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HYDROMER INC
Form 10QSB
May 16, 2005

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON D.C. 20549

FORM 10-QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15 (d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarter ended March 31, 2005

Commission File Number 0-10683

HYDROMER, INC.

(Exact name of registrant as specified in its charter)

New Jersey 22-2303576

(State of incorporation) (I.R.S. Employer
Identification No.)

35 Industrial Pkwy, Branchburg, New Jersey 08876-3424

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (908) 722-5000

Securities registered pursuant to Section 12 (b) of the Act: None

Securities registered pursuant to Section 12 (g) of the Act:

Common Stock Without Par Value

(Title of class)

Check whether the issuer (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 report(s), and (2) has been subject to such filing requirements for the past 90 days. Yes (X) No ()

Indicate the number of shares outstanding or each of the issuer's classes of Common Stock as of the close of the period covered by this report.

| Class | Outstanding at March 31, 2005 |
|--------|-------------------------------|
| ----- | ----- |
| Common | 4,623,942 |

HYDROMER, INC.

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Consolidated Financial Statements

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HYDROMER, INC. and CONSOLIDATED SUBSIDIARY CONSOLIDATED BALANCE SHEETS

| | March 31, 2005 UNAUDITED ----- | June 30, 2004 AUDITED ----- |
|---|---|--------------------------------------|
| Assets | | |
| Current Assets: | | |
| Cash and cash equivalents..... | \$ 170,692 | \$ 142,476 |
| Trade receivables less allowance for doubtful accounts of \$21,060 as of March 31, 2005 and \$10,727 as of June 30, 2004..... | 1,834,614 | 1,715,309 |
| Inventory..... | 833,206 | 808,989 |
| Prepaid expenses..... | 170,864 | 124,799 |
| Deferred tax asset..... | 152,601 | 141,798 |
| Other..... | 33,104 | 32,638 |
| | ----- | ----- |
| Total Current Assets..... | 3,195,081 | 2,966,009 |
| Property and equipment, net..... | 3,127,142 | 2,921,560 |
| Intangible assets, net..... | 778,343 | 676,291 |
| Goodwill, net..... | 238,172 | 238,172 |
| | ----- | ----- |
| Total Assets | \$ 7,338,738 ===== | \$ 6,802,032 ===== |
| Liabilities and Stockholders' Equity | | |
| Current Liabilities: | | |

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| | | |
|--|--------------|--------------|
| Accounts payable..... | \$ 624,298 | \$ 524,917 |
| Short-term borrowings..... | 521,981 | 131,010 |
| Accrued expenses | 205,120 | 246,019 |
| Bonus payable..... | - | 187,635 |
| Current portion of deferred revenue..... | 158,500 | 26,000 |
| Current portion of mortgage payable..... | 92,811 | 91,507 |
| Income tax payable..... | 78,654 | 88,317 |
| | ----- | ----- |
| Total Current Liabilities..... | 1,681,364 | 1,295,405 |
| Deferred tax liability..... | 223,222 | 191,500 |
| Long-term portion of deferred revenue..... | 152,000 | 104,000 |
| Long-term portion of mortgage payable..... | 1,295,137 | 1,363,723 |
| | ----- | ----- |
| Total Liabilities | 3,351,723 | 2,954,628 |
| Stockholders' Equity | | |
| Preferred stock - no par value, authorized 1,000,000 shares, no shares issued and outstanding | - | - |
| Common stock - no par value, authorized 15,000,000 shares; as of March 31, 2005, 4,634,859 shares issued and 4,623,942 shares outstanding; as of June 30, 2004, 4,608,904 shares issued and 4,597,987 shares outstanding..... | 3,631,615 | 3,615,615 |
| Contributed capital..... | 577,750 | 577,750 |
| Accumulated deficit..... | (216,210) | (339,821) |
| Treasury stock, 10,917 common shares at cost.. | (6,140) | (6,140) |
| | ----- | ----- |
| Total Stockholders' Equity | 3,987,015 | 3,847,404 |
| | ----- | ----- |
| Total Liabilities and Stockholders' Equity | \$ 7,338,738 | \$ 6,802,032 |
| | ===== | ===== |

