PRO DEX INC
Form 10-K/A
May 19, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A No. 2

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

For the fiscal year ended June 30, 2010

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 000-14942

PRO-DEX, INC.

(Exact name of registrant as specified in its charter)

Colorado	**84-1261240**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

2361 McGaw Avenue, Irvine, California 92614

(Address of principal executive offices) (Zip Code)

Registrant s telephone number: (949) 769-3200

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

Title of each class	Name of each exchange on which registered
Common Stock, no par value	NASDAQ Capital Market

Securities registered under Section 12(g) of the Exchange Act: None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. Yes ¨ No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes x 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained in this Form 10-K, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the closing sales price on the Nasdaq Capital Market of such common equity on December 31, 2009: $3,553,022 . For the purpose of this calculation, shares owned by officers, directors and 10% stockholders known to the registrant have been deemed to be owned by affiliates. This determination of affiliate status is not a determination for other purposes.

The number of shares outstanding of each of the issuer s classes of common stock outstanding as of the latest practicable date: 3,251,850 shares of common stock, no par value, as of September 23, 2010.

DOCUMENTS INCORPORATED BY REFERENCE: Part III incorporates by reference certain information from the registrant s definitive proxy statement (the Proxy Statement) for the 2010 Annual Meeting of Shareholders.

EXPLANATORY NOTE

On September 28, 2010, Pro-Dex, Inc. (the Company) filed its Annual Report on Form 10-K for the year ended June 30, 2010 with the Securities and Exchange Commission. On May 6, 2011, the Company filed Form 10-K/A No. 1 with the Securities and Exchange Commission to amend the aforementioned Annual Report on Form 10-K for the following:

In Item 9A of the Form 10-K, the conclusions of the Company s principal executive and principal financial officers regarding the effectiveness of the Company s disclosure controls and procedures were made for the quarter ended June 30, 2010, rather than as of June 30, 2010 as required by Item 307 of Regulation S-K. In the Form 10-K/A No. 1, the effective period covered by the conclusions regarding the Company s controls, as described above, has been corrected.

In the Form 10-K, the Company inadvertently failed to include the conformed signature of its independent registered accounting firm on both the Report of Independent Accounting Firm and Exhibit 23.1. In the Form 10-K/A No. 1, the conformed signature of the independent registered accounting firm has been included on both the Report of Independent Accounting Firm and Exhibit 23.1

The last paragraph of the Report of Independent Accounting Firm included in the Form 10-K contained a typographical error in that it referred to each of the two years in the two-year period ended June 30, 2010, rather than referring to each of the years in the two-year period ended June 30, 2010 as required by Item 302(a) of Regulation S-T. In the Form 10-K/A No. 1, this typographical error has been corrected.

In Item 7 and in Note 2 to Notes to Consolidated Financial Statements in the Form 10-K, the Company described its accounting policy for recording owned land and buildings as at the value of their best and highest use. In the Form 10-K/A No. 1, the description of this policy has been clarified to indicate that property, plant, equipment and leasehold improvements is recorded at historical cost.

In Exhibits 31.1 and 31.2 to the Form 10-K, certain wording was not in conformity with the requirements of Exchange Act Rule 13a-14(a). In the Form 10-K/A No. 1, such wording has been corrected.

This Form 10-K/A No. 2 is being filed to amend the aforementioned Form 10-K, as amended by Form 10-K/A No. 1, for the following:

The complete text of each of the Items in the aforementioned Annual Report on Form 10-K that were affected by the changes described above in connection with the Company s filing of the Form 10-K/A No. 1 has been provided in this Form 10-K/A No. 2 in conformity with Item 307 of Regulation S-K.

The Statement of Operations for the year ended June 30, 2010 in the aforementioned Annual Report on Form 10-K contained an item captioned Impairment of intangible assets, in which were included the aggregate charges for impairment of goodwill and patent. In this Form 10-K/A No. 2, the impairment for goodwill has been segregated from the impairment of patent in the Statement of Operations, in conformity with ASC 350-20-45-2.

Note 2 of Notes to Consolidated Financial Statements in the Form 10-K has been expanded to disclose the Company s accounting policy for research and development costs, which is to charge such costs to expense as incurred.

Other than the changes described in this Explanatory Note, the Company is not amending or updating any information contained within its Annual Report on Form 10-K for the year ended June 30, 2010 (the Initial Filing).

Therefore, this Form 10-K/A No. 2 should be read in conjunction with the Company s other filings made with the Securities and Exchange Commission subsequent to the date of the Initial Filing.

