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HYDROMER INC
Form 10QSB
November 14, 2006

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 September 30, 2006

Commission File Number 0-10683

HYDROMER, INC.

(Exact name of registrant as specified in its charter)

| | |
|---|--|
| New Jersey ----- (State of incorporation) | 22-2303576 ----- (I.R.S. Employer Identification No.) |
| 35 Industrial Pkwy, Branchburg, New Jersey ----- (Address of principal executive offices) | 08876-3424 ----- (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 September 30, 2006 ----- |
|----------------|--|
| Common | 4,644,164 |

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INDEX TO FORM 10-QSB
September 30, 2006

Page No.

Part I - Financial Information

| | |
|--|---|
| # 1 Consolidated Financial Statements | |
| Balance Sheets - September 30, 2006 & June 30, 2006 | 2 |
| Statements of Income for the three months ended September 30, 2006 and 2005 | 3 |
| Statements of Cash Flows for the three months ended September 30, 2006 and 2005 | 4 |
| Notes to Financial Statements | 5 |
| # 2 Management's Discussion and Analysis of the Financial Condition and Results of Operations | 6 |
| # 3 Controls and Procedures | 7 |

Part II - Other Information

| | |
|--|-----|
| # 1 Legal Proceedings | N/A |
| # 2 Change in Securities | N/A |
| # 3 Default of Senior Securities | N/A |
| # 4 Submission of Motion to Vote of Security Holders | N/A |
| # 5 Other Information | N/A |
| # 6 Exhibits and Reports on form 8-K | 8 |

EXHIBIT INDEX

| Exhibit No. | Description of Exhibit | |
|-------------|--|----|
| 33.1 | SEC Section 302 Certification - CEO certification | 9 |
| 33.2 | SEC Section 302 Certification - CFO certification | 10 |
| 99.1 | Certification of Manfred F. Dyck, Chief Executive Officer, pursuant to 18 U.S.C. Section 1350 | 11 |
| 99.2 | Certification of Robert Y. Lee, Chief Financial Officer, pursuant to 18 U.S.C. Section 1350 | 11 |

Part I - Financial Information
Item # 1

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HYDROMER, INC. and CONSOLIDATED SUBSIDIARY CONSOLIDATED BALANCE SHEETS

| | September 30, 2006 UNAUDITED | June 20 AUDIT |
|--|------------------------------------|---------------------|
| <hr/> | | |
| Assets | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 205,377 | \$ 434,000 |
| Trade receivables less allowance for doubtful accounts of \$44,479 as of September 30, 2006 and June 30, 2006 | 1,130,497 | 1,198,000 |
| Inventory | 916,808 | 988,000 |
| Prepaid expenses | 80,275 | 118,000 |
| Deferred tax asset | 8,976 | 8,000 |
| Income tax refund receivable | 123,524 | 91,000 |
| Other | 125,156 | 127,000 |
| <hr/> | | |
| Total Current Assets | 2,590,613 | 2,967,000 |
| <hr/> | | |
| Property and equipment, net | 3,343,480 | 3,377,000 |
| Deferred tax asset, non-current | 507,426 | 507,000 |
| Intangible assets, net | 876,278 | 849,000 |
| Other, non-current | 117,730 | 114,000 |
| <hr/> | | |
| Total Assets | \$ 7,435,527 | \$ 7,816,000 |
| <hr/> | | |
| Liabilities and Stockholders' Equity | | |
| Current Liabilities: | | |
| Accounts payable | \$ 549,622 | \$ 635,000 |
| Short-term borrowings | 711,972 | 656,000 |
| Accrued expenses | 271,571 | 374,000 |
| Current portion of deferred revenue | 102,611 | 128,000 |
| Current portion of mortgage payable | 205,537 | 202,000 |
| Income tax payable | 969 | 1,000 |
| <hr/> | | |
| Total Current Liabilities | 1,842,282 | 1,997,000 |
| Deferred tax liability | 271,058 | 271,000 |
| Long-term portion of deferred revenue | 70,972 | 93,000 |
| Long-term portion of mortgage payable | 2,041,072 | 2,093,000 |
| <hr/> | | |
| Total Liabilities | 4,225,384 | 4,455,000 |
| <hr/> | | |
| 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; 4,655,081 shares issued and 4,644,164 shares outstanding as of September 30, 2006 and June 30, 2006 | 3,639,315 | 3,639,000 |
| Contributed capital | 577,750 | 577,000 |
| Accumulated deficit | (1,000,782) | (849,000) |
| Treasury stock, 10,917 common shares at cost | (6,140) | (6,000) |
| <hr/> | | |
| Total Stockholders' Equity | 3,210,143 | 3,360,000 |
| <hr/> | | |
| Total Liabilities and Stockholders' Equity | \$ 7,435,527 | \$ 7,816,000 |
| <hr/> | | |