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HYDROMER, INC. and CONSOLIDATED SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|-------------|-------------------|-------------|
| | March 31, | | March 31, | |
| | 2005 | 2004 | 2005 | 2004 |
| | UNAUDITED | UNAUDITED | UNAUDITED | UNAUDITED |
| | ----- | ----- | ----- | ----- |
| Revenues | | | | |
| Sale of products..... | \$1,372,727 | \$1,448,217 | \$3,646,382 | \$3,660,176 |
| Service revenues..... | 244,111 | 316,397 | 829,523 | 577,606 |
| Royalties, options and licenses..... | 651,500 | 623,337 | 1,920,459 | 1,771,720 |
| | ----- | ----- | ----- | ----- |
| Total Revenues..... | 2,268,338 | 2,387,951 | 6,396,364 | 6,009,502 |
| Expenses | | | | |
| Cost of Sales..... | 869,268 | 826,782 | 2,325,431 | 2,170,267 |
| Operating Expenses..... | 1,203,428 | 1,189,047 | 3,783,314 | 3,261,972 |
| Other Expenses..... | 26,892 | 27,987 | 74,452 | 89,939 |
| Provision for Income Taxes.. | 78,544 | 135,887 | 89,556 | 189,550 |
| | ----- | ----- | ----- | ----- |
| Total Expenses..... | 2,178,132 | 2,179,703 | 6,272,753 | 5,711,728 |
| | ----- | ----- | ----- | ----- |

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| | | | | | | | | |
|--|----|-----------|----|-----------|----|-----------|----|-----------|
| Net Income..... | \$ | 90,206 | \$ | 208,248 | \$ | 123,611 | \$ | 297,774 |
| | | ===== | | ===== | | ===== | | ===== |
| Earnings Per Common Share.... | \$ | 0.02 | \$ | 0.05 | \$ | 0.03 | \$ | 0.06 |
| Weighted Average Number of Common Shares Outstanding... | | 4,623,214 | | 4,597,987 | | 4,611,365 | | 4,594,346 |

The effects of the common stock equivalents on diluted earnings per share are not included as they have no impact.

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HYDROMER, INC. and CONSOLIDATED SUBSIDIARY CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Nine Months Ended March 31, | |
|---|--------------------------------|-------------------|
| | 2005 UNAUDITED | 2004 UNAUDITED |
| Cash Flows From Operating Activities: | | |
| Net Income..... | \$ 123,611 | \$ 297,774 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation and amortization..... | 146,177 | 135,913 |
| Deferred income taxes..... | 20,919 | (4,000) |
| Changes in Assets and Liabilities | | |
| Trade receivables..... | (119,305) | (345,784) |
| Inventory..... | (24,217) | 62,024 |
| Prepaid expenses..... | (46,065) | (14,315) |
| Patents and Trademark..... | (102,052) | (37,107) |
| Other assets..... | (466) | 6,887 |
| Accounts payable and accrued liabilities..... | 51,346 | 283,273 |
| Income taxes payable..... | (9,663) | 165,020 |
| | 40,285 | 549,685 |
| Net Cash Provided by Operating Activities..... | 40,285 | 549,685 |
| Cash Flows From Investing Activities: | | |
| Cash purchases of property and equipment..... | (351,758) | (223,836) |
| | (351,758) | (223,836) |
| Net Cash Used for Investing Activities..... | (351,758) | (223,836) |
| Cash Flows From Financing Activities: | | |
| Net borrowings against Line of Credit... | 390,971 | (149,437) |
| Repayment of long-term borrowings..... | (67,282) | (619,457) |
| Proceeds from long-term borrowings..... | - | 555,000 |
| Proceeds from the issuance of common stock..... | 16,000 | 7,497 |
| | 339,689 | (206,397) |
| Net Cash Provided by (used for) Financing Activities..... | 339,689 | (206,397) |
| Net Increase in Cash and Cash Equivalents: | 28,216 | 119,452 |
| Cash and Cash Equivalents at Beginning of Period..... | 142,476 | 97,676 |

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| | | |
|-------------------------------------|------------|------------|
| Cash and Cash Equivalents at End of | | |
| Period..... | \$ 170,692 | \$ 217,128 |
| | ===== | ===== |

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HYDROMER, INC. and CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

In the opinion of management, the accompanying unaudited financial statements include all adjustments (consisting of only normal adjustments) necessary for a fair presentation of the results for the interim periods. Certain reclassifications have been made to the previous year's results to present comparable financial statements.

Segment Reporting:

The Company operates two primary business segments. The Company evaluates the segments by revenues, total expenses and earnings before taxes. Corporate Overhead is excluded from the business segments as to not distort the contribution of each segment.