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis provides information that management believes is relevant to an assessment and understanding of the Company s results of operations and financial condition for each of the two years ended June 30, 2010 and 2009, 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 below and elsewhere in this report 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.

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.

Revenue Recognition

Revenue on virtually all product sales is recognized upon shipment to the customer based on its terms of FOB shipping point, where the risk of loss and title transfer to the customer. We record sales in accordance with ASC 605 (formerly Staff Accounting Bulletin No. 104, *Revenue Recognition*). Under these guidelines, revenue is recognized when all of the following are satisfied: persuasive evidence that a sale arrangement exists, delivery of the product has occurred, the price is fixed or determinable, and payment is reasonably assured. We sell some of our products with a warranty that provides for repairs or replacement of any defective parts for a period after the sale. At the time of the sale, the Company accrues an estimate of the cost of providing the warranty based on prior experience. The Company recognizes revenue under research and development agreements as certain deliverables are met as specified in each development contract.

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 aging 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 receivables. We define aging of receivables as time passed since (i) the sale was completed, (ii) revenue was recognized and (iii) the receivable was established. If the receivable is aged over 90 days old, or has a known collection risk, it is reserved from anywhere between 10% of its value up to 100% of its value depending on account credit and collection history.

Goodwill

In accordance with ASC 350 (formerly SFAS No. 142, Intangible Goodwill and Other) intangible assets with definite lives are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Impairment indicators include, among other conditions, cash flow deficits, historic or anticipated declines in revenue or operating profit and adverse legal or regulatory developments. We assess potential impairment of our goodwill and intangible assets when there is evidence that recent events or changes in circumstances have made recovery of an asset s carrying value unlikely. We also assess potential impairment of our goodwill and intangible assets on an annual basis during our fiscal fourth quarter, regardless if there is evidence or suspicion of impairment.

If it is determined that such indicators are present and the review indicates that the assets will not be fully recoverable, based on undiscounted estimated cash flow over the remaining amortization periods, the carrying values are reduced to estimated fair market value. In accordance with ASC 350, a two-step impairment test is required to identify potential goodwill impairment and measure the amount of the goodwill impairment loss to be recognized. In the first step, the fair value of each reporting unit is compared to its

carrying value to determine if the goodwill is impaired. If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, then goodwill is not impaired and no further testing is required. If the carrying value of the net assets assigned to the reporting unit exceeds its fair value, then the second step is performed in order to determine the implied fair value of the reporting unit s goodwill and an impairment loss is recorded for an amount equal to the difference between the implied fair value and the carrying value of the goodwill.

Determining the fair value of a reporting unit (an intangible asset) is judgmental and involves the use of significant estimates and assumptions. We base our fair value estimates on assumptions that we believe are reasonable but are uncertain and subject to changes in market conditions. For the purposes of identifying and measuring impairment, goodwill assets are grouped with other assets and liabilities at the lowest level for which identifiable cash flows are largely independent of the cash flow of other assets and liabilities.

We identify two reporting units for purposes of our annual goodwill impairment testing arising from our acquisitions of Micro Motors and Astromec

Our Carson City reporting unit corresponds to the operations resulting from the Astromec acquisition,

Our Irvine reporting unit corresponds to the operations resulting from the Micro Motors acquisition.

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. While our operating units are influenced by changes in the general economic outlook of the United States, they are most heavily influenced by changes specific to the medical device industry. Furthermore, the magnitude of economic changes within the industry is viewed alongside the outlooks and forecasts specific to the reporting units to obtain a better sense of the likelihood that goodwill may be impaired. Declines within the industry s outlook are reflected in the unit s revenue projections.

During the preparation of the fiscal year 2010 financial statements, we determined a triggering event occurred for Micro Motors as new and replacement revenue sources for a potential loss of our largest customer had not been completed. During the preparation of the fiscal year 2010 financial statements we also determined a triggering event for Astromec as it became apparent that the expected product synergies and resulting financial benefits from the 2006 Astromec acquisition were not being realized. (See Note 10 of the consolidated financial statements).