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2

HYDROMER, INC. and CONSOLIDATED SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME

| | Three Months Ended | |
|---|--------------------|--------------|
| | September 30, | |
| | 2006 | 2005 |
| | UNAUDITED | UNAUDITED |
| ----- | | |
| Revenues | | |
| Sale of products | \$ 1,208,200 | \$ 1,054,750 |
| Service revenues | 368,480 | 245,283 |
| Royalties and contract revenues | 451,093 | 561,171 |
| ----- | | |
| Total Revenues | 2,027,773 | 1,861,204 |
| Expenses | | |
| Cost of Sales | 847,585 | 817,348 |
| Operating Expenses | 1,356,879 | 1,381,733 |
| Other (Income) / Expenses | 43,120 | 33,564 |
| Benefit for Income Taxes | (68,976) | (126,290) |
| ----- | | |
| Total Expenses | 2,178,608 | 2,106,355 |
| ----- | | |
| Net Loss | \$ (150,835) | \$ (245,151) |
| ===== | | |
| Loss Per Common Share | \$ (0.03) | \$ (0.05) |
| ----- | | |
| Weighted Average Number of Common Shares Outstanding | 4,644,164 | 4,625,542 |

The effects of the common stock equivalents on diluted earnings per share are not included as their effect would be anti-dilutive.

3

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

| | Three Months Ended | |
|--|--------------------|--------------|
| | September 30, | |
| | 2006 | 2005 |
| | UNAUDITED | UNAUDITED |
| ----- | | |
| Cash Flows From Operating Activities: | | |
| Net Loss | \$ (150,835) | \$ (245,151) |
| Adjustments to reconcile net loss to net cash provided by (used for) operating activities | | |
| Depreciation and amortization | 105,418 | 105,418 |
| Deferred income taxes | - | - |
| Changes in Assets and Liabilities: | | |
| Trade receivables | 67,592 | 67,592 |
| Inventory | 71,278 | 71,278 |

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| | | |
|--|------------|------|
| Prepaid expenses | 38,160 | |
| Other assets | (734) | |
| Accounts payable and accrued liabilities | (187,857) | (1) |
| Deferred income | (48,534) | (|
| Income taxes payable | (32,219) | |
| ----- | | |
| Net Cash (Used for) Provided by Operating Activities | (137,731) | |
| ----- | | |
| Cash Flows From Investing Activities: | | |
| Cash purchases of property and equipment | (24,273) | (|
| Cash payments on patents and trademarks | (74,168) | (|
| Cash purchases of short-term investments | - | (3 |
| ----- | | |
| Net Cash Used for Investing Activities | (98,441) | (4 |
| ----- | | |
| Cash Flows From Financing Activities: | | |
| Net borrowings against Line of Credit | 55,717 | (2 |
| Repayment of long-term borrowings | (49,033) | (|
| Proceeds from the issuance of common stock | - | |
| ----- | | |
| Net Cash Provided by (Used for) Financing Activities | 6,684 | (2 |
| ----- | | |
| Net Decrease in Cash and Cash Equivalents: | (229,488) | (6 |
| Cash and Cash Equivalents at Beginning of Period | 434,865 | 1,3 |
| ----- | | |
| Cash and Cash Equivalents at End of Period | \$ 205,377 | \$ 6 |
| ===== | | |

4

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 three months ended September 30, by segment are:

| | Polymer Research | Medical Products | Corporate Overhead | To |
|-----------------------|---------------------|---------------------|-----------------------|-------|
| ----- | | | | |
| 2006 | | | | |
| Revenues | \$1,034,620 | \$ 993,153 | | \$ 2, |
| Expenses | (971,011) | (907,264) | \$ (369,309) | (2, |
| ----- | | | | |
| Pre-tax Income (Loss) | \$ 63,609 | \$ 85,889 | \$ (369,309) | \$ (|

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| 2005 | | | | |
|-----------------------|-------------|--------------|--------------|-------|
| Revenues | \$1,108,114 | \$ 753,090 | | \$ 1, |
| Expenses | (909,361) | (937,049) | \$ (386,235) | (2, |
| ----- | | | | |
| Pre-tax Income (Loss) | \$ 198,753 | \$ (183,959) | \$ (386,235) | \$ (|

Geographic revenues were as follows for the three months ended September 30,

| | 2006 | 2005 |
|----------|------|------|
| | ---- | ---- |
| Domestic | 86% | 91% |
| Foreign | 14% | 9% |

5

Item #2

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

Results of Operations

The Company's revenues for the quarter ended September 30, 2006 were \$2,027,773, up 8.9% from the \$1,861,204 for the same period last year. Revenues are comprised of the sale of Products and Services and Royalty and Contract payments.

