MESA LABORATORIES INC /CO
Form 10-Q
August 01, 2017

United States

Securities and Exchange Commission

Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended June 30, 2017

TRANSITION REPORT PURSUANT TOSECTION 13 OR 15 (d) OF THE SECURITES EXCHANGE ACT OF 1934

For the transition period from ___ to ___

Commission File No: 0-11740

MESA LABORATORIES, INC.

(Exact name of registrant as specified in its charter)

Colorado	**84-0872291**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification number)

12100 West Sixth Avenue	
Lakewood, Colorado	**80228**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: **(303) 987-8000**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934, during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes 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 (Section 232.405 of this chapter) 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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	Accelerated filer	Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company	Emerging growth company

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the Issuer's classes of common stock, as of the latest practicable date:

There were 3,758,914 shares of the Issuer's common stock, no par value, outstanding as of July 25, 2017**.**

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Part I. Financial Information

Item 1. ***Financial Statements***

Mesa Laboratories, Inc.

Condensed Consolidated Balance Sheets

(In thousands, except share amounts)

	June 30, 2017 (Unaudited)	**March 31, 2017**
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,976	$ 5,820
Accounts receivable, less allowances of $267 and $252, respectively	12,903	14,319
Inventories, net	13,376	13,873
Prepaid income taxes	1,676	587
Prepaid expenses and other	1,808	1,186
Assets held for sale	1,012	--
Total current assets	33,751	35,785
Property, plant and equipment, net	25,821	26,002
Intangibles, net	36,681	37,790
Goodwill	72,730	72,156
Total assets	$ 168,983	$ 171,733
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 2,338	$ 2,168
Accrued salaries and payroll taxes	2,934	4,350
Unearned revenues	4,033	4,117
Current portion of contingent consideration	1,165	1,294
Other accrued expenses	2,503	2,999
Income taxes payable	704	514
Current portion of long-term debt	1,250	1,125
Total current liabilities	14,927	16,567
Deferred income taxes	3,644	3,554

Long-term debt, net of debt issuance costs and current portion	49,303	53,675
Contingent consideration	118	116
Total liabilities	67,992	73,912
Commitments and Contingencies (Note 8)		
Stockholders' equity:		
Common stock, no par value; authorized 25,000,000 shares; issued and outstanding, 3,758,175 and 3,727,704 shares, respectively	27,428	25,925
Retained earnings	74,572	73,656
Accumulated other comprehensive loss	(1,009)	(1,760)
Total stockholders' equity	100,991	97,821
Total liabilities and stockholders' equity	$ 168,983	$ 171,733

See accompanying notes to condensed consolidated financial statements.

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Mesa Laboratories, Inc.

Condensed Consolidated Statements of Income

(Unaudited)

(In thousands except per share data)

	Three Months Ended June 30, 2017	**2016**
Revenues	$22,673	$21,114
Cost of revenues	10,002	9,100
Gross profit	12,671	12,014
Operating expenses		
Selling	2,679	2,424
General and administrative	6,857	5,980
Research and development	1,153	1,035
Total operating expenses	10,689	9,439
Operating income	1,982	2,575
Other expense, net	679	406
Earnings before income taxes	1,303	2,169
Income tax benefit (expense)	214	(239)
Net income	$1,517	$1,930
Net income per share:		
Basic	$0.41	$0.53
Diluted	0.39	0.51
Weighted average common shares outstanding:		
Basic	3,736	3,646
Diluted	3,923	3,802

See accompanying notes to condensed consolidated financial statements.

Mesa Laboratories, Inc.

Condensed Consolidated Statements of Comprehensive Income

(Unaudited)

(In thousands except per share data)

	Three Months Ended June 30,	
	2017	**2016**
Net Income	$1,517	$1,930
Other comprehensive income, net of tax:		
Foreign currency translation	751	50
Total comprehensive income	$2,268	$1,980

See accompanying notes to condensed consolidated financial statements.

