

U.S. SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-QSB

(Mark One)

- Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended March 31, 2001.
- Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Commission File Number 0-14942

PRO-DEX, INC.

(Name of small business issuer in its charter)

Colorado  
(State or other jurisdiction of  
Incorporation or organization)

84-1261240  
(IRS Employer ID No.)

650 S. Taylor Avenue, Suite 20A, Louisville, CO 80027  
(Address of principal executive offices)

Issuer's telephone number: (303) 443-6136

Securities registered under Section 12(b) of the Exchange Act:

Title of each class  
None

Name of each exchange  
on which registered  
None

Securities registered under Section 12(g) of the Exchange Act:

Common Stock, no par value  
(Title of class)

The number of shares of the Registrant's no par value common stock outstanding as of May 8, 2001 was 8,787,300.

## PRO-DEX, INC. AND SUBSIDIARIES

DOCUMENTS INCORPORATED BY REFERENCE: None.

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SIGNATURES	
EXHIBITS	NONE

**PRO-DEX, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

**ASSETS**

	<u>March 31,</u> 2001 <u>(unaudited)</u>	<u>June 30,</u> 2000
Current assets:		
Cash and cash equivalents	\$ 233,000	\$ 473,000
Accounts receivable, net of allowance for doubtful accounts of \$166,000 and \$76,000	2,760,000	3,934,000
Inventories, net	4,604,000	4,246,000
Deferred taxes	1,288,000	1,230,000
Prepaid expenses	168,000	102,000
Total current assets	<u>9,053,000</u>	<u>9,985,000</u>
Property and equipment	5,375,000	6,274,000
Less accumulated depreciation	<u>(3,486,000)</u>	<u>(3,613,000)</u>
Net property and equipment	<u>1,889,000</u>	<u>2,661,000</u>
Land and buildings held for sale	<u>471,000</u>	<u>0</u>
Other assets:		
Deferred taxes	612,000	612,000
Other	116,000	306,000
Intangibles, net	<u>2,402,000</u>	<u>2,859,000</u>
Total other assets	<u>3,130,000</u>	<u>3,777,000</u>
Total assets	<u>\$ 14,543,000</u>	<u>\$ 16,423,000</u>

**PRO-DEX, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS - CONTINUED**  
**LIABILITIES & SHAREHOLDERS' EQUITY**

	<u>March 31,</u> 2001 <u>(unaudited)</u>	<u>June 30,</u> 2000
Current liabilities:		
Current portion of long-term debt	\$ 6,168,000	\$ 7,637,000
Accounts payable	1,047,000	849,000
Accrued expenses	<u>1,274,000</u>	<u>2,007,000</u>
Total current liabilities	<u>8,489,000</u>	<u>10,493,000</u>
 Commitments and contingencies		
Shareholders' equity:		
Series A convertible preferred shares, no par value; liquidation preference of \$3.60 per share; 10,000,000 shares authorized; 78,129 shares issued and outstanding	283,000	283,000
Common shares, no par value; 50,000,000 shares authorized; 8,787,300 shares issued and outstanding	14,976,000	14,976,000
Accumulated deficit	<u>(9,098,000)</u>	<u>(9,203,000)</u>
	6,161,000	6,056,000
Receivable for stock purchase	<u>(107,000)</u>	<u>(126,000)</u>
Total shareholders' equity	<u>6,054,000</u>	<u>5,930,000</u>
Total liabilities and shareholders' equity	<u>\$ 14,543,000</u>	<u>\$ 16,423,000</u>

