prolonged material and adverse impact on our business.

Even if we are successful in identifying and capturing additional revenue opportunities, we might be required to expand our overall production, development, marketing, sales, management and training capacity. 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 us.

We terminated our bank credit facility agreements in September 2012. An inability to achieve anticipated cash flows from operations over the next twelve months could have a material adverse effect on our liquidity and could require additional financing, which may not be available on acceptable terms or at all.

At June 30, 2012, we were in violation of profitability-based covenants related to our then-existing bank credit facility, for which the bank had the right to declare us in default of the bank credit facility agreements and the entire amount owing under the facility, consisting of a term loan, to become immediately due and payable. We historically had not made any borrowings against our bank lines of credit, and believed that existing cash balances and cash flows from operations would be sufficient to fund operations for the next twelve months and to fully repay the term loan. Accordingly, on August 30, 2012, we notified the bank of our intent to terminate the credit facility agreements and repay the term loan in full, which amounted to \$685,000 at the time of its repayment in September 2012.

An inability to achieve anticipated cash flows from operations could have a material adverse effect on our ability to fund operations for the next twelve months and require us to obtain new financing. However, there is no assurance that such financing will be available on acceptable terms, if at all.

A substantial portion of our business is derived from our two core business areas that, if not serviced properly, may result in a material adverse impact upon our business, results of operations and financial condition.

In fiscal year 2013, we derived more than 78% of our revenue from sales of our medical device and motion control products and related services. We believe that a primary factor in the market acceptance of our products and services is the value that is created for our customers by those products and related 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, while at the same time continuing to provide the value our customers have come to expect from us. We have historically expended a significant percentage of our revenue 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, or achieve market acceptance. If new products or product enhancements do not achieve market acceptance, our business, results of operations and financial condition could be materially adversely affected.

We face significant competition from a number of different sources, which could negatively impact our results of operations and business conditions.

The markets for products in the industries served by our customers 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.

**Pro-Dex 2013 Annual Report | 7**

## Table of Contents

We compete in all of our markets with other major surgical device and motion control related companies. As a provider of outsourced products and services, we also compete with our customers' own internal development groups. Competitive pressures and other factors, such as new product or new technology introductions by us, our customers' internal development and manufacturing departments, or our competitors may result in price or market share erosion that could have a material adverse effect on 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.

The industry in which we operate is subject to significant technological change and any failure or delay in addressing such change could adversely affect our competitive position or could make our current products obsolete.

The medical device and motion control 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 our 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 we have historically funded through operations; however we may be unable to do so in the future and we have no credit facility with which to fund such expenditures. 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. Although we target new markets for access, develop new products and update existing products, there can be no assurance that we will do so successfully or that even if we are successful, such efforts 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.

Two of our directors hold voting power with respect to a substantial portion of our outstanding common stock, which enables them to have significant influence over the outcome of all matters submitted to our shareholders for approval and which influence may be alleged to conflict with our interests and the interests of other shareholders.

As of August 31, 2013, two of our directors, Nicholas J. Swenson and Raymond E. Cabillot, controlled voting power over approximately 32.2% (21.6% and 10.6%, respectively) of the outstanding shares of our common stock. As a result of such voting control, these directors will have significant influence over all matters submitted to our shareholders for approval, including the election of our directors and other corporate actions, and may be alleged to conflict with our interests and the interests of other shareholders.

A conflict of interest exists with respect to certain investments approved by our Investment Committee.

In April 2013, our Board approved a Surplus Capital Investment Policy (the "Policy") that provides, among other items, for the following:

- (a) Determination by our Board of Directors of (i) our surplus capital balance and (ii) the portion of such surplus capital balance to be invested according to the Policy;

- (b) Selection of an Investment Committee responsible for implementing the Policy; and
- (c) Objectives and criteria under which investments may be made.

The current composition of the Investment Committee is: Messrs. Swenson (Chair) and Cabillot, both of whom are members of our Board of Directors and professional investment fund managers, and Mr. Hurwitz, our Chief Executive Officer and Chief Financial Officer. The Investment Committee has approved making investments in the common stocks of certain companies in which funds managed by Mr. Swenson and/or Mr. Cabillot currently hold common stock investments, and may approve making additional such investments in the future. In such situations, a potential conflict of interest exists, or will exist, in that Messrs. Swenson's or Cabillot's interests may not be independent of Investment Committee decisions.

Our investments are concentrated in stocks whose fair values are subject to a loss in value and which may not easily be sold.

Our current investments under the Policy are concentrated in common stocks of OTC companies. A significant decline in the value of our investments may produce a large decrease in our consolidated shareholders' equity and can have a material adverse effect on our consolidated book value per share. Under certain circumstances, significant

## Table of Contents

declines in the fair value of these investments may require the recognition of losses in the statement of operations and other comprehensive income. In addition, such stocks do not consistently trade on a daily basis which could adversely affect our ability to sell them on a timely basis or at an acceptable value.

Our quarterly results can fluctuate significantly from quarter to quarter, which may negatively impact the price of our shares and/or cause significant variances in the prices at which our shares trade.

Our sales 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; acceleration, deferral, or cancellation of customer orders and deliveries; changes in our strategy; revenue recognition policies in conformity with accounting principles generally accepted in the United States (“GAAP”); personnel changes; and general market and economic factors.

Because a significant percentage of our expenses are relatively fixed, a variation in the timing of sales can cause significant fluctuations 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.

In addition, it is possible that our operating results in future quarters may be below the expectations of public market analysts and investors. In such an event, the price of our common stock could be materially adversely affected.

Our operations are subject to a number of complex government regulations, the violation of which could have a material adverse effect on our business.

The manufacture and distribution of medical and dental devices are subject to state and federal requirements set forth by various agencies including the FDA and EPA. The statutes, regulations, administrative orders, and advisories that affect our businesses are complex and subject to diverse, often conflicting, interpretations. While we make every effort to maintain full compliance with all applicable laws and regulations, we are unable to eliminate an ongoing risk that one or more of our activities may at some point be determined to have been non-compliant. The penalties for non-compliance could range from an administrative warning to termination of a portion of our business. Furthermore, even if we are subsequently determined to have fully complied with applicable laws or regulations, the costs to achieve such a determination and the intervening loss of business could adversely affect or result in the cessation of a portion of our business. A change in such laws or regulations at any time may have an adverse effect on our operations. Notwithstanding the risks inherent in our business, management believes that our operations are in compliance with applicable laws and regulations.

The FDA regulates all medical devices into one of three classes (Class I, II or III) based on the level of control necessary to assure the safety and effectiveness of the device. The surgical instrumentation we manufacture is generally classified into Class I, and our dental instrumentation is generally classified into Class II. The FDA has broad enforcement powers to recall and prohibit the sale of products that do not comply with federal regulations, and to order the cessation of non-compliant processes. No claim has been made to date by the FDA regarding any of our products or processes. Nevertheless, as is common in the industry, certain of our products and processes are from time



to time subject to routine governmental reviews and investigations. While management believes that our products and processes fully comply with applicable laws and regulations, we are unable to predict the outcome of any such future review or investigation.

We believe that our business is conducted in a manner consistent with EPA and other agency regulations governing disposition of industrial waste materials. In February 2011, we became aware of a report entitled “Site Discovery Report, Southeast Santa Ana Project DTSC – Cypress Region,” dated February 2010 (the “Report”), that was prepared by the Cypress, California regional office of the Cal/EPA Department of Toxic Substances Control (“DTSC”) for Region 9 of the EPA under an agreement between the two agencies. The purpose of the Report was to identify sites within an area of southeast Santa Ana, California that may be sources of groundwater contamination previously detected in that area. The Report identified 25 sites, including our former Santa Ana site, for further screening by DTSC staff over the next two years. DTSC has informed us that no further evaluation of our former site took place during fiscal years 2011 through 2013. It is uncertain whether future developments, if any, from DTSC’s screening process would have any application to our former site and, if so, what exposure we might face concerning any findings that might be made concerning the site. In addition, we are unable to predict the outcome of any investigation or review that might be undertaken in the future with respect to our disposition of industrial waste materials.

**Pro-Dex 2013 Annual Report | 9**

## Table of Contents

If any of our products, processes or other operations were to be found in violation of government regulations, it could expose us to claims, liabilities and remedial obligations that could have a material adverse effect on our business.

We face significant uncertainty in the industry due to government healthcare reform.

Political, economic and regulatory influences are subjecting the healthcare industry to fundamental changes. The Healthcare Act enacted sweeping reforms to the U.S. healthcare industry, including mandatory health insurance, reforms to Medicare and Medicaid, the creation of large insurance purchasing groups, new taxes on medical equipment manufacturers that will apply to certain of our products and other significant modifications to the healthcare delivery system. Due to uncertainties regarding the ultimate features of the new federal legislation and its implementation, we cannot predict what impact the Healthcare Act may have on us, our customers or our industry.

We rely heavily on our proprietary technology, which, if not properly protected or if deemed invalid, could have a material adverse effect on our business, results of operations and financial condition.

We are dependent on the maintenance and protection of our proprietary technology and rely on patent filings, exclusive development and supply agreements, confidentiality procedures, and employee nondisclosure agreements to protect it. 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. Assertions or claims by others, whether or not valid, could cause us to incur significant legal costs defending our intellectual property rights and potentially require us to enter into a license agreement or royalty arrangement with the party asserting the claim or to cease our use of the infringing technology, any of which could have a material adverse effect on our business, results of operations and financial condition.

The global economic environment may impact our business, operating results or financial condition.

Changes in the global economic environment have caused, and may cause in the future, a general tightening in the credit markets, lower levels of liquidity, increases in rates of default and bankruptcy, and extreme volatility in credit, equity and fixed income markets. These macroeconomic developments could negatively affect our business, operating results or financial condition should they cause, for example, current or potential customers to become unable to fund purchases of our products, in turn resulting in delays, decreases or cancellations of purchases of our products and services, or causing the customer to not pay us or to delay paying us for previously purchased products and services. In addition, financial institution failures may cause us to incur increased expenses or make it more difficult either to obtain financing for our operations, investing activities (including the financing of any future acquisitions), or financing activities. Additional economic risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition or operating results.

We face risks and uncertainties associated with potential litigation by or against us, which could have a material adverse effect on our business, results of operations and financial condition.

We continually face the possibility of litigation as either a plaintiff or a defendant. It is not reasonably possible to estimate the awards or damages, or the range of awards or damages, if any, that we might incur in connection with such litigation.

Many of our products are complex and technologically advanced. Such products may, from time to time, be the subject of claims concerning product performance and construction, including warranty claims. While we are committed to correcting such problems as soon as possible, there is no assurance that solutions will be found on a timely basis, if at all, to satisfy customer demands or to avoid potential claims or litigation. Also, due to the location of our facilities, as well as the nature of our business activities, there is a risk that we could be subject to litigation related to environmental remediation claims. We maintain insurance to protect against claims associated with the use of our products, but there can be no assurance that our insurance coverage will adequately cover any claim asserted against us.

The uncertainty associated with potential litigation may have an adverse impact on our business. In particular, litigation could impair our relationships with existing customers and our ability to obtain new customers. Defending or prosecuting litigation could result in significant legal costs and a diversion of management's time and attention away from business operations, either of which could have a material adverse effect on our business, results of operations and financial condition. There can be no assurance that litigation would not result in liability in excess of our insurance

## Table of Contents

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.

Our operations are dependent upon our key personnel. If such personnel were to leave unexpectedly, we may not be able to execute our business plan.

Our future performance depends in significant part upon the continued service of our key technical and senior management personnel. 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, marketing and finance.

A high level of employee mobility and the aggressive recruiting of skilled personnel characterize the medical device 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.

The failure to maintain the market price of our common stock may affect our ability to remain listed on the NASDAQ exchange.

The minimum bid price for our publicly traded common stock was below \$1.00 for a significant period of time throughout 2008, 2009 and 2010, ultimately resulting in us effecting a one-for-three reverse split of our common stock on June 17, 2010 to increase our stock price to satisfy the \$1.00 minimum bid price listing requirement of the Nasdaq Capital Market. Notwithstanding the increased price of our common stock that resulted from the reverse split, our future performance, general market conditions and other factors could result in us failing to satisfy the listing standards of the Nasdaq Capital Market in the future. If our common stock were to be delisted from the Nasdaq Capital Market, our shareholders may find it difficult to either dispose, or obtain quotations for the price, of our common stock.

We are subject to changes in and interpretations of financial accounting matters that govern the measurement of our performance, compliance with which could be costly and time consuming.

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 Financial Accounting Standards Board, the U.S. Securities and Exchange Commission and the American Institute of Certified Public Accountants, management believes our performance, including current sales contract terms and business arrangements, has 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 may 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.

Our evaluation of internal controls and remediation of potential problems is costly and time consuming and could expose weaknesses in financial reporting.

Section 404 of the Sarbanes-Oxley Act of 2002, as amended, requires management's assessment of the effectiveness of the Company's internal control over financial reporting. This process is expensive and time consuming, and requires significant attention of management. Management can give no assurance that material weaknesses in internal controls will not be discovered. If a material weakness is discovered, corrective action may be time consuming and costly, and could further divert the attention of management. The disclosure of a material weakness, even if quickly remedied, could reduce the market's confidence in our financial statements and harm our stock price, especially if a restatement of financial statements for past periods is required.

Item 1B. Unresolved Staff Comments

None.

Item 2. Description of Property

Our executive offices and Irvine manufacturing facility are located at 2361 McGaw Avenue, Irvine, California 92614. We lease the 28,000 square foot facility from an unrelated third party at a base monthly lease rate of \$34,000,

Table of Contents

with annual increases of \$1,400 per month in the base lease rate through the expiration of the lease in April 2018. The building is a one-story stand-alone structure of concrete “tilt-up” construction, approximately 25 years old and in good condition.

