

PRO DEX INC  
Form 10-Q  
October 29, 2009

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

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

**For the quarterly period ended September 30, 2009**

**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 registrant as specified in its charter)**

UNITED STATES

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

**84-1261240**  
**(IRS Employer Identification No.)**

**2361 McGaw Avenue, Irvine, California 92614**  
**(Address of Principal Executive Offices)**

**Registrant's telephone number: 949-769-3200**

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 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 by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Indicate 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 Registrant's classes of Common Stock outstanding as of the latest practicable date: 9,668,671 shares of Common Stock, no par value, as of October 28, 2009.

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

	<i>9/30/2009</i>	<i>6/30/2009</i>
	<i>(Unaudited)</i>	<i>(Audited)</i>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,378,000	\$ 1,124,000
Accounts receivable, net of allowance for doubtful accounts of \$46,000 in 2010 and \$52,000 in 2009	2,830,000	2,515,000
Other Current Receivables	49,000	16,000
Inventories	3,532,000	3,365,000
Prepaid expenses	146,000	117,000
Prepaid income taxes	117,000	118,000
Total current assets	8,052,000	7,255,000
Property, plant, equipment and leasehold improvements, net	5,846,000	5,981,000
Other assets:		
Goodwill	2,997,000	2,997,000
Intangibles - Patents, net	144,000	147,000
Other	87,000	87,000
Total other assets	3,228,000	3,231,000
Total assets	\$ 17,126,000	\$ 16,467,000
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	1,402,000	827,000
Accrued expenses	1,354,000	1,394,000
Income taxes payable	54,000	53,000
Current Portion of T.I. Loan	400,000	400,000
Current portion of real estate loan	33,000	33,000
Total current liabilities	3,243,000	2,707,000
Long-term liabilities:		
Notes Payable - T.I. Loan	1,267,000	1,367,000
Real estate loan	1,519,000	1,528,000
Deferred income taxes	173,000	171,000
Deferred rent	224,000	212,000
Total long-term liabilities	3,183,000	3,278,000

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Total liabilities	6,426,000	5,985,000
Commitments and contingencies		
Shareholders' equity:		
Common shares; no par value; 50,000,000 shares authorized;		
9,668,671 shares issued and outstanding Sept 30, 2009		
9,668,671 shares issued and outstanding June 30, 2009	16,609,000	16,574,000
Accumulated deficit	(5,909,000)	(6,092,000)
 Total shareholders' equity	 10,700,000	 10,482,000
 Total liabilities and shareholders' equity	 \$ 17,126,000	 \$ 16,467,000

*See notes to condensed consolidated financial statements.*

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**PRO-DEX, INC. and SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**Three months ended September 30 (unaudited)**

	2009	2008
Net sales	\$ 5,633,000	\$ 5,656,000
Cost of sales	3,759,000	3,902,000
Gross profit	1,874,000	1,754,000
Operating expenses:		
Selling expenses	289,000	344,000
General and administrative expenses	727,000	835,000
Research and development costs	621,000	731,000
Total operating expenses	1,637,000	1,910,000
Income (loss) from operations	237,000	(156,000)
Other income (expense):		
Royalty income	1,000	2,000
Interest expense	(51,000)	(61,000)
Total	(50,000)	(59,000)
Income (loss) before provision (benefit) for income taxes	187,000	(215,000)
Provision (benefit) for income taxes	4,000	(97,000)
Net income (loss)	\$ 183,000	\$ (118,000)
Net income (loss) per share:		
Basic	\$ 0.02	\$ (0.01)
Diluted	\$ 0.02	\$ (0.01)
Weighted average shares outstanding - basic	9,668,671	9,783,407
Weighted average shares outstanding - diluted	9,675,437	9,783,407

*See notes to condensed consolidated financial statements.*





**PRO-DEX, INC. and SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**Three months ended September 30 (unaudited)**

	2009	2008
Cash Flows from Operating Activities:		
Net income (loss)	\$ 183,000	\$ (118,000)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	185,000	222,000
(Recovery) of provision for doubtful accounts	(6,000)	(14,000)
Stock based compensation	35,000	42,000
(Decrease) in deferred taxes	-	(5,000)
Changes in:		
(Increase) in accounts receivable	(343,000)	(122,000)
(Increase) Decrease in inventories	(167,000)	461,000
(Increase) in prepaid expenses	(29,000)	(50,000)
Decrease in other assets	-	5,000
Increase (decrease) in accounts payable and accrued expenses	547,000	(756,000)
Increase (decrease) in income taxes payable	4,000	(124,000)
Net Cash provided (used) by Operating Activities	409,000	(459,000)
Cash Flows From Investing Activities:		
Purchases of equipment and leasehold improvements	(47,000)	(144,000)
Net Cash used in Investing Activities	(47,000)	(144,000)
Cash Flows from Financing Activities:		
Net borrowing on line of credit	-	600,000
Principal payments on term note	-	(63,000)
Principal payments on TI Loan	(100,000)	-
Principal payments on mortgage	(8,000)	(7,000)
Stock repurchases	-	(60,000)
Net Cash (used) provided by Financing Activities	(108,000)	470,000
Net increase (decrease) in Cash and Cash Equivalents	254,000	(133,000)
Cash and Cash Equivalents, beginning of period	1,124,000	517,000
Cash and Cash Equivalents, end of period	\$ 1,378,000	\$ 384,000
<i>Supplemental Information</i>		
Cash payments for interest	\$ 52,000	\$ 56,000

Cash payments for income taxes

\$ -

\$ -

*See notes to condensed consolidated financial statements.*

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**PRO-DEX, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****NOTE 1. BASIS OF PRESENTATION**

The accompanying unaudited condensed consolidated financial statements of Pro-Dex, Inc. ( we , us , our , 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-Q and Regulation S-K. 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, 2009. 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-K for the year ended June 30, 2009.

