HYDRON TECHNOLOGIES INC
Form 10-Q
May 15, 2002

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

FORM 10-Q

(Mark One)
/X/ Quarterly Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934
For the Quarterly Period Ended: March 31, 2002
or

/ / Transition Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934
For the Period from ____________ to ____________

Commission File Number: 0-6333

HYDRON TECHNOLOGIES, INC.
(Exact name of Registrant as specified in its charter)

New York	13-1574215
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

2201 West Sample Road, Building 9, Suite 7B Pompano Beach, FL 33073	(954) 861-6400
(Address of Principal Executive Offices)	(Registrant's telephone number)

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. X Yes ___ No.

Number of shares of common stock outstanding as of March 31, 2002: 4,975,136

HYDRON TECHNOLOGIES, INC.

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HYDRON TECHNOLOGIES, INC.

Condensed Balance Sheets

	March 31, 2002 (Unaudited)	Dece
ASSETS		
Current assets		
Cash and cash equivalents	$ 171,078	$
Trade accounts receivable	45,484	
Inventories	1,114,577	
Prepaid expenses and other current assets	23,377	
Total current assets	1,354,516	
Property and equipment, less accumulated depreciation of $537,533 and $534,533 at 2002 and 2001, respectively	24,374	
Deposits	28,389	
Deferred product costs, less accumulated amortization of $5,554,021 and $5,482,021 at 2002 and 2001, respectively	472,347	
Total assets	$ 1,879,626	$
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 178,599	$
Deferred revenues	141,111	
Accrued liabilities	371,429	
Total current liabilities	691,139	
Commitments and contingencies	-	

Shareholders' equity		
Common stock - $.01 par value 30,000,000 shares authorized; 5,035,336 shares issued; and 4,975,136 shares outstanding	50,353	
Preferred stock - $.01 par value 5,000,000 shares authorized; no shares issued or outstanding	-	
Additional paid-in capital	19,501,837	
Accumulated deficit	(17,924,545)	
Treasury stock, at cost; 60,200 shares	(439,158)	
Total shareholders' equity	1,188,487	
Total liabilities and shareholders' equity	$ 1,879,626	$

Note: The balance sheet at December 31, 2001 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

See notes to condensed financial statements.

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HYDRON TECHNOLOGIES, INC.

Condensed Statements of Operations
(Unaudited)

	Three months ended M	
	2002	
Net Sales	$ 380,257	$
Cost of sales	85,581	
Gross profits	294,676	
Expenses:		
Royalty expense	19,086	
Research and development	17,877	
Selling, general & administration	377,469	
Depreciation & amortization	75,000	
Total expenses	489,432	
Operating loss	(194,756)	
Interest income	297	
Loss before income taxes	(194,459)	
Income taxes expense	-	

Net loss	$ (194,459)	$
Basic and diluted loss per share:		
Net loss per common share	$ (0.04)	$
Weighted average shares:		
Outstanding (basic and diluted)	4,975,136	

See notes to condensed financial statements.

HYDRON TECHNOLOGIES, INC.

Condensed Statements of Cash Flows
(Unaudited)

	Three months ended M	
	2002	
Operating Activities		
Net Loss	$ (194,459)	$
Adjustments to reconcile net loss to		
Net Cash provided by operating activities		
Depreciation and amortization	75,000	
Change in operating assets and liabilities		
Trade accounts receivables	15,960	
Inventories	49,720	
Prepaid expenses and other current assets	20,073	
Deposits	(187)	
Accounts payable	62,040	
Deferred revenues	(7,535)	
Accrued liabilities	(16,601)	
Net cash provided (used) by operating activities	4,011	
Investing activities		
Net cash provided (used) by investing activities	-	
Financing activities		
Net cash provided (used) by financing activities	-	
Net increase (decrease) in cash and cash equivalents	4,011	
Cash and cash equivalents at beginning of period	167,067	
Cash and cash equivalents at end of period	$ 171,078	$

See notes to condensed financial statements.

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HYDRON TECHNOLOGIES, INC.
Notes to Condensed Financial Statements
(Unaudited)

Note A -- Basis of Presentation

The accompanying unaudited financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management of Hydron Technologies, Inc. (the "Company"), all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three-month period ended March 31, 2002 are not necessarily indicative of the results that may be expected for the year ending December 31, 2002. For further information, refer to the financial statements and footnotes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2001.