PRO-DEX, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Quarter ended March 31,	
	2001	2000
	(unaudited)	(unaudited)
Net sales	\$ 5,554,000	\$ 6,847,000
Cost of sales (Includes rent paid to a director of \$91,000 and \$87,000 for 2001 and 2000)	<u>3,182,000</u>	<u>3,361,000</u>
Gross profits	<u>2,372,000</u>	<u>3,486,000</u>
Operating expenses:		
Selling	951,000	1,039,000
General and administrative	1,071,000	1,059,000
Research and development	422,000	436,000
Amortization	122,000	122,000
Unusual charges	227,000	0
Total operating expenses	<u>2,793,000</u>	<u>2,656,000</u>
Income (loss) from operations	<u>(421,000)</u>	<u>830,000</u>
Other income (expense):		
Other income, net	24,000	25,000
Interest (expense)	(199,000)	(290,000)
Total	<u>(175,000)</u>	<u>(265,000)</u>
Income (loss) before income taxes	(596,000)	566,000
Income taxes (credits)	<u>(238,000)</u>	<u>255,000</u>
Net income (loss)	<u>\$ (358,000)</u>	<u>\$ 311,000</u>
Basic and diluted net earnings (loss) per common and common equivalent share	\$ (0.04)	\$ 0.04
Weighted average number of common and common equivalent shares outstanding:		
Basic	8,787,300	8,787,300
Diluted	8,787,300	8,880,766

PRO-DEX, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Nine months ended March 31,	
	2001	2000
	(unaudited)	(unaudited)
Net sales	\$ 19,025,000	\$ 19,038,000
Cost of sales (Includes rent paid to a director of \$ 268,000 and \$262,000 for 2001 and 2000)	<u>9,109,000</u>	<u>8,673,000</u>
Gross profits	<u>9,916,000</u>	<u>10,365,000</u>
Operating expenses:		
Selling	2,937,000	2,840,000
General and administrative	3,707,000	3,225,000
Research and development	1,344,000	1,257,000
Amortization	368,000	366,000
Unusual charges	720,000	0
Total operating expenses	<u>9,076,000</u>	<u>7,688,000</u>
Income from operations	<u>840,000</u>	<u>2,677,000</u>
Other income (expense):		
Other income, net	36,000	8,000
Interest (expense)	<u>(702,000)</u>	<u>(808,000)</u>
Total	<u>(666,000)</u>	<u>(800,000)</u>
Income before income taxes	174,000	1,877,000
Income taxes	<u>70,000</u>	<u>761,000</u>
Net income	<u>\$ 104,000</u>	<u>\$ 1,116,000</u>
Basic and diluted net earnings per common and common equivalent share	\$ 0.01	\$ 0.13
Weighted average number of common and common equivalent shares outstanding:		
Basic	8,787,300	8,787,300
Diluted	8,928,373	8,971,300

PRO-DEX, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine months ended March 31,	
	2001	2000
	(unaudited)	(unaudited)
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income (loss)	\$ 104,000	\$ 1,116,000
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	852,000	850,000
Loss on disposal of assets	30,000	0
Provision for doubtful accounts	110,000	29,000
Reserve for obsolete inventory	177,000	(212,000)
Non-cash compensation	19,000	0
Deferred taxes	28,000	770,000
Change in working capital components net of effects of purchases and divestitures:		
(Increase) decrease in accounts receivable	1,097,000	(343,000)
(Increase) Decrease in inventories	(535,000)	391,000
(Increase) in prepaid expenses	(153,000)	(42,000)
(Increase) decrease in other assets	246,000	(147,000)
(Decrease) in accounts payable and accrued expense	(487,000)	(1,004,000)
(Decrease) in income taxes payable	(47,000)	0
	<u>1,441,000</u>	<u>1,408,000</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from sale of property and equipment	4,000	0
Purchase of property and equipment	(216,000)	(160,000)
	<u>(212,000)</u>	<u>(160,000)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Proceeds from short-term borrowing	115,000	0
Principal payments on long-term borrowing	(1,584,000)	(826,000)
	<u>(1,469,000)</u>	<u>(826,000)</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	(240,000)	422,000
Cash and cash equivalents, beginning of period	473,000	107,000
Cash and cash equivalents, end of period	<u>\$ 233,000</u>	<u>\$ 529,000</u>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Cash payments for interest	\$ 702,000	\$ 809,000
Cash payments for income taxes	\$ 78,000	\$ 0

## PRO-DEX, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS For The Nine Months Ended March 31, 2001

#### BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instruction to Form 10-QSB and Regulation S-B. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the quarter ended March 31, 2001 are not necessarily indicative of the results that may be expected for the year ended June 30, 2001. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-KSB for the year ended June 30, 2000.