**NOTE 2. INVENTORIES**

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

	September 30, 2009 (unaudited)	June 30, 2009 (audited)
Raw Materials	\$ 1,591,000	\$ 1,290,000
Work in process	750,000	867,000
Finished goods	1,191,000	1,208,000
Total inventories	\$ 3,532,000	\$ 3,365,000

**NOTE 3. WARRANTY**

The warranty reserve is based on historical costs of warranty repairs and expected future identifiable warranty expenses. As of September 30, 2009, within our accrued expenses, we carried a warranty reserve of \$569,000, which was comprised of \$28,000 for future warranty expenses related to medical products that have been received back from the field and are currently in the process of being repaired, \$474,000 for future warranty expenses related to medical and aerospace products that are still in the field, and \$67,000 for our legacy dental and industrial products. Warranty expenses are reflected in the financial statements in cost of sales ( COS ). The total warranty expense reflected in the COS for the quarter ended September 30, 2009 was \$184,000. The total warranty expense reflected in the COS for the quarter ended September 30, 2008 was \$194,000.

Changes in our warranty accrual and (benefit)/expenses for the three months ended September 30, 2009 and 2008 are presented below (unaudited):

	Three months Ended September 30,	
	2009	2008
Beginning Balance	\$ 518,000	\$ 861,000
Warranties issued during period	\$ 162,000	\$ 165,000
Adjustments to pre-existing warranties due to assumption changes	\$ 22,000	\$ 29,000
Settlements (actual expenditures)	\$ (133,000)	\$ (177,000)
Ending Balance	\$ 569,000	\$ 878,000

The method of calculating the reserve remained the same as in previous periods, but by updating the estimates and assumptions for current repair cost and return profile data, the accrued warranty was increased by \$22,000 in the quarter ended September 30, 2009 compared to an increase of \$29,000 in the quarter ended September 30, 2008.

#### NOTE 4. NET INCOME (LOSS) PER SHARE

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

	Three Months Ended September 30,	
	2009	2008
Net income (loss)	\$ 183,000	\$ (118,000)
Basic net income (loss) per common share:		
Weighted average number of common shares outstanding	9,668,671	9,783,407
Basic net income (loss) per common share	\$ 0.02	\$ (0.01)
Diluted net income (loss) per share:		
Weighted average of common shares outstanding	9,668,671	9,783,407
Effect of potentially dilutive securities (options)	6,766	-
Effect of potentially dilutive securities (restricted shares)	-	-
Effect of potentially dilutive securities (warrants)	-	-
Weighted average number of common and shares - Diluted	9,675,437	9,783,407
Diluted net income (loss) per common share	\$ 0.02	\$ (0.01)

Potentially dilutive securities not included in the diluted loss per share calculation due to net losses from continuing operations and for options that have a strike price higher than the market price for our common stock (no intrinsic value) are as follows (unaudited):

	Three Months Ended September 30,	
	2009	2008
Options to purchase common shares	-	1,139,500
Restricted Shares	-	170,000

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Warrants to purchase common shares	-	100,000
Total potentially dilutive securities due to net loss	-	1,409,500
Options to purchase common shares	873,000	-
Restricted Shares	85,000	-
Warrants to purchase common shares	-	-
Total potentially dilutive securities due to no intrinsic value	958,000	-

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**NOTE 5. CREDIT FACILITIES**

We have a credit facility with Wells Fargo and a mortgage with Union Bank.

Wells Fargo Credit Facility

As of September 30, 2009, the Wells Fargo credit facility had two components:

- a revolving Credit Line Note ( line of credit ) of up to \$1,000,000 in borrowing availability, and
- a Five year Term Note (the TI Loan ) with an initial balance of \$2,000,000, of which \$1,666,667 was outstanding as of September 30, 2009.

If borrowings under the line of credit exceed \$500,000, the maximum amount of borrowing is limited to the lesser of \$1,000,000 or 70% of the eligible accounts receivable plus 40% of the eligible inventory. Its terms require monthly interest payments at either (i) the prime rate of interest (3.25% at September 30, 2009) plus 1.50%, or (ii) three month LIBOR (0.287% at September 30, 2009) plus 2.50%, at our discretion, based on outstanding borrowings. The line of credit expires on November 1, 2009. We are charged an unused credit line fee of 0.25% per annum payable quarterly on the average balance of the line of credit that is not used. There was no outstanding balance under the credit line as of September 30, 2009. Therefore, the total eligible additional borrowing capacity under the line of credit as of September 30, 2009 was \$1,000,000.

The TI Loan had an initial balance of \$2,000,000. The borrowings from this term commitment were used for construction of tenant improvements for our Irvine, California facility. Its terms require monthly principal and interest payments over the 60-month life of the loan, based on outstanding borrowings. The interest rate is fixed at 5.72% over the life of the loan. There was a \$1,666,667 outstanding balance under the TI Loan as of September 30, 2009.

All assets of the Company except our Carson City land and building secure the outstanding borrowings under the Wells Fargo credit facility.

Union Bank Mortgage

In March 2006, we entered into a ten-year mortgage with Union Bank for \$1,650,000. The principal balance of the mortgage bears interest at a fixed annual rate of 6.73%. Payments on the mortgage are \$11,379 per month (based on a 25 year amortization), with the balance of \$1,291,666 in principal due on April 1, 2016. The mortgage is secured by our Carson City land and building. There was \$1,552,331 in principal outstanding under the mortgage as of September 30, 2009.

There are certain financial and non-financial covenants that the Company must meet to be in compliance with the terms of the Wells Fargo credit facility and mortgage with Union Bank. As of the quarter ended September 30, 2009, we were in compliance with the Wells Fargo and Union Bank covenants.

