HESKA CORP
Form 10-Q
November 15, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2010

OR

o 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: 000-22427

HESKA CORPORATION
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	77-0192527 (I.R.S. Employer Identification Number)
3760 Rocky Mountain Avenue Loveland, Colorado (Address of principal executive offices)	80538 (Zip Code)

Registrant's telephone number, including area code: (970) 493-7272

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 x No o

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 (§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 o No o

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. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o (Do not check if a small reporting company)	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 o No x

The number of shares of the Registrant's NOL Restricted Common Stock outstanding at November 12, 2010 was 52,236,930.

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DRI-CHEM is a registered trademark of FUJIFILM Corporation. SPOTCHEM is a trademark of Arkray, Inc. TRI-HEART is a registered trademark of Schering-Plough Animal Health Corporation ("SPAH") in the United States and is a trademark of Heska Corporation in other countries. HESKA, ALLERCEPT, AVERT, E.R.D.-HEALTHSCREEN, E-SCREEN, FELINE ULTRANASAL, HEMATRUE, SOLO STEP, THYROMED and VET/OX are registered trademarks and CBC-DIFF, G2 DIGITAL, VET/IV and VITALPATH are trademarks of Heska Corporation. This Form 10-Q also refers to trademarks and trade names of other organizations.

HESKA CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(amounts in thousands except shares and per share amounts)
(unaudited)

ASSETS

	December 31, 2009	September 30, 2010
Current assets:		
Cash and cash equivalents	$ 5,400	$ 5,745
Accounts receivable, net of allowance for doubtful accounts of $177 and $131, respectively	9,222	10,934
Inventories, net	12,018	10,894
Deferred tax asset, current	940	54
Other current assets	913	731
Total current assets	28,493	28,358
Property and equipment, net	6,349	5,560
Goodwill	905	962
Deferred tax asset, net of current portion	28,387	29,553
Total assets	$ 64,134	$ 64,433
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 4,172	$ 3,561
Accrued liabilities	3,689	4,243
Current portion of deferred revenue	1,664	1,573
Line of credit	4,201	4,989
Current portion of long-term debt	381	—
Total current liabilities	14,107	14,366
Deferred revenue, net of current portion, and other	4,972	4,790
Total liabilities	19,079	19,156
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $.001 par value, 25,000,000 shares authorized; none issued or outstanding	—	—
Common stock, $.001 par value, 75,000,000 shares authorized; 52,159,738 and 0 shares issued and outstanding, respectively	52	—
NOL Restricted Common stock, $.001 par value, 0 and 75,000,000 shares authorized, respectively; 0 and 52,236,930 shares issued and outstanding, respectively	—	52
Additional paid-in capital	216,829	217,123
Accumulated other comprehensive income	(30)	152
Accumulated deficit	(171,796)	(172,050)

Total stockholders' equity	45,055	45,277
Total liabilities and stockholders' equity	$ 64,134	$ 64,433

See accompanying notes to condensed consolidated financial statements.

HESKA CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
Revenue, net:				
Core companion animal health	$16,892	$14,144	$ 51,908	$ 43,667
Other vaccines, pharmaceuticals and products	2,658	3,491	6,412	6,769
Total revenue, net	19,550	17,635	58,320	50,436
Cost of revenue	12,130	11,042	36,496	31,791
Gross profit	7,420	6,593	21,824	18,645
Operating expenses:				
Selling and marketing	3,695	3,912	11,075	11,604
Research and development	457	455	1,308	1,300
General and administrative	2,109	1,861	6,255	6,071
Total operating expenses	6,261	6,228	18,638	18,975
Operating income (loss)	1,159	365	3,186	(330)
Interest and other (income) expense, net	(13)	(118)	193	177
Income (loss) before income taxes	1,172	483	2,993	(507)
Income tax expense (benefit)	429	242	1,211	(253)
Net income (loss)	$ 743	$ 241	$ 1,782	$ (254)
Basic net income (loss) per share	$ 0.01	$ 0.00	$ 0.03	$ (0.00)
Diluted net income (loss) per share	$ 0.01	$ 0.00	$ 0.03	$ (0.00)
Weighted average outstanding shares used to compute basic net income (loss) per share	52,123	52,237	52,049	52,188
Weighted average outstanding shares used to compute diluted net income (loss) per share	52,192	52,376	52,060	52,188

See accompanying notes to condensed consolidated financial statements.

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HESKA CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2010
CASH FLOWS PROVIDED BY (USED IN) OPERATING ACTIVITIES:		
Net income (loss)	$ 1,782	$ (254)
Adjustments to reconcile net income (loss) to cash provided by (used in) operating activities:		
Depreciation and amortization	1,975	1,717
Deferred tax expense (benefit)	1,038	(280)
Stock-based compensation	245	251
Unrealized (gain)/loss on foreign currency translation	108	(78)
Changes in operating assets and liabilities:		
Accounts receivable	80	(1,712)
Inventories	2,326	380
Other current assets	106	182
Accounts payable	(261)	(611)
Accrued liabilities	(165)	555
Deferred revenue and other	(498)	(269)
Net cash provided by (used in) operating activities	6,736	(119)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(177)	(185)
Net cash provided by (used in) investing activities	(177)	(185)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock	36	43
Proceeds from (repayments of) line of credit borrowings, net	(5,058)	787
Proceeds from (repayments of) debt, net	(578)	(381)
Net cash provided by (used in) financing activities	(5,600)	449
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(61)	200
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	898	345
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	4,705	5,400
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 5,603	$ 5,745
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest	$ 350	$ 144
Non-cash transfer of inventory to property and equipment	$ 71	$ 744

See accompanying notes to condensed consolidated financial statements.