#### LAND AND BUILDINGS HELD FOR SALE

Land and buildings are held at lower of cost or net realizable value.

#### INVENTORIES

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

	March 31, 2001	June 30, 2000
Raw materials	\$ 1,402,000	\$ 975,000
Work in process	382,000	454,000
Finished goods	3,580,000	3,400,000
Total	5,364,000	4,829,000
Reserve for slow moving items	(760,000)	(583,000)
Total inventories, net	\$ 4,604,000	\$ 4,246,000

## EARNINGS PER COMMON SHARE

Diluted per share amounts assume the conversion, exercise or issuance of all potential common stock instruments unless the effect is to reduce a loss or increase the income per common share from continuing operations. No adjustments to net income were made for purposes of computing basic or diluted earnings per share. At March 31, 2001 there were 141,073 option and warrant shares that were anti-dilutive. The weighted-average number of common shares and common share equivalents outstanding during the period used to compute basic and diluted earnings per common share is as follows:

	Quarter ended March 31, 2001	Nine-months ended March 31, 2001	Quarter ended March 31, 2000	Nine-months ended March 31, 2000
Weighted-average common shares used in computation of basic earnings per share	8,787,300	8,787,300	8,787,300	8,787,300
Effect of dilutive securities:				
Common stock options and warrants	-	88,987	15,337	106,000
Convertible preferred stock	-	52,086	78,129	78,000
Weighted-average common and common share equivalents used in the computation of diluted earnings per share	8,787,300	8,928,373	8,880,766	8,971,300

## LONG TERM DEBT

The Company's credit facility with Harris Bank was terminated by the bank in July, 1999 as a result of various loan covenant violations. The entire obligation to the bank consisting of a \$1.8 million balance on a term loan, and a revolving line of credit with a balance of \$4 million is shown as currently due. The Company has been unable to borrow any additional funds under either facility since July 1999, and has been operating under a series of forbearance agreements provided by Harris Bank. The new forbearance agreement expires on July 31, 2001, and requires monthly principal payments of \$125,000 plus an additional payment calculated monthly as a percentage of excess cash flow. The Company continues to meet all of the covenant requirements contained in the forbearance agreement and all fees have been paid when due.

## STOCK OPTIONS

During the quarter ended March 31, 2001, the Company granted 30,000 stock options to employees at the average price of \$2.60. 35,000 options expired during the quarter ended March 31, 2001.

## SEGMENT INFORMATION

The Company's reportable segments are strategic business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies.

There are four reportable segments: Biotrol International, Inc. (Biotrol/Challenge), Micro Motors, Inc. (Micro), Oregon Micro Systems, Inc. (OMS), and the parent company (Corporate). Biotrol/Challenge manufactures and distributes infection control products, preventive products, tooth brightening systems and a full line of hand care products for the dental industry. Micro manufactures a complete line of handpieces for the dental industry, and miniature pneumatic motors with dental, medical and industrial applications. OMS designs and manufactures motion controllers used to control the motion of servo and stepper motors, predominantly for the medical analysis equipment and semiconductor industries.

The accounting policies applied to determine the segment information are the same as those described in the summary of significant accounting policies. Interest expense is allocated based upon the specific identification of debt incurred by the individual segment. Corporate overhead and the provision for income taxes are not allocated to the individual reported segments. Inter-segment sales and transfers are accounted for at amounts that management believes provides the transferring segment with fair compensation for the products transferred, considering their condition, market demand, and, where appropriate, a reasonable profit that recognized which segment will be responsible for marketing costs. Management evaluates the performance of each segment based on income (loss) before income taxes.

