

PRO DEX INC
Form 10QSB
May 12, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

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

For the quarterly period ended March 31, 2005

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934. FOR THE TRANSITION PERIOD FROM _____ TO _____.

Commission File Number 0-14942

PRO-DEX, INC.

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

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

84-1261240
(IRS Employer Identification No.)

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

Issuer's telephone number: 714-241-4411

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

Indicate the number of shares outstanding of each of the Registrant's classes of Common Stock outstanding as of the latest practicable date: 9,340,903 shares of Common Stock, no par value, as of May 6, 2005.

Transitional Small Business Disclosure Format: Yes No

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

	<i>March 31, 2005 (unaudited)</i>	<i>June 30, 2004 (audited)</i>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 2,259,000	\$ 2,070,000
Accounts receivable, net of allowance for doubtful accounts of \$45,000 at March 31 and \$40,000 at June 30	2,565,000	2,370,000
Inventories, net	2,952,000	2,542,000
Prepaid expenses	170,000	76,000
Deferred income taxes	793,000	793,000
Total current assets	8,739,000	7,851,000
Equipment and leasehold improvements, net	1,010,000	1,030,000
Other assets:		
Goodwill	1,110,000	1,110,000
Deferred income taxes	788,000	788,000
Other	48,000	16,000
Total other assets	1,946,000	1,914,000
Total assets	\$ 11,695,000	\$ 10,795,000
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 625,000	\$ 397,000
Current portion of long term debt to shareholder	-	70,000
Accrued expenses	432,000	780,000
Income taxes payable	655,000	809,000
Total current liabilities	1,712,000	2,056,000
Long-term debt to a shareholder, net of current portion	-	75,000
Total liabilities	1,712,000	2,131,000
Commitments and contingencies		
Shareholders' equity:		
Series A convertible preferred shares; no par value; liquidation preference of \$3.60 per share; 10,000,000 shares authorized; 0 shares issued and outstanding.	-	283,000
Common shares; no par value; 50,000,000 shares authorized; 9,039,217 shares issued and outstanding,	15,737,000	15,075,000
Accumulated deficit	(5,748,000)	(6,669,000)
	9,989,000	8,689,000
Receivable for stock purchase	(6,000)	(25,000)
Total shareholders' equity	9,983,000	8,664,000
Total liabilities and shareholders' equity	\$ 11,695,000	\$ 10,795,000

See notes to consolidated financial statements.

PRO-DEX, INC. and SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
Three months ended March 31 (unaudited)

	2005		2004
Net sales	\$	3,241,000	\$ 3,302,000
Cost of sales		1,598,000	1,698,000
Gross profit		1,643,000	1,604,000
Operating expenses:			
Selling		249,000	231,000
General and administrative expenses		586,000	501,000
Research and development costs		467,000	472,000
Total operating expenses		1,302,000	1,204,000
Income from operations		341,000	400,000
Other income (expense):			
Royalty income		6,000	40,000
Other income, net		12,000	4,000
Interest expense		-	(9,000)
Total		18,000	35,000
Income before provision for income taxes		359,000	435,000
Provision for income taxes		84,000	174,000
Net income	\$	275,000	\$ 261,000
Net Income per share:			
Basic	\$	0.03	\$ 0.03
Diluted	\$	0.03	\$ 0.03
Weighted average shares outstanding - basic		9,163,900	8,797,325
Weighted average shares outstanding - diluted		9,615,127	9,398,688

See notes to consolidated financial statements.

PRO-DEX, INC. and SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
Nine months ended March 31 (unaudited)

	2005	2004
Net sales	\$ 9,466,000	\$ 10,534,000
Cost of sales	4,344,000	5,683,000
Gross profit	5,122,000	4,851,000
Operating expenses:		
Selling	726,000	629,000
General and administrative expenses	1,711,000	1,796,000
Research and development costs	1,343,000	1,299,000
Total operating expenses	3,780,000	3,724,000
Income from operations	1,342,000	1,127,000
Other income (expense):		
Royalty income	47,000	40,000
Other income, net	56,000	16,000
Interest expense	(9,000)	(44,000)
Total	94,000	12,000
Income before provision for income taxes	1,436,000	1,139,000
Provision for income taxes	515,000	456,000
Net income	\$ 921,000	\$ 683,000
Net Income per share:		
Basic	\$ 0.10	\$ 0.08
Diluted	\$ 0.10	\$ 0.07
Weighted average shares outstanding - basic	9,006,073	8,779,913
Weighted average shares outstanding - diluted	9,434,431	9,288,056

See notes to consolidated financial statements.