**NOTE 6. 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.

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Significant management judgment is required in determining our provision for income taxes and the recoverability of our deferred tax asset. Such determination is based primarily on our historical taxable income, with some consideration given to our estimates of future taxable income by jurisdictions in which we operate and the period over which our deferred tax assets will be recoverable. Due to cumulative taxable losses during the past three years, we recorded \$2,241,000 valuation allowance against our deferred tax assets in the year ended June 30, 2009. As of September 30, 2009, the valuation allowance against our deferred tax assets was approximately \$2,206,000.

As of September 30, 2009, pursuant to FASB ASC 740-10-25-6 (formerly FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes"), we have accrued \$54,000 of uncertain tax positions related to state income tax matters that would reduce the Company's income tax expense if recognized and would result in a corresponding decrease in the Company's effective tax rate.

During the quarter ended September 30, 2008, the Internal Revenue Service settled its audit of our federal income tax returns for the fiscal years ended June 30, 2004 through June 30, 2006. This settlement resulted in the reversal of \$41,000 of unrecognized tax benefits associated with Section 263A costs we reported, which reduced our tax expense by \$6,000. During the quarter ended March 31, 2009, we filed amended state returns for the fiscal years ended June 30, 2004 through June 30, 2006 to report the related changes to the Section 263A costs. The filing of the amended state tax returns resulted in the reversal of \$9,000 of unrecognized tax benefits associated with the Section 263A costs we reported, which reduced our tax expense by \$1,000. Our remaining liability for uncertain tax positions, related to the fiscal years ended June 30, 2005 through June 30, 2009 is \$54,000 as of September 30, 2009. We have not identified any new unrecognized tax benefits.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (unaudited)::

Balance at July 1, 2009	\$ 54,000
Additions based on tax positions related to the current year	0
Additions for tax positions of prior years	0
Reductions for tax positions of prior years	0
Settlements	0

Balance at September 30, 2009	\$ 54,000
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We recognize accrued interest and penalties related to unrecognized tax benefits in income tax expense. As of September 30, 2009, we had approximately \$13,000 in accrued interest and penalties which is included as a component of the \$54,000 unrecognized tax benefit noted above. The liability for the payment of interest and penalties has increased by approximately \$500 for the three months ended September 30, 2009.

Pro-Dex and its subsidiaries are subject to U.S. federal income tax, as well as income tax of multiple state tax jurisdictions. We are currently open to audit under the statute of limitations by the Internal Revenue Service for the years ended June 30, 2007 and June 30, 2008. Our state income tax returns are open to audit under the statute of limitations for the years ended June 30, 2005 through June 30, 2008. We do not anticipate a significant change to the total amount of unrecognized tax benefits within the next 12 months.

**NOTE 7. SHARE-BASED COMPENSATION**

Share-based compensation expense pursuant to FASB ASC 718-10-10-2 (formerly SFAS 123(R)) for the three months ended September 30, 2009 and 2008 was \$35,000 and \$42,000, respectively, which was related to stock options and restricted stock grants. Share-based compensation expense reduced our results of operations as shown:

	Three months ended September 30, (unaudited)	
	2009	2008
Share-based compensation expense recognized:		
General and administrative, options	6,000	\$ 13,000
General and administrative, restricted stock	29,000	29,000
Subtotal expense	35,000	42,000
Related deferred tax benefit	-	(12,000)
Decrease in net income	35,000	\$ 30,000
Decrease in basic earnings per share	\$ 0.00	\$ 0.00
Decrease in diluted earnings per share	\$ 0.00	\$ 0.00

As of September 30, 2009, there was \$42,000 of total unrecognized compensation cost related to 77,250 non-vested outstanding stock options with a per share weighted average value of \$1.00. The unrecognized expense is anticipated to be recognized on a straight-line basis over a weighted average period of 0.8 years. The following is a summary of stock option activity in the three months ending September 30, 2009 and 2008 (unaudited):

	2009		2008	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Fixed Options				
Outstanding at beginning of fiscal year (7/1)	933,000	\$ 1.42	1,109,500	\$ 1.58
Granted	15,000	0.45	30,000	0.96
Exercised	-	-	-	-
Forfeited	-	-	-	-
Outstanding at end of period (9/30)	948,000	\$ 1.40	1,139,500	\$ 1.58

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Exercisable at end of period (9/30)	870,750	\$ 1.42	992,750	\$ 1.60
Weighted-average fair value per Option granted during the period		\$ 0.19		\$ 0.45

The intrinsic value indicated in the table below is based on the closing stock price at September 30, 2009 of \$0.59 per common share. The following table summarizes information regarding options outstanding and options exercisable at September 30, 2009 (unaudited):

Range of Exercise Price	Number Outstanding	Options Outstanding			Options Exercisable		
		Weighted- Average Remaining Contractual Life	Weighted- Average Exercise Price	Aggregate Intrinsic Value	Weighted- Average Exercise Price	Aggregate Intrinsic Value	
\$0.42 to \$0.81	311,000	4.1 years	\$ 0.65	\$ 19,200	290,000	\$ 0.67	\$ 16,500
\$1.00 to \$1.56	357,000	4.7 years	1.33	\$ -	307,000	1.31	\$ -
\$1.74 to \$2.18	190,000	1.9 years	2.07	\$ -	190,000	2.07	\$ -
\$2.44 to \$3.30	90,000	5.8 years	2.89	\$ -	83,750	2.91	\$ -
Total	948,000	4.1 years	\$ 1.40	\$ 19,200	870,750	\$ 1.46	\$ 16,500

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**Restricted Stock**

The following is a summary of restricted share activity in the three months ending September 30, 2009 and 2008, respectively (unaudited):

	2009	Weighted-	2008	Weighted-
	Shares	Average	Shares	Average
		Exercise Price		Exercise Price
Restricted shares				
Outstanding at beginning of fiscal year (7/1)	85,000	\$ 1.38	170,000	\$ 1.38
Granted	-	-	-	-
Vested	-	\$ -	-	\$ -
Forfeited	-	-	-	-
Outstanding at end of period (9/30)	85,000	\$ 1.38	170,000	\$ 1.38
Exercisable at end of period (9/30)	-	\$ -	-	\$ 1.38

As of September 30, 2009, there was \$48,875 of total unrecognized compensation cost related to 85,000 non-vested outstanding restricted shares with a per share weighted average value of \$1.38. The unrecognized expense is anticipated to be recognized on a straight-line basis over a weighted average period of 0.4 years.