Financial information with respect to the reportable segments follows (in thousands):

Nine-months ended March 31, 2001	Biotrol	Micro Motors	Oregon Micro Systems	Corp.	Total
Sales from external customers	\$7,045	\$5,616	\$6,364	--	\$19,025
Intersegment sales	473	181	--	--	654
Segment profit (loss)	186	(1,132)	2,909	(1,859)	104
Segment assets	2,637	6,468	2,496	2,942	14,543

Nine-months ended March 31, 2000	Biotrol	Micro Motors	Oregon Micro Systems	Corp.	Total
Sales from external customers	\$7,519	\$5,092	\$6,427	--	\$19,038
Intersegment sales	716	321	--	--	1,037
Segment profit (loss)	1,296	(1,012)	3,105	(2,273)	1,116
Segment assets	3,722	7,191	2,949	3,140	17,002

Three months ended March 31, 2001	Biotrol	Micro Motors	Oregon Micro Systems	Corp.	Total
Sales from external customers	\$2,313	\$1,928	\$1,313	--	\$ 5,554
Intersegment sales	--	44	--	--	44
Segment profit (loss)	(29)	(427)	293	(195)	(358)
Segment assets	2,637	6,468	2,496	2,942	14,543

Three months ended March 31, 2000	Biotrol	Micro Motors	Oregon Micro Systems	Corp.	Total
Sales from external customers	\$2,584	\$1,935	\$2,328	--	\$ 6,847
Intersegment sales	229	48	--	--	277
Segment profit (loss)	374	(390)	1,025	(698)	311
Segment assets	3,722	7,191	2,949	3,140	17,002

## Item 2. Management's Discussion and Analysis

### Results of Operations

**Forward Looking Statements.** All forward looking statements in the following discussion of management's analysis of results of operation, liquidity and capital requirements, and the possible effect of inflation, as well as elsewhere in the Company's assumptions regarding factors such as (1) market acceptance of the products of each subsidiary, including brand and name recognition for quality and value in each of the Company's subsidiaries' markets, (2) existence, scope, defensibility and non-infringement of patents, trade-secrets and other trade rights, (3) each subsidiary's relative success in achieving and maintaining technical parity or superiority with competitors, (4) interest rates for domestic and Eurofunds, (5) the relative success of each subsidiary in attracting and retaining technical and sales personnel with the requisite skills to develop, manufacture and market the Company's products, (6) the non-occurrence of general economic downturns or downturns in any of the Company's market regions or industries (such as dental products and tools or computer chip manufacturers), (7) the relative competitiveness of products manufactured by the Company's facilities, including any contractors in the global economy, (8) the non-occurrence of natural disasters, (9) a stable regulatory environment in areas of significance to each of the Company's subsidiaries, (10) the Company's success in managing its regulatory relations and avoiding any adverse determinations, (11) the availability of talented senior executives for the parent and each of the subsidiaries, (12) other factors affecting the sales and profitability of the Company in each of its markets, (13) the ability to generate larger margins from the consolidation of the Challenge operations into the Biotrol facility. Should any of the foregoing assumptions or other assumptions not listed fail to be realized, the forward-looking statements herein may be inaccurate. In making forward looking statements in this and other Sections of the Company's report on Form 10-QSB, the Company relies upon recently promulgated policies of the Securities and Exchange Commission and

statutory provisions, including Section 21E of the Securities Exchange Act of 1934, which provide a safe-harbor for forward looking statements.

### Results of Operations for the Quarter Ended March 31, 2001 Compared to the Quarter Ended March 31, 2000.

On April 10, 2001 the Registrant announced that Dentsply was withdrawing its original proposal announced November 8, 2000 to acquire Pro-Dex in a stock for stock transaction at an exchange ratio of .091 shares of Dentsply shares for each share of Pro-Dex stock. On that date the parties agreed to continue discussion regarding Dentsply's possible acquisition of the Registrant's dental operations. On April 30, 2001 the Company announced that it was unable to reach agreement on terms satisfactory to both parties, and terminated all discussions concerning possible acquisition of its dental subsidiaries by Dentsply International.