Our Beaverton office and manufacturing facility is located at 15201 N.W. Greenbrier Parkway, B-1 Ridgeview, Beaverton, Oregon 97006. The Company leases the 7,500 square foot facility from an unrelated third party, at a base monthly lease rate of \$6,300 through the expiration of the lease in April 2014. The building is a one-story suite in a 20-year-old industrial office complex and is in good condition.

The current leased facilities are believed to be adequate for our expected needs. We believe each facility is in full compliance with applicable state, EPA and other agency environmental standards.

Item 3. Legal Proceedings

In February 2011, we became aware of a report entitled “Site Discovery Report, Southeast Santa Ana Project DTSC – Cypress Region,” dated February 2010 (the “Report”), that was prepared by the Cypress, California regional office of the Cal/EPA Department of Toxic Substances Control (“DTSC”) for Region 9 of the EPA under an agreement between the two agencies. The purpose of the Report was to identify sites within an area of southeast Santa Ana, California that may be sources of groundwater contamination previously detected in that area. The Report identified 25 sites, including our former Santa Ana site, for further screening by DTSC staff over the next two years. DTSC has informed us that no further evaluation of our former site took place during fiscal years 2011 through 2013. It is uncertain whether future developments, if any, from DTSC’s screening process would have any application to our former site and, if so, what exposure we might face concerning any findings that might be made concerning the site.

In general, we are from time to time a party to various legal proceedings incidental to our business, none of which we consider may be material. There can be no certainty, however, that we may not ultimately incur liability or that such liability will not be material and adverse.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market For Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock is quoted under the symbol “PDEX” on the automated quotation system of the Nasdaq Capital Market (“NASDAQ”). The following table sets forth for the quarters indicated the high and low sales prices of our common stock as reported by NASDAQ. The quotations reflect inter-dealer prices, without retail markup, markdown, or commissions, and may not necessarily represent actual transactions. On August 30, 2013, the last sale price of our common stock as reported by NASDAQ was \$1.92 per share.

| Quarter Ended      | High   | Low    |
|--------------------|--------|--------|
| September 30, 2011 | \$2.59 | \$1.64 |
| December 31, 2011  | \$2.57 | \$1.81 |

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|                    |        |        |
|--------------------|--------|--------|
| March 31, 2012     | \$3.90 | \$1.92 |
| June 30, 2012      | \$2.43 | \$1.80 |
| September 30, 2012 | \$2.10 | \$1.52 |
| December 31, 2012  | \$2.19 | \$1.72 |
| March 31, 2013     | \$2.37 | \$1.92 |
| June 30, 2013      | \$2.10 | \$1.84 |

At June 30, 2013, there were approximately 235 holders of record of our common stock. This number does not include beneficial owners including holders whose shares are held in nominee, or “street,” name.

We have never paid a cash dividend with respect to our common stock. The current policy of our Board of Directors is to retain earnings to provide funds for the operation and expansion of the business.

12 | **Pro-Dex 2013 Annual Report**

Table of Contents

## Equity Compensation Plan Information

Following is information with respect to securities issued and authorized for issuance under our equity compensation plans as of June 30, 2013:

| Plan Category  | Weighted Average Exercise   |  |  |
|--|---|--|--|
|  | Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a) | Price of Outstanding Warrants and Rights (b) | Number of Securities Available for Issuance Under Equity Compensation Plans (excluding securities reflected in column (a)) (c) |
| Equity compensation plans approved by security holders | 292,504   | \$ 2.35                                      | 579,133  |
| Total  | 292,504   | \$ 2.35                                      | 579,133  |

## Item 6. Selected Financial Data

Not Required.

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis provides information that management believes is relevant to an assessment and understanding of the Company's results of operations and financial condition for the years ended June 30, 2013 and 2012. Unless otherwise indicated, this discussion excludes the results of our fractional horsepower motor product line, operating under the name Pro-Dex Astromec, which we sold in February 2012 and which has been classified as a discontinued operation. This discussion should be read in conjunction with the Consolidated Financial Statements and the Notes thereto beginning on page 21 of this report. This report contains certain forward-looking statements and information. The cautionary statements included below and elsewhere in this report 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.

## Critical Accounting Estimates and Judgments

Our consolidated financial statements are prepared in accordance with 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.

## Revenue Recognition

Revenue on product sales is recognized upon shipment to the customer when risk of loss and title transfer to the customer and all other conditions required by GAAP, as promulgated by the Financial Accounting Standards Board ("FASB") in Accounting Standards Codification ("ASC") Section 605 (formerly Staff Accounting Bulletin No. 104,



Revenue Recognition), have been satisfied.

Revenue from billable product development service portions of development and supply contracts is generally recognized upon completion of such product development services, in conformity with ASC Section 605. Anticipated losses on product development services are charged to cost of sales in the period in which such losses become probable.

Returns of our product for credit are minimal; accordingly, we do not establish a reserve for product returns at the time of sale.

#### Warranties

Certain of our products are sold with a warranty that provides for repairs or replacement of any defective parts for a period, generally one year, after the sale. At the time of the sale, we accrue an estimate of the cost of providing the warranty based on prior experience with such factors as return rates and repair costs, which factors are reviewed quarterly.

Warranty expenses, including changes of estimates, are included in cost of sales in our consolidated statements of operations.

**Pro-Dex 2013 Annual Report | 13**

## Table of Contents

### Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market value. Reductions to estimated market value are recorded, and charged to cost of sales, when indicated based on a formula that compares on-hand quantities to estimated demand over the ensuing 12 months from the measurement date.

### Accounts Receivable

Trade receivables are stated at their original invoice amounts, less an allowance for doubtful portions of such accounts. Management determines the allowance for doubtful accounts based on facts and circumstances related to specific accounts, and on historical experience related to the age of accounts. Trade receivables are written off when deemed uncollectible. Recoveries of trade receivables previously reserved are offset against the allowance when received.

### Investments

Investments consist of marketable equity securities of publicly held companies. Management intends to hold such securities for a sufficient period in which to realize a reasonable return, although there is no assurance that positive returns will be realized or that such securities will not be liquidated in a shorter than expected time frame to accommodate the Company's liquidity requirements. Accordingly, investments have been classified as non-current and available-for-sale in conformity with ASC Section 320. Investments are marked to market at each measurement date, with unrealized gains and losses presented as adjustments to accumulated other comprehensive income or loss.

### Long-lived Assets and Real Estate Held for Sale

We review the recoverability of long-lived assets, consisting of equipment and leasehold improvements, and of real estate held for sale, when events or changes in circumstances occur that indicate carrying values may not be recoverable.

### Stock-Based Compensation

We recognize compensation expense for all share-based awards made to employees and directors. The fair value of share-based awards is estimated at the grant date using the Black-Scholes option-pricing model. The portion that is ultimately expected to vest is recognized as compensation cost over the requisite service period using the straight-line single option method.

The determination of fair value using the Black-Scholes model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables, including expected stock price volatility, risk-free interest rate, expected dividends and projected employee stock option exercise behavior. We estimate stock price volatility based on two factors: (a) the measurement date (typically the grant date) and (b) the expected life of the option, which we calculate using the Staff Accounting Bulletin No. 107 simplified method.

### Income Taxes

We recognize deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of our assets and liabilities along with net operating loss and tax credit carryovers. Deferred tax assets at both

June 30, 2013 and 2012 consisted primarily of basis differences related to research and development tax credit utilization, net operating loss carryovers, intangible assets, accrued expenses and inventories.

Significant management judgment is required in determining our provision for income taxes and the recoverability of our deferred tax assets. Such determination is based on our historical taxable income, with consideration given to our estimates of future taxable income and the periods over which deferred tax assets will be recoverable. We record a valuation allowance against deferred tax assets to reduce the net carrying value to an amount that we believe is more likely than not to be realized. When we establish or reduce the valuation allowance against deferred tax assets, the provision for income taxes will increase or decrease, respectively, in the period such determination is made. At June 30, 2013 and 2012, we maintained a valuation allowance against the entire balance of our deferred tax assets, net of deferred tax liabilities.

14 | **Pro-Dex 2013 Annual Report**

Table of Contents

## RESULTS OF OPERATIONS

**Results of Operations for the Fiscal Year Ended June 30, 2013, Compared to the Fiscal Year Ended June 30, 2012**

The following table sets forth financial data and the percentage of net sales regarding our financial position and operating results:

|  | <b>Fiscal Year ended June 30,</b> |       |             |       |
|--|-----------------------------------|-------|-------------|-------|
|  | <b>2013</b>                       |       | <b>2012</b> |       |
|  | <b>Dollars in thousands</b>       |       |             |       |
| Net sales  | \$ 12,249                         | 100 % | \$ 17,257   | 100 % |
| Cost of sales  | 8,533                             | 70 %  | 11,841      | 69 %  |
| Gross profit   | 3,716                             | 30 %  | 5,416       | 31 %  |
| Selling expenses   | 1,255                             | 10 %  | 1,531       | 9 %   |
| General and administrative expenses                      | 2,566                             | 21 %  | 3,182       | 18 %  |
| Research and development costs                           | 1,790                             | 15 %  | 2,068       | 12 %  |
| Loss from continuing operations before items below       | (1,895 )                          | -16 % | (1,365 )    | -8 %  |
| Interest expense, net                                    | 8                                 | 0 %   | 36          | 0 %   |
| Benefit from income taxes                                | (39 )                             | 0 %   | (441 )      | 3 %   |
| Loss from continuing operations                          | (1,864 )                          | -16 % | (960 )      | -5 %  |
| Income from discontinued operations, net of income taxes | 80                                | 1 %   | 84          | 0 %   |
| Net loss   | \$ (1,784 )                       | -15 % | \$ (876 )   | -5 %  |

Net sales in 2013 decreased 29%, or \$5.0 million, to \$12.2 million from \$17.3 million in 2012. Contributing to this decrease was a reduction, amounting to \$6.0 million, in product sales and repair services to our former largest medical device customer, partially offset by an increase of \$394,000 to our current second largest customer and a net increase of \$1.0 million in product sales and repair services to other medical device customers as compared to 2012.

Additionally, sales in our dental and industrial product lines decreased \$464,000 and 105,000, respectively, in 2013 as compared to 2012 due primarily to a increased focus in of our resources in 2013, relative to 2012, on development of medical device product sales.

Although selective price increases were implemented during 2013 in response to market conditions, the primary factor underlying the medical device sales increases (excluding sales to our former largest customer) described above is unit volume change.

At June 30, 2013, we had a backlog of \$6.7 million compared with a backlog of \$5.3 million at June 30, 2012. The increase in orders is due to normal variability in our new order bookings.

Gross profit in 2013 decreased \$1.7 million, or 31%, to \$3.8 million from \$5.4 million in 2012. Contributing to this decrease was \$1.9 million resulting from the reduced sales volume described above and the accrual in 2013 of \$176,000 representing anticipated losses from the development services portion of certain contracts. Partially offsetting these changes was a \$369,000 reduction in warranty costs in 2013, relative to 2012. As a percentage of

sales, gross margin was 30% for 2013, as compared to 31% in 2012. Underlying this result was the accrual in 2013 of the anticipated contract losses, partially offset by the favorable changes in warranty costs, both as described above.

Selling expenses decreased \$276,000, or 18%, to \$1.3 million in 2013 from \$1.5 million in 2012. This decrease is attributable primarily to decreases in (a) advertising and market research expenses of \$220,000, and (b) tradeshow expense of \$80,000, partially offset by an increase in severance expense of \$26,000 from 2012 to 2013.

General and administrative expenses decreased \$616,000, or 19%, to \$2.6 million in 2013 from \$3.2 million in 2012, due to (a) the lower costs incurred in 2013, relative to 2012, related to changes in each such year of Chief Executive Officers, such costs amounting to \$167,000 and \$339,000 in 2013 and 2012, respectively, (b) a decrease in compensation expense of \$315,000 and (c) a decrease in professional consulting and legal expense (excluding proxy contest expenses discussed below) of \$264,000. Partially offsetting these decreases were increases in legal and shareholder reporting expenses, aggregating \$190,000, incurred in connection with proxy contest expenses related to the contested election of directors at our 2012 Annual Meeting of Shareholders held in January 2013.

**Pro-Dex 2013 Annual Report | 15**

Table of Contents

Research and development costs, which include costs related to development of new products and enhancements to existing products, decreased \$279,000, or 13%, to \$1.8 million in 2013 from \$2.1 million in 2012. This decrease was due primarily to the deployment of engineering resources, normally charged to research and development expense, to support revenue-producing development contracts with customers, the costs of which are deferred, and recorded as cost of sales when the development projects are completed. Such deferred costs amounted to \$370,000 in 2013 and \$10,000 in 2012. Partially offsetting the effect of these deferred costs was an increase in departmental compensation of \$51,000 in 2013 compared to 2012.

Interest income in 2013 was \$3,000, due to the investment of a portion of our cash balances in money market funds in June 2013. There was no interest income in 2012. Interest expense was \$11,000 in 2013, compared to \$36,000 in 2012. This decrease was attributable to our repayment, in September 2012, of the entire principal balance, amounting to \$685,000, of the then-outstanding term loan (see Note 5 of Notes to Consolidated Financial Statements contained elsewhere in this report).