In estimating the fair value of the reporting units, we considered the two traditional approaches to valuation, the market approach and the income (discounted cash flow DCF) approach. The market approach compares the subject company with guideline publicly-traded companies. Valuation multiples are calculated from the selected companies to provide an indication of how much a current investor in the marketplace would be willing to pay for a company with similar characteristics. The income approach measures the projected cash flows expected to be realized from the asset. The value of a business is the expected cash flows discounted to a present value at a discount rate that considers the degree of risk associated with the realization of the projected monetary benefits. The cash flow analysis relies upon estimates of the entity s future revenue and expenses to ultimately project the future cash flows resulting from the business activity of each entity. An appropriate discount rate is reached by calculating the weighted average cost of capital, or WACC, which is determined by the assumptions underlying the Capital Asset Pricing Model, or CAPM, and is considered to reflect the view of Market Participants, as required under ASC 825 (formerly SFAS 157).

The material assumptions relied upon in the analyses used to value the Micro Motors and Astromec reporting units and goodwill are shown below.

<u>Astromec</u>

1) Market Approach

(a) Nine public companies were identified that had a range of revenue to value multiples of between 0.19 times to a high of 1.02 times with a median revenue multiple of 0.43.

(b) Eleven similar open market transactions were identified that had revenue to value multiples that ranged from a low of 0.25 to a high of 0.77 with a median revenue multiple of 0.56

(c) The low multiples were used to determine the fair value due to Astromec s small size and profitability.

2) Income Approach

(a) A discounted cash flow model was constructed using a ten year forecast for the reporting unit to determine a debt-free cash flow forecast. The present value of the cash flows and residual value were discounted to a present value using the WACC.

1. The inputs to the CAPM to determine the cost of equity used in the WACC were:

i. Risk free rate of 3.74%
ii. Relevered Beta of 1.24

iii. Equity risk premium of 5.18%
iv. Small cap stock premium of 6.28%
v. Reporting unit risk premium of 2.0%

2. The reporting unit s cost of equity was estimated to be 16.4%

(b) The cost of debt was 6.05% based on Moody s Baa seasoned bond rate.

(c) Based on the debt/equity capital structure of the peer group of 83% equity and 17% debt, the WACC was estimated at 15.8%.

Micro Motors

1) Market Approach

(a) Ten public companies were identified that had a range of revenue to value multiples of between 0.20 times to a high of 1.00 times with a median revenue multiple of 0.47.

(b) Eleven similar open market transactions were identified that had revenue to value multiples that ranged from a low of 0.25 to a high of 0.77 with a median revenue multiple of 0.56

(c) The mean multiples were used to determine the fair value due to Micro Motor s size.

2) Income Approach

(a) A discounted cash flow model was constructed using a ten year forecast for the reporting unit to determine a debt-free cash flow forecast. The present value of the cash flows and residual value were discounted to a present value using the WACC.

1. The inputs to the CAPM to determine the cost of equity used in the WACC were:

i. Risk free rate of 3.74%
ii. Relevered Beta of 0.85
iii. Equity risk premium of 5.18%
iv. Small cap stock premium of 6.28%

2. The reporting unit s cost of equity was estimated to be 14.4%

(b) The cost of debt was 6.05% based on Moody s Baa seasoned bond rate.

(c) Based on the debt/equity capital structure of the peer group of 83% equity and 17% debt, the WACC was estimated at 12.5%.

As the fair value of the equity was below the carrying value of the equity at both Astromec and Micro Motors, the goodwill was considered impaired and a step 2 analysis was required. In the step two analysis, it was determined that all the remaining goodwill for these two reporting units was impaired. Goodwill impairment associated with Astromec recognized as an operating expense was $1,887,000. Goodwill impairment associated with Micro Motors recognized as an operating expense was $1,110,000.

Long-lived assets

In accordance with ASC 360 (formerly SFAS No. 144, Accounting for the Impairment or Disposal for Long-Lived Assets), we review the recoverability of our long-lived assets, such as property and equipment, when events or changes in circumstances occur that indicate the carrying value of the asset group may not be recoverable. The assessment of possible impairment is based on our ability to recover the carrying value of the asset or asset group from the expected future pre-tax cash flows, undiscounted and without interest charges, of the related operations. If these cash flows are less than the carrying value of such assets, an impairment loss is recognized for the difference between estimated fair value and carrying value. The measurement of impairment requires management to estimate future cash flows and the fair value of long-lived assets.