On November 1, 2000, the Registrant announced that its Challenge Products division will be integrated with Pro-Dex's Biotrol International division. The Challenge Products division will continue to operate as an independent division, but will move all of its operations to the Biotrol facility in Louisville, Colorado. The Challenge operations and manufacturing were discontinued on November 14, 2000. The move of the Challenge operation was completed by January 5, 2001. As of January 8, 2001, a substantial portion of the production and shipping resumed at the Biotrol facility. The transfer of the Challenge operation to Biotrol will likely yield greater gross profit margins in the future due to reduced manufacturing costs and increased efficiency.

Net sales by subsidiary follows:

	2001	2000	Increase/ (Decrease)
Biotrol / Challenge	\$ 2,313,000	\$ 2,813,000	\$ (500,000)
Micro Motors	1,972,000	1,983,000	(11,000)
Oregon Micro Systems	1,313,000	2,328,000	(1,015,000)
(Inter-company sales)	(44,000)	(277,000)	233,000
	<u>\$ 5,554,000</u>	<u>\$ 6,847,000</u>	<u>\$ (1,293,000)</u>

Consolidated sales decreased 18.9% for the quarter ended March 31, 2001, over the quarter ended March 31, 2000. At Biotrol/Challenge, sales for the quarter decreased 17.8% compared to the previous year when combined with Challenge's net sales for the same period. The decrease in sales is partially due to the temporary delay in shipments caused by the closing of the Challenge facility, and transfer of its operation to the Biotrol facility. Additional revenue was lost due to the disruption in the Biotrol/Challenge business caused by the announcement made November 8, 2000 that the Company was being acquired by Dentsply International, Inc. At Micro Motors, sales decreased less than 1% for the quarter ended March 31, 2001 compared to the quarter ended March 31, 2000. At Oregon Micro Systems, sales decreased 43.6% for the quarter ended March 31, 2001 compared to the quarter ended March 31, 2000 due to a severe decline in the semiconductor industry.

Gross profits by subsidiary follows:

	2001	2000	Increase/ (Decrease)
Biotrol / Challenge	\$ 1,102,000	\$ 1,432,000	\$ (330,000)
Micro Motors	411,000	358,000	53,000
Oregon Micro Systems	859,000	1,696,000	(837,000)
	<u>\$ 2,372,000</u>	<u>\$ 3,486,000</u>	<u>\$ (1,114,000)</u>

Overall gross profit dollars decreased 32% for the quarter ended March 31, 2001, compared to the quarter ended March 31, 2000 primarily due to the decrease in revenue. The gross profit percentage for the quarter ended March 31, 2001, was 43% compared to 51% for the quarter ended March 31, 2000. The decrease in the gross profit is primarily due to the non-recurring costs and the interruption of production necessary to integrate the Challenge unit

into the Biotrol facility. The transfer of the Challenge operation to Biotrol will likely yield greater gross profit margins in the future due to reduced manufacturing costs and increased efficiency.

Operating expenses without unusual charges decreased 3.4% to \$2,566,000 for the quarter ended March 31, 2001, from \$2,656,000 for the quarter ended March 31, 2000. Operating expenses, with unusual charges of \$227,000 included, for the quarter ended March 31, 2001, were \$2,793,000 (50.3% of net sales) compared to \$2,656,000 (38.8% of net sales) for the quarter ended March 31, 2000, an increase of 5.2%. The unusual charges include \$192,000 of costs associated with the break-up of the Dentsply transaction.

Loss from operations for the quarter ended March 31, 2001 was (\$421,000), compared to income from operations of \$830,000 for the quarter ended March 31, 2000. Decreased gross profit combined with an increase in operating expenses contributed to the decrease in net operating income.