PRO-DEX, INC. and SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
Nine months ended March 31 (unaudited)

	2005	2004
Cash Flows from Operating Activities:		
Net Income	\$ 921,000	\$ 683,000
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	176,000	273,000
Provision for doubtful accounts	5,000	10,000
(Recovery) reserve for obsolete inventory	37,000	(116,000)
Stock based compensation	19,000	19,000
Deferred taxes	-	20,000
Changes in:		
(Increase) in accounts receivable	(200,000)	(278,000)
(Increase) decrease in inventories	(447,000)	350,000
(Increase) in prepaid expenses	(94,000)	(29,000)
(Increase) decrease in other assets	(32,000)	9,000
(Decrease) in accounts payable and accrued expenses	(120,000)	(237,000)
Increase (decrease) in income taxes payable	(154,000)	456,000
Net Cash provided by Operating Activities	111,000	1,160,000
Cash Flows From Investing Activities:		
Purchases of equipment and leasehold improvements	(156,000)	(233,000)
Net Cash (used in) Investing Activities	(156,000)	(233,000)
Cash Flows from Financing Activities:		
Principal payments on long-term shareholder borrowings	(145,000)	(54,000)
Net payments on line of credit	-	(432,000)
Proceeds from option and warrant exercise	379,000	70,000
Net Cash provided by (used in) Financing Activities	234,000	(416,000)
Net Increase (decrease) in Cash and Cash Equivalents	189,000	511,000
Cash and Cash Equivalents, beginning of period	2,070,000	795,000
Cash and Cash Equivalents, end of period	\$ 2,259,000	\$ 1,306,000

Supplemental Information

Cash payments for interest	\$ 9,000	\$ 42,000
Cash payments for income taxes	\$ 668,000	\$ 6,000

See notes to consolidated financial statements.

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

BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of Pro-Dex, Inc. ("Pro-Dex" or the "Company") have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-QSB and Regulation S-B. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. These financial statements should be read in conjunction with the audited financial statements presented in our Annual Report for the fiscal year ended June 30, 2004. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. The results of operations for such interim periods are not necessarily indicative of the results that may be expected for the full year. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-KSB for the year ended June 30, 2004.

INVENTORIES

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

	March 31, 2005 (unaudited)	June 30, 2004
Raw Materials	\$ 1,142,000	\$ 1,068,000
Work in process	483,000	242,000
Development costs under contract	105,000	23,000
Finished goods	1,567,000	1,517,000
Total	3,297,000	2,850,000
Reserve for slow moving items	(345,000)	(308,000)
Total inventories, net	2,952,000	2,542,000

GOODWILL

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

In accordance with the requirements of SFAS No. 142, we performed impairment tests and recorded no impairment charges in fiscal years ended June 30, 2003 or 2004. We prepare our annual impairment testing on April 1 of each year. We have compared the estimated carrying value with the estimated fair value of the operations and determined that none of the goodwill recorded as of April 1, 2004 was impaired. Additionally, during the nine months ended March 31, 2005, management determined that there are no events or circumstances which have occurred that would indicate an impairment of the goodwill.

NET INCOME PER SHARE

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

	Nine Months Ended March 31,	
	2005	2004
Net income	\$ 921,000	\$ 683,000
Basic net income per common share:		
Weighted average of common shares outstanding	9,006,073	8,779,913
Basic net income per common share	\$ 0.10	\$ 0.08
Diluted net income per share:		
Weighted average of common shares outstanding	9,006,073	8,779,913
Effect of potentially dilutive securities (options)	352,032	374,764
Effect of potentially dilutive securities (warrants)	76,326	55,250
Effect of potentially dilutive securities (convertible Preferred Shares)	-	78,129
Weighted average number of common and shares - Diluted	9,434,431	9,288,056
Diluted net income per common share	\$ 0.10	\$ 0.07

CREDIT FACILITY

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

In October 2004, the credit facility with Wells Fargo was renewed again with a more favorable facility for borrowings up to \$2,000,000. The credit facility expires in October 2005 and its terms require monthly interest payments at the prime rate of interest (5.75% at March 31, 2005); or LIBOR plus 2.50% (5.37% (one month) to 5.62% (three months) at March 31, 2005), based on outstanding borrowings with no minimum interest charge. The outstanding borrowings are secured by all assets of and guaranteed by the Company. There was no outstanding balance under the terms of this credit facility as of March 31, 2005. The total eligible borrowing capacity at March 31, 2005 was \$2,000,000.