Mesa Laboratories, Inc.

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(In thousands)

	Three Months Ended June 30, 2017	2016
Cash flows from operating activities:		
Net income	$1,517	$1,930
Depreciation and amortization	2,278	2,170
Stock-based compensation	540	429
Amortization of debt issuance costs	28	--
Deferred income taxes	90	138
Foreign currency adjustments	(176)	67
Adjustment to contingent consideration	300	--
Change in assets and liabilities, net of effects of acquisitions		
Accounts receivable, net	1,416	2,890
Inventories, net	497	(67)
Prepaid expenses and other	(1,711)	(426)
Accounts payable	170	(66)
Accrued liabilities and taxes payable	(1,747)	(3,584)
Unearned revenues	(84)	40
Contingent consideration	(437)	111
Net cash provided by operating activities	2,681	3,632
Cash flows from investing activities:		
Acquisitions	(62)	(2,565)
Purchases of property, plant and equipment	(1,505)	(3,456)
Net cash used in investing activities	(1,567)	(6,021)
Cash flows from financing activities:		
Proceeds from the issuance of debt	--	1,500
Payments on debt	(4,250)	(750)
Dividends	(601)	(583)
Proceeds from the exercise of stock options	963	1,160
Net cash (used in) provided by financing activities	(3,888)	1,327
Effect of exchange rate changes on cash and cash equivalents	(70)	4
Net decrease in cash and cash equivalents	(2,844)	(1,058)
Cash and cash equivalents at beginning of period	5,820	5,695

Cash and cash equivalents at end of period	$2,976	$4,637
Cash paid for:		
Income taxes	$658	$1,207
Interest	561	292
Supplemental non-cash activity:		
Contingent consideration as part of an acquisition	$--	$1,168

See accompanying notes to condensed consolidated financial statements.

Mesa Laboratories, Inc.

Notes to Condensed Consolidated Financial Statements

Note 1 -Description of Business and Summary of Significant Accounting Policies

Description of Business

Mesa Laboratories, Inc. was incorporated under the laws of the State of Colorado on March 26, 1982. The terms “we,” “us,” “our,” the “Company” or “Mesa” are used in this report to refer collectively to the parent company and the subsidiaries through which our various businesses are conducted. We pursue a strategy of focusing primarily on quality control products and services, which are sold into niche markets that are driven by regulatory requirements. We prefer markets that have limited competition where we can establish a strong presence and achieve high gross margins. We are organized into four divisions across eight physical locations. Our Instruments Division designs, manufactures and markets quality control instruments and disposable products utilized in the healthcare, pharmaceutical, food and beverage, medical device, industrial hygiene, environmental air sampling and semiconductor industries. Our Biological Indicators Division provides testing services, along with the manufacturing and marketing of biological indicators and distribution of chemical indicators used to assess the effectiveness of sterilization processes, including steam, hydrogen peroxide, ethylene oxide and radiation, in the hospital, dental, medical device and pharmaceutical industries. Our Cold Chain Monitoring Division designs, develops and markets systems which are used to monitor various environmental parameters such as temperature, humidity and differential pressure to ensure that critical storage and processing conditions are maintained in hospitals, pharmaceutical and medical device manufacturers, blood banks, pharmacies and other laboratory and industrial environments. Our Cold Chain Monitoring Division also provides parameter (primarily temperature) monitoring of products during transport in a cold chain and consulting services such as compliance monitoring and validation or mapping of transport and storage containers. Our Cold Chain Packaging Division provides packaging development consulting services and thermal packaging products such as coolers, boxes, insulation materials and phase-change products to control temperature during transport.