Note B - Inventories

Inventories consist of the following:

	March 31, 2002	December 31, 2001
Finished goods	$ 481,876	$ 543,880
Raw material and components	632,701	620,417
	$ 1,114,577	$ 1,164,297

Note C - Distribution

The majority of the Company's products are currently sold in the United States through Hydron direct marketing channels (proprietary Catalog and the World Wide Web site). The Company also sells its products to private label customers, television retailers and, to a lesser extent, internationally through salons and doctors offices.

While in prior years television retail was the primary focus for the marketing and distribution of the Company's products, Management believes that the Company's exclusive agreements with television retailers had limited the marketing opportunities to build its business through additional sales channels. Under exclusive contracts with television retailers the Company neither controlled its airtime nor the selling priorities of those television retailers, effectively handicapping the Company's ability to influence sales trends.

The Company began diversifying away from television retailers in 2001 with continued focus on developing the Catalog business and the addition of a private label customer to provide additional cash flow. Further, the Company has been pursuing new international distribution and new products that would significantly augment Hydron's direct marketing efforts. This development includes filing a patent in February 2002 on new acne formulas that provide marked performance improvements versus other over-the-counter products currently on the market.

Note C - Distribution (continued)

- Catalog Sales

In November 1996, the Company opened a new channel of distribution for Hydron products with the launch of its proprietary Catalog. This full color Catalog offers the Company's personal care products for sale directly to consumers. The Catalog also provides information on new products, educates consumers on proper skin care and facilitates consumer re-ordering. The Company sells its products on the World Wide Web and regularly transmits E-mail broadcasts to its customer base. Catalog sales represented approximately 60% of Hydron's total annual sales in 2001. The Company is continuing to explore new ways to enhance Catalog sales and operations.

- Private Label Contracting

Effective March 1, 2001, the Company entered into an agreement with Reliv International, Inc ("Reliv") to develop and manufacture a line of private label skin care products under their brand name, ReversAge(R). Five products were introduced in August 2001 at a national sales meeting to Reliv's multitier marketing distribution network. The agreement requires minimum product purchases and advance payments to cover packaging and design costs. Reliv is a public company traded on NASDAQ (symbol RELV). Private label sales represented approximately 20% of Hydron's total annual sales in 2001.

- Direct Response Television

Sales of the Company's products to television retailers once were central to the Company's marketing and distribution strategy. However, such sales have declined dramatically in recent years. With the termination of the Company's agreement with HSN in September 2001, sales to television retailers have been reduced to limited sales made to QVC on a non-exclusive basis. Sales to television retailers accounted for approximately 18%, 50%, 68%, 79%, and 82% of the Company's total sales for 2001, 2000, 1999, 1998, and 1997, respectively.

In March, the Company reached a settlement agreement with HSN relative to prior year's purchase commitments. As a result, Hydron will be able to market directly to HSN customers who purchased Hydron Products in the past, all of Hydron's products in HSN's inventory will be returned and callers asking for Hydron products will be referred to Hydron's call center.

Note C - Distribution (continued)

- International

In 1996, the Company signed an agreement for conventional retail sales with

Doctors Formula Pty. Ltd., an Australia-based health and beauty products distributor, to market Hydron products in retail salon stores and medical offices in Australia and New Zealand.

The Company entered into a distribution agreement with a distributor in Taiwan in April 2001. The first shipment to Taiwan was in May 2001. The Company also distributes dental products into Spain and, to a lesser extent, other countries. Although this category is not significant at this time, Management is committed to the expansion of international sales and believes that international sales represent one of the foundations for the future growth of the Company.

Note D - Earnings Per Share

Options and warrants to purchase 206,500 shares of common stock were outstanding at December 31, 2001, but were not included in the computation of diluted earnings per share because the effect would be anti-dilutive to the net loss per share for the period.

The Board of Directors has approved the issuance of an additional 402,500 options; subject to the approval of a stock option plan amendment at the next shareholders' meeting. These options have not been reflected; as of December 31, 2001 calculations since there are insufficient options available without the shareholders actions.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Critical Accounting Policies

We have identified the policies outlined below as critical to our business operations and an understanding of our results of operations. The listing is not intended to be a comprehensive list of all our accounting policies. In many cases, the accounting treatment of a particular transaction is specifically dictated by accounting principles generally accepted in the United States, with no need for management's judgment in their application. The impact and any associated risks related to these policies on our business operations is discussed throughout management's Discussion and Analysis of financial Condition and results of Operations where such policies affect our reported and expected financial results. For detailed discussion on the application of these and other accounting policies, see the Notes to the Financial Statements. Note that our preparation of the financial statements requires us to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of our financial statements, and the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of our financial statements, and the reported amount of revenue and expenses during the reported period. There can be no assurance that actual results will not differ from those estimates.