**NOTE 8. MAJOR CUSTOMERS**

We had two major customers (defined as a customer that represents greater than 10% of our total revenues) in the three months ended September 30, 2009 and 2008.

Three months ended Septmeber 30 (unaudited),			
2009		2008	
Revenues	Accts. Rec.	Revenues	Accts. Rec.

Customer 1	\$	1,050,000	\$	508,000	\$	1,046,000	\$	409,000
Customer 2	\$	2,522,000	\$	1,130,000	\$	1,408,000	\$	978,000

**NOTE 9. COMMITMENTS AND CONTINGENCIES**

Our manufacture and distribution of certain products involves a risk of legal action, and, from time to time, we are named as defendants in lawsuits. It is not reasonably possible to estimate the awards or damages, or the range of awards or damages, if any, we might incur in connection with such litigation. Other than the case pending with the Orange County Water District discussed below, management is not aware of any material actual, pending or threatened litigation at this time.

On June 23, 2008, the Orange County Water District ( OCWD ) filed a complaint in the Superior Court of the State of California in the County of Orange concerning remediation of alleged ground water contamination in the Orange County Groundwater South Basin; Orange County Water District v. Sabic Innovative Plastics U.S. LLC, et al., Case No. 00078246. The South Basin underlies parts of Santa Ana, California and adjacent cities. The complaint identifies 17 named defendants, including Pro-Dex, and also designates 400 unnamed Doe defendants. We moved out of this Santa Ana site in April, 2008 and have no remaining operations there.

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The complaint alleges that the defendants contaminated the South Basin with volatile organic chemicals ( VOCs ) and perchlorate through various activities at properties each defendant now controls or has controlled in the past. Through its lawsuit, the OCWD seeks compensatory relief for all its own remedial activities, and injunctive relief to compel the defendants to undertake remedial activities in general. The complaint does not, however, specify any remedial activities that the OCWD has undertaken to date or any remedial activities that it seeks any particular defendants to undertake. Moreover, from our investigation of OCWD s remedial activities to date, we have determined that the OCWD is in the early stages of its remedial investigation for the South Basin groundwater contamination.

As noted above, 16 other entities are named defendants in this case along with Pro-Dex. While some are small businesses, others are larger corporations or their subsidiaries. Further, as this case progresses, the OCWD is likely to add at least a few more named defendants to the case from the 400 Doe defendants it has designated in the current complaint. In the indeterminable event that we would be held liable in the case, OCWD s total recovery probably would be allocated among several defendants, each of which would pay only a proportionate share of that total recovery.

One of our past insurers has committed to pay most of our defense costs for the lawsuit, while reserving its rights as to whether it will cover any damages awarded against us, or any settlement payment to which Pro-Dex agrees to resolve the lawsuit, under past policies issued to us for a three-year period, March 31, 1983 to March 31, 1986. The policies of these years have occurrence payment limits of \$500,000.

Overall, the OCWD complaint remains vague, the OCWD is in an early stage of its remedial activities in the South Basin, the lawsuit is in the early stages of discovery, one of our insurers has committed to pay most defense costs and has reserved rights under one three-year set of policies and is continuing to consider extending coverage to us under other past policies, and any recovery the OCWD may gain through the lawsuit is likely to be allocated among several defendants. Therefore, our liabilities, as well as our costs of defending, monitoring and concluding our involvement in this case are uncertain, and those costs cannot now be estimated.

#### **NOTE 10. FAIR VALUE MEASUREMENTS**

*Fair Value Measurements* Effective July 1, 2008, the Company adopted FASB ASC 820-10-35-19 (formerly Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ) for financial assets and liabilities

measured at fair value on a recurring basis. ASC 820-10-35-19 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. In addition to expanding the disclosures surrounding fair value measurements, ASC 820-10-35-19 indicates that fair value represents the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is determined based upon assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, ASC 820-10-35-19 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

- Level 1 - Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access.
- Level 2 - Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

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- Level 3 - Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

In many cases, a valuation technique used to measure fair value includes inputs from multiple levels of the fair value hierarchy described above. The lowest level of significant input determines the placement of the entire fair value measurement in the hierarchy.

The following valuation methodology was used for the Company's assets to measure fair value at September 30, 2009:

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

*Goodwill and intangible assets:* The carrying value of these assets is based on valuations based on inputs that are unobservable and significant to the overall fair value measurement. As such these investments are classified within level 3 of the valuation hierarchy.

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

The use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following fair value hierarchy table presents information about the company's assets measured at fair value on a recurring basis as of September 30, 2009:

Description	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 1,378,000			\$ 1,378,000
Goodwill			\$ 2,997,000	\$ 2,997,000
Intangibles - Patents			\$ 144,000	\$ 144,000

Total                                    \$ 1,378,000    \$ -    \$ 3,141,000    \$ 4,519,000

The following table presents a summary of changes in the fair value of the company's level 3 assets for the three months ended September 30, 2009:

**Carrying Value**

	6/30/2009	Amortization	9/30/2009
Goodwill	\$ 2,997,000	\$ -	\$ 2,997,000
Intangibles - Patents	\$ 147,000	\$ (3,000)	\$ 144,000
Total	\$ 3,144,000	\$ (3,000)	\$ 3,141,000

## **NOTE 11. SUBSEQUENT EVENTS**

We have evaluated events or transactions that occurred after the balance sheet date of September 30, 2009 through October 29, 2009, which is the date the financial statements were issued. There were no subsequent events identified that required adjustment to the financial statements.

