MESA LABORATORIES INC /CO
Form 10-Q
October 31, 2018

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United States

Securities and Exchange Commission

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2018

or

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 every Interactive Data File required to be submitted 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 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.

Large accelerated filer Accelerated filer Non-accelerated filer 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 3,852,835 shares of the Issuer's common stock, no par value, outstanding as of October 26, 2018**.**

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Part I. Financial Information

Item 1. ***Financial Statements***

Mesa Laboratories, Inc.

Condensed Consolidated Balance Sheets

(in thousands, except share amounts)

	September 30, 2018 (unaudited)	March 31, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	$ 5,625	$ 5,469
Accounts receivable, less allowances of $128 and $179, respectively	13,242	14,302
Inventories, net	8,336	9,228
Prepaid income taxes	4,165	273
Prepaid expenses and other	2,223	782
Assets held for sale	--	1,934
Total current assets	33,591	31,988
Property, plant and equipment, net	23,235	23,593
Deferred taxes	120	127
Intangibles, net	38,260	42,850
Goodwill	65,082	65,543
Total assets	$ 160,288	$ 164,101
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 2,295	$ 2,380
Accrued salaries and payroll taxes	4,607	4,284
Current portion of long-term debt	1,875	1,625
Unearned revenues	3,744	3,921
Current portion of contingent consideration	46	709
Income taxes payable	--	1,008
Estimated legal liability	3,300	--
Other accrued expenses	3,665	3,363
Total current liabilities	19,532	17,290

Deferred income taxes	2,532	2,621
Long-term debt, net of debt issuance costs and current portion	31,188	44,635
Other long-term liabilities	133	194
Total liabilities	53,385	64,740
Stockholders' equity:		
Common stock, no par value; authorized 25,000,000 shares; issued and outstanding, 3,852,747 and 3,801,439 shares, respectively	35,421	30,516
Retained earnings	72,279	68,281
Accumulated other comprehensive (loss) income	(797)	564
Total stockholders' equity	106,903	99,361
Total liabilities and stockholders' equity	$ 160,288	$ 164,101

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 September 30,		Six Months Ended September 30,	
	2018	**2017**	**2018**	**2017**
Revenues	$24,865	$22,954	$50,007	$45,627
Cost of revenues	10,288	9,721	20,339	19,723
Gross profit	14,577	13,233	29,668	25,904
Operating expenses:				
Selling	1,804	2,288	3,694	4,967
General and administrative	7,493	6,412	15,093	13,269
Research and development	842	885	1,679	2,038
Estimated legal settlement	3,300	--	3,300	--
Total operating expenses	13,439	9,585	23,766	20,274
Operating income	1,138	3,648	5,902	5,630
Other (income) expense, net	(168)	542	196	1,221
Earnings before income taxes	1,306	3,106	5,706	4,409
Income tax expense	312	753	482	539
Net income	$994	$2,353	$5,224	$3,870
Earnings per share:				
Basic	$0.26	$0.63	$1.36	$1.03
Diluted	0.25	0.60	1.30	0.98
Weighted-average common shares outstanding:				
Basic	3,850	3,764	3,833	3,754
Diluted	4,046	3,935	4,029	3,934

See accompanying notes to condensed consolidated financial statements.

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Mesa Laboratories, Inc.

Condensed Consolidated Statements of Comprehensive Income

(unaudited)

(in thousands)

	Three Months Ended September 30,		**Six Months Ended September 30,**	
	2018	**2017**	**2018**	**2017**
Net income	$994	$2,353	$5,224	$3,870
Other comprehensive (loss) income, net of tax:				
Foreign currency translation adjustments	(49)	948	(1,361)	1,699
Comprehensive income	$945	$3,301	$3,863	$5,569

See accompanying notes to condensed consolidated financial statements.

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Mesa Laboratories, Inc.