The results for the nine months ended March 31, by segment are:

| | Polymer Research | Medical Products | Corporate Overhead | Total |
|---|---------------------|---------------------|-----------------------|--------------|
| ----- | | | | |
| 2005 | | | | |
| Revenues..... | \$ 4,065,309 | \$ 2,331,055 | | \$ 6,396,364 |
| Expenses..... | (2,501,288) | (2,747,266) | \$ (934,643) | (6,183,197) |
| ----- | | | | |
| Earnings (Loss) before Income Taxes..... | \$ 1,564,021 | \$ (416,211) | \$ (934,643) | \$ 213,167 |
| | ===== | ===== | ===== | ===== |

| | Polymer Research | Medical Products | Corporate Overhead | Total |
|---|---------------------|---------------------|-----------------------|--------------|
| ----- | | | | |
| 2004 | | | | |
| Revenues..... | \$ 3,801,160 | \$ 2,208,342 | | \$ 6,009,502 |
| Expenses..... | (2,232,866) | (2,365,260) | \$ (924,052) | (5,522,178) |
| ----- | | | | |
| Earnings (Loss) before Income Taxes..... | \$ 1,568,294 | \$ (156,918) | \$ (924,052) | \$ 487,324 |
| | ===== | ===== | ===== | ===== |

Geographic revenues were as follows for the nine months ended March 31,

| | 2005 | 2004 |
|----------|-------|-------|
| | ----- | ----- |
| Domestic | 83% | 82% |
| Foreign | 17% | 18% |

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Subsequent Events:

In April 2005, the Company finalized contracts with a total value of \$340,000 entailing a transfer of technology know-how, a contract amendment fee [on a pre-existing contract] and a resource dedication/increased output fee. These agreements, in which the associated costs were expended in prior periods, cumulated almost two years of discussions. The Company has completed its obligations under these agreements and has received the cash in April 2005.

Also in April, the Company entered into a seventeen year license and supply agreement with another customer for \$50,000, minimum quarterly royalties plus the then value of coating supplies, subject to cancellation with 30 days notice by the licensee. Although the \$50,000 license fee has been received, it is recorded as deferred revenue until earned over the life of the agreement.

Such transactions are representative of the nature of some of the transactions the Company typically engages in: a high value and/or long-term revenue stream against sunk costs (including capitalized patented costs). While some of these agreements can be negotiated quickly, some, though not the norm, may take a much longer time frame.

On May 6, 2005 Hydromer's patent 4,642,267 expired. This patent was the subject of four (4) licenses with a total annual income to Hydromer of approximately \$2.1 million. Management is negotiating with these licensees to replace the patent license with a supply/support/know-how arrangement to recoup some of the lost revenue.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations

The Company's revenues for the quarter ended March 31, 2005 were \$2,268,338 as compared to \$2,387,951 for the same period last year or a 5.0% decrease. Revenues for the nine months ended March 31, 2005 were \$6,396,364, up 6.4% from \$6,009,502 the corresponding period a year ago. Revenues are comprised of the sale of Products and Services and Royalty, Options and License payments.

Product sales and services were \$1,616,838 for the quarter ended March 31, 2005 as compared to \$1,764,614 for the same period last year, a decrease of 8.4%. Included in the three months ended March 31, 2004 was a private label order of \$176,148 which did not occur in the corresponding quarterly period this year. For the nine months ended March 31, 2005, product sales and services were \$4,475,905 as compared to \$4,237,782 the prior year, a 5.6% increase. Stronger sales in our contract coating

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services this year contributed to the increase.

Royalty, license and option revenues from patented products were \$651,500 for the quarter, up 4.5% from \$623,337 the same period a year ago. For the nine months ended March 31, 2005, royalty, license and option revenues were \$1,920,459, up 8.4% from \$1,771,720 the same period a year ago. New licensee agreements accounted for an increase of \$72,000 or 4.1%, reflecting the continual strong demand for our patented technology.

As of March 31, 2005, our open sales order book was approximately \$1,585,000, a significant part of which represents orders for delivery during the remainder of the current fiscal year. Some of these orders are subject to cancellation, however, the Company is of the opinion that no substantial cancellations will occur. Our open order book excludes though, future orders that would come up during the normal course of business for immediate delivery also during this fiscal year.