Interest expense declined to \$199,000 for the quarter ended March 31, 2001 compared to \$290,000 for the comparable period in the prior year. The decrease in interest expense is attributed to debt reduction as well as a drop in interest rates during the period.

The Company's effective income tax rate for the quarter ended March 31, 2001 is 40% compared to 45% for the quarter ended March 31, 2000. The Company has non-deductible expenses for goodwill that are generally offset by allowable research and development credits.

Net loss was (\$358,000) for the quarter ended March 31, 2001, compared to a net income of \$311,000 for the quarter ended March 31, 2000.

#### **Results of Operations for the Nine Months Ended March 31, 2001 Compared to the Nine Months Ended March 31, 2000.**

Net sales by subsidiary follows:

	2001	2000	Increase/ (Decrease)
Biotrol / Challenge	\$ 7,518,000	\$ 8,235,000	\$ (717,000)
Micro Motors	5,797,000	5,413,000	384,000
Oregon Micro Systems	6,364,000	6,427,000	(63,000)
(Inter-company sales)	(654,000)	(1,037,000)	383,000
	<u>\$ 19,025,000</u>	<u>\$ 19,038,000</u>	<u>\$ (13,000)</u>

Consolidated sales from continuing operations decreased less than 1% for the nine months ended March 31, 2001, compared to the nine months ended March 31, 2000. At Biotrol/Challenge, sales for the nine months decreased by 8.7% combining Challenge net sales for the nine-month period. The decrease in sales is partially due to the temporary delay in shipments caused by the closing of the Challenge facility, and transfer of its operation to the Biotrol facility. Additional revenue was lost due to the disruption in the Biotrol/Challenge business caused by the announcement made November 8, 2000 that the Company was being acquired by Dentsply International, Inc. Sales at Micro Motors increased 7.1% for the nine months ended March 31, 2001 over the nine months ended March 31, 2000, primarily due to increased revenue from private label sales to its endodontic customers. Revenue at Oregon Micro Systems decreased 1.0% for the nine months ended March 31, 2001 compared to the same nine months of the previous year.

Gross profits by subsidiary follows:

	2001	2000	Increase/ (Decrease)
Biotrol / Challenge	\$ 3,675,000	\$ 4,233,000	\$ (558,000)
Micro Motors	1,522,000	1,288,000	234,000

## Oregon Micro Systems

	<u>4,719,000</u>		<u>4,844,000</u>		<u>(125,000)</u>
\$	<u>9,916,000</u>	\$	<u>10,365,000</u>	\$	<u>(449,000)</u>

Consolidated gross profit dollars from continuing operations for the nine months ended March 31, 2001 decreased 4.3%. The Company's consolidated gross profit percentage decreased to 52.1% for the nine months ended March 31, 2001 compared to 54.4% for the nine months ended March 31, 2000. The decrease in the gross profit is primarily due to the non-recurring costs and the interruption of production necessary to integrate the Challenge unit into the Biotrol facility. The transfer of the Challenge operation to Biotrol will likely yield greater gross profit margins in the future due to reduced manufacturing costs and increased efficiency. At Micro Motors, the gross profit percentage declined due to higher manufacturing costs. Higher costs were attributed to efforts to decrease the backlog of past due sales orders. Higher sales of lower margin products also contributed to the lower gross profit at Micro. The backlog of past due orders has been cleared up, and steps have been taken to increase gross profit on low margin products.

Operating expenses increased to \$9,076,000 for the nine months ended March 31, 2001 compared to \$7,688,000 for the nine months ended March 31, 2000. Included in operating expenses for the nine months ended March 31, 2001 are unusual charges of \$720,000. Unusual charges include approximately \$492,000 of costs associated with the failed Dentsply negotiations, and \$156,000 of costs related to the integration of the Challenge operation into the Biotrol facility. Also included in operating expenses for the period are non-recurring payroll costs for severance and other adjustments totaling approximately \$294,000. Operating expense as a percentage of revenue was 47.7% for the nine months ended March 31, 2001 compared to 40.4% for the nine months ended March 31, 2000.