Condensed Consolidated Statements of Cash Flows

(unaudited)

(in thousands)

	Six Months Ended September 30, 2018	2017
Cash flows from operating activities:		
Net income	$5,224	$3,870
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,889	4,531
Stock-based compensation	1,729	985
Gain on disposition of assets	(288)	(116)
Deferred taxes	--	144
Foreign currency adjustments	--	(533)
Adjustment to contingent consideration	(33)	300
Other	111	55
Cash provided by changes in operating assets and liabilities:	--	
Accounts receivable, net	643	2,132
Inventories, net	1,022	960
Prepaid expenses and other current assets	(1,301)	(2,241)
Accounts payable	(70)	(132)
Accrued liabilities and taxes payable	(866)	(1,819)
Unearned revenues	(177)	(312)
Contingent consideration	(683)	(456)
Net cash provided by operating activities	10,200	7,368
Cash flows from investing activities:		
Acquisitions	--	(62)
Proceeds from sale of assets	2,222	1,133
Purchases of property, plant and equipment	(849)	(2,012)
Net cash provided by (used in) investing activities	1,373	(941)
Cash flows from financing activities:		
Proceeds from the issuance of debt	--	4,000
Payments on debt	(13,250)	(7,000)
Dividends	(1,226)	(1,201)
Proceeds from the exercise of stock options	3,176	2,064
Net cash used in financing activities	(11,300)	(2,137)
Effect of exchange rate changes on cash and cash equivalents	(117)	158
Net increase in cash and cash equivalents	156	4,448
Cash and cash equivalents at the beginning of the period	5,469	5,820

Cash and cash equivalents at the end of the period	$5,625	$10,268
Cash paid for:		
Income taxes paid	$5,310	$2,446
Interest paid	938	1,007

See accompanying notes to condensed consolidated financial statements.

Mesa Laboratories, Inc.

Notes to Condensed Consolidated Financial Statements

(unaudited)

(dollar amounts in thousands, unless otherwise specified)

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

Description of Business

In this quarterly report on Form 10-Q, Mesa Laboratories, Inc., a Colorado corporation, together with its subsidiaries is collectively referred to as "we," "us," "our," the "Company" or "Mesa."

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 in which we can establish a strong presence and achieve high gross margins. We are organized into four divisions across nine physical locations. Our Sterilization and Disinfection Control Division manufactures and sells biological, cleaning, and chemical indicators. Biological, cleaning, and chemical indicators are used to assess the effectiveness of sterilization and disinfection processes in the hospital, dental, medical device, and pharmaceutical industries. The division also provides testing and laboratory services, mainly to the dental industry. 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, and environmental air sampling 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 laboratory environments. 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 the customer's transport of their own products.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, such unaudited information includes all adjustments, consisting of normal recurring adjustments necessary for a fair presentation of our financial position and results of operations. The results of operations for the interim periods are not necessarily indicative of results that may be achieved for the entire year. The financial statements and related notes do not include all information and footnotes required by U.S. GAAP for annual reports. This quarterly report should be read in conjunction with the consolidated financial statements included in our annual report on Form 10-K for the year ended March 31, 2018.

Recently Issued Accounting Pronouncements

In August 2018, the SEC issued Release No. 33-10532 that amends and clarifies certain financial reporting requirements. The principal change to our financial reporting will be the inclusion of the annual disclosure requirement of changes in stockholders' equity in Rule 3-04 of Regulation S-X to interim periods. We will adopt this new rule beginning with our financial reporting for the quarter ended December 31, 2018. Upon adoption, we will include our Consolidated Statements of Stockholders' Equity with each quarterly filing on Form 10-Q.

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-02, *Leases (Topic 842)*. The pronouncement requires lessees to recognize a liability for lease obligations, which represents the discounted obligation to make future minimum lease payments, and a corresponding right-of-use asset on the balance sheet for all leases with terms greater than 12 months. The guidance also requires qualitative and quantitative disclosures designed to present financial statement users with the ability to assess the amount, timing, and uncertainty of cash flows arising from leases. We have initiated our plan for the adoption and implementation of this new accounting standard, including assessing our lease arrangements, evaluating practical expedients, and making necessary changes to our accounting policies, processes, and internal controls over financial reporting. We expect to adopt the standard using the optional transition method, which will allow us to apply the standard as of the effective date, therefore we will not apply changes to comparative periods presented in our financial statements. We are still assessing the expected impact of the standard on our consolidated balance sheets, but it will not significantly impact our consolidated statements of income and cash flows.

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Recently Adopted Accounting Pronouncements

During the three months ended September 30, 2018, we elected to early-adopt ASU 2018-15 *Intangibles – Goodwill and Other Internal-Use Software: Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract* ("ASU 2018-15") on a prospective basis. ASU 2018-15 aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs of other internal-use software arrangements. Accordingly, we capitalized $144 of costs incurred during the three months ended September 30, 2018 to implement a hosted enterprise resource planning system to our European subsidiaries. The related asset is held in prepaid expenses and other on the condensed consolidated balance sheets, and we began amortizing the expense to general and administrative costs on our condensed consolidated statements of income on a straight-line basis over the contractual term of the arrangement.