There are certain financial and non-financial covenants that we must meet to be in compliance with the terms of the October 2004 Wells Fargo credit facility. At March 31, 2005, we were in compliance with all such covenants.

LONG TERM DEBT TO SHAREHOLDER

Long-term debt was comprised of a Not to Compete liability under the terms of a Noncompetition Agreement with a shareholder offset by a Note Receivable asset from the same shareholder. The interest rate on both was 7% annually. The Note was collateralized by the Not to Compete liability and was subordinated to the line of credit with Wells Fargo.

On October 27, 2004, the Not to Compete Liability and the Note Receivable were each paid in full at book value, with no further obligation under either instrument remaining.

INCOME TAXES

Deferred income taxes are provided on a liability method whereby deferred tax assets and liabilities are recognized for temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. We have a net operating loss carry forward of \$2,012,000 for state income tax purposes which expires beginning in 2012. Tax credit carry forwards totaling \$325,000 for Federal tax purposes expire beginning in 2018 and \$237,000 for state tax purposes do not expire.

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

STOCK OPTIONS

During the quarter ended March 31, 2005, we granted no Common Stock Options under the Company's Director Stock Option Plan or the Employee Stock Option Plan. There are 1,109,316 Common Stock options under both of these plans granted and outstanding, of which 883,691 are vested.

During the quarter ended March 31, 2005, 98,679 Common Stock Options under the Employee Stock Option Plan expired unexercised.

		Three Months Ended March 31,	
		2005	2004
Net income as reported:		\$ 275,000	\$ 261,000
	Add stock-based employee compensation expense included in reported net income, net of related tax effects		
	(Deduct) total stock-based employee and director compensation expense determined under fair value based method for all awards, net of related tax effects	(51,000)	-
Pro-forma net income:		\$ 224,000	\$ 261,000
Basic earnings per share	As reported	\$ 0.03	\$ 0.03
	Pro-forma	\$ 0.02	\$ 0.03
Diluted earnings per share	As reported	\$ 0.03	\$ 0.03
	Pro-forma	\$ 0.02	\$ 0.03

PREFERRED STOCK

78,129 Preferred Stock shares representing 100% of all Preferred stock shares outstanding were converted to 78,129 shares of Common Stock in the quarter ended March 31, 2005, leaving no Preferred Stock shares outstanding. We received no cash proceeds from the conversion.

SEGMENT INFORMATION

Prior to July 1, 2004, our reports included two business segments that were each strategic business units and which offered different products and services. They were operated separately as each business required different technology and marketing strategies. The two reportable segments within Pro-Dex were: Rotary Devices (formerly, Micro Motors Inc.) and Motion Control (formerly, Oregon Micro Systems Inc.).

As of July 1, 2004, due to subsidiary mergers of Micro Motors and Oregon Micro Systems into Pro-Dex, Inc. and the consolidation of the Company's management control, resource allocation and operations, separate business segments are no longer applicable under FASB 133 and are no longer separately defined. There is no restatement of our consolidated financial information due to the subsidiary merger and segment elimination.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

COMPANY OVERVIEW

The following discussion and analysis provides information that the Company's management believes is relevant to an assessment and understanding of our results of operations and financial condition for each of the three month and nine month periods ended March 31, 2004 and 2005, respectively. This discussion should be read in conjunction with the Consolidated Financial Statements and the Notes thereto included elsewhere in this Report. This Report contains certain forward-looking statements and information. The cautionary statements included herein should be read as being applicable to all related forward-looking statements wherever they may appear. Our actual future results could differ materially from those discussed herein. Our critical accounting policies relate to inventory valuation for slow moving items, impairment of goodwill, and recoverability of deferred income taxes.