Income from operations for the nine months ended March 31, 2001 was \$840,000 compared to income from operations for the nine months ended March 31, 2000 of \$2,677,000, a decrease of \$1,837,000.

Interest expense for the nine months ended March 31, 2001 was \$702,000 compared to \$808,000 for the nine months ended March 31, 2000. The Company lowered its debt during the period, and reduced its interest rate due to the lowering of the discount rate by the bank.

The Company's effective tax rate is 40.5% for the nine months ended March 31, 2001, compared to 40% for the prior year's nine-month period. The Company has deductions for goodwill that are not tax deductible, and are offset by the availability of a research and development credit.

Net income for the nine months ended March 31, 2001 was \$104,000 compared to a net of \$1,116,000 for the same nine months of the previous year.

### Liquidity and Capital Resources

The operations of the Company are conducted primarily through its three wholly owned subsidiaries. The Company is currently unable to borrow funds from its existing credit facility with Harris Bank. In addition, it is required to present the entire obligation of \$5.8 million to the bank as a current liability. Consequently, working capital on March 31, 2001 is \$564,000. The Company's cash flow from operations enabled it to finance current operations and retire \$1,584,000 of outstanding debt. This was offset by net borrowings on a short-term note for the payment of insurance of \$115,000.

The Company's credit facility with Harris Bank was terminated by the bank in July, 1999, as a result of various covenant violations. Since then the Company has been operating under a series of forbearance agreements provided by the bank. The most recent forbearance agreement expires on July 31, 2001 under terms that obligate the Company to make principal payments of \$125,000 per month plus an additional payment calculated monthly as a percentage of excess cash flow. The Company continues to meet all the covenant requirements contained in the new forbearance agreement.

On 8 November 2000, the Registrant announced it had reached an agreement in principal whereby DENTSPLY International, Inc. (NASDAQ: XRAY) will acquire all of the issued and outstanding shares of Pro-Dex, Inc. The agreement in principal provides that each share of Pro-Dex will be exchanged, at the completion of the transaction, for .091 shares of DENTSPLY. On April 10, 2001, the Registrant further announced that Dentsply was withdrawing its original proposal announced November 8, 2000 to acquire Pro-Dex in a stock for stock transaction at an exchange ratio of .091 shares of Dentsply shares for each share of Pro-Dex stock. On April 30, 2001 the Company announced that it was unable to reach agreement on terms satisfactory to both parties, and terminated all discussions concerning possible acquisition of its dental subsidiaries by Dentsply International.

### **Impact of Inflation and Changing Prices**

The industries in which the Company competes are labor intensive, often involving personnel with high-level technical or sales skills. Wages and other expenses increase during periods of inflation and when shortages in the marketplace occur. The Company expects its subsidiaries to face somewhat higher labor costs, as the market for personnel with the skills sought by the Company becomes tighter in a period of full employment. In addition, suppliers pass along rising costs to the Company's subsidiaries in the form of higher prices. Further, the Company's credit facility with Harris Bank involves increased costs if domestic interest rates rise or there are other adverse changes in the international interest rates, exchange rates, and/or Eurocredit availability. To some extent, the Company's subsidiaries have been able to offset increases in operating costs by increasing charges, expanding services and implementing cost control measures. Nevertheless, each of the Company's subsidiaries' ability to increase prices is limited by market conditions, including international competition in many of the Company's markets.

The nature of the foregoing discussion requires the use of forward-looking statements that involve assumptions, risks, and uncertainties that could cause outcomes to be substantially different from those projected.

### **Item 6. Exhibits and Reports on Form 8-K**

(a) none

(b) none

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: May 7, 2001

/s/ Kent E. Searl

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Kent E. Searl, Chairman

Date: May 7, 2001

/s/ George J. Isaac

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George J. Isaac, Chief Financial Officer