Effective April 1, 2018, we adopted ASU 2014-09 *Revenue from Contracts with Customers (Topic 606)* and all related amendments (referred to collectively hereinafter as "ASU 606") on a modified retrospective basis. ASU 606 requires an entity to recognize revenue for the transfer of goods or services equal to the amount it expects to be entitled to receive for the goods and services. The adoption did not have a material impact on our condensed consolidated balance sheets, statements of income, or cash flows. The primary impact of adoption was the enhancement of disclosures to provide additional clarity regarding how revenue is earned and recognized, and to show revenues at a more disaggregated level, included in Note 2. "Revenue Recognition."

In March 2018, the FASB issued ASU 2018-05, Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118. The amendments in this update provide guidance on when to record and disclose provisional amounts for certain income tax effects of the Tax Cuts and Jobs Act ("TCJA"). The amendments also require any provisional amounts or subsequent adjustments to be included in net income from continuing operations. Additionally, this ASU discusses required disclosures that an entity must make with regard to the TCJA. This ASU is effective immediately as new information is available to adjust provisional amounts that were previously recorded. We have adopted this standard and will continue to evaluate indicators that may give rise to a change in our tax provision as a result of the TCJA. Refer to Note 7. "Income Taxes" for additional information on the TCJA.

Note 2. Revenue Recognition

We design, manufacture, market, sell, and maintain quality control instruments, consumables, and services driven primarily by the regulatory requirements of niche markets. Our consumables, such as biological indicator test strips and packaging materials, are typically used on a standalone basis; however, some, such as calibration solutions, are also critical to the ongoing use of our instruments. Instruments sales, such as medical meters, wireless sensors, and data loggers are generally driven by our acquisition of new customers, growth of existing customers, or customer replacement of existing equipment. We generally generate service revenues from three categories: 1) discrete installation of our hardware, 2) discrete but recurring calibration and maintenance of our hardware or 3) contracted and recurring testing and maintenance services. We evaluate our revenues internally both by product line as well as by timing of revenue generation and nature of goods and services provided. Typically, discrete revenue is recognized at the shipping point or upon completion of the service, while contracted revenue is recognized over a period of time reflective of the performance obligation period in the applicable contract.

Substantially all of our revenues and related receivables are generated from contracts with customers that are 12 months or less in duration. For both discrete and contracted revenue, evidence of an arrangement is typically in the form of a formal contract and/or purchase order. Prices are fixed at the time of the order and no price protections or variables are offered. Collectability is reasonably assured through our customer credit and review process, and payment is typically due within 60 days or less. Revenue is recognized when performance obligations under the terms of the contracts with our customers are satisfied. We elected to adopt the practical expedient that allows us to expense commission costs as incurred.

Our performance obligations related to the sale of instruments and consumables generally consist of the promise to sell tangible goods to distributors or end users. Ownership of these goods is typically transferred at time of shipment, at which point we have satisfied our performance obligation and we recognize revenue.

Our performance obligations related to services may include testing, installation, and/or maintenance of our products, either on-site at our customers' facilities or in our own calibration laboratories. Performance obligations arise from service contracts when discrete services are contracted in advance and performed at a future time, often at the time of the customer's choosing. In this case, the performance obligation is satisfied, and revenue is recognized, upon the customer's acceptance of the completion of the specified work. Alternately, service revenue may be recognized for contracted services or maintenance provided continually over a period of time, and our performance obligations are satisfied by completing any service that is contractually required, if applicable, or simply by the passage of time if no services are required or requested. For contracted services, revenue is recognized on a straight-line basis over the life of the service contract, which is a faithful depiction of these annual service contracts, which may or may not be invoked.

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The following tables present disaggregated revenues for the three and six months ended September 30, 2018 and September 30, 2017, respectively:

	Three Months Ended September 30, 2018				
	Sterilization and Disinfection Control	**Instruments**	**Cold Chain Monitoring**	**Cold Chain Packaging**	**Total**
Discrete Revenues					
Consumables	$9,093	$ 641	$ 127	$ 1,533	$11,394
Hardware	704	5,672	1,193	--	7,569
Services	291	2,391	698	96	3,476
Contracted Revenues					
Services	1,494	--	932	--	2,426
Total Revenues	$11,582	$ 8,704	$ 2,950	$ 1,629	$24,865

