MESA LABORATORIES INC /CO
Form 10-Q
February 06, 2018

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 December 31, 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 (State or other jurisdiction of incorporation or organization)	**84-0872291** (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 3,783,158 shares of the Issuer's common stock, no par value, outstanding as of January 26, 2018**.**

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Part I. Financial Information

Item 1. ***Financial Statements***

Mesa Laboratories, Inc.

Condensed Consolidated Balance Sheets

(In thousands, except share amounts)

	December 31, 2017 (Unaudited)	**March 31, 2017**
ASSETS		
Current assets:		
Cash and cash equivalents	$ *5,843*	$ *5,820*
Accounts receivable, less allowances of $201 and $252, respectively	*12,361*	*14,319*
Inventories, net	*10,454*	*13,873*
Prepaid income taxes	*2,158*	*587*
Prepaid expenses and other	*1,339*	*1,186*
Assets held for sale	*1,934*	--
Total current assets	*34,089*	*35,785*
Property, plant and equipment, net	*23,956*	*26,002*
Intangibles, net	*44,436*	*37,790*
Goodwill	*65,296*	*72,156*
Total assets	$ *167,777*	$ *171,733*
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ *2,029*	$ *2,168*
Accrued salaries and payroll taxes	*3,235*	*4,350*
Unearned revenues	*3,675*	*4,117*
Current portion of contingent consideration	*709*	*1,294*
Other accrued expenses	*3,249*	*2,999*
Income taxes payable	--	*514*
Current portion of long-term debt	*1,500*	*1,125*
Total current liabilities	*14,397*	*16,567*

Deferred income taxes	*4,115*	*3,554*
Long-term debt, net of debt issuance costs and current portion	*54,608*	*53,675*
Other long-term liabilities	*210*	*116*
Total liabilities	*73,330*	*73,912*
Commitments and Contingencies (Note 9)		
Stockholders' equity:		
Common stock, no par value; authorized 25,000,000 shares; issued and outstanding, 3,781,806 and 3,727,704 shares, respectively	*29,694*	*25,925*
Retained earnings	*64,633*	*73,656*
Accumulated other comprehensive income (loss)	*120*	*(1,760*)
Total stockholders' equity	*94,447*	*97,821*
Total liabilities and stockholders' equity	$ *167,777*	$ *171,733*

See accompanying notes to condensed consolidated financial statements.

Mesa Laboratories, Inc.

Condensed Consolidated Statements of Operations

(Unaudited)

(In thousands except per share data)

	Three Months Ended December 31,		**Nine Months Ended December 31,**	
	2017	**2016**	**2017**	**2016**
Revenues	$*23,671*	$*23,843*	$*69,298*	$*69,366*
Cost of revenues	*10,990*	*10,306*	*30,713*	*30,091*
Gross profit	*12,681*	*13,537*	*38,585*	*39,275*
Operating expenses				
Selling	*1,942*	*2,409*	*6,909*	*7,527*
General and administrative	*6,256*	*5,881*	*19,525*	*17,834*
Research and development	*752*	*861*	*2,790*	*2,941*
Impairment loss on goodwill	*13,819*	--	*13,819*	--
Total operating expenses	*22,769*	*9,151*	*43,043*	*28,302*
Operating (loss) income	*(10,088*)	*4,386*	*(4,458*)	*10,973*
Other expense, net	*438*	*506*	*1,659*	*1,712*
(Loss) earnings before income taxes	*(10,526*)	*3,880*	*(6,117*)	*9,261*
Income taxes	*560*	*628*	*1,099*	*1,721*
Net (loss) income	$*(11,086*)	$*3,252*	$*(7,216*)	$*7,540*
Net (loss) income per share:				
Basic	$*(2.93*)	$*0.88*	$*(1.92*)	$*2.06*
Diluted	*(2.93*)	*0.84*	*(1.92*)	*1.97*
Weighted average common shares outstanding:				
Basic	*3,781*	*3,688*	*3,765*	*3,668*
Diluted	*3,781*	*3,868*	*3,765*	*3,835*

See accompanying notes to condensed consolidated financial statements.