HESKA CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2010
(UNAUDITED)

1. ORGANIZATION AND BUSINESS

Heska Corporation ("Heska" or the "Company") develops, manufactures, markets, sells and supports veterinary products. Heska's core focus is on the canine and feline companion animal health markets.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements are the responsibility of the Company's management and have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and pursuant to the instructions to Form 10-Q and rules and regulations of the Securities and Exchange Commission (the "SEC"). The condensed consolidated balance sheet as of September 30, 2010, the condensed consolidated statements of operations for the three months and nine months ended September 30, 2009 and 2010 and the condensed consolidated statements of cash flows for the nine months ended September 30, 2009 and 2010 are unaudited, but include, in the opinion of management, all adjustments (consisting of normal recurring adjustments) which the Company considers necessary for a fair presentation of its financial position, operating results and cash flows for the periods presented. All material intercompany transactions and balances have been eliminated in consolidation. Although the Company believes that the disclosures in these financial statements are adequate to make the information presented not misleading, certain information and footnote disclosures normally included in complete financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the SEC.

Results for any interim period are not necessarily indicative of results for any future interim period or for the entire year. The accompanying financial statements and related disclosures have been prepared with the presumption that users of the interim financial information have read or have access to the audited financial statements for the preceding fiscal year. Accordingly, these financial statements should be read in conjunction with the audited financial statements and the related notes thereto for the year ended December 31, 2009, included in the Company's Annual Report on Form 10-K/A filed with the SEC on February 25, 2010.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenue and expense during the reported period. Actual results could differ from those estimates. Significant estimates are required when establishing the allowance for doubtful accounts and the provision for excess/obsolete inventory, in determining the period over which the Company's obligations are fulfilled under agreements to license product rights and/or technology rights, and in determining the need for, and the amount of, a valuation allowance on certain deferred tax assets.

Inventories

Inventories are stated at the lower of cost or market using the first-in, first-out method. Inventory manufactured by the Company includes the cost of material, labor and overhead. If the cost of inventories exceeds estimated fair value, provisions are made to reduce the carrying value to estimated fair value.

Inventories, net consist of the following (in thousands):

	December 31, 2009	September 30, 2010
Raw materials	$ 4,969	$ 3,982
Work in process	3,371	3,129
Finished goods	4,782	5,132
Allowance for excess or obsolete inventory	(1,104)	(1,349)
	$ 12,018	$ 10,894

Basic and Diluted Net Income (Loss) Per Share

Basic net income (loss) per common share is computed using the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is computed using the sum of the weighted average number of shares of common stock outstanding, and, if not anti-dilutive, the effect of outstanding common stock equivalents (such as stock options and warrants) determined using the treasury stock method. For the three months ended September 30, 2010 and 2009, and the nine months ended September 30, 2009, the Company reported net income and therefore, dilutive common stock equivalent securities, as computed using the treasury stock method, were added to basic weighted average shares outstanding for the period to derive the weighted average shares for the diluted earnings per share calculation. Common stock equivalent securities that were anti-dilutive for the three months ended September 30, 2010 and 2009, and the nine months ended September 30, 2009, and therefore excluded, were outstanding options to purchase 12,102,783, 12,015,652 and 12,028,952 shares of common stock, respectively. These securities are anti-dilutive primarily due to exercise prices greater than the average trading price of the Company's common stock during the three months ended September 30, 2010 and 2009, and the nine months ended September 30, 2009. All common stock equivalent securities were anti-dilutive for the nine months ended September 30, 2010 because the Company reported a net loss for that period.

3. CAPITAL STOCK

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model, with the following weighted average assumptions for options granted in the three and nine months ended September 30, 2009 and 2010.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
Risk-free interest rate	1.48%	N/A	1.43%	1.44%
Expected lives	3.0 years	N/A	2.9 years	2.9 years
Expected volatility	69%	N/A	67%	68%
Expected dividend yield	0%	N/A	0%	0%

A summary of the Company's stock option plans is as follows:

	Year Ended December 31, 2009		Nine Months Ended September 30, 2010	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding at beginning of period	12,835,269	$ 1.2836	12,917,702	$ 1.1846
Granted at market	1,075,000	$ 0.4529	299,000	$ 0.8417
Cancelled	(992,567)	$ 1.6713	(465,810)	$ 2.3590
Exercised	—	$ —	(12,013)	$ 0.5836
Outstanding at end of period	12,917,702	$ 1.1846		