On October 27, 2009, we entered into an agreement to extend the Credit Agreement and Revolving Line of Credit Note through November 1, 2010. The terms of the note remained the same except the unused line fee was increased from 0.25% to 1.5% beginning November 1, 2009.

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

### **COMPANY OVERVIEW**

The following discussion and analysis provides information that our management believes is relevant to an assessment and understanding of our results of operations and financial condition for each of the three month periods ended September 30, 2009 and 2008, 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, warranty reserves, and recoverability of deferred income taxes.

Except for the historical information contained herein, the matters discussed in this Quarterly Report on Form 10-Q, 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. We refer you to the risk factors and cautionary language contained in our reports filed with the Securities and Exchange Commission from time to time, including, but not limited to, those risks and uncertainties which may be listed in our Annual Report on Form 10-K.

Pro-Dex, Inc. ( Company, Pro-Dex, we, our, , us ), with operations in Irvine, California, Beaverton, Oregon and C City, Nevada, provides power and control products used in medical, aerospace, military, research and industrial applications. Experience in multi-axis motion control, fractional horsepower motors and rotary drive systems allows us to develop products that require high precision in harsh environments.

Pro-Dex's products are found in hospitals, dental offices, medical engineering labs, commercial and military aircraft, scientific research facilities and high tech manufacturing operations around the world. The names of Micro Motors, Oregon Micro Systems, and Astromec are used for marketing purposes as brand names.

Pro-Dex's principal headquarters are located at 2361 McGaw Avenue, Irvine, California 92614 and our phone number is 949-769-3200. Our Internet address is [www.pro-dex.com](http://www.pro-dex.com). Our annual reports on Form 10-K quarterly reports on Form 10-Q, current reports on Form 8-K, amendments to those reports and other Securities and Exchange Commission (SEC) filings, are available free of charge through our website as soon as reasonably practicable after such reports are electronically filed with, or furnished to, the SEC. In addition, our Code of Ethics and other corporate governance documents may be found on our website at the Internet address set forth above. Our filings with the SEC may also be read and copied at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at [www.sec.gov](http://www.sec.gov) and company specific information at [www.sec.gov/edgar/searchedgar/companysearch.html](http://www.sec.gov/edgar/searchedgar/companysearch.html).

### **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 our reported financial results include revenue recognition, warranty reserve, inventory valuations for slow moving items, impairment of goodwill, and the recovery of deferred income tax assets.

We recognize sales and associated cost of sales, upon shipment, FOB origin. There have been minimal returns for credit, so no reserve for product returns has been established.

### **Inventory**

We determine our inventory value at the lower of cost (first-in, first-out method) or market value. We determine a reduced market value of our inventory based on the age of inventory on hand. We define aging of inventory as inventory that exceeds an estimated 12 months of usage and exceeds orders on hand.

### **Accounts Receivable**

We determine the reserve for our accounts receivable by examining the aging of the receivables. We define aging of receivables as time passed since the sale was completed, revenue was recognized and the receivable was established. If the receivable is aged over 90 days old, or has a known collection risk, it is reserved from 10% of its value up to 100%. The actual amount reserved may vary depending on account credit and collection history.

### **Goodwill**

The Company identifies two reporting units for purposes of its annual goodwill impairment testing, based on the ASC 350-10-05-5 (formerly SFAS No. 142) requirements arising from its acquisitions of Micro Motors and Astromec. The Company's Carson City reporting unit corresponds to the operations resulting from the Astromec acquisition, while its Irvine reporting unit corresponds to the operations resulting from the Micro Motors acquisition.

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We monitor current market conditions and review for potential triggering events quarterly to determine if there is a need for interim impairment testing. We did not determine that a triggering event for the Astromec and Micro Motors goodwill occurred in the past 12 months. Our standard annual impairment testing is done April 1 of each year.

In determining if a triggering event has occurred, we consider not only expectations for growth in the entire US economy, but also expectations for regional growth specific to our sales markets and specific to our industry and product lines.

### Warranties

The warranty accrual is determined by reviewing the return rates and warranty repair costs for warranty eligible products. We accrue an amount of expected repair cost based on these factors projected for the future applicable warranty period. If actual return rates or repair costs differ from our estimates, actual results could vary from the projected accrual. The repair return rates and cost assumptions are reviewed quarterly.

### Property, Plant, Equipment & Leasehold Improvements, Net

Property, plant and equipment is recorded at cost and consists of the following:

	9/30/2009 Unaudited	6/30/2009 Audited
Land	\$ 757,000	\$ 757,000
Building	\$ 1,470,000	\$ 1,470,000
Leasehold Improvements	\$ 2,284,000	\$ 2,283,000
Equipment	\$ 6,666,000	\$ 6,620,000
Total	\$ 11,177,000	\$ 11,130,000
Accumulated Depreciation	\$ (5,331,000)	\$ (5,149,000)
Total property, plant & equipment, net	\$ 5,846,000	\$ 5,981,000

Depreciation is provided using the straight-line method over the estimated useful lives of the assets as follows: Building - 39 years, equipment - 3 to 10 years; and leasehold improvements are depreciated over the shorter of the term of the lease or their estimated useful lives.

### **Stock-Based Compensation**

We are subject to FASB ASC 718-10-10-10 (formerly Statement of Financial Accounting Standards ( SFAS ) No. 123 (R) *Accounting for Stock-Based Compensation* as revised December 2004.) This standard establishes the accounting standards for equity compensation, and applies to us in the recognition of the cost of stock options awarded based on the grant-date fair value of those awards.