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

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

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

Description of Business

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

Company-funded research and development supports the development of rotary drive and motion control platforms. We then seek customer-funded projects to customize these platforms to specific customer requirements. Company-funded research and development projects are generally expected to convert to customer-funded projects within six to eighteen months. Company-funded project costs are expensed as incurred. In the three months ended March 31, 2005, \$467,000 was expensed; a \$5,000 decrease from the \$472,000 expensed in the three months ended March 31, 2004.

In customer-funded development projects, costs are capitalized and recognized as a cost of sales as specific deliverables within the development contracts are produced, matching the costs to the revenue. In the three months ended March 31, 2005, \$88,000 was recognized as cost of sales, compared to \$4,000 recognized as cost of sales in the three months ended March 31, 2004, reflecting the completion of new product launches this quarter.

Customer-funded research and development provided \$285,000 in revenue in the three months ended March 31, 2005, and \$107,000 in revenue in the three months ended March 31, 2004. The results of the development work are intended to provide long-term exclusive manufacturing agreements and provide the customer with the retention of the intellectual property developed. The identity of the customer is generally protected by a non-disclosure agreement.

Medical product sales represent the manufacture of proprietary designs developed by the Company under exclusive design and supply agreements. Our dental products are sold to original equipment manufacturers and dental product distributors. An independent dealer network was engaged in 2003 to market our own branded line of dental products in a more effective manner. We also design and manufacture embedded multi-axis motion controllers used to regulate the motion of servo and stepper motors, predominantly for the factory automation and medical analysis equipment industries. The controllers support the platforms for PCI, VME, ISA, and cPCI busses as well as stand-alone requirements. Other products sold by Pro-Dex include motors, drivers, cables, software and a variety of accessories to meet most embedded motion control requirements; as well as pneumatic motors for industrial applications that are marketed directly to end-users and through industrial supply distributors. The increase in the percentage of sales of medical products and the decrease in the percentage of sales of dental product sales is a direct result of the shift in the

focus of our research and development efforts away from dental products and toward the our capabilities in the medical product market.

10

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

At the present time, we are generally able to fill orders within sixty (60) days. At March 31, 2005 we had a backlog, including orders for delivery beyond 60 days, of \$8.3 million compared with a backlog of \$5.1 million at June 30, 2004 and \$3.3 million at March 31, 2004. We expect to fill all of our future orders during the next twelve months. The increased backlog from June 30, 2004 is due to the development of new products to be supplied under exclusive long-term supply agreements. The increase in backlog from March 31, 2004 to March 31, 2005 is due to the timing of receiving and shipping against long-term purchase orders, of which we had a higher amount of bookings than shipments in the quarter. Although we may experience seasonal fluctuations in our new order bookings due to the timing of major medical, dental and industrial trade shows and events, we do not typically experience seasonal fluctuations in our order shipments.

We distribute our products directly to end users, original equipment manufacturers and through a network of high technology distributors within the United States. Internationally, we have sales agreements with foreign distributors or sell through the domestic subsidiaries of foreign customers.

CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States (GAAP). The preparation of our financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures. We base our estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. The significant accounting policies that are believed to be the most critical to fully understanding and evaluating the reported financial results include inventory valuations for slow moving items, impairment of goodwill, and the recovery of deferred income tax assets.

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

On July 1, 2002 the Company adopted SFAS No. 142 "Goodwill and Other Intangible Assets." SFAS No. 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142. In accordance with the requirements of SFAS No. 142, we have recorded no impairment charge in 2003 or 2004. We prepare our annual impairment testing on April 1 of each year.

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

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

RISK FACTORS

Competition

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

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

Fluctuation in Quarterly Operating Results

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

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

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

likely be materially adversely affected.

Dependence on Principal Product and New Product Development

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

There can be no assurance that we will be successful in our product development efforts, that the market will continue to accept our existing products, or that new products or product enhancements will be developed and implemented in a timely manner, meet the requirements of our customers, 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.

Technological Change

The healthcare 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 the Company's existing products obsolete and unmarketable. There can be no assurance that we will be successful in developing and marketing new products that respond to technological changes or evolving industry standards.

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

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

Litigation

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

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

Proprietary Technology

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

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

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

Ability to Manage Growth

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

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

Dependence Upon Key Personnel

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

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

other forms of incentive compensation to attract and retain such key personnel.

