MESA LABORATORIES INC /CO
Form 10-Q
November 06, 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 September 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 3,779,749 shares of the Issuer's common stock, no par value, outstanding as of October 27, 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)

	September 30, 2017 (Unaudited)	**March 31, 2017**
ASSETS		
Current assets:		
Cash and cash equivalents	$ *10,268*	$*5,820*
Accounts receivable, less allowances of $245 and $252, respectively	*12,187*	*14,319*
Inventories, net	*12,913*	*13,873*
Prepaid income taxes	*2,039*	*587*
Prepaid expenses and other	*1,975*	*1,186*
Assets held for sale	*1,934*	--
Total current assets	*41,316*	*35,785*
Property, plant and equipment, net	*23,760*	*26,002*
Intangibles, net	*35,443*	*37,790*
Goodwill	*73,414*	*72,156*
Total assets	$ *173,933*	$*171,733*
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ *2,036*	$*2,168*
Accrued salaries and payroll taxes	*3,420*	*4,350*
Unearned revenues	*3,805*	*4,117*
Current portion of contingent consideration	*1,165*	*1,294*
Other accrued expenses	*2,649*	*2,999*
Income taxes payable	--	*514*
Current portion of long-term debt	*1,375*	*1,125*
Total current liabilities	*14,450*	*16,567*

Deferred income taxes	*3,698*	*3,554*
Long-term debt, net of debt issuance costs and current portion	*50,455*	*53,675*
Contingent consideration	*92*	*116*
Total liabilities	*68,695*	*73,912*
Commitments and Contingencies (Note 8)		
Stockholders' equity:		
Common stock, no par value; authorized 25,000,000 shares; issued and outstanding, 3,779,717 and 3,727,704 shares, respectively	*28,974*	*25,925*
Retained earnings	*76,325*	*73,656*
Accumulated other comprehensive loss	*(61*)	*(1,760*)
Total stockholders' equity	*105,238*	*97,821*
Total liabilities and stockholders' equity	$ *173,933*	$ *171,733*

See accompanying notes to condensed consolidated financial statements.

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,**	
	2017	**2016**	**2017**	**2016**
Revenues	$*22,954*	$*24,409*	$*45,627*	$*45,523*
Cost of revenues	*9,721*	*10,685*	*19,723*	*19,785*
Gross profit	*13,233*	*13,724*	*25,904*	*25,738*
Operating expenses				
Selling	*2,288*	*2,694*	*4,967*	*5,118*
General and administrative	*6,412*	*5,973*	*13,269*	*11,953*
Research and development	*885*	*1,045*	*2,038*	*2,080*
Total operating expenses	*9,585*	*9,712*	*20,274*	*19,151*
Operating income	*3,648*	*4,012*	*5,630*	*6,587*
Other expense, net	*542*	*800*	*1,221*	*1,206*
Earnings before income taxes	*3,106*	*3,212*	*4,409*	*5,381*
Income taxes	*753*	*854*	*539*	*1,093*
Net income	$*2,353*	$*2,358*	$*3,870*	$*4,288*
Net income per share:				
Basic	$*0.63*	$*0.64*	$*1.03*	$*1.17*
Diluted	*0.60*	*0.62*	*0.98*	*1.12*
Weighted average common shares outstanding:				
Basic	*3,764*	*3,669*	*3,754*	*3,657*
Diluted	*3,935*	*3,831*	*3,934*	*3,816*

See accompanying notes to condensed consolidated financial statements.

Mesa Laboratories, Inc.

Condensed Consolidated Statements of Comprehensive Income

(Unaudited)

(In thousands)

	Three Months Ended September 30,		**Six Months Ended September 30,**	
	2017	**2016**	**2017**	**2016**
Net Income	$*2,353*	$*2,358*	$*3,870*	$*4,288*
Other comprehensive income (loss), net of tax:				
Foreign currency translation	*948*	*(185*)	*1,699*	*(135*)
Total comprehensive income	$*3,301*	$*2,173*	$*5,569*	$*4,153*

See accompanying notes to condensed consolidated financial statements.

Mesa Laboratories, Inc.

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(In thousands)

	Six Months Ended September 30, 2017	**2016**
Cash flows from operating activities:		
Net income	$3,870	$4,288
Depreciation and amortization	4,531	4,411
Stock-based compensation	985	841
Amortization of debt issuance costs	55	--
Deferred income taxes	144	138
Foreign currency adjustments	(533)	(28)
Gain on disposition of assets	(116)	--
Adjustment to contingent consideration	300	--
Change in assets and liabilities, net of effects of acquisitions		
Accounts receivable, net	2,132	1,900
Inventories, net	960	(348)
Prepaid expenses and other	(2,241)	(509)
Accounts payable	(132)	661
Accrued liabilities and taxes payable	(1,819)	(5,392)
Unearned revenues	(312)	(39)
Contingent consideration	(456)	(4,594)
Net cash provided by operating activities	7,368	1,329
Cash flows from investing activities:		
Acquisitions	(62)	(3,401)
Proceeds from sale of assets	1,133	--
Purchases of property, plant and equipment	(2,012)	(6,669)
Net cash used in investing activities	(941)	(10,070)
Cash flows from financing activities:		
Proceeds from the issuance of debt	4,000	9,500
Payments on debt	(7,000)	(2,000)
Dividends	(1,201)	(1,169)
Proceeds from the exercise of stock options	2,064	1,767
Net cash (used in) provided by financing activities	(2,137)	8,098
Effect of exchange rate changes on cash and cash equivalents	158	18