Our effective combined federal and state tax benefit rate in 2013 was 2%, as compared to a tax benefit rate in 2012 of 31%. The decrease in rates from 2012 to 2013 is due to the ability, in 2012, to carry back a substantial portion of 2012 net operating losses to offset taxable income in prior years, fully utilizing our loss carryback capacity. Accordingly, the net operating losses generated in 2013 may be used only to offset future years' taxable income. There is no assurance, however, that we will generate sufficient, or any, taxable income in future years to utilize such net operating loss carryforward capacity. Because we were not able to utilize the entire amount of net operating losses generated in either 2012 or 2013 to offset taxable income, the tax benefit rates in both years were lower than the federal statutory rate (see Note 7 of Notes to Consolidated Financial Statements contained elsewhere in this report).

As a result of the foregoing, loss from continuing operations for 2013 was \$1.9 million, as compared to a loss from continuing operations of \$960,000 for 2012.

## Liquidity and Capital Resources

The following table presents selected financial information as of June 30, 2013 and 2012:

|  | <b>June 30, 2013</b> | <b>June 30, 2012</b> |
|--|----------------------|----------------------|
| Cash   | \$ 1,680,000         | \$ 4,112,000         |
| Working capital (current assets, less current liabilities) | \$ 5,033,000         | \$ 6,618,000         |
| Cash, net of debt  | \$ 1,660,000         | \$ 3,338,000         |

Net cash used in operating activities in 2013 amounted to \$1.3 million. The primary use of cash arose from an increase in (a) unbilled receivables amounting to \$244,000 and relating to the development portion of certain contracts we entered into with customers in 2013, and (b) inventories of \$1.0 million, resulting primarily from a build-up of our stock of components related to certain of our products with the objective of shortening lead times when forecasted purchase orders are received. In the fourth quarter of 2013, our largest customer began deferring the timing of its product orders, thus prolonging the effect of the inventory build-up described above with respect to inventory unique to that customer's products. Based on discussions with the customer, we believe that partial relief of the inventory build-up related to that customer's products will likely be weighted toward the latter half of fiscal 2014 and possibly the first half of fiscal 2015. Sources of cash arose primarily from reductions in (a) accounts receivable amounting to \$325,000, attributable primarily to the lower sales volume experienced during 2013 relative to 2012, and (b) income

taxes receivable amounting to \$608,000, resulting primarily from tax refunds received in 2013 from the carryback of tax-basis net operating losses generated in 2012, and from increases in (a) accrued expenses, resulting primarily from the accrual in 2013 of anticipated losses on development contracts amounting to \$176,000, and (b) deferred revenue amounting to \$121,000, resulting from collections received in 2013 from customers in connection with the contractual terms of development contracts that will not qualify for revenue recognition until we complete the related non-recurring engineering services.

During 2012, net cash provided by operating activities amounted to \$45,000. Sources of cash arose from increases in accounts payable and accrued liabilities, amounting to \$383,000 and due primarily to high ordering activity relative to sales volumes and accruals for employee bonuses related to 2011 results. Uses of cash arose from increases in accounts receivable of \$418,000 and inventories of \$475,000, both increases due primarily to the high sales volumes during 2011.

Net cash used in investing activities during 2013 consisted primarily of investments, aggregating \$366,000, in common stock of public companies under the direction of the Investment Committee of our Board (see “Surplus Capital Investment Policy” below), and of purchases of equipment amounting to \$86,000. Net cash used in investing activities during 2012 consisted of purchases of equipment, amounting to \$341,000, net of proceeds received, amounting to \$82,000, from the sale of equipment in connection with the sale of the Astromec business (see Note 3 of Notes to Consolidated Financial Statements contained elsewhere in this report).

16 | **Pro-Dex 2013 Annual Report**

## Table of Contents

Net cash used in financing activities for 2013 consisted primarily of (a) our payment, in September 2012, of the remaining balance due, amounting to \$685,000, on the Union Bank term loan, fully retiring such indebtedness (see Note 5 of Notes to Condensed Consolidated Financial Statements contained elsewhere in this report), and (b) normal reductions in the principal balance of the bank term loan, prior to the repayment described above, of \$90,000, partially offset by \$66,000 in proceeds from the exercise of stock options. Net cash used in financing activities during 2012 consisted primarily of reductions in the principal balance of our bank term loan, amounting to \$357,000.

We believe that existing cash balances and cash flows from operations will be sufficient to fund operations for the next twelve months.

### Reduction in Large Customer Orders

In December 2009, our then-largest customer informed us that it was in the process of developing, and planned to eventually manufacture, its own surgical devices which were functionally comparable to the products we provided to the customer at that time. We had been the exclusive manufacturer of these products since they were developed. The resulting reduction in orders from our largest customer and its expected future impact on our business is more fully described in “Description of Business” under Item 1 of this report.

### Reduction in Directors’ Compensation

At our 2012 Annual Meeting of Shareholders held on January 17, 2013, our shareholders elected four new members to our Board of Directors. At a meeting of the newly constituted Board on February 4, 2013, three of those newly elected directors, Messrs. Swenson, Cabillot and Farrell, each opted to waive, through the date of our 2013 Annual Meeting of Shareholders, (a) receipt of stock options they were otherwise entitled to receive under the provisions of the directors’ compensation plan then in effect (the “2010 Plan”), and (b) any cash retainers or meeting fees they were otherwise entitled to receive under the 2010 Plan in excess of \$200 per meeting and \$2,000 per year.

At its meeting on May 2, 2013, our Board replaced the 2010 Plan with the 2013 Directors’ Compensation Plan (the “2013 Plan”) that provides for the following:

Fees of \$200 for participation in Board or Committee meetings, to a maximum of \$2,000 per fiscal year;

An annual retainer of \$23,000 for the Audit Committee Chair (which may be modified in compensating any future Audit Committee Chair).

The 2013 Plan has no provision for (a) retainers other than that described above, or (b) grants of options, restricted stock or other equity or equity-based compensation or incentives (see Note 8 of Notes to Consolidated Financial Statements contained elsewhere in this report).

We believe that, when compared to the 2010 Plan, the 2013 Plan will result in a reduction of directors’ cash compensation on an annualized basis of approximately \$85,000, and in a reduction of aggregate (cash and non-cash) directors’ compensation expense on an annualized basis of approximately \$140,000.

### Sale of Real Estate



On July 5, 2013, we completed the sale of the land and building constituting the facility in which Astromec formerly operated in Carson City, Nevada (see Note 3 of Notes to Condensed Consolidated Financial Statements contained elsewhere in this report).

The sale price for the facility was \$980,000, which, after approximately \$65,000 in deductions for sale-related expenses such as commissions and fees, resulted in our receipt of net proceeds of approximately \$915,000. The facility was not encumbered by any debt.

#### Surplus Capital Investment Policy

At its April 17, 2013 meeting, our Board approved a Surplus Capital Investment Policy (the “Policy”) that provides, among other items, for the following:

- (a) Determination by our Board of Directors of (i) our surplus capital balance and (ii) the portion of such surplus capital balance to be invested according to the Policy;
- (b) Selection of an Investment Committee responsible for implementing the Policy; and
- (c) Objectives and criteria under which investments may be made.

The initial composition of the Investment Committee, also approved by our Board at its April 17, 2013 meeting, is Messrs. Swenson (Chair) and Cabillot, both of whom are members of our Board of Directors, and Mr. Hurwitz, Chief Executive Officer and Chief Financial Officer.

## Table of Contents

In June 2013, the Investment Committee approved investments aggregating \$500,000, and approved an additional \$500,000 in July 2013. At September 25, 2013, \$592,289 was invested in marketable public equity securities, having a market value of \$654,580, and \$407,711 was invested in money market funds.

In September 2013, our Board approved a share repurchase program authorizing the Company, at the direction of the Investment Committee, to repurchase up to 750,000 shares of our common stock under parameters to be determined by the Investment Committee. The repurchase program has no stated expiration date.

### Changes in Bank Debt and Credit Facilities

As discussed above in “Liquidity and Capital Resources” under this Item 7, on August 30, 2012 we notified the bank with whom we had a then-existing bank credit facility of our intent to terminate the credit facility agreements and repay the term loan outstanding thereunder, which was repaid in September 2012.

### Impact of Inflation and Changing Prices

The industries in which we compete are labor intensive, often involving personnel with high-level technical or sales skills. Wages and other expenses increase during periods of inflation and when shortages in the marketplace occur. In addition, suppliers pass along rising costs to us in the form of higher prices. We have been able to partially offset increases in operating costs by increasing prices, expanding services and implementing cost control measures. However, our ability to increase prices is limited by competitive market conditions, including international competition in many of our markets.

### Recent Accounting Pronouncements

We evaluate authoritative accounting pronouncements upon their issuance and estimate the effect, if any, of such pronouncements on our financial statements. In our evaluation, we have concluded that there are no such pronouncements that have been issued with effective dates subsequent to June 30, 2013 that would have an effect on our financial statements or accounting policies had such pronouncements been currently in effect.

### Item 7A. Quantitative and Qualitative Disclosures About Market Risks

Not applicable.

### Item 8. Financial Statements and Supplementary Data

The financial statements and supplemental data of the Company may be found in this report on the pages indicated below.

|  |    |
|--|----|
| <u>Report of Independent Registered Public Company Accounting Firm</u> | 20 |
| <u>Consolidated Balance Sheets</u>                                     | 21 |
| <u>Consolidated Statements of Operations</u>                           | 22 |
| <u>Consolidated Statements of Shareholders' Equity</u>                 | 23 |
| <u>Consolidated Statements of Cash Flows</u>                           | 24 |
| <u>Notes to Consolidated Financial Statements</u>                      | 25 |

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer (our principal executive officer and principal financial officer) has concluded, based on his evaluation as of June 30, 2013, that 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”)) are effective at a reasonable assurance level to ensure that information required to be disclosed by us in the reports filed or submitted by us under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission’s rules and forms, including to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Our management is responsible for establishing and maintaining adequate “internal control over financial reporting” (as defined in Rule 13a-15(f) under the Exchange Act). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the

18 | **Pro-Dex 2013 Annual Report**

Table of Contents

effectiveness of our internal control over financial reporting based on the framework set forth in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, our management concluded that our internal control over financial reporting was effective as of June 30, 2013.

Our internal control over financial reporting is supported by written policies and procedures, that:

- (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets;
- (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of our Company are being made only in accordance with authorizations of our management and directors; and
- (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our registered public accounting firm pursuant to rules of the SEC that apply to smaller reporting companies that permit us to provide only management's attestation in this annual report.

During the quarter ended June 30, 2013, there were no changes in the Company's 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, the Company's internal controls over financial reporting.

Item 9B. Other Information.

None.

PART III

Item 10. Directors, Executive Officers, and Corporate Governance

Information required by this Item is incorporated by reference from the information contained in the Company's definitive Proxy Statement for the Company's 2013 Annual Meeting of Shareholders to be filed with the SEC within 120 days after the end of the fiscal year ended June 30, 2013 (the "Proxy Statement").

Item 11. Executive Compensation

Information required by this Item is incorporated by reference from the Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information required by this Item is incorporated by reference from the Proxy Statement.

Item 13. Certain Relationships and Related Transactions, and Director Independence

Information required by this Item is incorporated by reference from the Proxy Statement.

Item 14. Principal Accountant Fees and Services

Information required by this Item is incorporated by reference from the Proxy Statement.

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) Reference is made to the index of financial statements and supplemental data under Part II, Item 8 this report.

(b) Reference is made to the Exhibit Index beginning on page 38 of this report.

Table of Contents

Report of Independent Registered Public Accounting Firm

The Stockholders and Board of Directors  
Pro-Dex, Inc.

We have audited the accompanying consolidated balance sheets of Pro-Dex, Inc. and Subsidiaries (the Company) as of June 30, 2013 and 2012 and the related consolidated statements of operations and comprehensive loss, shareholders' equity and cash flows for each of the years in the two-year period ended June 30, 2013. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Pro-Dex, Inc. and Subsidiaries as of June 30, 2013 and 2012, and the results of their operations and their cash flows for each of the years in the two-year period ended June 30, 2013 in conformity with accounting principles generally accepted in the United States of America.

/s/ Moss Adams LLP  
Moss Adams LLP  
Irvine, California  
September 27, 2013

20 | **Pro-Dex 2013 Annual Report**

Table of Contents

PRO-DEX, INC. and SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

|  | <b>June 30, 2013</b> | <b>June 30, 2012</b> |
|--|----------------------|----------------------|
| <b>ASSETS</b>  |                      |                      |
| Current assets:  |                      |                      |
| Cash and cash equivalents  | \$ 1,680,000         | \$ 4,112,000         |
| Accounts receivable, net of allowance for doubtful accounts of \$24,000 and \$16,000 at June 30, 2013 and 2012, respectively                             | 1,339,000            | 1,581,000            |
| Unbilled receivables   | 244,000              | —                    |
| Other current receivables  | 32,000               | 123,000              |
| Inventories  | 3,834,000            | 2,791,000            |
| Prepaid expenses   | 157,000              | 172,000              |
| Income taxes receivable  | 2,000                | 609,000              |
| Deferred income taxes  | 59,000               | 109,000              |
| <br>   |                      |                      |
| Total current assets   | 7,347,000            | 9,497,000            |
| Investments  | 370,000              | —                    |
| Property, plant, equipment and leasehold improvements, net   | 2,065,000            | 2,539,000            |
| Real estate held for sale  | 733,000              | 733,000              |
| Other assets   | 80,000               | 53,000               |
| <br>   |                      |                      |
| Total assets   | \$ 10,595,000        | \$ 12,822,000        |
| <br>   |                      |                      |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                      |                      |
| Current liabilities:   |                      |                      |
| Accounts payable   | \$ 844,000           | \$ 633,000           |
| Accrued expenses   | 1,276,000            | 1,405,000            |
| Deferred revenue   | 141,000              | 20,000               |
| Income taxes payable   | 48,000               | 47,000               |
| Bank term loan   | —                    | 774,000              |
| Capital lease obligations  | 5,000                | —                    |
| <br>   |                      |                      |
| Total current liabilities  | 2,314,000            | 2,879,000            |
| <br>   |                      |                      |
| Non-current liabilities:   |                      |                      |
| Deferred income taxes  | 59,000               | 109,000              |
| Deferred rent  | 270,000              | 284,000              |
| Capital lease obligations  | 15,000               | —                    |
| <br>   |                      |                      |
| Total non-current liabilities  | 344,000              | 393,000              |
| <br>   |                      |                      |
| Total liabilities  | 2,658,000            | 3,272,000            |
| <br>   |                      |                      |
| Commitments and contingencies  |                      |                      |
| Shareholders' equity:  |                      |                      |
| Common shares; no par value; 50,000,000 shares authorized; 3,348,184 and 3,272,350 shares issued and outstanding at June 30, 2013 and 2012, respectively | 17,012,000           | 16,846,000           |

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|  |               |               |
|--|---------------|---------------|
| Accumulated other comprehensive income     | 5,000         | —             |
| Accumulated deficit                        | (9,080,000 )  | (7,296,000 )  |
| Total shareholders' equity                 | 7,937,000     | 9,550,000     |
| Total liabilities and shareholders' equity | \$ 10,595,000 | \$ 12,822,000 |

See notes to consolidated financial statements.