	Three Months Ended September 30, 2017				
	Sterilization and Disinfection Control	**Instruments**	**Cold Chain Monitoring**	**Cold Chain Packaging**	**Total**
Discrete Revenues					
Consumables	$8,206	$ 553	$ 80	$ 1,599	$10,438
Hardware	221	5,230	1,272	--	6,723
Services	312	2,200	488	236	3,236
Contracted Revenues					
Services	1,246	--	1,311	--	2,557
Total Revenues	$9,985	$ 7,983	$ 3,151	$ 1,835	$22,954

	Six Months Ended September 30, 2018				
	Sterilization and Disinfection Control	**Instruments**	**Cold Chain Monitoring**	**Cold Chain Packaging**	**Total**
Discrete Revenues					
Consumables	$18,663	$ 1,433	$ 191	$ 3,273	$23,560
Hardware	908	11,212	2,533	--	14,653

Services	642	4,790	1,241	196	6,869
Contracted Revenues					
Services	2,717	--	2,208	--	4,925
Total Revenues	$22,930	$ 17,435	$ 6,173	$ 3,469	$50,007

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	Six Months Ended September 30, 2017				
	Sterilization and Disinfection Control	Instruments	Cold Chain Monitoring	Cold Chain Packaging	Total
Discrete Revenues					
Consumables	$16,875	$ 1,497	$ 111	$ 2,486	$20,969
Hardware	354	10,770	2,444	--	13,568
Services	521	4,319	1,214	319	6,373
Contracted Revenues					
Services	2,418	--	2,299	--	4,717
Total Revenues	$20,168	$ 16,586	$ 6,068	$ 2,805	$45,627

Contract Balances

Our contracts have varying payment terms and conditions. Some customers prepay for services, resulting in unearned revenues or customer deposits, called contract liabilities, which are included within other accrued expenses and unearned revenues in the accompanying condensed consolidated balance sheets. Contract assets would exist when sales are recorded (i.e. the control of the goods or services has been transferred to the customer), but customer payment is contingent on a future event besides the passage of time (such as satisfaction of additional performance obligations). We do not have any contract assets. Unbilled receivables, which are not classified as contract assets, represent arrangements in which sales have been recorded prior to billing and right to payment is unconditional.

A summary of contract liabilities is as follows:

Contract liabilities balance as of March 31, 2018	$4,147
Prior year liabilities recognized in revenues during the six months ended September 30, 2018	(2,485)
Contract liabilities added during the six months ended September 30, 2018, net of revenues recognized	2,756
Contract liabilities balance as of September 30, 2018	$4,418

Note 3. Inventories

Inventories consist of the following:

	September 30, 2018	**March 31, 2018**
Raw materials	$ 7,895	$ 9,059
Work-in-process	482	380
Finished goods	3,378	3,152
Less: reserve	(3,419)	(3,363)
Inventories, net	$ 8,336	$ 9,228

Note 4. Facility Relocation

In August 2016, we announced that we planned to shut down both our Omaha and Traverse City 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 was completed as of June 30, 2018. The total cost of the relocation was $1,584 (which is comprised primarily of facility moving expenses, retention bonuses for existing personnel and payroll costs for duplicative personnel during the transition period) and these costs pertain to the Sterilization and Disinfection Control Division.

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Facility relocation amounts accrued and paid for the six months ended September 30, 2018 are as follows:

Balance at March 31, 2018	$408
Facility relocation expense	17
Cash payments	(425)
Balance at September 30, 2018	$--

We completed the sale of our old Bozeman facility during the period ended September 30, 2018, for $2,222 (net of commissions) resulting in a gain of $288, which is recorded in other (income) expense, net on our condensed consolidated statements of income.

Note 5. Long-Term Debt

Long-term debt consists of the following:

	September 30, 2018	**March 31, 2018**
Line of credit (3.625%, as of September 30, 2018)	$ 15,500	$28,000
Term loan (3.750% as of September 30, 2018)	17,875	18,625
Less: discount	(312)	(365)
Less: current portion	(1,875)	(1,625)
Long-term portion	$ 31,188	$44,635

On March 1, 2017, we entered into a five-year agreement (the “Credit Facility”) for an $80,000 revolving line of credit (“Line of Credit”), a $20,000 term loan (“Term Loan”) and up to $2,500 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.

Line of Credit and Term Loan indebtedness bears interest at either: (1) LIBOR, as defined in the agreement, plus an applicable margin ranging from 1.50% 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 t