### **Income Taxes**

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, inventory reserves and net operating loss carry forwards. 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 in determining our provision for income taxes and the recoverability of our deferred tax asset. Such determination is based primarily on our historical taxable income, with some consideration given to our estimates of future taxable income by jurisdictions in which we operate and the period over which our deferred tax assets will be recoverable. We carry a valuation allowance against our deferred tax assets and changes in this allowance are reflected through income tax expense.

## Description of Business

The majority of our revenue is derived from designing, developing and manufacturing rotary drive systems for the medical device and dental industries, motion control software and hardware for industrial and scientific applications, and fractional horsepower DC motors for aerospace, medical and military applications. A large part of the revenue of the Company has been driven by developing and selling numerous types of 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, fractional horsepower DC motors and motion control systems for industrial applications in the automotive, aerospace, and apparel industries.

Our revenue is derived from five main customer types. The proportion of total sales (including repair sales) to each customer type and sales by location are noted in the tables below (unaudited):

Sales by customer type (\$'000)	Three months Ended September 30,			
	2009		2008	
Dental	\$ 592	11%	\$ 774	14%
Medical	3,890	69%	3,072	54%
Industrial	489	9%	1,005	18%
Aerospace	613	11%	767	14%
Government and other	49	1%	38	1%
Total Sales	\$ 5,633	100%	\$ 5,656	100%

The majority of the Irvine-based sales include medical products that utilize proprietary designs developed by us under exclusive design and supply agreements. Our dental products are primarily sold to original equipment manufacturers and dental product distributors. In Beaverton, we design and manufacture embedded multi-axis motion controllers used to regulate the motion of servo and stepper motors, predominantly for the factory automation, scientific research, and medical analysis equipment industries. Our Carson City products include high reliability fractional horsepower DC motors designed for harsh environments, primarily for the aerospace and medical markets.

We hold the following three independently verified 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 days. At September 30, 2009, we had a backlog, including orders for delivery beyond sixty days, of \$8.1 million compared with a backlog of \$8.0 million at September 30, 2008 and \$9.9 million at June 30, 2009. We expect to ship most of our backlog in fiscal year 2010 and the remainder in fiscal years 2011 and 2012. The backlog compared to September 30, 2008 is relatively flat and is down compared to June 30, 2009 due to normal fluctuations in the timing of receipt and shipment of orders. We do not typically experience seasonal fluctuations in our new order bookings, but may experience variability in such bookings due to the timing of major new product launches. Similarly, we do not typically experience seasonal fluctuations in our shipments and revenues.

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**RESULTS OF OPERATIONS****For the Three-Month periods ended September 30, 2009 and 2008**

The following table sets forth the percentage of net revenues represented by each item in our Consolidated Statements of Operations.

(in thousands)	Three Months Ended September 30, (unaudited)			
	2009		2008	
Net sales:	\$ 5,633	100%	\$ 5,656	100%
Cost of sales	3,759	67%	3,902	69%
Gross Profit	1,874	33%	1,754	31%
Selling, general and administrative expenses	1,016	18%	1,179	21%
Research and development costs	621	11%	731	13%
Income from Operations	237	4%	(156)	-3%
Net interest and other expense	50	1%	59	1%
Earnings before provision for income taxes	187	3%	(215)	-4%
Provision for income taxes	4	0%	(97)	-2%
Net income	\$ 183	3%	\$ (118)	-2%

**Net Sales.** Consolidated sales decreased \$23,000 from \$5,656,000 to \$5,633,000 for the quarter ended September 30, 2009 compared to the quarter ended September 30, 2008. The decrease was primarily due to a reduction in dental sales and a substantial decrease in industrial motion control sales as that industry has been severely negatively impacted by the current economic climate. The offsetting increase in medical sales was due to the increased volume to a single medical customer as their volume returned to their historic average.

Although selective price increases and decreases were implemented in response to market conditions, the majority of the sales changes for each product line are due primarily to changes in sales volume, not the effect of price changes.

**Gross Profit.** Our consolidated gross profit for the quarter ended September 30, 2009 increased \$120,000 or 7% compared to the same quarter in the previous year. Gross profit as a percentage of sales was 2% higher at 33% for the quarter ended September 30, 2009 compared to 31% for the quarter ended September 30, 2008. Net gross profit margins were higher than the same quarter in the previous year due to a favorable sales mix that included a higher proportion of high margin medical products and fewer lower margin dental products. The margin benefit of the medical products was offset slightly by minor reductions in the industrial motion control sales. Gross profit and gross profit as a percentage of sales were as follows (unaudited):

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	Three Months Ended September 30,		Increase
	2009	2008	
Gross Profit	\$ 1,874,000	\$ 1,754,000	7%
Gross Profit Percentage of Sales	33%	31%	

**Selling, General and Administrative Costs (S, G&A).** Consolidated S, G&A costs decreased \$164,000 or 14% to \$1,016,000 for the quarter ended September 30, 2009 from \$1,180,000 for the quarter ended September 30, 2008. The \$55,000 decrease in selling cost is mainly due to lower advertising product promotion and trade show fees. Operational general and administrative costs were lower by \$109,000 due to \$45,000 in lower labor and related expenses, \$30,000 in decreased expense relating to Sarbanes Oxley compliance and \$22,000 in lower amortization expense related to the write down of the Intra-Flow intangible patent asset . .