**Pro-Dex 2013 Annual Report | 21**



Table of Contents

PRO-DEX, INC. and SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

|   | For The Years Ended<br>June 30, |              |
|---|---------------------------------|--------------|
|   | 2013                            | 2012         |
| Net sales   | \$12,249,000                    | \$17,257,000 |
| Cost of sales   | 8,533,000                       | 11,841,000   |
| Gross profit  | 3,716,000                       | 5,416,000    |
| Operating expenses:   |                                 |              |
| Selling expenses  | 1,255,000                       | 1,531,000    |
| General and administrative expenses   | 2,566,000                       | 3,182,000    |
| Research and development costs  | 1,790,000                       | 2,068,000    |
| Total operating expenses  | 5,611,000                       | 6,781,000    |
| Loss from continuing operations before items below  | (1,895,000 )                    | (1,365,000 ) |
| Other income (expense):   |                                 |              |
| Interest income   | 3,000                           | —            |
| Interest expense  | (11,000 )                       | 36,000       |
| Total other expense   | (8,000 )                        | (36,000 )    |
| Loss from continuing operations before provision for income taxes   | (1,903,000 )                    | (1,401,000 ) |
| Benefit from income taxes   | (39,000 )                       | (441,000 )   |
| Loss from continuing operations   | (1,864,000 )                    | (960,000 )   |
| Income from discontinued operations, net of income taxes of \$51,000 in 2013 and net of benefit for income taxes of \$146,000 in 2012 | 80,000                          | 84,000       |
| Net loss  | \$(1,784,000 )                  | \$(876,000 ) |
| Other comprehensive income, net of tax  |                                 |              |
| Unrealized gain from marketable equity investments  | 5,000                           | —            |
| Total other comprehensive income  | 5,000                           | —            |
| Comprehensive loss  | \$(1,779,000 )                  | \$(876,000 ) |
| Per share data (basic and diluted):   |                                 |              |
| Loss from continuing operations   | \$(0.56 )                       | \$(0.29 )    |
| Income from discontinued operations   | \$0.02                          | \$0.02       |
| Net loss  | \$(0.54 )                       | \$(0.27 )    |

|                                     |           |           |
|-------------------------------------|-----------|-----------|
| Weighted average shares outstanding | 3,321,732 | 3,272,350 |
|-------------------------------------|-----------|-----------|

See notes to consolidated financial statements.

Table of Contents

PRO-DEX, INC. and SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
 For The Years Ended June 30, 2013 and 2012

**Common Shares**

|  | <b>Number of<br/>Shares</b> | <b>Amount</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Income</b> | <b>Accumulated<br/>Deficit</b> | <b>Total</b>  |
|--|-----------------------------|---------------|---|--------------------------------|---------------|
| Balances, June 30, 2011                            | 3,272,350                   | \$ 16,744,000 | —   | \$ (6,420,000)                 | \$ 10,324,000 |
| Repurchase of stock options                        | —                           | (6,000 )      | —   | —                              | (6,000 )      |
| Stock-based compensation plan activity             | —                           | 108,000       | —   | —                              | 108,000       |
| Net loss   | —                           | —             | —   | (876,000 )                     | (876,000 )    |
| Balances, June 30, 2012                            | 3,272,350                   | 16,846,000    | —   | \$ (7,296,000)                 | \$ 9,550,000  |
| Exercise of stock options                          | 43,334                      | 66,000        | —   | —                              | 66,000        |
| Stock-based compensation plan activity             | 32,500                      | 100,000       | —   | —                              | 100,000       |
| Net loss   | —                           | —             | —   | (1,784,000)                    | (1,784,000 )  |
| Unrealized gain from marketable equity investments | —                           | —             | \$ 5,000  | —                              | 5,000         |
| Balances, June 30, 2013                            | 3,348,184                   | \$ 17,012,000 | \$ 5,000  | \$ (9,080,000)                 | \$ 7,937,000  |

See notes to consolidated financial statements.

Table of Contents

PRO-DEX, INC. and SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

|   | For The Years Ended June 30, |                     |
|---|------------------------------|---------------------|
|   | 2013                         | 2012                |
| <b>Cash flows from operating activities:</b>  |                              |                     |
| Net loss  | \$ (1,784,000)               | \$ (876,000 )       |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: |                              |                     |
| Depreciation and amortization   | 582,000                      | 647,000             |
| Allowance for doubtful accounts   | 8,000                        | 9,000               |
| Share-based compensation  | 100,000                      | 108,000             |
| Changes in:   |                              |                     |
| Accounts receivable and other receivables   | 325,000                      | 1,428,000           |
| Unbilled receivables  | (244,000 )                   | —                   |
| Inventories   | (1,043,000)                  | 912,000             |
| Prepaid expenses  | 14,000                       | (26,000 )           |
| Other assets  | (27,000 )                    | 7,000               |
| Accounts payable, accrued expenses and deferred rent                                      | 69,000                       | (1,503,000)         |
| Deferred revenue  | 121,000                      | (20,000 )           |
| Income taxes receivable and payable   | 608,000                      | (641,000 )          |
| <b>Net cash provided by (used in) operating activities</b>                                | <b>(1,271,000)</b>           | <b>45,000</b>       |
| <b>Cash flows from investing activities:</b>  |                              |                     |
| Purchase of equipment   | (86,000 )                    | (341,000 )          |
| Proceeds from sale of equipment   | —                            | 82,000              |
| Purchase in investments   | (366,000 )                   | —                   |
| <b>Net cash used in investing activities</b>  | <b>(452,000 )</b>            | <b>(259,000 )</b>   |
| <b>Cash flows from financing activities:</b>  |                              |                     |
| Principal payments on bank term loan  | (775,000 )                   | (357,000 )          |
| Repurchase of stock options   | —                            | (6,000 )            |
| Proceeds from exercise of stock options   | 66,000                       | —                   |
| <b>Net cash used in financing activities</b>  | <b>(709,000 )</b>            | <b>(363,000 )</b>   |
| <b>Net decrease in cash</b>   | <b>(2,432,000)</b>           | <b>(577,000 )</b>   |
| Cash, beginning of year   | 4,112,000                    | 4,689,000           |
| <b>Cash and cash equivalents, end of year</b>   | <b>\$ 1,680,000</b>          | <b>\$ 4,112,000</b> |
| <b>Supplemental Information</b>   |                              |                     |
| Cash paid for interest  | —                            | \$ 37,000           |
| Cash paid for income taxes  | \$ 9,000                     | \$ 56,000           |

**Supplemental Non-Cash Information**

In February 2013, the Company entered into a capital lease agreement for the acquisition of equipment having a cost of \$22,000.

See notes to consolidated financial statements.

24 | **Pro-Dex 2013 Annual Report**

Table of Contents

PRO-DEX, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – DESCRIPTION OF BUSINESS

Pro-Dex, Inc. (“Pro-Dex”, the “Company”, “we”, “us” or “our”) specializes in the design and manufacture, and bringing speed to market, of powered surgical and dental instruments and multi-axis motion control applications, and serves such markets as medical, research and industrial. Pro-Dex’s products are found in hospitals, dental offices, medical engineering labs, scientific research facilities and high tech manufacturing operations around the world.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Pro-Dex Astromec, Inc. (Note 3), and Pro-Dex Management, Inc., a non-operating subsidiary. All significant inter-company accounts and transactions have been eliminated.

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”).

Revenue Recognition

Revenue on product sales is recognized upon shipment to the customer when risk of loss and title transfer to the customer and all other conditions required by GAAP, as promulgated by the Financial Accounting Standards Board (“FASB”) in Accounting Standards Codification (“ASC”) Section 605 (formerly Staff Accounting Bulletin No. 104, Revenue Recognition), have been satisfied.

Certain of our contracts are development and supply contracts. Such contracts provide for billable, fixed-price, non-recurring engineering services in addition to product sales, which are considered as multiple deliverables under the provisions of ASC 605. Revenue from the non-recurring engineering service portions of such contracts is generally recognized under the completed contract method. Contract costs include all direct material, labor and those indirect costs related to contract performance. Provision for estimated losses on uncompleted contracts are made in the period in which such losses are determined, and are recorded in accrued expenses as an accrual for loss contracts.

Returns of our product for credit are minimal; accordingly, we do not establish a reserve for product returns at the time of sale.

Warranties

Certain of our products are sold with a warranty that provides for repairs or replacement of any defective parts for a period, generally one year, after the sale. At the time of the sale, we accrue an estimate of the cost of providing the warranty based on prior experience with such factors as return rates and repair costs, which factors are reviewed

quarterly.

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. 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.

#### Comprehensive Income

Comprehensive income encompasses all changes in equity other than those with shareholders and consists of net income (loss) and unrealized gain (loss) on marketable equity investments.

#### Cash and Cash Equivalents

We consider all highly liquid investments with an original maturity of ninety days or less to be cash equivalents. At June 30, 2013, cash equivalents consisted of investments in money market funds. We had no cash equivalents during fiscal year 2012.

Table of Contents

Accounts Receivable and Unbilled Receivables

Trade receivables are stated at their original invoice amounts, less an allowance for doubtful portions of such accounts. Management determines the allowance for doubtful accounts based on facts and circumstances related to specific accounts and on historical experience related to the age of accounts. Trade receivables are written off when deemed uncollectible. Recoveries of trade receivables previously reserved are offset against the allowance when received.

Unbilled receivables reflect revenues from non-recurring engineering services not yet billable to customers under the terms of the related development and supply contracts.

Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market value. Reductions to estimated market value are recorded, and charged to cost of sales, when indicated based on a formula that compares on-hand quantities to estimated demand over the ensuing 12 months from the measurement date.

Investments

Investments consist of marketable equity securities of publicly held companies. Management intends to hold such securities for a sufficient period in which to realize a reasonable return, which periods may range between one and several years, although there is no assurance that positive returns will be realized or that such securities will not be liquidated in a shorter than expected time frame to accommodate our future liquidity requirements. Accordingly, investments have been classified as non-current and available-for-sale in conformity with ASC Section 320. Investments are marked to market at each measurement date, with unrealized gains and losses presented as adjustments to accumulated other comprehensive income or loss.

Property, Plant, Equipment and Leasehold Improvements, and Real Estate Held For Sale

Property, plant, equipment and leasehold improvements are recorded at historical cost and depreciation is provided using the straight-line method over the following periods:

|                       |  |
|-----------------------|--|
| Building              | 39 years   |
| Leasehold improvement | Shorter of the lease term or the asset's estimated useful life |
| Equipment             | Three to ten years   |

As more fully described in Note 3, on February 27, 2012, we completed the sale of our fractional horsepower motor product line, operating under the name Pro-Dex Astromec (“Astromec”), consisting primarily of inventories and equipment. On that date we also reclassified the land and building we then owned, which comprised the facility in which Astromec operated, to real estate held for sale. The carrying value of real estate held for sale is based on its historical cost at the date on which such assets were classified as held for sale (Note 3), and is not subject to depreciation. Also as described in Note 3, on July 5, 2013, we completed the sale of the land and building.

Long-Lived Assets



We review the recoverability of the carrying amount of long-lived assets, such as equipment and leasehold improvements, and real estate held for sale, when events or changes in circumstances occur that indicate such carrying values may not be recoverable. With respect to equipment and leasehold improvements, carrying values are compared to expected future pre-tax cash flows, undiscounted and without interest charges, of related operations. With respect to real estate held for sale, the carrying value is compared to the estimated net proceeds from sale of the real estate. Impairment losses are recognized in instances where carrying values are less than such expected future cash flows or net proceeds from sale, as applicable.

#### Income Taxes

We recognize deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of our assets and liabilities along with net operating loss and tax credit carryovers. Deferred tax assets at both June 30, 2013 and 2012 consisted primarily of basis differences related to research and development tax credit utilization, intangible assets, accrued expenses and inventories.

Significant management judgment is required in determining our provision for income taxes and the recoverability of our deferred tax assets. Such determination is based on our historical taxable income, with consideration given to our estimates of future taxable income and the periods over which deferred tax assets will be recoverable. We record a valuation allowance against deferred tax assets to reduce the net carrying value to an amount that we believe is more

## Table of Contents

likely than not to be realized. When we establish or reduce the valuation allowance against deferred tax assets, the provision for income taxes will increase or decrease, respectively, in the period such determination is made.