Given the Company s lack of a direct dental distribution channel, in fiscal year 2009 third quarter, it stopped actively promoting the intraosseous dental anesthesia delivery product (Intraflow) that is based on the intangible asset resulting from the purchase of certain assets from IntraVantage, Inc. in October 2005. Any substantial future value therefore is derived from the possibility that a company with a direct dental distribution channel (a Market Participant) might be interested in access to the technology through product purchases, licenses, acquisition, joint venture, or other means. Given the current economic environment, the general lack of investment in new products, the limited number of Market Participants to whom this technology relates, the time and expense necessary to consummate a transaction, and other factors considered by management, there is also a significant possibility that no distribution partner will be found, resulting in effectively no value of the asset. Given this change in circumstance, in accordance with ASC 360 (formerly SFAS No. 144 Accounting for the Impairment or Disposal of Long-Lived Assets.) management tested the carrying amount of the intangible asset for recoverability as of March 31, 2009. The result of management s analysis (based on several scenarios with varying probabilities of occurring) was that the asset s value was impaired and, accordingly, a charge of $997,000 was taken in the fiscal 2009 third quarter. As market conditions have not improved and no distribution partner has been found as of December 31, 2009, management concluded that the asset s value was further impaired and, accordingly, a charge for the remaining value of $140,000 was taken in the fiscal 2010 second quarter.

	Carrying Value			
	6/30/2009	Amortization	Impairment	6/30/2010
Intangibles - Patents	$ 147,000	$ (7,000)	$ (140,000)	$

We determined a triggering event occurred with the Carson City land and building (the property) due to the expected undiscounted cash flows being below the carrying value of the property, indicating impairment. The fair value is defined pursuant to ASC 820 *Fair Value Measurements* as the price that would be received in an orderly transaction between market participants at the measurement date. The fair value was estimated based on market conditions and comparable transactions.

	Carrying Value			
	6/30/2009	Depreciation	Impairment	6/30/2010
Land	$ 757,000		$ (478,000)	$ 279,000
Building	$ 1,470,000		$ (829,000)	$ 641,000
Accumulated Depreciation	$ (122,000)	$ (38,000)	$	$ (160,000)
Total Land & Building, net	$ 2,105,000	$ (38,000)	$ (1,307,000)	$ 760,000

Warranties

Our 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 and Leasehold Improvements, Net

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

	6/30/2010 Audited	6/30/2009 Audited
Land	$ 279,000	$ 757,000
Building	$ 641,000	$ 1,470,000
Leasehold Improvements	$ 2,286,000	$ 2,283,000
Equipment	$ 6,745,000	$ 6,620,000
Total	$ 9,951,000	$ 11,130,000
Accumulated Depreciation	$ (5,859,000)	$ (5,149,000)
Total property, plant & equipment, net	$ 4,092,000	$ 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.

As noted above, the value of the Carson City land and building was revalued to its current market value in 2010. The land was reduced to $279,000 from $757,000 and the building was reduced to $641,000 from $1,470,000.

Stock-Based Compensation

We are subject to ASC 718 (formerly 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.

Year in Review

2010 proved to be a much better year for Pro-Dex following the down year for the world s economy and Pro-Dex in fiscal year 2009. Our consolidated sales for 2010 grew by 10% as compared to 2009, bringing our five year cumulative average growth back to over 10% per year. Over a longer term, we maintained a cumulative average growth rate of almost 10% per year since fiscal year 2003.

Our medical products business resumed its growth in 2010 as sales were over 13% higher than the previous year. Strong demand from our top two customers and a new product that we delivered to one of those customers drove the sales increase. Unfortunately, as discussed elsewhere in this report, in December 2009 we received notice from our largest customer that it is working to manufacture for itself the two products that we currently produce for the customer, potentially reducing our sales to them beginning in calendar year 2011.

Our motion control business was particularly adversely affected in 2009 as our high margin products associated with this business are used by capital equipment providers, and these orders slowed substantially in our third quarter (January-March 2009). In response to the unfavorable demand environment for these products, we sensed an opportunity to gain market share in the motion control marketplace and added additional sales resources in January 2009 to aggressively uncover and pursue new customer and new sales channel opportunities. Sales levels gradually increased through the year and ended 2010 at a run rate of approximately 80% of the sales levels seen before the 2009 downturn.

Our year-end backlog of orders remained at the high end of the historical range at $11.2 million, up from $9.8 million at June 2009 and $10.4 million at June 2008.

The cost control efforts established in the prior years continued to show positive results. Our gross margin increased from 32% in 2009 to 36% of sales in 2010, a level not seen since 2006. Our reported operating costs in 2010 were $11.6 million, up from $8.3 million in 2009, but as in 2009, were clouded by non-cash impairment charges. These non-cash charges totaled over $4.4 million dollars in 2010, consisting of:

(1) We wrote off the remaining $140,000 of the patent intangible in December 2010 as no strategic distribution partner was found for the product line.