As a percentage of sales, S, G&A expenses decreased to 18% from 21% of sales for the three months ended September 30, 2009 and 2008 respectively. S, G&A costs were as follows (unaudited):

	Three Months Ended September 30,		Decrease
	2009	2008	
Selling	\$ 289,000	\$ 344,000	(16%)
General and administrative	\$ 727,000	\$ 836,000	(13%)
Total Sales General & Administrative	\$ 1,016,000	\$ 1,180,000	(14%)
Sales General & Administrative Percentage of Sales	18%	21%	

**Research and Development (R&D) Costs.** Research and development cost decreased \$110,000 to \$621,000 for the quarter ended September 30, 2009 from \$731,000 for the quarter ended September 30, 2008, a decrease of 15%. The decrease was due mainly to \$99,000 in lower labor and related costs and \$9,000 in reduced small motor development costs. Research and development costs were as follows (unaudited):

	Three Months Ended September 30,		Decrease
	2009	2008	

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Research and Development costs	\$ 621,000	\$ 731,000	(15%)
Research & Development as a Percentage of Sales	11%	13%	

**Operating Profit (loss).** Our resulting consolidated operating profit for the quarter ended September 30, 2009 increased to \$237,000 compared to an operating loss of \$156,000 for the same quarter in the previous year. The increase in operating profit was due to a better mix of higher margin revenue and, as previously described, lower S, G&A and R&D expenses. Operating profit as a percentage of sales increased to 4% for the quarter ended September 30, 2009 compared to -3% for the quarter ended September 30, 2008. Operating profit and margin were as follows (unaudited):

Three Months Ended September 30,	2009	2008	Increase
Operating Profit (Loss)	\$ 237,000	\$ (156,000)	N/A
Operating Profit (Loss) as a Percentage of Sales	4%	-3%	

**Royalties and Other Income.** We earned and received \$1,000 royalty income in the quarter ended September 30, 2009, compared to \$1,600 in royalty income in the same period during the prior year. We had no Other Income in either period.

**Net Interest Expense.** Net interest expense for the quarter ended September 30, 2009 was \$51,000 compared to \$61,000 in the quarter ended September 30, 2008 due to the lower debt levels.

**Income Tax Provision.** Our estimated effective combined federal and state tax rate on income from operations for the quarter ended September 30, 2009 resulted in a 2% provision of earnings before tax compared to a 45% credit of earnings before tax for the quarter ended September 30, 2008. The difference in the 2009 rate is due to the reduction of the deferred tax asset valuation allowance previously against our current and long term deferred tax assets. The deferred tax valuation allowance is more fully described in Note 6 of the accompanying Unaudited Condensed Consolidated Financial Statements, Income Taxes.

**Net Income/(Loss).** Our net income for the three months ended September 30, 2009 was \$183,000 or \$0.02 per share on a basic and diluted basis, as compared to net loss of \$118,000 or \$0.01 per share for the three months ended September 30, 2008.

### Liquidity and Capital Resources

	As of September 30, 2009 (Unaudited)	2008 (Unaudited)	As of June 30, 2009 (Audited)
Cash and cash equivalents	\$ 1,378,000	\$ 384,000	\$ 1,124,000
Working Capital <sup>1</sup>	\$ 4,810,000	\$ 4,544,000	\$ 4,548,000
Credit Line outstanding balance	\$ 0	\$ 2,600,000	\$ 0
Net Debt <sup>3</sup>	\$ 1,840,000	\$ 4,087,000	\$ 2,204,000
Tangible book value/common share <sup>2</sup>	\$ 0.78	\$ 0.92	\$ 0.76
Number of days of sales outstanding (DSO) in accounts receivable at end of quarter <sup>4</sup>	46	51	41

The following table presents selected financial information as of the end of the first quarter of fiscal 2009 and 2008, respectively, as well as of the year ended June 30, 2009:

<sup>1</sup> Working Capital = Ending Current Assets less Ending Current Liabilities.

<sup>2</sup> Tangible book value/common share = (Total shareholders equity - Net intangible asset (patents) - Goodwill) / (basic outstanding shares).

<sup>3</sup> Net Debt = Total Ending Long Term plus Current Portion of Debt plus Credit Line less Cash

<sup>4</sup> DSO = Ending Net Accounts Receivable balance / (Previous Quarter Sales / 91).

Our working capital at September 30, 2009 increased to \$4.8 million compared to \$4.5 million at September 30, 2008 and was \$0.3 million higher than the \$4.5 million at June 30, 2009. Cash flow provided by operations was \$409,000 in the three months ended September 30, 2009 compared to a cash flow used by operations of \$459,000 for the three months ended September 30, 2008. The increase in working capital and operating cash flow was due to an increase in payables and accrued expenses within our normal payment processing cycle.

At September 30, 2009, we had cash and cash equivalents of \$1,378,000. We believe that our cash and cash equivalents on hand, together with cash flows from operations, if any, and amounts available, if any, under our credit facilities will be sufficient to meet our working capital and capital expenditure requirements for the next twelve months.



In September 2002, our Board of Directors authorized the repurchase on the open market of up to 500,000 shares of our outstanding Common Stock at a share price no greater than \$1.25, 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. From the inception of the repurchase authorization through the fiscal 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 years 2004 through 2008. During the 2009 fiscal year, we repurchased 219,695 shares of common stock for \$133,472, at an average price of \$0.61 per share. Since the initiation of the buyback program in 2002 through June 30, 2009, we have repurchased 295,395 shares for \$177,213 at an average price of \$0.60 per share. Our Board suspended the buyback authorization in May 2009 and has not set a reinitiation date for the purchase of our shares pursuant to this program.

As of September 30, 2009, we had a credit facility with Wells Fargo comprised of two components:

- a revolving Credit Line Note ( line of credit ) of up to \$1,000,000 in borrowing availability, and
- a Five year Term Note (the TI Loan ) with an initial balance of \$2,000,000, of which \$1,666,667 was outstanding as of September 30, 2009.