Revenue Recognition and Product Warranty

Revenue from product sales is recognized at the time of shipment. Provision is made in the period of the sale for estimated product returns from the ultimate end user.

Research and Development

Research and development costs are charged to operations when incurred and are included in operating expenses.

Advertising

Advertising costs are expensed as incurred and are included in "selling, general and administrative expenses."

Business

Hydron Technologies, Inc. markets a broad range of consumer and oral health care products using a moisture-attracting ingredient (the "Hydron(R) polymer"), and owns a non-prescription drug delivery system for topically applied pharmaceuticals, which uses such polymer. The Company holds U.S. and international patents on, what Management believes is, the only known cosmetically acceptable method to suspend the Hydron polymer in a stable emulsion for use in personal care/cosmetic products. The Company is developing other personal care/cosmetic products for consumers using its patented technology and would, when appropriate, either seek licensing arrangements with third parties, or develop and market proprietary products through its own efforts. Management believes that because of their unique properties, products that utilize the Hydron polymer have the potential for wide acceptance in consumer and professional health care markets.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Business (continued)

The Company has been engaged in the development of various consumer products using Hydron polymers since 1986. The Company's products are designed to address concerns about aging, and include Hydron skincare, hair care, bath and body and sun care. The Company currently has thirty-nine individual products available in the following product lines: skin care (22 products), hair care (7 products), bath and body (8 products) and sun care (2 products). These products are also packaged into collections and sold at a more favorable value than the individual products sold separately. All of the products are sold directly by the Company to consumers through the Hydron Catalog and Web site www.hydron.com ("Catalog").

Management believes that the Company's product lines are unique and offer the following competitive benefits: the moisturizers self-adjust to match the skin's optimal pH balance soon after they are applied to the skin; they become water-insoluble on the skin's surface, and unlike all other water-based cremes and lotions, are not removed by the skin's perspiration or plain water; they are oxygen-permeable, allowing the skin to breathe; they do not emulsify the skin's natural moisturizing agents, as do conventional cremes and lotions; and they attract and hold water, creating a cushion of moisture on the skin's surface that promotes penetration of other beneficial product ingredients, all while leaving no greasy after-feel.

The Company's products are dermatologist tested and approved for all skin types. Products for use around the eye area are also ophthalmologist tested and safe for contact lens wearers. Most of the Company's moisturizing products are based on the Company's patented emulsion system, which permits the product ingredients to deliver their intended benefits over an extended period of time and in a more efficient manner.

The Company has also developed and currently markets a group of Hydron polymer-based products for dental professionals under the Hydrocryl(R) brand name. These include a heat cured material used in the manufacture of dentures, as well as cold cure kits used in connection with the relining or repairing of existing Hydrocryl or conventional acrylic dentures that is necessitated by the continual changes that occur in the tissue structure of the mouth. Management believes that the hydrophilic, or moisture attracting properties, of these Hydron polymer-based products give them competitive advantages over conventional acrylic dentures and denture repair kits, which are not hydrophilic.

Management believes that the Company's patented Hydron emulsion system can enhance the effectiveness of over-the-counter medications applied to the skin. The system is designed to deposit a uniform film on the skin's surface and to have a relatively low affinity for the drug associated with the application. Management believes that the Hydron system has a number of advantages over traditional lotions as it promotes hydration of the stratum corneum (the outer layer of skin), which improves penetration into the skin's pores, and has good tactility and flexibility. The Company expects to continue to focus research and development resources on additional Hydron polymer-based products, as well as other proprietary technology-based products as determined by Management's assessment of consumer demand.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Business (continued)

In 2000, the Company discovered that the Hydron emulsion system also adjusts pH on the skin to match the pH of the stratum corneum, the skin's surface layer. It is evident in recent skin research that the pH range of the emulsion system is essential for contributing to the skin's natural healing process and enzyme production responsible for rebuilding the skin's lipid barrier.