### Shipping and Handling

Payments from customers for shipping and handling are included in net sales. Shipping expenses, consisting primarily of payments made to freight companies, are included in cost of sales.

### Concentration of Credit Risk

Financial instruments that potentially subject us to credit risk consist principally of cash and trade receivables. The Company places its cash with major financial institutions. At June 30, 2013 and 2012, and throughout the fiscal years then ended, we had deposits in excess of federally insured limits. Credit sales are made to original equipment manufacturers and resellers throughout the world, and sales to such customers account for a substantial portion of our trade receivables. While such receivables are not collateralized, we evaluate their collectability based on several factors including customers' payment histories.

### Compensation Plans

#### Share-Based Plans

We recognize compensation expense for all share-based awards made to employees and directors. The fair value of share-based awards is estimated at the grant date using the Black-Scholes option-pricing model. The portion that is ultimately expected to vest is recognized as compensation cost over the requisite service period using the straight-line single option method.

The determination of fair value using the Black-Scholes model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables, including expected stock price volatility, risk-free interest rate, expected dividends, projected employee stock option exercise behaviors and forfeitures. We estimate stock price volatility based on two factors: (a) the measurement date (typically the grant date) and (b) the expected life of the option, which we calculate using the Staff Accounting Bulletin No. 107 simplified method.

#### Cash-Based Plans

Our Annual Incentive Plan ("AIP") provides annual cash-based incentive opportunities for our key employees based upon the attainment of certain performance goals. Compensation expense is recognized in the year in which awards under the terms of the AIP are earned.

Our Long-Term Incentive Plan ("LTIP") provides incentive opportunities to our executives and other key employees. LTIP awards, if any, are conditioned on attainment of certain performance goals for one or more fiscal years as ratified by our Board of Directors. The amount of awards are defined in the LTIP as a percentage, ranging from 12.5% to 75%, of the employee's base compensation at the award date, which amount is then divided by the per share market price of our common stock at the award date in order to determine the number of common shares to be awarded. Accordingly, LTIP awards, although paid in shares of our common stock, are dollar-based and accrued as liabilities when their payment becomes probable.

## Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Our operations are affected by numerous factors including market acceptance of our products, changes in technologies, and new laws, government regulations and policies. We cannot predict what impact, if any, the occurrence of these or other events might have on our operations. Significant estimates and assumptions made by management include, but are not limited to: revenue recognition, the allowance for doubtful accounts, accrued warranty expense, inventory valuation, the carrying value of long-lived assets, and the recovery of deferred income tax assets.

## Basic and Diluted Per Share Information

Basic per share amounts are computed on the basis of the weighted-average number of common shares outstanding during each period presented. Diluted per share amounts assume the exercise of all potential common stock equivalents, consisting solely of options to purchase common stock as discussed in Note 9, unless the effect of such exercise is to increase income, or decrease loss, per common share.

## Table of Contents

### Fair Value Measurements

Fair value is measured based on the prices that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements are based on a three-tier hierarchy that prioritizes the inputs used to measure fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs for which little or no market data exists, therefore requiring an entity to develop its own assumptions.

Cash and cash equivalents: The carrying value of cash and cash equivalents is considered to be representative of their fair values based on the short term nature of these instruments. As such, cash and cash equivalents are classified within Level 1 of the valuation hierarchy.

Investments: Investments consist of marketable equity securities of publicly held companies. As such, investments are classified within Level 1 of the valuation hierarchy.

Although the methods above may produce a fair value calculation that may not be indicative of the net realizable value or reflective of future fair values, the Company believes its valuation methods are appropriate.

### Research and Development

Research and development costs support the development of our product line platforms, and are charged to expense as incurred.

### Advertising

Advertising costs are charged to selling expense as incurred and amounted to \$220,000 and \$358,000 for the fiscal years ended June 30, 2013 and 2012, respectively.

### Recent Accounting Standards

In February 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2013-02, “Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income,” that requires entities to disclose either on the face of, or in the notes to, the financial statements the effects of reclassifications out of Accumulated Other Comprehensive Income (“AOCI”). For items reclassified out of AOCI and into net income in their entirety, entities must disclose the effect of the reclassification on each affected net income item. For items that are not reclassified in their entirety into net income, entities must provide a cross reference to other required GAAP disclosures. This ASU does not change the items currently reported in other comprehensive income and is effective for annual reporting periods beginning after December 15, 2012 and interim periods within those years. The adoption of these provisions did not have a material impact on the consolidated financial statements of the Company.

In August 2013, the FASB issued ASU No. 2013-11, “Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists,” that sets forth circumstances in which an unrecognized tax benefit, generally reflecting the difference between a tax position taken or expected to be taken on a company’s income tax return and the benefit recognized on its financial statements, should be presented in the company’s financial statements as a liability rather than as a reduction of a deferred tax asset. The ASU is

effective for fiscal years, and interim periods within those years, beginning after December 15, 2013, with early adoption permitted. The adoption of these provisions is not expected to have a material impact on the consolidated financial statements of the Company.

**NOTE 3 – DISCONTINUED OPERATIONS AND REAL ESTATE HELD FOR SALE**

On February 27, 2012 (the “Closing Date”), we completed the sale of our fractional horsepower motor product line, operating under the name Pro-Dex Astromec (“Astromec”) and located in Carson City, Nevada, to SL Montevideo Technology, Inc. (“MTI”), a wholly owned subsidiary of SL Industries, Inc., pursuant to an Asset Purchase Agreement (the “APA”).

Under the terms of the APA, we sold substantially all the assets of Astromec, consisting primarily of inventory, equipment and intangibles, and excluding cash, accounts receivable and the Carson City facility. We retained substantially all of Astromec’s liabilities except for those liabilities associated with certain contracts and unfilled purchase orders assumed by MTI.

Table of Contents

Upon closing of the sale and finalization of other items required by the APA, such as a physical inventory count, we recorded proceeds from the sale of \$756,000, equal to the actual net book value of the assets sold as of the Closing Date, summarized as follows:

|             |            |
|-------------|------------|
| Inventories | \$ 664,000 |
| Equipment   | 82,000     |
| Other       | 10,000     |
| Total       | \$ 756,000 |

Costs directly related to the sale aggregated \$302,000, and consisted primarily of a \$100,000 fee paid to our financial advisor in connection with the transaction, other professional fees amounting to \$66,000, and employee severance payments amounting to \$125,000. Based on the foregoing, we recorded net proceeds from the sale of \$454,000, and a loss on the sale, equal to the aforementioned direct costs, of \$302,000, which is included in loss from discontinued operations for the year ended June 30, 2012 in the accompanying consolidated statements of operations.

Under the terms of the APA, we may also receive earnout payments based on revenues generated from the sale of (i) Astromec products and (ii) MTI products to Astromec prospects (defined in the APA) (collectively, the “Earnout Sales Base”). Such earnout payments, if and when earned, are paid by MTI to us within 30 days following the end of each of our fiscal quarters during the three years subsequent to the Closing Date, and amount to 6%, 4% and 2% of the Earnout Sales Base in the first, second and third such years, respectively. The earnout payments are recognized in the quarter in which we become entitled to receive them. For the years ended June 30, 2013 and 2012, we recognized income from earnout payments of \$165,000 and \$65,000, respectively, of which \$31,000 and \$45,000 was included in other receivables in the accompanying June 30, 2013 and 2012 balance sheets, respectively, and were received in July 2013 and 2012, respectively.

Also on the Closing Date, we entered into a Transition Production Agreement (the “TPA”) with MTI, under which we provided MTI with manufacturing and certain administrative support services. MTI paid us for all our costs in providing the manufacturing services, and a fixed monthly amount for the administrative support services. In conformity with its terms, the TPA was terminated effective May 10, 2012.

Based on the foregoing, and in conformity with applicable accounting guidance, the Astromec product line qualifies as a discontinued operation. Accordingly, financial results of Astromec have been reported as discontinued operations in the accompanying consolidated statements of operations for all periods presented. Information regarding revenue and operating results of Astromec included in discontinued operations is as follows:

|  | Years Ended June 30, |              |
|--|----------------------|--------------|
|  | 2013                 | 2012         |
| Revenues                                       | \$ 166,000           | \$ 2,160,000 |
| Income (loss) before benefit from income taxes | \$ 130,000           | \$ (62,000 ) |

Information regarding Astromec assets and liabilities included in the accompanying consolidated balance sheets is as follows:

June 30,

|                     | 2013      | 2012      |
|---------------------|-----------|-----------|
| Accounts receivable | \$ 31,000 | \$ 45,000 |
| Accounts payable    | —         | \$ 3,000  |
| Accrued expenses    | \$ 5,000  | \$ 25,000 |

#### Real Estate Held For Sale

In addition, as a result of the sale of the Astromec product line, we listed for sale the land and building constituting the facility we owned in Carson City, Nevada, which are presented as real estate held for sale in the accompanying June 30, 2013 and 2012 consolidated balance sheets with an aggregate carrying amount of \$733,000. We evaluated the aggregate carrying amount of the land and building in relation to their aggregate estimated fair value less cost to sell, and we determined that an adjustment to such carrying amount was not required.

On April 22, 2013, we entered into a Purchase Agreement (the “Agreement”) with Aesthetic and Reconstructive Technologies, Inc., a Nevada corporation (“AART”), whereby we agreed to sell the Carson City facility described above. On July 5, 2013 (the “Closing Date”), we completed the sale and closed the Agreement in conformity with its terms. The sales price of the property was \$980,000, resulting in our receipt at the Closing Date of approximately \$915,000 in net proceeds, after deductions for expenses related to the sale, primarily consisting of broker commissions and fees, aggregating approximately \$65,000.

Table of Contents

## NOTE 4 – COMPOSITION OF CERTAIN FINANCIAL STATEMENT ITEMS

## Inventories

|                                      | <b>June 30,</b>     |                     |
|--------------------------------------|---------------------|---------------------|
|                                      | <b>2013</b>         | <b>2012</b>         |
| Raw materials / purchased components | \$ 1,640,000        | \$ 1,087,000        |
| Work in process                      | 572,000             | 579,000             |
| Sub-assemblies / finished components | 1,291,000           | 895,000             |
| Finished goods                       | 331,000             | 230,000             |
|                                      | <b>\$ 3,834,000</b> | <b>\$ 2,791,000</b> |

## Investments

|                              | <b>June 30,</b> |             |
|------------------------------|-----------------|-------------|
|                              | <b>2013</b>     | <b>2012</b> |
| Marketable equity securities | \$ 370,000      | —           |

Investments at June 30, 2013 have an aggregate cost basis of \$365,000, gross unrealized gains aggregating \$5,000 and no unrealized losses. There were no investments at June 30, 2012.

In September 2013, our Board approved a share repurchase program authorizing the Company, at the direction of the Investment Committee of the Board, to repurchase up to 750,000 shares of our common stock under parameters to be determined by the Investment Committee. The repurchase program has no stated expiration date.

## Equipment and Leasehold Improvements

|                          | <b>June 30,</b>     |                     |
|--------------------------|---------------------|---------------------|
|                          | <b>2013</b>         | <b>2012</b>         |
| Equipment                | \$ 6,833,000        | \$ 6,735,000        |
| Leasehold improvements   | 2,312,000           | 2,307,000           |
| Total                    | 9,145,000           | 9,042,000           |
| Accumulated depreciation | (7,080,000)         | (6,503,000)         |
|                          | <b>\$ 2,065,000</b> | <b>\$ 2,539,000</b> |

Depreciation expense, which includes capital lease amortization, for the years ended June 30, 2013 and 2012 amounted to \$582,000 and \$647,000, respectively.

## Accrued Expenses

|                           | <b>June 30,</b> |             |
|---------------------------|-----------------|-------------|
|                           | <b>2013</b>     | <b>2012</b> |
| Warranty                  | \$ 323,000      | \$ 526,000  |
| Payroll and related items | 243,000         | 400,000     |



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|   |              |              |
|---|--------------|--------------|
| Accrued losses on development contracts | 176,000      | —            |
| Termination benefits                    | 165,000      | 13,000       |
| Unvouchered inventory in transit        | 142,000      | 234,000      |
| Other                                   | 227,000      | 232,000      |
|   | \$ 1,276,000 | \$ 1,405,000 |

Accumulated Other Comprehensive Income

|   | <b>June 30,</b> |             |
|---|-----------------|-------------|
|   | <b>2013</b>     | <b>2012</b> |
| Unrealized gain on marketable equity securities | \$ 5,000        | —           |

NOTE 5 – BANK DEBT

On February 4, 2011, we entered into a credit facility agreement with Union Bank, N.A. that provided for the following:

A revolving credit line of up to \$1.5 million in borrowing availability, under which no amounts were borrowed;

Table of Contents

A non-revolving credit line of up to \$350,000 in borrowing availability for the purchase of equipment, which expired unused on February 4, 2012; and

A term loan of \$1.25 million, the outstanding balance of which, amounting to \$685,000, was repaid in full on September 24, 2012, as discussed further below.

The revolving credit line's terms required monthly interest payments based on borrowed amounts at a floating interest rate, calculated as Union Bank's Reference Rate plus 0.5% (an aggregate interest rate of 3.75% during the term over which the line was in effect). The line's initial term was to expire on December 15, 2012.

The terms of the \$1.25 million term loan required monthly principal payments of \$29,762, plus interest over its 42-month term. The term loan bore interest at a floating rate, calculated as Union Bank's Reference Rate plus 0.5% (an aggregate interest rate of 3.75% during the term over which the loan was outstanding).