Product sales and services were \$1,576,680 for the quarter ended September 30, 2006 as compared to \$1,300,033 for the same period the year before, an increase of \$276,647 or 21.3%. The increase in demand in our contract coating business and an inventory call from one of our medical device OEM customers accounted for the increase during the period.

Royalty and Contract revenues includes royalties received and the periodic recurring payments from license, option and other agreements for other than product and services. Included in Royalty and Contract revenues are revenues from support and supply agreements. For the quarter ended September 30, 2006, Royalty and Contract revenues were \$451,093, down \$110,078 or 19.6% from the \$561,171 the same period a year ago. The September 2005 quarter included an additional \$175,000, representing support fees for May and June 2005, which was recorded in the July-September quarter as the agreement was finalized in that period.

As of September 30, 2006, our open sales order book was approximately \$944,000. Although some of these orders are subject to cancellation, 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.

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Total Expenses for the quarter ended September 30, 2006 were \$2,178,608 as compared with \$2,106,355 the year before, an increase of 3.4%.

The Company's Cost of Goods Sold was \$847,585 for the quarter ended September 30, 2006 as compared with \$817,348 the year prior, an increase of 3.7%. The higher volume of products sold resulted in the higher cost of sales.

Operating expenses were \$1,356,879 for the quarter ended September 30, 2006 as compared with \$1,381,733 the year before, lower by \$24,854 or 1.8%. Included in the prior year's amount was \$77,000 in litigation costs on an infringement claim against a former licensee and other parties, which was settled in early 2006, offset by approximately \$55,000 higher in salaries expense in Research and Development.

Interest expense, included in Other Expenses, for the three months ended September 30, 2006 and September 30, 2005 were \$47,937 and \$41,216, respectively.

A net loss of \$150,835 (\$0.03 per share) is reported for the quarter ended September 30, 2006 as compared to a net loss of \$245,151 (\$0.05 per share) the year before.

In this fiscal quarter, we saw higher product and services revenues, when compared with the same period a year ago, reflecting the continued demand for our products and services. Even our Royalty and Contract revenues were higher this year when discounting the 2005 May and June fees included in the quarter ended September 30, 2005. Re-investment expenditures (research and development, patents) accounted for approximately 25.1% of the current period's operating expenses. Our re-investment expenditures over the past few years has lead to some exciting new developments in the areas of thrombogenicity and cell mitosis, for use in the cardiovascular and neurovascular fields. The findings of our developments were announced in October 2006 and a patent application on these technologies was filed in November. New technologies in the medical field typically are longer-range initiatives through our customers, who would commercialize them into the markets. Though the bulk of the "rewards" to our investment may be a few years down the road, there is immediate opportunity in the current duration from R&D projects, stand-still agreements and others.

6

Financial Condition

Working capital decreased \$221,780 during the three months ended September 30, 2006.

Net operating activities used \$137,731 for the three month period ended September 30, 2006.

The net loss as adjusted for non-cash expenses, used \$45,417 in net cash. The cash used for accounts payable and accrued liabilities, as off-set by the decrease in accounts receivables rounded out the use of cash in operating activities.

Investing activities used \$98,441 and financing activities provided \$6,684

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during the three months ended September 30, 2006.

During the three months, the Company expended \$24,273 on capital expenditures and \$74,168 into its patent estate. The Company also repaid down its long-term borrowings by \$49,033 while utilizing an additional \$55,717 from its revolving line of credit during the period.

The Company's \$750,000 Line of Credit is due to mature on January 31, 2007. The Company is seeking to renew this credit facility or seek alternative financing/cash sources to enable a smooth transition until its new developments repays for its investment costs.

Item # 3

Disclosure Controls and Procedures

As of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of our management, including the Chief Executive Officer and President and the Chief Financial Officer, of the effectiveness of the design and operation of the disclosure controls and procedures.

Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, our disclosure controls and procedures were effective and that there were no changes to our Company's internal control over financial reporting that have materially affected, or is reasonably likely to materially affect the Company's internal control over financial reporting during the period covered by the Company's quarterly report.

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 - There were no Form 8-K's filed during the quarter ending September 30, 2006.

7

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

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undersigned thereunto duly authorized.

HYDROMER, INC.

/s/ Robert Y. Lee

Robert Y. Lee
Chief Financial Officer

DATE: November 13, 2006