Basis of Presentation

The accompanying condensed consolidated balance sheet as of March 31, 2017, has been derived from audited consolidated financial statements. The accompanying unaudited interim condensed consolidated financial statements have been prepared on the same basis as our annual audited consolidated financial statements and in accordance with accounting principles generally accepted in the United States (“GAAP”) for interim financial information and the rules and regulations of the Securities and Exchange Commission (“SEC”) for interim financial statements. In the opinion of management, such unaudited information includes all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation of this interim information. Operating results and cash flows for interim periods are not necessarily indicative of results that can be expected for the entire year. The information included in this report should be read in conjunction with our audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended March 31, 2017.

The summary of our significant accounting policies is incorporated by reference to our Annual Report on Form 10-K for the year ended March 31, 2017.

Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which will replace most existing revenue recognition guidance in U.S. GAAP and is intended to improve and converge with international standards the financial reporting requirements for revenue from contracts with customers. The core principle of ASU 2014-09 is that an entity should recognize revenue for the transfer of goods or services equal to the amount that it expects to be entitled to receive for those goods or services. ASU 2014-09 also requires additional disclosures about the nature, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments. ASU 2014-09 allows for adoption either on a full retrospective basis to each prior reporting period presented or on a modified retrospective basis with the cumulative effect of initially applying the new guidance recognized at the date of initial application, which will be effective for the Company beginning April 1, 2018.

We plan to adopt ASU 2014-09 and its amendments on a modified retrospective basis and are continuing to assess all future impacts of the guidance by reviewing our current contracts with customers to identify potential differences that could result from applying the new guidance. Based on our preliminary review, we expect that the adoption of ASU 2014-09 will not have a material impact on our consolidated financial statements. As we complete our overall assessment, we are evaluating our accounting policies and practices, business processes, systems and controls to determine if changes are necessary to support the new revenue recognition and disclosure requirements. Our assessment will be completed during the year ending March 31, 2018.

In January 2017, the FASB issued ASU 2017-04, *Intangibles – Goodwill and Other*, which eliminates the requirement to calculate the implied fair value of goodwill to measure a goodwill impairment charge. ASU 2017-04 is required to be applied prospectively and we elected to early adopt ASU 2017-04 effective April 1, 2017. We do not anticipate that the adoption will have a significant impact on our consolidated financial statements.

Note 2 – Acquisitions

For the three months ended June 30, 2017, our acquisitions of businesses totaled $362,000, of which none were material in nature (see Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations).

Note 3 – Inventories

Inventories consist of the following (in thousands):

	June 30, 2017	March 31, 2017
Raw materials	$10,770	$10,815
Work-in-process	365	342
Finished goods	3,801	3,604
Less: reserve	(1,560)	(888)
	$13,376	$13,873

Note 4 – Facility Relocation

In August 2016, we announced that we planned to shut down both our Omaha and Traverse City Biological Indicator manufacturing facilities and relocate those operations to the new Bozeman building. The move of those two facilities, along with the current Bozeman operations, began in March 2017 and is estimated to be completed by the end of our year ending March 31, 2018. We estimate that the total costs of the relocation will be $2,100,000 (which is comprised primarily of facility moving expenses, retention bonuses for existing personnel and payroll costs for duplicative personnel during the transition period) of which $725,000 was incurred during the year ended March 31, 2017. We incurred $522,000 in relocation costs for the three months ended June 30, 2017, of which $291,000 and $231,000 are reflected in cost of revenues and general and administrative expense, respectively in the accompanying condensed consolidated statements of income. Facility relocation costs, which are associated with our Biological Indicators segment, are as follows for the three months ended June 30, 2017:

- Retention bonuses for existing personnel of $207,000
- Duplicative employment costs of $84,000
- Moving costs of $231,000

Facility relocation amounts accrued and paid for the three months ended June 30, 2017 are as follows (in thousands):

Balance at March 31, 2017	$673
Facility relocation expense	522
Cash payments	(594)
Balance at June 30, 2017	$601

Subsequent to June 30, 2017, we completed the move from the Omaha facility and subsequently sold that building for $1,116,000 (net of commission costs) which resulted in a gain of $116,000. The Omaha facility is presented on the accompanying condensed consolidated balance sheets as assets held for sale.