Product Liability

We maintain insurance to protect against claims associated with the use of our products, but there can be no assurance that our insurance coverage would adequately cover any claim asserted against us. A successful claim brought against us in excess of our insurance coverage could have a material adverse effect on our business, results of operations and financial condition. Even unsuccessful claims could result in the expenditure of funds in litigation and management time and resources.

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

Accounting Matters

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

Internal Controls

Any weaknesses identified in our internal controls as part of the evaluation being undertaken by us and our independent public accountants pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 could have an adverse effect on our business. We are in the process of evaluating and documenting our controls pursuant to Section 404 of the Sarbanes-Oxley Act.

Stock Option Expense

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

RESULTS OF OPERATIONS**For the Three-Month periods ended March 31, 2005 and 2004**

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

	Three Months Ended March 31,	
	2005	2004
Net Revenues:	100.0%	100.0%
Cost of Goods Sold	49.3%	51.4%
Gross Profit	50.7%	48.6%
Selling, General and Administrative Expenses	25.8%	22.2%
Research and Development Costs	14.4%	14.3%
Income from Operations	10.5%	12.1%
Net interest and other expense (income)	-0.6%	-1.1%
Provision for Income Taxes	2.6%	5.3%
Net Income	8.5%	7.9%

Net Sales. Consolidated sales decreased from \$3,302,000 to \$3,241,000 (\$61,000 or 2%) for the quarter ended March 31, 2005, compared to the quarter ended March 31, 2004. We continued to shift our product mix away from lower margin dental sales to higher margin medical and factory automation sales. As a result, medical products increased as a percentage of total sales to 45% from 40% in the same quarter last year. Shipments to dental customers were reduced to 25% of total sales compared to 41% for the same quarter in the prior year. Sales to factory automation and industrial customers increased to 23% from 15% for the same quarter in the prior year as the industry maintained its recent higher levels of activity as compared to the last three fiscal years. Although selective price increases and decreases were implemented in response to market conditions, the majority of the sales growth and declines for each product line is due primarily to increased or decreased sales volume, not the effect of price changes. Our revenue is derived from four main customer types. The proportion of Pro-Dex total sales to each customer type is noted in the table below:

% of Total Sales	Three Months Ended March 31,		FY	FY	FY
	2005	2004	2004	2003	2002
Dental	25%	41%	32%	43%	54%
Medical	45%	40%	41%	28%	17%
Factory Automation	23%	15%	18%	19%	19%
Government research and other	7%	4%	9%	10%	10%

Gross Profit and Gross Profit Percentage of Sales. Our consolidated gross profit percentage for the quarter ended March 31, 2005 increased 2% over the same quarter in the previous year despite a decline in sales as lower margin dental sales were replaced by higher margin medical sales. Gross profit as a percentage of sales increased to 50.7% for the quarter ended March 31, 2005 compared to 48.6% for the quarter ended March 31, 2004, as the continued gains from manufacturing cost improvements and a richer product mix were realized. Gross profit and gross profit percentage were as follows:

	Three Months Ended March 31,		Increase
	2005	2004	
Gross Profit	\$1,643,000	\$1,604,000	2.4%
Gross Profit Percentage	50.7%	48.6%	4.3%

Selling, General and Administrative Costs (S, G&A). S, G & A expenses increased to \$835,000 for the quarter ended March 31, 2005 from \$732,000 for the quarter ended March 31, 2004. The increase is mainly due to increased labor costs, in addition to increased sales and marketing expenses. S, G & A costs were as follows:

	Three Months Ended March 31,		Increase
	2005	2004	
Selling	\$ 249,000	\$ 231,000	8%
General and administrative	\$ 586,000	\$ 501,000	17%
Total S, G&A	\$ 835,000	\$ 732,000	14%

Research and Development Costs. Company-funded research and development expenses decreased to \$467,000 for the quarter ended March 31, 2005 from \$472,000 for the quarter ended March 31, 2004. The decrease in Company-funded research and development costs is due to an increase in customer-funded research and development in support of a higher number of medical and dental new product development projects. Company-funded research and development costs were as follows:

	Three Months Ended March 31,		Decrease
	2005	2004	
Research and Development costs	\$ 467,000	\$ 472,000	-1%

We engage in two types of research and development efforts: Company-funded and customer-funded. Company funded research and development is intended to develop generic rotary device and multi axis motion control platforms that will subsequently be utilized to meet the needs of individual customers. In this initial phase, there are generally no revenues generated and the associated costs are expensed as incurred.