All personal property assets of the Company collateralized the outstanding borrowings under the credit facility.

The credit facility agreements contained various covenants, including certain covenants measured annually based on fiscal year results, concerning our financial performance. At June 30, 2012, we were in violation of profitability-based covenants, for which the bank had the right to declare us in default of the bank credit facility agreements and the entire amount owing under the facility, consisting of a term loan, to become immediately due and payable.

On August 30, 2012, we notified the bank of our intent to terminate the credit facility agreements and repay the term loan in full on or before September 30, 2012. By letter to us dated September 4, 2012, the bank waived, through October 1, 2012, the rights it otherwise would have had pursuant to the covenant violations described above. In conformity with the correspondence described in this paragraph, on September 24, 2012, we repaid the entire principal balance of the term loan, amounting to \$685,000, and the credit facility agreements were terminated.

As a result of the foregoing, we no longer have a credit facility with a financial institution.

**NOTE 6 – WARRANTY ACCRUAL**

Information regarding the accrual for warranty costs for the years ended June 30, 2013 and 2012 is as follows:

|   | <b>2013</b> | <b>2012</b> |
|---|-------------|-------------|
| Balance at beginning of year                  | \$ 526,000  | \$ 688,000  |
| Accruals during the year                      | 344,000     | 486,000     |
| Changes in estimates of prior period accruals | (51,000 )   | 94,000      |
| Warranty expenditures                         | (498,000)   | (742,000)   |
| Balance at end of year                        | \$ 321,000  | \$ 526,000  |

Warranty expense from continuing operations was \$293,000 and \$580,000 for the fiscal years ended June 30, 2013 and 2012, respectively.

In 2013, we reclassified certain amounts, previously classified as warranty costs, to a classification as out-of-warranty repair costs. The 2012 amounts appearing in the table above have been reclassified to conform to the 2013

presentation. Such reclassifications had no effect on the accompanying condensed consolidated statements of operations.

#### NOTE 7 – INCOME TAXES

The provision (benefit) for income taxes for the years ended June 30, 2013 and 2012 are as follows:

|                           | <b>2013</b>  | <b>2012</b>  |
|---------------------------|--------------|--------------|
| <b>Current:</b>           |              |              |
| Federal                   | \$ 5,000     | \$ (435,000) |
| State                     | 7,000        | (6,000 )     |
| <b>Deferred:</b>          |              |              |
| Federal                   | (41,000 )    | —            |
| State                     | (10,000 )    | —            |
| Benefit from income taxes | \$ (39,000 ) | \$ (441,000) |

Table of Contents

A reconciliation of the expected tax to the amount computed by applying the federal statutory income tax rates to loss before income taxes for the years ended June 30, 2013 and 2012 is as follows:

|   | <b>2013</b> | <b>2012</b> |
|---|-------------|-------------|
| Federal income tax benefit at the statutory rate              | (34 )%      | (34 )%      |
| Change in valuation allowance against net deferred tax assets | 45          | 26          |
| State income taxes, net of federal tax benefit                | (7 )        | (9 )        |
| State income tax rate adjustment                              | (1 )        | (10 )       |
| Tax incentives  | (7 )        | (7 )        |
| Non-deductible items  | 2           | 3           |
| Benefit from income taxes                                     | (2 )%       | (31 )%      |

Deferred income tax assets and liabilities in the accompanying consolidated balance sheets at June 30, 2013 and 2012 are as follows:

|   | <b>2013</b>  | <b>2012</b>   |
|---|--------------|---------------|
| <b>Deferred tax assets/(liabilities) — current:</b>     |              |               |
| Accrued expenses  | \$ 206,000   | \$ 332,000    |
| Inventories   | 504,000      | 282,000       |
| Net operating losses                                    | —            | —             |
| State taxes   | 2,000        | (19,000 )     |
| Valuation allowance                                     | (653,000)    | (486,000)     |
|   | \$ 59,000    | \$ 109,000    |
|   | <b>2013</b>  | <b>2012</b>   |
| <b>Deferred tax assets/(liabilities) — non-current:</b> |              |               |
| Income tax credit carry forwards                        | \$ 1,381,000 | \$ 1,235,000  |
| Net operating losses                                    | 1,092,000    | 534,000       |
| Intangible assets                                       | 350,000      | 430,000       |
| Deferred rent   | 149,000      | 163,000       |
| State taxes   | 16,000       | 37,000        |
| Depreciation  | (291,000 )   | (405,000 )    |
| Share based compensation                                | 32,000       | —             |
| Unrealized gain on investment                           | (2,000 )     | —             |
| Valuation allowance                                     | (2,786,000)  | (2,103,000)   |
|   | \$ (59,000 ) | \$ (109,000 ) |

We have a federal net operating loss carry forward at June 30, 2013 in the amount of \$1,701,000, which expires in 2033, and a state net operating loss carry forward at June 30, 2013 in the amount of \$6,134,000, which expires at various dates from 2018 through 2033. Federal and state tax credit carry forwards amount to \$867,000 and \$514,000, respectively, at June 30, 2013. These credit carry forwards will expire at various dates from 2014 through 2033.

Significant management judgment is required in determining our provision for income taxes and the recoverability of our deferred tax asset. Such determination is based primarily on our historical taxable income, with some consideration given to our estimates of future taxable income by jurisdictions in which we operate and the period over which our deferred tax assets will be recoverable. Due to cumulative taxable losses in the three years preceding 2013,

we have maintained a full valuation allowance against our deferred tax assets at June 30, 2013 and 2012, information related to which is as follows:

|   |                |
|---|----------------|
| Balance, July 1, 2012                     | \$ (2,589,000) |
| Increase in tax asset valuation allowance | (850,000 )     |
| Balance, June 30, 2013                    | \$(3,439,000 ) |

As of June 30, 2013, we have accrued \$347,000 of unrecognized tax benefits related to federal and state income tax matters, which is included in accrued liabilities on the accompanying consolidated balance sheets. The amount that would reduce the Company's income tax expense if recognized and result in a corresponding decrease in the Company's effective tax rate is \$47,000.

Table of Contents

Information with respect to our accrual for unrecognized tax benefits is as follows:

|   |            |
|---|------------|
| Balance, July 1, 2012                           | \$ 313,000 |
| Additions related to current year tax positions | 34,000     |
| Additions related to prior year tax positions   | —          |
| Balance, June 30, 2013                          | \$ 347,000 |

We recognize accrued interest and penalties related to unrecognized tax benefits in income tax expense when applicable. As of June 30, 2013, no interest or penalties applicable to our unrecognized tax benefits have been accrued since we have sufficient tax attributes available to fully offset any potential assessment of additional tax.

We are subject to U.S. federal income tax, as well as income tax of multiple state tax jurisdictions. We are currently open to audit under the statute of limitations by the Internal Revenue Service for the years ended June 30, 2010 and later. Our state income tax returns are open to audit under the statute of limitations for the years ended June 30, 2009 and later. We do not anticipate a significant change to the total amount of unrecognized tax benefits within the next 12 months.

## NOTE 8 – COMMITMENTS AND CONTINGENCIES

## Leases

We lease our office, production and warehouse facilities in Irvine, California and Beaverton, Oregon under agreements that expire in April 2018 and April 2014, respectively. Both leases require us to pay insurance, taxes, and other expenses related to the leased space. Rent expense in 2013 and 2012 was \$592,000 and \$574,000, respectively. On July 15, 2013, we entered into an amendment with respect to our Irvine, California lease which provides for a \$4,227 reduction in the monthly base rent (as compared to the monthly base rent that would have been payable under the original lease terms) beginning on July 1, 2013 and continuing for the remainder of the term of the lease. Minimum lease payments for future fiscal years ending June 30 are:

|      |              |
|------|--------------|
| 2014 | \$ 477,000   |
| 2015 | 423,000      |
| 2016 | 440,000      |
| 2017 | 457,000      |
| 2018 | 359,000      |
|      | \$ 2,156,000 |

## Compensation Arrangements

## Retirement Savings 401(k) Plan

The Pro-Dex, Inc. Retirement Savings 401(k) Plan (the “401(k) Plan”) is a defined contribution plan we administer that covers substantially all our employees and is subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended. Employees are eligible to participate in the 401(k) Plan when they have attained 19 years of

age and then can enter into the 401(k) Plan on the first day of each calendar quarter. Participants are eligible to receive non-discretionary Pro-Dex matching contributions of 25% of their contributions up to 5% of eligible compensation, once they have completed six months of service. For the years ended June 30, 2013 and 2012, we recognized compensation expense amounting to \$41,000 and \$44,000, respectively, in connection with the 401(k) Plan.

#### Annual Incentive Plan (“AIP”)

The AIP provides annual incentive opportunities for our key employees based upon the attainment of certain performance goals. Compensation expense under the terms of the AIP amounted to \$29,000 in fiscal year 2012, which amount was included in accrued liabilities in the accompanying consolidated balance sheets. No compensation expense was accrued under the terms of the AIP in fiscal year 2013.

#### Long-Term Incentive Plan (“LTIP”)

The LTIP provides incentive opportunities to our executives and other key employees, and are conditioned on attainment of certain performance goals for one or more fiscal years. Awards under the LTIP are accrued when payment of such awards becomes probable. For the years ended June 30, 2013 and 2012, compensation expense under the terms of the LTIP amounted to a benefit of \$52,000 and an expense of \$43,000, respectively, which amounts are included in accrued liabilities in the accompanying consolidated balance sheets.

## Table of Contents

### Change in Composition of our Board of Directors

In June 2012, AO Partners Group, whose members then owned approximately 22% of our outstanding common stock, nominated a slate of three director nominees (the “AO Nominees”) to run in opposition to the slate of five director nominees placed into nomination by our then-incumbent Board of Directors (the “Pro-Dex Nominees”). At our January 17, 2013 Annual Meeting of Shareholders (the “Annual Meeting Date”), our shareholders elected the three AO Nominees and two Pro-Dex Nominees, only one of whom was an incumbent member of our Board of Directors, to fill the five seats on our new Board of Directors. As a result, the new Board of Directors was composed of four new members and one continuing member as of the 2013 Annual Meeting Date.

The degree of change in composition of our Board as described above constituted a “change of control” as that term is defined in existing change of control agreements we previously entered into with members of senior management (“Change of Control Agreements”) and as defined in our Stock Option Plans. The impact on the accompanying financial statements of the change of control as defined in these instruments and the remaining potential effects of the change of control are as follows:

### Change of Control Agreements

The Change of Control Agreements provide that, if the individual’s employment with us involuntarily terminates (as such term is defined in the Change of Control Agreements) within 12 months after a change of control, the individual will receive, subject to signing a release of claims, (i) a lump sum amount equal to 30 weeks base compensation of the individual at the time of such termination and (ii) 100% Company-paid insurance coverage as provided to the individual immediately prior to his termination of employment for a period equal to the earlier of (i) 12 months following termination or (ii) until the individual becomes covered under another employer’s insurance plan. In addition, the individual shall be entitled to receive bonus or compensation award payments, if any, in accordance with the terms of our incentive compensation plans in which the individual was an eligible participant at the time of the termination.

As discussed further below, on February 25, 2013, Michael J. Berthelot, the Company’s Chief Executive Officer and President, was separated from the Company. In connection with the separation, Mr. Berthelot was paid, among other items, \$165,423 as contemplated by his Change of Control Agreement. In addition, on June 19, 2013, we effected a reduction in force that included one additional member of senior management, resulting in a \$97,000 benefit as contemplated by this individual’s Change of Control Agreement, which was included in accrued expenses as of June 30, 2013 and paid in July 2013.

After giving effect to our payment to Mr. Berthelot and the additional member of senior management under their respective Change of Control Agreements as described above, we have remaining Change of Control Agreements with Mr. Hurwitz and our Chief Operating Officer, Richard Van Kirk, who could be entitled to benefits under such Agreements in the event of termination under the conditions described above and whose annual base compensation aggregates \$405,000. Such Change of Control Agreements expire in July 2014.

Additionally, in the event of a change of control, our Board had the discretion to accelerate the vesting of any outstanding options or shares of restricted stock held by employees. At its meeting on February 4, 2013, the Board took no action to effect such acceleration. In addition, as of the Annual Meeting Date, all outstanding options held by members of our then-incumbent Board were already fully vested under such options’ terms. Accordingly, the change of control described above had no effect with respect to our stock option plans (as further described in Note 9).

### Board Compensation



From July 1, 2010 until May 2, 2013, the compensation plan for non-employee directors (the “2010 Plan”) of the Board provided for the following:

An annual retainer of \$24,000 for each director;

An additional annual retainer of \$7,000 for the Board Chairman or Lead Director, and \$5,000 for each Board Committee Chair;

Fees ranging from \$500 to \$1,000 for participation in Board or Committee meetings in excess of six per year; and

An option grant under the Directors Plan (as defined in Note 8) for the purchase of (i) 15,000 shares of common stock upon the director’s initial election or appointment to the Board, and (ii) 10,000 shares of common stock upon the director’s re-election to the Board.

On February 4, 2013, the AO Nominees each opted to waive (a) receipt of stock options they were otherwise entitled to receive upon their election to the Board at the 2013 Annual Meeting, and (b) any cash retainers or meeting fees in excess of \$200 per meeting and \$2,000 per year.