Mesa Laboratories, Inc.

Condensed Consolidated Statements of Comprehensive (Loss) Income

(Unaudited)

(In thousands)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2017	**2016**	**2017**	**2016**
Net (loss) income	$*(11,086)*	$*3,252*	$*(7,216)*	$*7,540*
Other comprehensive income (loss), net of tax:				
Foreign currency translation	*181*	*(634)*	*1,880*	*(769)*
Total comprehensive (loss) income	$*(10,905)*	$*2,618*	$*(5,336)*	$*6,771*

See accompanying notes to condensed consolidated financial statements.

Mesa Laboratories, Inc.

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(In thousands)

	Nine Months Ended December 31,	
	2017	**2016**
Cash flows from operating activities:		
Net (loss) income	$(7,216)	$7,540
Depreciation and amortization	6,981	6,609
Stock-based compensation	1,423	1,221
Amortization of debt issuance costs	83	--
Impairment loss on goodwill	13,819	--
Change in inventory reserve	2,120	(507)
Deferred income taxes	(1,077)	418
Foreign currency adjustments	(255)	(17)
Gain on disposition of assets	(116)	--
Adjustment to contingent consideration	300	--
Change in assets and liabilities, net of effects of acquisitions		
Accounts receivable, net	2,621	2,369
Inventories	1,414	97
Prepaid expenses and other	(1,687)	(1,094)
Accounts payable	(139)	96
Accrued liabilities and taxes payable	(1,751)	(4,401)
Unearned revenues	(442)	(484)
Contingent consideration	(905)	(5,076)
Net cash provided by operating activities	15,173	6,771
Cash flows from investing activities:		
Acquisitions	(15,433)	(6,618)
Proceeds from sale of assets	1,133	--
Purchases of property, plant and equipment	(2,540)	(9,367)
Net cash used in investing activities	(16,840)	(15,985)
Cash flows from financing activities:		
Proceeds from the issuance of debt	11,000	11,500
Payments on debt	(9,750)	(3,750)
Dividends	(1,807)	(1,760)
Proceeds from the exercise of stock options	2,346	2,815

Net cash provided by financing activities	*1,789*	*8,805*
Effect of exchange rate changes on cash and cash equivalents	*(99*)	*119*
Net increase (decrease) in cash and cash equivalents	*23*	*(290*)
Cash and cash equivalents at beginning of period	*5,820*	*5,695*
Cash and cash equivalents at end of period	$*5,843*	$*5,405*
Cash paid for:		
Income taxes	$*4,191*	$*4,188*
Interest	*1,477*	*913*
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 and environmental air sampling 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 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 review, we expect that the adoption of ASU *2014-09* will *not* have a material impact on our consolidated financial statements. As we continue our assessment, we are also identifying and preparing to implement minor changes to our accounting policies and practices, business processes, systems and controls 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.*

Note *2* – Acquisitions

For the *nine* months ended *December 31, 2017,* our acquisitions of businesses totaled *$15,433,000,* of which *none* were material in nature (see Item *2. Management's Discussion and Analysis of Financial Condition and Results of Operations).*

Note *3* – Impairment Loss on Goodwill

During the *nine* months ended *December 31, 2017,* revenues in our Cold Chain Packaging reporting segment decreased significantly as compared to the same period in the prior year primarily due to a significant decrease in revenues from our largest customer and the loss of the business of *one* of our larger customers. During the *three* months ended *December 31, 2017* we completed a detailed review of the cold chain packaging business and concluded that long and difficult sales-cycles associated with this product set, when coupled with higher than previously contemplated costs for operating and expanding the necessary infrastructure to support revenues growth have resulted in a forecast of lower than expected revenues, gross margin percentages and overall profitability as compared to our original model for this business. Based on these facts, we concluded that we had a triggering event requiring assessment of impairment for certain of our long-lived assets associated with the Cold Chain Packaging reporting segment. As a result, we reviewed the long-lived assets associated with this reporting segment and recorded a *$13,819,000* impairment charge related to goodwill, which is included in impairment loss on goodwill on the accompanying condensed consolidated statements of operations for the *three* and *nine* months ended *December 31, 2017.* The impairment loss was measured using a market approach utilizing an EBITA multiple model. The remaining goodwill and intangible assets associated with this segment are *$1,434,000* and *$4,340,000,* respectively as of *December 31, 2017.*