(2) By the end of fiscal 2010, it became apparent that the expected product synergies and resulting financial benefits from the 2006 Astromec acquisition were not being realized. As a result, we determined that the asset was impaired and wrote off $1.9 million in goodwill associated with the acquisition.

(3) We also realized the decline in market value of the Carson City land and building and wrote down that asset s value by $1.3 million.

(4) In addition, due to the uncertain outlook of the medical device business related to the potential reduction in business from a major customer, the remaining $1.1 million in goodwill from the 1995 acquisition of Micro Motors was determined to be impaired and written off.

2009 included a $997,000 charge for writing down the majority of the value of the patent intangible.

Without the impairment charges, operating expenses remained stable at $7.2 million in 2010 and in 2009.

We continue to have a full allowance on our $3.0 million in deferred tax assets at the end of 2010, up from $2.1 million at the end of 2009.

Despite the reported loss, we significantly improved the Company s financial position by generating over $3.2 million in operating cash for the 2010 fiscal year, following the $1.7 million generated in 2009 and $2.0 million in 2008. Our net debt balance of $2.2 million from 2009 turned to a net cash balance of $900 thousand as our cash balances exceeded our debt balances. The cash generated was a result of normal ongoing operations generating over $1.2 million in pre-tax profitability in 2010 before consideration of the impairments. We also benefited from a change in the tax law that allowed us to recover $547,000 in previously unavailable tax credits. We continue to have nothing borrowed on our credit line and ended the year with approximately $3.8 million in cash on hand.

RESULTS OF OPERATIONS

Results of Operations for Fiscal Year Ended June 30, 2010, Compared to Fiscal Year Ended June 30, 2009

The following table sets forth financial data and the percentage of net revenues regarding the Company s financial position and operating results.

	Fiscal Year ended June 30,			
(In Thousands)	2010		2009	
Net sales:	$ 23,211	100%	$ 21,122	100%
Cost of sales	14,847	64%	14,374	68%
Gross Profit	8,364	36%	6,748	32%
Selling, general and administrative expenses	4,670	20%	4,452	21%
Intangible and Property Value Impairment	4,444	19%	997	5%
Research and development costs	2,480	11%	2,791	13%
Loss from Operations	(3,230)	(14%)	(1,492)	(7%)
Net interest expense and net other income	158	1%	212	1%
Benefit for Income Taxes	(1,130)	(5%)	(1,100)	(5%)
Allowance for deferred tax asset	710	3%	2,241	11%
Net Loss	$ (2,968)	(13%)	$ (2,845)	(13%)

Net Sales. Consolidated sales increased 10% or $2,089,000 to $23,211,000 from $21,122,000 for 2010 as compared to 2009. Medical sales were higher by $2,693,000 or 24%, due to higher sales to our largest customer of $2,737,000 as that customer continues to build inventory (see Note 8 of the consolidated financial statements). Shipments to dental customers decreased by $501,000 or 19%, as we strategically reduced sales of certain low profit products. Sales to industrial customers decreased by $130,000 or 5%, reflecting a slowdown in our motion control business primarily in the first six months of fiscal year 2010. Aerospace sales were up $361,000 or 14%, due to higher commercial aircraft motor shipments. Sales related to government research related products and product repairs were down 14%, due primarily to a decline in government agency related work.

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

The amount of Pro-Dex total sales to each customer type and the year-to-year change is noted in the table below:

	Fiscal Year ended June 30,		Increase/
Sales by customer type ($ 000)	2010	2009	(Decrease)
Medical	$ 13,800	$ 11,107	24%
Aerospace	2,985	2,624	14%
Industrial	2,318	2,448	(5%)
Dental	2,119	2,620	(19%)

Government research and other	1,989	2,324	(14%)
Total Sales	$ 23,211	$ 21,123	10%

Gross Profit and Gross Profit Percentage of Sales. Our consolidated gross profit for 2010 increased $1,616,000 or 24% compared to the gross profit in the previous year, due to the higher medical sales and improved Industrial sales mix. Gross profit as a percentage of sales increased to 36% for the year ended June 30, 2010 compared to 32% for the year ended June 30, 2009. Gross margin as a percentage of sales was positively impacted as a more favorable sales mix comprised mostly of the increase higher margin medical products and the decrease in lower margin dental products. Gross profit and gross profit as a percentage of sales were as follows:

	Fiscal Year ended June 30,		
	2010	2009	Increase
Gross Profit			