## Table of Contents

At its meeting on May 2, 2013, our Board replaced the 2010 Plan with the 2013 Directors' Compensation Plan (the "2013 Plan") that provides for the following:

Fees of \$200 for participation in Board or Committee meetings, to a maximum of \$2,000 per fiscal year;

An annual retainer of \$23,000 for the Audit Committee Chair (which may be modified in compensating any future Audit Committee Chair)

The 2013 Plan has no provision for (a) retainers other than that described above, or (b) grants of options, restricted stock or other equity or equity-based compensation or incentives.

### 2013 Change in Chief Executive Officer

In connection with Mr. Berthelot's separation of employment, as described above, the Company and Mr. Berthelot entered into a Separation Agreement and General Release of All Claims ("Separation Agreement") concerning the conclusion of Mr. Berthelot's employment services with the Company. Under the terms of the Separation Agreement, Mr. Berthelot was paid all unpaid base salary and unreimbursed business expenses for the period through February 25, 2013, plus his prorated portion under the Company's Long Term Incentive Plan in the amount of \$1,971, in addition to the \$165,423 under the terms of the Change of Control Agreement described above and as additional consideration for the release of claims under the terms of the Separation Agreement. In addition, as a result of Mr. Berthelot's separation, the option to purchase 200,000 shares of the Company's common stock, issued to Mr. Berthelot in May 2012 pursuant to his appointment as the Company's Chief Executive Officer, expired as unvested and unexercised.

Concurrent with Mr. Berthelot's separation of employment, Harold A. Hurwitz began service as the Company's Chief Executive Officer and President. Mr. Hurwitz had been the Company's Chief Financial Officer and continues to serve in such capacity concurrent with his service as the Company's Chief Executive Officer and President. In connection with Mr. Hurwitz's appointment, Mr. Hurwitz's base compensation was increased to an annualized rate of \$225,000. All other terms of Mr. Hurwitz's employment remained unchanged.

### 2012 Change in Chief Executive Officer

Effective April 20, 2012 (the "Separation Date"), Mark P. Murphy, Chief Executive Officer, President and a member of the Board of Directors of Pro-Dex and its subsidiaries, resigned from all of such positions. On that date, the Company and Mr. Murphy entered into a Separation Agreement and General Release of All Claims ("Separation Agreement").

Under the terms of the Separation Agreement, we, among other actions, (i) paid Mr. Murphy severance compensation of \$300,000, in accordance with the terms of our employment letter agreement with Mr. Murphy dated July 14, 2010, and (ii) paid the monthly premiums for continued health insurance coverage under COBRA for a period from the Separation Date through March 31, 2013, an aggregate amount of approximately \$16,000.

Also on April 20, 2012, we executed an employment letter agreement with Michael J. Berthelot under which he commenced employment as Chief Executive Officer and President of Pro-Dex and its subsidiaries. Mr. Berthelot had been a member of our Board of Directors since 2009, and continued in that capacity until the 2013 Annual Meeting Date, as described above.

### Legal Matters

In February 2011, we became aware of a report entitled “Site Discovery Report, Southeast Santa Ana Project DTSC – Cypress Region,” dated February 2010 (the “Report”), that was prepared by the Cypress, California regional office of the Cal/EPA Department of Toxic Substances Control (“DTSC”) for Region 9 of the U.S. Environmental Protection Agency (“USEPA”) under an agreement between the two agencies. The purpose of the Report was to identify sites within an area of southeast Santa Ana, California that may be sources of groundwater contamination previously detected in that area. The Report identified 25 sites, including our former Santa Ana site, for further screening by DTSC staff over the next two years. DTSC has informed us that no further evaluation of our former site took place during fiscal years 2011 through 2013. It is uncertain whether future developments, if any, from DTSC’s screening process would have any application to our former site and, if so, what exposure we might face concerning any findings that might be made concerning the site.

In general, we are from time to time a party to various legal proceedings incidental to our business, none of which we consider may be material. There can be no certainty, however, that we may not ultimately incur liability or that such liability will not be material and adverse.

#### NOTE 9 – SHARE-BASED COMPENSATION

We have two equity compensation plans, the Second Amended and Restated 2004 Stock Option Plan (the “Employees Stock Option Plan”) and the Amended and Restated 2004 Directors Stock Option Plan (the “Directors Stock Option Plan”) (collectively, the “Plans”), pursuant to which (i) options to purchase shares of common stock, or (ii) restricted shares of

Table of Contents

common stock, may be granted up to an aggregate amount of 1,333,333 common shares, with 1,066,667 and 266,666 shares distributed between the Employees Stock Option Plan and the Directors Stock Option Plan, respectively. The Plans are substantially similar, providing for a strike price equal to the closing price for a share of our common stock as of the last business day immediately prior to the Grant Date, vesting periods, as determined by the Board for the Employees Stock Option Plan and six months for the Directors Stock Option Plan, and terms of up to ten years, subject to forfeit 30 days after the holder ceases to be an employee or 90 days after the holder ceases to be director, as the case may be. At June 30, 2013, options to purchase an aggregate of 439,000 and 140,000 shares under the Employees Stock Option Plan and the Directors Stock Option Plan, respectively, are available to grant in future years. Aggregate share-based compensation expense under the Plans for the years ended June 30, 2013 and 2012 were \$100,000 and \$108,000, respectively.

The following weighted average assumptions were used in the calculation of share-based compensation expense for options granted during the years ended June 30, 2013 and 2012:

|                         | 2013      | 2012         |
|-------------------------|-----------|--------------|
| Dividend rate           | None      | None         |
| Price volatility        | 89 %      | 75 %         |
| Risk-free interest rate | 0.9 %     | 0.9% - 1.3 % |
| Expected life           | 5.7 years | 5.9 years    |

As of June 30, 2013, there was an aggregate of \$74,000 of unrecognized compensation cost under the Plans related to 95,000 non-vested outstanding stock options with a per share weighted average value of \$1.26. The unrecognized expense is anticipated to be recognized on a straight-line basis over a weighted average period of 1.6 years.

The following is a summary of stock option activity under the Plans for the years ended June 30, 2013 and 2012:

|  | 2013       |                                 | 2012       |                                 |
|--|------------|---------------------------------|------------|---------------------------------|
|  | Shares     | Weighted-Average Exercise Price | Shares     | Weighted-Average Exercise Price |
| Outstanding at beginning of period                               | 591,672    | \$ 2.48                         | 320,842    | \$ 3.04                         |
| Granted  | 70,000     | 1.92                            | 425,000    | 2.01                            |
| Exercised  | (43,334 )  | 1.53                            | (24,722 )  | 1.96                            |
| Forfeited  | (325,834 ) | 2.61                            | (129,448 ) | 2.41                            |
| Outstanding at end of period                                     | 292,504    | \$ 2.35                         | 591,672    | \$ 2.48                         |
| Exercisable at end of period                                     | 197,920    | \$ 2.61                         | 276,951    | \$ 3.10                         |
| Weighted-average fair value per option granted during the period |            | \$ 1.36                         |            | \$ 1.43                         |

The following table summarizes information regarding options outstanding and options exercisable under the Plans at June 30, 2013:

| Range of Exercise Price | Options Outstanding |   |                                 |                           | Options Exercisable |   |                                 |                           |
|-------------------------|---------------------|---|---------------------------------|---------------------------|---------------------|---|---------------------------------|---------------------------|
|                         | Number Outstanding  | Weighted-Average Remaining Contractual Life | Weighted-Average Exercise Price | Aggregate Intrinsic Value | Number Outstanding  | Weighted-Average Remaining Contractual Life | Weighted-Average Exercise Price | Aggregate Intrinsic Value |
| \$1.73 to \$3.21        | 255,834             | 8.3 years                                   | \$ 1.91                         | \$ 16,025                 | 161,250             | 8.1 years                                   | \$ 1.95                         | \$ 6,125                  |
| \$3.22 to \$4.69        | 18,335              | 4.1 years                                   | 4.41                            | —                         | 18,335              | 4.1 years                                   | 4.41                            | —                         |
| \$4.70 to \$6.17        | 10,001              | 1.0 years                                   | 5.61                            | —                         | 10,001              | 1.0 years                                   | 5.61                            | —                         |
| \$6.18 to \$7.65        | 8,334               | 2.5 years                                   | 7.65                            | —                         | 8,334               | 2.5 years                                   | 7.65                            | —                         |
| <b>Total</b>            | <b>292,504</b>      | <b>7.6 years</b>                            | <b>\$ 2.35</b>                  | <b>\$ 16,025</b>          | <b>197,920</b>      | <b>7.1years</b>                             | <b>\$ 2.61</b>                  | <b>\$ 6,125</b>           |

Table of Contents

## Restricted Stock

The following is a summary of restricted share activity for the year ended June 30, 2013:

|                                  | Shares | Weighted-Average<br>Grant Date<br>Fair Value |
|----------------------------------|--------|--|
| Outstanding at beginning of year | —      | —  |
| Granted                          | 35,000 | \$ 1.73                                      |
| Vested                           | —      | —  |
| Forfeited                        | 2,500  | 1.73   |
| Outstanding at end of period     | 32,500 | \$ 1.73                                      |

As of June 30, 2013, there was \$32,000 in unrecognized compensation cost related to non-vested outstanding restricted shares. The unrecognized expense is anticipated to be amortized over the next 2.2 years.

There was no restricted share activity during 2012, nor were any restricted shares outstanding during that period.

## NOTE 10 – MAJOR CUSTOMERS

Information with respect to two customers, the identities of whom are protected by confidentiality agreements, accounting for sales in excess of 10% of our total sales in either of the years ended June 30, 2013 and 2012, is as follows:

|            | As of and for the year ended June 30, |                        |                     |       |                     |                        |                     |      |
|------------|---------------------------------------|------------------------|---------------------|-------|---------------------|------------------------|---------------------|------|
|            | 2013                                  |                        |                     | 2012  |                     |                        |                     |      |
| Sales      | Percent of<br>Total                   | Accounts<br>Receivable | Percent of<br>Total | Sales | Percent of<br>Total | Accounts<br>Receivable | Percent of<br>Total |      |
| Customer 1 | \$ 5,809,000                          | 47 %                   | \$417,000           | 31 %  | \$ 5,721,000        | 33 %                   | \$ 812,000          | 51 % |
| Customer 2 | \$ 722,000                            | 6 %                    | \$ 47,000           | 3 %   | \$ 6,710,000        | 39 %                   | \$ 57,000           | 4 %  |

In December 2009, Customer 2 in the table above, which was our then-largest customer (the “Customer”), informed us that it was in the process of developing, and planned to eventually manufacture, its own surgical devices which were functionally comparable to the products the Company provided to the Customer at that time. Pro-Dex had been the exclusive manufacturer of these products since they were developed. Through May 2012, we provided the Customer with two products and continue to provide repair services for both products. Sales to the Customer for the years ended June 30, 2013 and 2012 were as follows:

|                      | 2013       | 2012         |
|----------------------|------------|--------------|
| Products             | —          | \$ 5,010,000 |
| Non-warranty repairs | \$ 722,000 | 1,700,000    |
| Total                | \$ 722,000 | \$ 6,710,000 |

The Customer indicated that its plan was to limit repair requests from us to those units covered by our product warranty. Although the warranty period for such units has since lapsed and we continue to receive non-warranty repair orders from the Customer, such repair revenue will decline to zero or a negligible amount should the Customer decide to cease placing new repair orders with us.

We continue to implement the steps of a strategic plan, the objectives of which are to identify and capture additional revenue opportunities and concurrently reduce operating costs not critical to revenue growth. There can be no assurance, however, as to either the timing or success of achieving these objectives, which, during any period not achieved, may cause a prolonged material and adverse impact on our business.

**Pro-Dex 2013 Annual Report | 37**

Table of Contents

## NOTE 11 – PER SHARE INFORMATION

The difference in the weighted average shares outstanding used in the calculation of basic and diluted per share information for fiscal years 2013 and 2012 is as follows:

|   | <b>Years Ended June 30,</b> |                      |
|---|-----------------------------|----------------------|
|   | <b>2013</b>                 | <b>2012</b>          |
| <b>Numerators for basic and diluted per share data:</b>   |                             |                      |
| Loss from continuing operations                           | \$ (1,864,000)              | \$ (960,000 )        |
| Income from discontinued operations                       | 80,000                      | 84,000               |
| <b>Net loss</b>   | <b>\$ (1,784,000)</b>       | <b>\$ (876,000 )</b> |
| <b>Denominators for basic and diluted per share data:</b> |                             |                      |
| Weighted average common shares outstanding                | 3,321,732                   | 3,272,350            |
| Shares used in the computation of basic per share data    | 3,321,732                   | 3,272,350            |
| <b>Basic and diluted per share data:</b>                  |                             |                      |
| Loss from continuing operations                           | \$ (0.56 )                  | \$ (0.29 )           |
| Income from discontinued operations                       | 0.02                        | 0.02                 |
| <b>Net loss</b>   | <b>\$ (0.54 )</b>           | <b>\$ (0.27 )</b>    |

Potentially dilutive securities, consisting of options to purchase shares of our common stock as described in Note 9, are not included in the calculation of diluted loss per share for the years ended June 30, 2013 and 2012 due to their anti-dilutive effect.

## NOTE 12 – SUBSEQUENT EVENTS

We have evaluated events or transactions that occurred after the balance sheet date of June 30, 2013 and have identified no such events or transactions which required adjustment to, or disclosure in, these Consolidated Financial Statements other than as presented in such financial statements and the Notes thereto, including Note 3, “Discontinued Operations and Real Estate Held For Sale,” Note 4, “Composition of Certain Financial Statement Items,” and Note 8, “Commitments and Contingencies.”