Note *4* - Inventories

Inventories consist of the following (in thousands):

	December 31, 2017	March 31, 2017
Raw materials	$ 9,886	$ 10,815
Work-in-process	411	342
Finished goods	3,165	3,604
Less: reserve	(3,008)	(888)
	$ 10,454	$ 13,873

Note *5* – Facility Relocation

In *August 2016,* we announced that we planned to shut down both our Omaha and Traverse City manufacturing facilities and relocate those operations to the new Bozeman building. The move of those *two* facilities, along with the current Bozeman operations, began in *March 2017* and 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 *$772,000* in relocation costs for the *nine* months ended *December 31, 2017,* of which *$503,000* and *$269,000* are reflected in cost of revenues and general and administrative expense, respectively, in the accompanying condensed consolidated statements of operations. Facility relocation costs, which are associated with our Sterilization and Disinfection reporting segment, are as follows for the *nine* months ended *December 31, 2017:*

Retention bonuses for existing personnel of *$305,000*
Duplicative employment costs of *$97,000*
Moving costs of $*370,000*

Facility relocation amounts accrued and paid for the *nine* months ended *December 31, 2017* are as follows (in thousands):

Balance at March 31, 2017	$ 673
Facility relocation expense	772
Cash payments	(1,082)
Balance at December 31, 2017	$ 363

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 operations for the *nine* months ended *December 31, 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 *December 31, 2017* as assets held for sale.

Note *6* - Long-Term Debt

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

	December 31, 2017	**March 31, 2017**
Line of credit (3.44% at December 31, 2017)	$ *37,500*	$ *35,500*
Term loan (3.63% at December 31, 2017)	*19,000*	*19,750*
Less: discount	*(392*)	*(450*)
Less: current portion	*(1,500*)	*(1,125*)
Long-term portion	$ *54,608*	$ *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 in the agreement, plus an applicable margin ranging from *1.50%* to *2.50%;* or (*2*) the alternate base rate ("ABR"), which is the greater of JPMorgan's prime rate or the federal funds effective rate or 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 in the agreement, 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 *December 31, 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 *December 31*, *2017,* future contractual maturities of debt are as follows (in thousands):

Year Ending March 31,	
2018	$*375*
2019	*1,625*
2020	*2,125*
2021	*2,625*
2022	*49,750*
	$*56,500*

In *January 2018,* we made a *$3,500,000* payment under our Line of Credit.

Note *7* - 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		Nine Months Ended	
	December 31,		December 31,	
	2017	2016	2017	2016
Total cost of stock-based compensation charged against (loss) income before income taxes	$*438*	$*380*	$*1,423*	$*1,221*
Amount of income tax (expense) benefit recognized in earnings	*(99*)	*328*	*893*	*1,027*
Amount charged against net (loss) income	$*537*	$*52*	$*530*	$*194*
Impact on net (loss) income per common share:				
Basic	$*0.14*	$*0.01*	$*0.14*	$*0.05*
Diluted	*0.14*	*0.01*	$*0.14*	*0.05*

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

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 *nine* months ended *December 31, 2017:*

Number of Shares	Weighted-Average Exercise	Weighted-Average Remaining	Aggregate Intrinsic Value

		Price per Share	Contractual Term	(000s)
Outstanding at March 31, 2017	*510,361*	$ *75.78*	*5.0*	$ *23,956*
Stock options granted	*95,605*	*123.09*	*5.3*	
Stock options forfeited	*(52,833)*	*95.29*	*4.8*	
Stock options expired	*(964)*	*79.87*	*3.1*	
Stock options exercised				