The line of credit borrowing availability is a maximum of \$1,000,000. If borrowings under the line of credit exceed \$500,000, the maximum amount of borrowing is limited to 70% of the eligible accounts receivable plus 40% of the eligible inventory. Its terms require monthly interest payments at either (i) the prime rate of interest (3.25% at September 30, 2009) plus 1.50%, or (ii) three month LIBOR (0.287% at September 30, 2009) plus 2.50%, at our discretion, based on outstanding borrowings. The line of credit expires on November 1, 2009. We are charged an unused credit line fee of 0.25% per annum payable quarterly on the average balance of the line of credit that is not used. There was no outstanding balance under the credit line as of September 30, 2009 and there continues to be no borrowing under such credit line as of October 16, 2009. Therefore, the total eligible additional borrowing capacity under the line of credit as of September 30, 2009 was \$1,000,000 and as of October 16, 2009 is \$1,000,000.

The TI Loan had an initial balance of \$2,000,000. The borrowings from this term commitment were used for construction of tenant improvements for our Irvine, California facility. Its terms require monthly principal and interest payments over the 60 month life of the loan, based on outstanding borrowings. The interest rate is fixed at 5.72% over the life of the loan. There was a \$1,666,667 outstanding balance under the TI Loan as of September 30, 2009.

All assets of the Company except our Carson City land and building secure the outstanding borrowings under the Wells Fargo credit facility.

In March 2006, we entered into a ten year mortgage with Union Bank for \$1,650,000. The principal balance of the mortgage bears interest at a fixed annual rate of 6.73%. Payments on the mortgage are \$11,379 per month (based on a 25 year amortization), with the balance of \$1,291,666 in principal due on April 1, 2016. The mortgage is secured by our Carson City land and building. There was \$1,552,331 in principal outstanding under the mortgage as of September 30, 2009.

There are certain financial and non-financial covenants that the Company must meet to be in compliance with the terms of the Wells Fargo credit facility and mortgage with Union Bank. As of the quarter ended September 30, 2009, we were in compliance with the Wells Fargo and Union Bank covenants.

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### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Not applicable.

### **Item 4T. 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 for the quarter ended September 30, 2009, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures are effective.

During the quarter ended September 30, 2009, there were no direct 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.

## **PART II**

### **OTHER INFORMATION**

#### **Item 1. Legal Proceedings**

On June 23, 2008, the Orange County Water District ( OCWD ) filed a complaint in the Superior Court of the State of California in the County of Orange concerning remediation of alleged ground water contamination in the Orange County Groundwater South Basin; Orange County Water District v. Sabic Innovative Plastics U.S. LLC, et al., Case No. 00078246. The South Basin underlies parts of Santa Ana, California and adjacent cities. The complaint identifies 17 named defendants, including Pro-Dex, and also designates 400 unnamed Doe defendants. We moved out of this Santa Ana site in April, 2008 and have no remaining operations there.

The complaint alleges that the defendants contaminated the South Basin with volatile organic chemicals ( VOCs ) and perchlorate through various activities at properties each defendant now controls or has controlled in the past. Through its lawsuit, the OCWD seeks compensatory relief for all its own remedial activities, and injunctive relief to compel the defendants to undertake remedial activities in general. The complaint does not, however, specify any remedial activities that the OCWD has undertaken to date or any remedial activities that it seeks any particular defendants to undertake. Moreover, from our investigation of OCWD s remedial activities to date, we have determined that the OCWD is in the early stages of its remedial investigation for the South Basin groundwater contamination.

As noted above, 16 other entities are named defendants in this case along with Pro-Dex. While some are small businesses, others are larger corporations or their subsidiaries. Further, as this case progresses, the OCWD is likely to add at least a few more named defendants to the case from the 400 Doe defendants it has designated in the current complaint. In the indeterminable event that we would be held liable in the case, OCWD s total recovery probably would be allocated among several defendants, each of which would pay only a proportionate share of that total recovery.

One of our past insurers has committed to pay most of our defense costs for the lawsuit, while reserving its rights as to whether it will cover any damages awarded against us, or any settlement payment to which Pro-Dex agrees to resolve the lawsuit, under past policies issued to us for a three-year period, March 31, 1983 to March 31, 1986. The policies of these years have occurrence payment limits of \$500,000.

Overall, the OCWD complaint remains vague, the OCWD is in an early stage of its remedial activities in the South Basin, the lawsuit is in the early stages of discovery, one of our insurers has committed to pay most defense costs and has reserved rights under one three-year set of policies and is continuing to consider extending coverage to us under other past policies, and any recovery the OCWD may gain through the lawsuit is likely to be allocated among several defendants. Therefore, our liabilities, as well as our costs of defending, monitoring and concluding our involvement in this case are uncertain, and those costs cannot now be estimated.

**Item 1A. Risk Factors.**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for our fiscal year ended June 30, 2009 and in our subsequent quarterly reports on Form 10-Q. The risks discussed in our Annual Report on Form 10-K and in our subsequent quarterly reports on Form 10-Q could materially affect our business, financial condition and future results. The risks described in our Annual Report on Form 10-K and in our subsequent quarterly reports on Form 10-Q are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition or operating results.

**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:

- |      |   |
|------|---|
| 10.1 | Revolving Line of Credit Note and Amendment 5 to the existing credit agreement with Wells Fargo Bank, National Association dated November 1, 2010.  |
| 31.1 | Certifications of Chief Executive 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 Financial Officer Required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32   | Certification of the Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002             |

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: October 29, 2009

Date: October 29, 2009

PRO-DEX INC.

By: / s / Mark Murphy

Mark Murphy

Chief Executive Officer

PRO-DEX INC.

By: / s / Jeffrey J. Ritchey

Jeffrey J. Ritchey

Secretary and Chief Financial Officer

(Principal Financial and Accounting Officer)

**End of Filing**