Total Expenses for the quarter ended March 31, 2005 were \$2,178,132 as compared with \$2,179,703 the year before, or a decrease of 0.1%. For the nine months ended March 31, 2005, Total Expenses were \$6,272,753 as compared with \$5,711,728 the same period the year before, an increase of 9.8%.

The Company's Cost of Goods Sold was \$869,268 for the quarter ended March 31, 2005 as compared with \$826,782 the year prior, an increase of 5.1%. On a year-to-date basis, cost of goods sold was \$2,325,431 this year as compared with \$2,170,267 the corresponding period a year ago, an increase of 7.1%. Increases to our labor cost, including healthcare benefits, in addition to the increase in the year-to-date services revenues resulted in higher cost of goods sold.

Operating expenses were \$1,203,428 for the quarter ended March 31, 2005 as compared with \$1,189,047 the year before, an increase of 1.2%. For the nine month periods, operating expenses were \$3,783,314 this year as compared with \$3,261,972 the previous year. The addition of four scientists, a production manager, a plant engineer and a QC manager since March 1, 2004, as part of the Company's investment for the future, resulted in an increase of \$329,000 in higher personnel costs. In addition, during this nine month period, the Company expended an additional \$100,000 in litigation costs in its continued infringement claim against a former licensee and other parties.

Interest expense, included in other expenses, for the nine months ended March 31, 2005 and March 31, 2004 were \$78,200 and \$90,379, respectively, lower this year-to-date as a result of lower interest rates from the refinance of the first mortgage in October 2003 and from the amortization of the mortgage balances.

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Net Income of \$90,206 (\$0.02 per share) is reported for the quarter ended March 31, 2005 as compared to Net Income of \$208,248 (\$0.05 per share) the year before. For the nine months ended March 31, 2005, Net Income of \$123,611 (\$0.03 per share) is reported as compared to Net Income of \$297,774 (\$0.06 per share) the year before.

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Our reinvestment back into the Company (primarily from an increase in R&D staffing) increased current operating expenses for expected returns in the future. Our developmental projects, including those Medical related, are typically long-term initiatives where the costs come way before any revenues are returned.

Financial Condition

Working capital decreased \$156,887 during the nine months ended March 31, 2005.

Net operating activities provided for \$40,285 for the nine month period ended March 31, 2005.

The Net Income adjusted for non-cash expenses, provided \$290,707 in net cash. Working capital accounts utilized \$148,369 in net cash: primarily due to the increase in accounts receivables of \$119,305.

Investing activities used \$351,758 on capital expenditures and financing activities provided \$339,689 during the nine months ended March 31, 2005.

Capital expenditures (the adding of new production capabilities and facilities to meet current demand as well as expanding our QA laboratories and general building maintenance & improvements) were the Company's investing activities this period. These activities are substantially complete and the Company believes that the current infrastructure is sufficient for the near term.

The Company manages its working capital and other cash requirements through utilization of its available short-term borrowings - a revolving Line of Credit. During the nine months ending March 31, 2005, the Company borrowed, net of repayments, \$390,971 from the Line-of-Credit.

The Company has not yet obtained final resolution to a ratio coverage covenant matter from the quarter ended December 31, 2004, though it expects to do so, at minimal or no cost, shortly.

Management believes that its current working capital and available line of credit, along with expected income and expense streams, are sufficient to maintain its current level of operations.

Disclosure Controls and Procedures

The evaluation of the Company's Internal Controls Environment concluded that it was effective for the safeguarding of assets and in ensuring that management is presented material information regarding the organization. The evaluation also determined that there are areas that could be improved upon; however, the controls and procedures in place were appropriate for the type and size of the Company.

The Company has again reviewed its Internal Controls Environment during the prior 90 days, and it has been determined that there have been no significant changes in internal controls or in other factors that could significantly affect the financial statements.

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PART II - Other Information

The Company operates entirely from its sole location at 35 Industrial Parkway in Branchburg, New Jersey, an owned facility secured by mortgages through banks.

The existing facility will be adequate for the Company's operations for the foreseeable future.

Item 6. Exhibits and Reports on form 8-K:

- a) Exhibits - none
- b) Reports on form 8-K - A Form 8-K was filed during the quarter ending March 31, 2005 announcing earnings for the quarter ending December 30, 2004

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on his behalf by the undersigned thereunto duly authorized.

HYDROMER, INC.

/s/ Robert Y. Lee

Robert Y. Lee
Chief Financial Officer

DATE: May 16, 2005