Note 5 – Long-Term Debt

Long-term debt consists of the following (in thousands):

	June 30, 2017	March 31, 2017
Line of credit (3.25% at June 30, 2017)	$31,500	$35,500
Term loan (3.25% at June 30, 2017)	19,500	19,750
Less: discount	(447)	(450)
Less: current portion	(1,250)	(1,125)
Long-term portion	$49,303	$53,675

On March 1, 2017, we entered into a five-year agreement (the “Credit Facility”) for an $80,000,000 revolving line of credit (“Line of Credit”), a $20,000,000 term loan (“Term Loan”) and up to $2,500,000 of letters of credit with a banking syndicate of four banks. In addition, the Credit Facility provides a post-closing accordion feature which allows for the Company to request to increase the Line of Credit or Term Loan up to an additional $100,000,000. Funds from the Credit Facility may be used to pay down the previous credit facility, finance working capital needs and for general corporate purposes in the ordinary course of business (including, without limitation, permitted acquisitions).

Line of Credit and Term Loan indebtedness bears interest at either: (1) LIBOR, as defined, plus an applicable margin ranging from 1.5% to 2.50%; or (2) the alternate base rate (“ABR”), which is the greater of JPMorgan’s prime rate or the federal funds effective rate or the overnight bank funding rate plus 0.5%. We elect the interest rate with each borrowing under the line of credit. In addition, there is an unused line fee of 0.15% to 0.35%. Letter of credit fees are based on the applicable LIBOR rate.

The Term Loan requires 20 quarterly principal payments (the first due date was March 31, 2017) in the amount of $250,000 (increasing by $125,000 each year up to $750,000 in the fifth year). The remaining balance of principal and accrued interest are due on March 1, 2022.

The Credit Facility is secured by all of our assets and requires us to maintain a ratio of funded debt to our trailing four quarters of EBIDTA (the “Leverage Ratio”), as defined, of less than 3.0 to 1.0, provided that, we may once during the term of the Credit Facility, in connection with a Permitted Acquisition for which the aggregate consideration paid or to be paid in respect thereof equals or exceeds $20,000,000, elect to increase the maximum Leverage Ratio permitted hereunder to (i) 3.50 to 1.00 for a period of four consecutive fiscal quarters commencing with the fiscal quarter in which such Permitted Acquisition occurs (the “Initial Holiday Period”) and (ii) 3.25 to 1.00 for the period of four consecutive fiscal quarters immediately following the Initial Holiday Period. The Credit Facility also requires us to maintain a minimum fixed charge coverage ratio of less than 1.25 to 1.0. We were compliant with the required covenants at June 30, 2017.

We incurred origination and debt issuance costs of $460,000 which are treated as a debt discount and are netted against amounts outstanding on the condensed consolidated balance sheets.

As of June 30, 2017, future contractual maturities of debt as are as follows (in thousands):

Year ending March 31,	
2018	$875
2019	1,625
2020	2,125
2021	2,625
2022	43,750
	$51,000

Note 6 – Stock-Based Compensation

Amounts recognized in the condensed consolidated financial statements related to stock-based compensation are as follows (in thousands, except per share data):

	Three Months Ended June 30,	
	2017	**2016**
Total cost of stock-based compensation charged against income before income taxes	$540	$429
Amount of income tax benefit (expense) recognized in earnings	89	(47)
Amount charged against net income	$629	$382
Impact on net income per common share:		
Basic	$0.17	$0.10
Diluted	0.16	0.10

Stock-based compensation expense is included in cost of revenues, selling, and general and administrative expense in the accompanying condensed consolidated statements of income.

The fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option-pricing model (“Black-Scholes”). We use historical data to estimate the expected price volatility, the expected stock option life and expected forfeiture rate. The risk-free interest rate is based on the United States Treasury yield curve in effect at the time of grant for the estimated life of the stock option. The dividend yield is calculated based upon the dividend payments made during the prior four quarters as a percent of the average stock price for that period.

The following is a summary of stock option activity for the three months ended June 30, 2017:

Number of Shares	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value (000s)

Outstanding at March 31, 2017	510,361	$ 75.78	5.0	$ 23,956
Stock options granted	93,435	122.77	5.8	
Stock options forfeited	(5,866)	96.96	5.4	
Stock options expired	--	--	--	
Stock options exercised	(27,135)	54.41	--	
Outstanding at June 30, 2017	570,795	84.27	5.0	$ 33,701
Exercisable at June 30, 2017	185,614	61.10	4.2	$ 15,260

The total intrinsic value of stock options exercised was $2,422,642 and $2,242,938 for the three months ended June 30, 2017 and 2016, respectively.

A summary of the status of our unvested stock option shares as of June 30, 2017 is as follows:

	Number of Shares	**Weighted-Average Grant-Date Fair Value**
Unvested at March 31, 2017	373,766	$ 22.49
Stock options granted	93,435	38.83
Stock options forfeited	(5,866)	27.95
Stock options vested	(76,154)	20.92
Unvested at June 30, 2017	385,181	28.14

As of June 30, 2017, there was $9,120,867 of total unrecognized compensation expense related to unvested stock options. As of June 30, 2017, we have 715,803 shares available for future stock option grants.

Note 7 - Net Income Per Share

Basic net income per share is computed by dividing net income by the weighted-average number of common shares outstanding during the reporting period. Diluted net income per share is computed similarly to basic net income per share, except that it includes the potential dilution that could occur if dilutive securities were exercised.

The following table presents a reconciliation of the denominators used in the computation of net income per share - basic and diluted (in thousands, except per share data):

	Three Months Ended June 30,	
	2017	**2016**
Net income available for stockholders	$1,517	$1,930
Weighted average outstanding shares of common stock	3,736	3,646
Dilutive effect of stock options	187	156
Common stock and equivalents	3,923	3,802
Net income per share:		
Basic	$0.41	$0.53
Diluted	0.39	0.51

For the three months ended June 30, 2017 and 2016, 117,000 and 184,000 outstanding stock options, respectively, were excluded from the calculation of diluted net income per share as their inclusion would have been anti-dilutive.

Note 8- Commitments and Contingencies

Under the terms of the PCD Agreement, we are required to pay contingent consideration if the cumulative revenues for our process challenge device business for the three years subsequent to the acquisition meet certain levels. The potential consideration payable ranges from $0 to $1,500,000 and is based upon a sliding scale of three-year cumulative revenues between $9,900,000 and $12,600,000, with payments made annually. Based upon both historical and projected growth rates, we initially recorded $300,000 of contingent consideration payable which represented our best estimate of the amount that would ultimately be paid. We paid $150,000 of the contingent consideration during the year ended March 31, 2016 (based upon the then current run rate projected over the entire three-year contingent consideration period).

Since the initial payment, the revenues for these products have significantly increased and as a result, during the year ended March 31, 2017 we recorded an additional $450,000 accrual (which was paid in our third quarter ending December 31, 2016.). During the three months ended June 30, 2017 revenues continued to increase and after revising our forecast for the PCD product revenues through the end of the earn-out period, we recorded an additional $300,000 accrual, which is included in other income, net in the accompanying condensed statement of operations for the three months ended June 30, 2017. The remaining contingent consideration amount is also subject to additional modification at the end of the third year of the earn-out period (October 2017) based upon the actual revenues earned over the contingent consideration period. Any changes to the contingent consideration ultimately paid will result in additional income or expense in our condensed consolidated statements of income. We will continue to monitor the results of our process challenge device business and we will adjust the contingent liability on a go forward basis, based on then current information.