Customer-funded research and development effort is the work performed for and funded by specific customers under the terms of formal research and development agreements. These efforts are generally for specific applications of the generic platforms developed by the Company-funded research. These projects typically take place within twelve months of the generic development work being completed. We recognize revenue under these research and development agreements when certain deliverables are completed as specified in each development contract. The research and development costs associated with the customer-funded research and development are capitalized as inventory and recognized as costs of sales (COS) when the contracted deliverable is made, matching the cost to the revenue. Customer-funded research and development provided \$285,000 and \$107,000 in revenue in the quarters ended March 31, 2005 and March 31, 2004, respectively. In the quarter ended March 31, 2005, \$88,000 was recognized as COS, and \$4,000 was recognized as COS in the quarter ended March 31, 2004.

Operating Profit and Operating Profit Percentage of Sales. Our consolidated operating profit for the quarter ended March 31, 2005 decreased to \$341,000 compared operating profit of \$400,000 for the same quarter in the previous year. The decrease was due to decreased factory automation sales levels and higher general and administrative expenses, partially offset by a more profitable sales mix. Operating profit as a percentage of sales decreased to 10.5% for the quarter ended March 31, 2005 compared to 12.1% for the quarter ended March 31, 2004 due to the higher selling, general and administrative expenses. Operating profit and margin were as follows:

	Three Months Ended March 31,		Decrease
	2005	2004	
Operating Profit	\$341,000	\$400,000	-15%
Operating Profit Percentage	10.5%	12.1%	-13%

Net Interest Expense. Net interest expense was \$0 in the quarter ended March 31, 2005, down from \$9,000 in the prior year's quarter due to the Company's current debt-free status.

Provision for Taxes. Our estimated effective combined federal and state tax rate on income from operations for the quarter ended March 31, 2005 was 23% due to the filing of the 2004 tax return that resulted in a \$59,000 refund received in the quarter and was 40% for the quarter ended March 31, 2004.

Net Income. Our net income for the three months ended March 31, 2005 was \$275,000 or \$0.03 per share on a basic and diluted basis, as compared to a net income of \$261,000 or \$0.03 per share on a basic and diluted basis for the three months ended March 31, 2004.

For the Nine-Month periods ended March 31, 2005 and 2004

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

	Nine Months Ended March 31,	
	2005	2004
Net Revenues:	100.0%	100.0%
Cost of Goods Sold	45.9%	54.0%
Gross Profit	54.1%	46.0%
Selling, General and Administrative Expenses	25.8%	23.0%
Research and Development Costs	14.2%	12.3%
Income from Operations	14.1%	10.7%
Net interest and other expense (income)	-1.0%	-0.1%
Provision for Income Taxes	5.4%	4.3%
Net Income	9.7%	6.5%

Net Sales. Consolidated sales decreased from \$10,534,000 to \$9,466,000 (\$1,068,000 or 10%) for the nine months ended March 31, 2005, compared to the nine months ended March 31, 2004. The reduction in sales is mainly due to a \$698,000 decrease in sales due to HealOzone shipments being replaced by a royalty agreement, transitioning away from low margin customers and customer driven new product shipment delays. Medical products declined as a percent of total sales to 36% from 42% in the same nine months last year due to the timing of new product launches that were delayed for shipment into future periods. Shipments to dental customers decreased to 25% as HealOzone shipments in the prior nine months were replaced by royalty payments. Sales to factory automation and industrial customers increased to 28% as the industry maintained its recent higher levels of activity as compared to the last three years. Although selective price increases and decreases were implemented in response to market conditions, the majority of the sales growth and declines for each product line is due to increased or decreased sales volume, not the effect of price changes. Our revenue is derived from four main customer types. The proportion of Pro-Dex total sales to each customer type is noted in the table below:

% of Total Sales	Nine Months Ended March 31,		FY	FY	FY
	2005	2004	2004	2003	2002
Dental	25%	34%	32%	43%	54%
Medical	36%	42%	41%	28%	17%
Factory Automation	28%	15%	18%	19%	19%
Government research and other	10%	9%	9%	10%	10%