Net increase (decrease) in cash and cash equivalents	4,448	(625)
Cash and cash equivalents at beginning of period	5,820	5,695
Cash and cash equivalents at end of period	$10,268	$5,070
Cash paid for:		
Income taxes	$2,446	$3,140
Interest	1,007	588
Supplemental non-cash activity:		
Contingent consideration as part of an acquisition	--	1,822

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 where we can establish a strong presence and achieve high gross margins. We are organized into *four* divisions across *ten* 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 Sterilization and Disinfection Control Division (formerly named the Biological Indicators Division) provides testing services, along with the manufacturing and marketing of both biological and cleaning indicators, and the marketing of chemical indicators used to assess the effectiveness of sterilization and disinfection processes 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 *six* months ended *September 30, 2017,* our acquisitions of businesses totaled *$62,000,* 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):

	September 30, 2017	**March 31, 2017**
Raw materials	$ *10,293*	$ *10,815*
Work-in-process	*464*	*342*
Finished goods	*3,605*	*3,604*
Less: reserve	*(1,449*)	*(888*)
	$ *12,913*	$ *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 *June 30, 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 *$622,000* in relocation costs for the *six* months ended *September 30, 2017,* of which *$353,000* and *$269,000* 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 Sterilization and Disinfection Control segment, are as follows for the *six* months ended *September 30, 2017:*

- Retention bonuses for existing personnel of *$259,000*
- Duplicative employment costs of *$97,000*
- Moving costs of *$266,000*

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

Balance at March 31, 2017	$*673*
Facility relocation expense	*622*
Cash payments	*(570*)
Balance at September 30, 2017	$*725*

In *July 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* which is included in other expense, net in the accompanying condensed consolidated statements of net income for the *six* months ended *September 30, 2017.*

In *July 2017,* we put our old Bozeman facility up for sale. The assets associated with this facility are presented on the accompanying condensed consolidated balance sheets as of *September 30, 2017* as assets held for sale.

Note *5* - Long-Term Debt

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

	September 30, 2017	**March 31, 2017**
Line of credit (3.0% at September 30, 2017)	$ *33,000*	$*35,500*
Term loan (3.0% at September 30, 2017)	*19,250*	*19,750*
Less: discount	*(420*)	*(450*)
Less: current portion	*(1,375*)	*(1,125*)
Long-term portion	$ *50,455*	$*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 *September 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 *September 30, 2017,* future contractual maturities of debt as are as follows (in thousands):

Year Ending March 31,	
2018	$*625*
2019	*1,625*
2020	*2,125*
2021	*2,625*
2022	*45,250*
	$*52,250*

In *October 2017,* we made a *$1,000,000* payment under our Line of Credit and a draw of *$7,000,000.*

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		Six Months Ended	
	September 30,		September 30,	
	2017	**2016**	**2017**	**2016**
Total cost of stock-based compensation charged against income before income taxes	$*445*	$*412*	$*985*	$*841*
Amount of income tax benefit recognized in earnings	*108*	*110*	*120*	*171*
Amount charged against net income	$*337*	$*302*	$*865*	$*670*
Impact on net income per common share:				
Basic	$*0.09*	$*0.08*	$*0.23*	$*0.18*
Diluted	*0.09*	*0.08*	$*0.22*	*0.18*

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 *six* months ended *September 30, 2017:*

Number of Shares	Weighted-Average Exercise	Weighted-Average Remaining	Aggregate Intrinsic Value (000s)

		Price per Share	**Contractual Term**	
Outstanding at March 31, 2017	*510,361*	$ *75.78*	*5.0*	$ *23,956*
Stock options granted	*95,605*	*123.09*	*5.5*	
Stock options forfeited	*(40,661*)	*93.74*	*5.1*	
Stock options expired	*(96*)	*97.78*	*4.5*	
Stock options exercised	*(50,503*)	*61.09*	--	
Outstanding at September 30, 2017	*514,706*	*84.58*	*4.8*	$ *33,320*
Exercisable at September 30, 2017	*162,831*	*60.05*	*4.0*	$ *14,536*

The total intrinsic value of stock options exercised was *$4,181,318* and *$3,218,000* for the *six* months ended *September 30, 2017* and *2016,* respectively.

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

	Number of Shares	**Weighted-Average Grant-Date Fair Value**
Unvested at March 31, 2016	*373,766*	$ *22.49*
Stock options granted	*95,605*	*39.00*
Stock options forfeited	*(40,661*)	*26.84*
Stock options vested	*(76,835*)	*20.93*
Unvested at September 30, 2017	*351,875*	*28.41*

As of *September 30, 2017,* there was *$7,860,927* of total unrecognized compensation expense related to unvested stock options. As of *September 30, 2017,* we have *740,379* 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 September 30,