Table of Contents

Index to Exhibits

| Exhibit<br>No. | Document  |
|----------------|---|
| 3.1            | Articles of Incorporation (incorporated herein by reference to Exhibit 3.1 to the Company's Form 8-K filed April 23, 2007).   |
| 3.2            | Articles of Amendment to Articles of Incorporation (incorporated herein by reference to Exhibit 3.1 to the Company's Form 8-K filed December 5, 2007).  |
| 3.3            | Articles of Amendment to Articles of Incorporation (incorporated herein by reference to Exhibit 3.1 to the Company's Form 8-K filed June 18, 2010).   |
| 3.4            | Amended and Restated Bylaws, dated January 31, 2011 (incorporated herein by reference to Exhibit 3.1 to the Company's Form 8-K filed February 4, 2011)  |
| 10.1*          | 1994 Employees Stock Option Plan, as amended (incorporated herein by reference to Exhibit 10.22 to the Company's Registration Statement on Form S-4 filed April 13, 1994).  |
| 10.2*          | 1994 Directors Stock Option Plan as amended (incorporated herein by reference to Exhibit 10.22 to the Company's Registration Statement on Form S-4 filed April 13, 1994).   |
| 10.3*          | Second Amended and Restated 2004 Stock Option Plan (incorporated herein by reference to Exhibit 4.1 to the Company's Form S-8 filed February 15, 2012).   |
| 10.4*          | Amended and Restated 2004 Directors Stock Option Plan (incorporated herein by reference to Exhibit 4.2 to the Company's Form S-8 filed February 15, 2012).  |
| 10.5           | Asset Purchase Agreement, dated October 31, 2005, between IntraVantage, Inc. (incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K filed November 2, 2005).   |
| 10.6           | Exclusive License Agreement, dated October 31, 2005, between Pro-Dex, Inc. and IntraVantage, Inc. (incorporated herein by reference to Exhibit 10.2 to the Company's Form 8-K filed November 2, 2005).  |
| 10.7           | Royalty Agreement, dated October 31, 2005, between Pro-Dex, Inc. and IntraVantage, Inc. (incorporated herein by reference to Exhibit 10.3 to the Company's Form 8-K filed November 2, 2005).  |
| 10.8           | Asset Purchase Agreement, dated January 5, 2006, between Pro-Dex, Astromec, Inc., Astromec, Inc., M.D. Glover, Inc., Malcolm D. Glover, Jr., and Malcolm D. Glover, Sr. (incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K filed |

January 6, 2006).

- 10.9 Purchase and Sale Agreement and Escrow Instructions, dated January 3, 2006, between Pro-Dex, Inc. and M.D. Glover, Inc. (incorporated herein by reference to Exhibit 10.2 to the Company's Form 8-K filed January 6, 2006).
- 10.10 Credit Agreement, dated November 1, 2007, between Pro-Dex, Inc. and Wells Fargo Bank, N.A. (incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K filed November 20, 2007).
- 10.11 First Amendment to Credit Agreement, dated November 17, 2008, between Pro-Dex, Inc. and Wells Fargo Bank, N.A. (incorporated herein by reference to Exhibit 10.3 to the Company's Form 8-K filed January 13, 2009).
- 10.12 Term Note in favor of Wells Fargo Bank, N.A. dated November 17, 2008 (incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K filed January 13, 2009).
- 10.13 Forbearance Letter, dated May 12, 2009, between Pro-Dex, Inc. and Wells Fargo Bank, N.A. (incorporated herein by reference to Exhibit 10.1 to the Company's Form 10-Q filed May 14, 2009).
- 10.14 Third Amendment to Credit Agreement, dated June 22, 2009, between Pro-Dex, Inc. and Wells Fargo Bank, N.A. (incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K filed July 6, 2009).
- 10.15 Fourth Amendment to Credit Agreement, dated June 30, 2009, between Pro-Dex, Inc. and Wells Fargo Bank, N.A. (incorporated herein by reference to Exhibit 10.2 to the Company's Form 8-K filed July 6, 2009).
- 10.16 Revolving Line of Credit Note and Fifth Amendment to Credit Agreement, dated November 1, 2009, with Wells Fargo Bank, N.A. (incorporated herein by reference to Exhibit 10.1 to Form 10-Q filed October 29, 2009).
- 10.17\* Form of Indemnification Agreement for directors and certain officers (incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K filed October 29, 2008).
- 10.18\* Employment Agreement with Mark Murphy dated July 14, 2010 (incorporated herein by reference to Exhibit 10.4 to the Company's Form 8-K filed July 16, 2010).

Table of Contents

- 10.19 Lease agreement with Irvine Business Properties, dated August 3, 2007 (incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K filed August 23, 2007).
- 10.20\* Severance Agreement between Jeffrey J. Ritchey and Pro-Dex, Inc. dated January 7, 2008 (incorporated herein by reference to Exhibit 10.2 to the Company's Form 8-K filed January 9, 2008).
- 10.21\* Long-Term Incentive Plan (incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K filed July 16, 2010).
- 10.22\* Annual Incentive Plan for the Senior Management (incorporated herein by reference to Exhibit 10.2 to the Company's Form 8-K filed July 16, 2010).
- 10.23\* Description of Non-Employee Director Compensation Program (incorporated herein by reference to Exhibit 10.3 to the Company's Form 8-K filed July 16, 2010).
- 10.24\* Separation Agreement between Pro-Dex, Inc. and Jeffrey S. Ritchey, dated October 7, 2010 (incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K filed October 12, 2010).
- 10.25\* Employment Arrangement between Pro-Dex, Inc. and Harold A. Hurwitz (incorporated herein by reference to Exhibit 10.2 to the Company's Form 8-K filed October 12, 2010).
- 10.26\* Long-Term Incentive Plan as amended on October 7, 2010 (incorporated herein by reference to Exhibit 10.3 to the Company's Form 8-K filed October,12, 2010).
- 10.27 Business Loan Agreement, dated as of February 4, 2011, between Pro-Dex, Inc. and Union Bank, National Association (incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K filed February 10, 2011).
- 10.28 Revolving Credit Line Note, dated as of February 4, 2011, by Pro-Dex, Inc. in favor of Union Bank, National Association (incorporated herein by reference to Exhibit 10.2 to the Company's Form 8-K filed February 10, 2011).
- 10.29 Non-Revolving Credit Line Note, dated as of February 4, 2011, by Pro-Dex, Inc. in favor of Union Bank, National Association (incorporated herein by reference to Exhibit 10.3 to the Company's Form 8-K filed February 10, 2011).
- 10.30 Term Loan Note, dated as of February 4, 2011, by Pro-Dex, Inc. in favor of Union Bank, National Association (incorporated herein by reference to Exhibit 10.4 to the Company's Form 8-K filed February 10, 2011).
- 10.31 Security Agreement, dated as of February 4, 2011, by Pro-Dex, Inc. in favor of Union Bank, National Association (incorporated herein by reference to Exhibit 10.5 to the Company's Form 8-K filed February 10, 2011).

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- 10.32 Security Agreement, dated as of February 4, 2011, by Pro-Dex Astromec, Inc. in favor of Union Bank, National Association (incorporated herein by reference to Exhibit 10.6 to the Company's Form 8-K filed February 10, 2011.)
- 10.33\* Employee Severance Policy, adopted July 1, 2011 (incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K filed July 7, 2011).
- 10.34\* Change of Control Agreement entered into between Pro-Dex, Inc. and Harold A. Hurwitz, dated July 19, 2011 (incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K filed July 22, 2011).
- 10.35 Asset Purchase Agreement entered into by and among Pro-Dex, Inc., Pro-Dex Astromec, Inc., SL Montevideo Technology, Inc. and SL Industries, Inc., dated February 27, 2012 (incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K filed March 1, 2012).
- 10.36\* Separation Agreement entered into between Pro-Dex, Inc. and Mark P. Murphy, dated April 19, 2012 (incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K filed April 20, 2012).
- 10.37\* Independent Contractor Agreement entered into between Pro-Dex, Inc. and Mark P. Murphy, effective April 23, 2012 (incorporated herein by reference to Exhibit 10.2 to the Company's Form 8-K filed April 20, 2012).
- 10.38\* Employment Arrangement entered into between Pro-Dex, Inc. and Michael J. Berthelot, dated April 20, 2012 (incorporated herein by reference to Exhibit 10.3 to the Company's Form 8-K filed April 20, 2012).
- 10.39\* Change of Control Agreement entered into between Pro-Dex, Inc. and Michael J. Berthelot, dated April 20, 2012 (incorporated herein by reference to Exhibit 10.4 to the Company's Form 8-K filed April 20, 2012).
- 10.40 First Amendment to the Business Loan Agreement dated February 4, 2011 between Pro-Dex, Inc. and Union Bank, N.A., dated May 31, 2012 (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed June 5, 2012).

Table of Contents

- 10.41 Letter from Union Bank, N.A. to Pro-Dex, Inc. dated September 4, 2012 (incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K filed September 4, 2012).
- 10.42 Waiver of Director Compensation of Nick Swenson, dated February 4, 2013 (incorporated herein by reference to Exhibit 10.1 to the Company's Form 10-Q filed February 13, 2013).
- 10.43 Waiver of Director Compensation of Ray Cabillot, dated February 4, 2013 (incorporated herein by reference to Exhibit 10.2 to the Company's Form 10-Q filed February 13, 2013).
- 10.44 Waiver of Director Compensation of William Farrell, dated February 4, 2013 (incorporated herein by reference to Exhibit 10.3 to the Company's Form 10-Q filed February 13, 2013).
- 10.45\* Separation Agreement and General Release of All Claims entered into between Pro-Dex, Inc. and Michael J. Berthelot, dated February 25, 2013 (incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K filed February 25, 2013).
- 10.46\* Employment Arrangement entered into between Pro-Dex, Inc. and Harold A. Hurwitz, dated February 19, 2013 (incorporated herein by reference to Exhibit 10.2 to the Company's Form 8-K filed February 25, 2013).
- 10.47\* Employment Arrangement entered into between Pro-Dex, Inc. and Richard L. Van Kirk, dated April 23, 2013 (incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K filed April 24, 2013).
- 10.48\* Employment Arrangement entered into between Pro-Dex, Inc. and Richard L. Van Kirk, dated January 6, 2006 (incorporated herein by reference to Exhibit 10.2 to the Company's Form 8-K filed April 24, 2013).
- 10.49\* Change of Control Agreement entered into between Pro-Dex, Inc. and Richard L. Van Kirk dated July 19, 2011 (incorporated herein by reference to Exhibit 10.3 to the Company's Form 8-K filed April 24, 2013).
- 10.50 Purchase Agreement, dated April 22, 2013, by and between Pro-Dex, Inc. and Aesthetic and Reconstructive Technologies, Inc. (incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K filed April 26, 2013).
- 10.51 Letter from William L. Healey to Mr. Nick Swenson dated June 7, 2013 (incorporated herein by reference to Exhibit 99.1 to the Company's Form 8-K filed June 12, 2013).
- 10.52 First Amendment To Lease – July 2013 by and between Irvine Business Properties and Pro-Dex, Inc., dated effective July 1, 2013 (incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K filed July 17, 2013).

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- 21.1 List of Subsidiaries (incorporated herein by reference to Exhibit 21.1 to the Company's Form 10-KSB filed September 28, 2007).
- 23 Consent of Independent Registered Public Accounting Firm.
- 31 Certification of the Chief Executive Officer and 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.

101.INS\*\* XBRL Instance Document

101.SCH\*\* XBRL Taxonomy Extension Schema Document

101.CAL\*\* XBRL Taxonomy Extension Calculation Linkbase Document

101.LAB\*\* XBRL Taxonomy Extension Label Linkbase Document

101.PRE\*\* XBRL Taxonomy Extension Presentation Linkbase Document

101.DEF\*\* XBRL Extension Definition Linkbase Document

\* Denotes management contract or compensatory arrangement required to be filed as an exhibit to the Form 10-K.

\*\* Pursuant to applicable securities laws and regulations, the Company is deemed to have complied with the reporting obligation relating to the submission of interactive data files in such exhibits and are not subject to liability under any anti-fraud provisions of the federal securities laws as long as the Company has made a good faith attempt to comply with the submission requirements and promptly amend the interactive data files after becoming aware that the interactive data files fail to comply with the submission requirements. Users of this data are advised that, pursuant to Rule 406T, these interactive data files are deemed not filed and otherwise are not subject to liability.

**Pro-Dex 2013 Annual Report | 41**

Table of Contents

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PRO-DEX INC.

/ s / Harold A. Hurwitz  
Harold A. Hurwitz  
President, Chief Executive Officer and Director  
(Principal Executive Officer)

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

|   |                            |
|---|----------------------------|
| / s / Harold A. Hurwitz<br>Harold A. Hurwitz<br>President, Chief Executive Officer, Treasurer, Chief<br>Financial Officer, Secretary and Director<br>(Principal Executive Officer, and Principal Financial<br>and Accounting Officer) | September 27, 2013<br>Date |
|---|----------------------------|

|  |                            |
|--|----------------------------|
| / s / Nicholas J. Swenson<br>Nicholas J. Swenson<br>Director | September 27, 2013<br>Date |
|--|----------------------------|

|  |                            |
|--|----------------------------|
| / s / Raymond E. Cabillot<br>Raymond E. Cabillot<br>Director | September 27, 2013<br>Date |
|--|----------------------------|

|                                    |      |
|------------------------------------|------|
| William J. Farrell III<br>Director | Date |
|------------------------------------|------|

|  |                            |
|--|----------------------------|
| / s / David C. Hovda<br>David C. Hovda<br>Director | September 27, 2013<br>Date |
|--|----------------------------|