Gross Profit and Gross Profit Percentage of Sales. Our consolidated gross profit for the nine months ended March 31, 2005 increased \$271,000 or 6% over the same nine months in the previous year despite the decline in sales as lower margin dental sales were replaced by higher margin factory automation and medical sales. Gross profit as a percentage of sales increased to 54.1% for the nine months ended March 31, 2005 compared to 46.0% for the nine months ended March 31, 2004, due to gains from increased high margin factory automation sales and manufacturing cost improvements. Gross profit and gross profit percentage were as follows:

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	Nine Months Ended March 31,		Increase
	2005	2004	
Gross Profit	\$5,122,000	\$4,851,000	6%
Gross Profit Percentage	54.1%	46.0%	18%

Selling, General and Administrative Costs (S, G&A). S, G & A expenses increased by \$12,000 or 0.5% for the nine months ended March 31, 2005 from the nine months ended March 31, 2004. The increase is mainly due to a higher level of sales and marketing expenses supporting the new business wins offset by reduced legal and insurance costs. S, G & A costs were as follows:

	Nine Months Ended March 31,		Increase Decrease
	2005	2004	
Selling	\$ 726,000	\$ 629,000	15%
General and administrative	\$ 1,711,000	\$ 1,796,000	-5%
Total S, G&A	\$ 2,437,000	\$ 2,425,000	0%

Research and Development Costs. Research and development expenses increased to \$1,343,000 for the nine months ended March 31, 2005 from \$1,299,000 for the nine months ended March 31, 2004, an increase of \$44,000 or 3%. The increase is due to higher support levels of the new product development in the medical and dental product lines and continuing investment in support of motion control system product line extensions. Company-funded research and development costs were as follows:

	Nine Months Ended March 31,		Increase
	2005	2004	
Research and Development Costs	\$1,343,000	\$1,299,000	3%

We engage in two types of research and development efforts: Company-funded and customer-funded. Company funded research and development is intended to develop generic rotary device and multi axis motion control platforms that will subsequently be utilized to meet the needs of individual customers. In this initial phase, there are generally no revenues generated and the associated costs are expensed as incurred.

Customer-funded research and development effort is the work performed for and funded by specific customers under the terms of formal research and development agreements. These efforts are generally for specific applications of the generic platforms developed by the Company-funded research. These projects typically take place within twelve months of the generic development work being completed. We recognize revenue under these research and development agreements as certain deliverables are completed as specified in each development contract. The research and development costs associated with these efforts are capitalized as inventory and recognized as costs of sales (COS) when the contracted deliverable is made, matching the cost to the revenue. Customer-funded research and development provided \$537,000 and \$299,000 in revenue in the nine months ended March 31, 2005 and March 31, 2004, respectively. In the nine months ended March 31, 2005, \$130,000 was recognized as COS, and \$200,000 was recognized as COS in the nine months ended March 31, 2004.

Operating Profit and Operating Profit Percentage of Sales. Our consolidated operating profit for the nine months ended March 31, 2005 increased to \$1,342,000 compared to operating profit of \$1,127,000 in the same nine months of the previous year. The increase was due to a more favorable product mix, led by a greater contribution of factory automation products. Operating profit as a percentage of sales increased to 14.2% for the nine months ended March 31, 2005 compared to 10.7% for the nine months ended March 31, 2004 due to the effects of a more favorable sales mix offsetting the loss of efficiencies from the lower sales volumes. Operating profit and margin were as follows:

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	Nine Months Ended March 31,		
	2005	2004	Increase
Operating Profit	\$1,342,00	\$1,127,000	19.1%
Operating Profit Percentage	14.2%	10.7%	32.7%

Royalties and Other Income. We received \$47,000 in royalty payments in the nine months ended March 31, 2005, compared to \$40,000 in the same period of the prior year.

Net Interest Expense. Net interest expense was \$9,000 in the nine months ended March 31, 2005, down from \$44,000 in the prior year's nine months due to the reduced balance and rates on the restructured credit line and the payoff of the net note to a shareholder.

Provision for Taxes. Our estimated effective combined Federal and state tax rate on income from operations for the nine months ended March 31, 2005 was 36% due to the filing of the 2004 tax return that resulted in a \$59,000 refund received in the third quarter and was 40% for the nine months ended March 31, 2004.

Net Income. Our net income for the nine months ended March 31, 2005 increased 35% to \$921,000 or \$0.10 per share on a basic and diluted basis, as compared to a net income of \$683,000 or \$0.08 per share on a basic and \$0.07 per share on a diluted basis for the nine months ended March 31, 2004.

Liquidity and Capital Resources

The following table presents selected financial information for the comparative period last year and the year ended June 30, 2004:

	As of March 31,		Year Ending
	2005	2004	June 30, 2004
Cash and cash equivalents	\$2,259,000	\$1,306,000	\$2,070,000
Working Capital ¹	\$7,027,000	\$5,353,000	\$5,795,000
Credit Line outstanding balance	\$0	\$0	\$0
Tangible book value/common share ²	\$0.97	\$0.81	\$0.85
Number of days of sales outstanding (DSO) in accounts receivable at end of quarter ³	72	52	59
	Nine Months Ended March 31,		Year Ending
	2005	2004	June 30, 2004
Net cash provided by operations	\$111,000	\$1,160,000	\$2,054,000

¹ Working Capital is calculated as follows: ending current assets balance less ending current liabilities balance.

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

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

Our working capital at March 31, 2005 increased to \$7.0 million compared to \$5.4 million at March 31, 2004 and \$5.8 million at June 30, 2004. Sustained higher profitability contributed to the provision of cash and increased working capital for the quarter, even as we began to make significant tax payments of \$668,000 in the nine months ended March 31, 2005 compared to \$4,000 in the comparable nine months last year.

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

In October 2004, the credit facility with Wells Fargo was renewed again with a more favorable facility for borrowings up to \$2,000,000. The credit facility expires in October 2005 and its terms require monthly interest payments at the prime rate of interest (5.75% at March 31, 2005); or LIBOR plus 2.50% (5.37% (one month) to 5.62% (three months) at March 31, 2005), based on outstanding borrowings with no minimum interest charge. The outstanding borrowings are secured by all assets of, and guaranteed by the Company. There was no outstanding balance under the terms of this credit facility as of March 31, 2005. The total eligible borrowing capacity at March 31, 2005 was \$2,000,000.

There are certain financial and non-financial covenants that we must meet to be in compliance with the terms of the October 2004 Wells Fargo credit facility. At March 31, 2005, we were in compliance with all such covenants.

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

At March 31, 2005, we had cash and cash equivalents of \$2,259,000. We believe that our cash and cash equivalents on hand, together with cash flows from operations, if any, and amounts available under the credit facility will be sufficient to meet our working capital and capital expenditure requirements for the next twelve months.

Recent Accounting Pronouncements

We are subject to the revised requirements of the Statement of Financial Accounting Standards ("SFAS") No. 123R "accounting for Stock-Based Compensation" as revised December 2004. This standard establishes the accounting standards for equity compensation, and will apply to us in the recognition of the cost of stock options awarded based on the grant-date fair value of those awards. As a small business issuer, the statement is effective for us at the beginning of the first fiscal year that begins after December 15, 2005. Accordingly we will begin to report the expense of vested stock options in our report for the quarter and ending September 30, 2006.

Item 3. Controls and Procedures

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

During the quarter ended March 31, 2005, there were no changes in our internal controls over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act) that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting except that subsequent to the ending of our second quarter, we improved the information and financial controls by consolidating our accounting and Enterprise Resource Planning system to a unified platform. This allowed us to eliminate two of the previous three accounting systems which we operated. As the systems were consolidated, many of the operating procedures and information processing steps were streamlined, reducing the opportunity for error and increasing the Company's information processing efficiency.

PART II

OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Submissions of Matters to a Vote of Securities Holders.

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

Exhibits:

31.1 Certifications of Chief Executive officer 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

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

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

SIGNATURES

In accordance with the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: May 12, 2005

Date: May 12, 2005

PRO-DEX INC.

PRO-DEX INC.

By: / s / Patrick Johnson

By: / s / Jeffrey J. Ritchey

Patrick Johnson
Chief Executive Officer

Jeffrey J. Ritchey
Secretary and Chief Financial Officer
(Principal Financial and Accounting Officer)