Hydron filed for patent protection in February 2002 for this revolutionary delivery system for over-the-counter (OTC) acne drug ingredients. The new system significantly reduces the harshness and irritation caused by most acne products currently in the marketplace. The Brand will be developed under the registered Aclime(R) trademark. The Company is currently finalizing packaging and evaluating alternative distribution channels for the line, including: direct marketing, limited retail and infomercials.

The market for acne treatment is growing, particularly among adults who are one of the primary targets for the Aclime(R) brand. According to current market research studies, the core acne consumer market is about 25 million consumers. Up to 47% of adult women experience at least occasional breakouts. Retail sales of OTC acne treatments account for $380 million in sales and an industry analyst estimates an additional $300 million is accounted for by direct marketing, primarily through infomercials. An additional $650 million is spent in the prescription market in the United States.

The Company is also researching and developing new technology-based and possibly patentable skin treatment systems that would augment its product line. During 2001, the Company's research and development efforts advanced research into a skin treatment that may provide anti-aging treatments, wound treatments and healing enhancement. When appropriate, the Company may license additional existing technology to fully secure its marketing rights. Research and development efforts include product formulation, clinical testing, packaging design and prototypes, extensive product safety and stability testing conducted by medical professionals, efficacy studies to support product claims, and consumer research. Charles Fox, a consultant and a former member of the

Company's Board of Directors from September 1997 to October 1998, leads the Company's research and development efforts. Mr. Fox was formerly director of product development for Warner Lambert Company's personal products division and president of the Society of Cosmetic Chemists.

Results of Operations

Net sales for the three months ended March 31, 2002 were $380,257; an increase of $50,564, or 15%, from net sales of $329,693 for the three months ended March 31, 2001. Catalog sales increased by approximately $27,917, or 9%, from $305,684 for the three months ended March 31, 2001 to $333,600 for the three months ended March 31, 2002. The increase in direct marketing catalog sales resulted primarily from continuation of promotional offers to existing customers. The Company has begun testing new direct marketing programs targeted at new potential customers. Further testing will determine new catalog marketing programs for future expansion.

Non-catalog net sales, including HSN, QVC, contract sales and international, for the three months ended March 31, 2002 were $46,656; an increase of $22,647, or 94%, from non-catalog net sales of $24,009 for the three months ended March 31, 2001. The quarterly non-catalog sales increase reflects the shift in

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations (continued)

sales to lower margin private label customers. The Company sold no products to television retailers during the first quarter 2002 as compared to $24,009 for the three months ended March 31, 2001.

The Company's overall gross profit margin for the three months ended March 31, 2002 was 78%, as compared to 83% for the three months ended March 31, 2001. The decrease in gross profit margins for the first quarter reflects a shift in product mix and the fact that non-catalog sales with lower margins made up a larger portion of the Company's total sales.

R&D expenses for the three months ended March 31, 2002 were $17,877; an increase of $2,498, or 16%, from R&D expenses of $15,379 for the three months ended March 31, 2001. The amount of R&D expenses per year varies, depending on the nature of the development work during each year, as well as the number and type of products under development at such time.

Selling, general and administrative ("SG&A") expenses for the three months ended March 31, 2002 were $377,469; an increase of $12,870, or 4%, from SG&A expenses of $364,599 for the three months ended March 31, 2001. The increase was principally due to increased postage, sales commissions and legal expenses.

Interest and investment income for the three months ended March 31, 2002 was $298, a decrease of $1,516, or 84%, from interest and investment income of $1,814 for the three months ended March 31, 2001. This decrease is due to lower cash balances in the 2002 period compared to the 2001 period. The Company maintains a conservative investment strategy, deriving investment income primarily from U.S. Treasury securities.

The net loss for the three months ended March 31, 2002 was $194,459, a decrease of $25,704, or 12%, as compared to a net loss of $220,163 for the three months ended March 31, 2001. The decrease in the net loss resulted primarily from the factors discussed above.

Liquidity and Financial Resources

The Company's working capital was approximately $663,377 at March 31, 2002, including cash and cash equivalents of approximately $171,078. There were no investing or financing activities for the three months ended March 31, 2002.

The Company has incurred significant losses over the past four years. The ability of the Company to continue as a going concern is dependent on increasing sales and reducing operating expenses.

Management's plan to increase sales and reduce operating expenses includes several specific actions. Catalog sales will continue to be emphasized since they have higher profit margins and represent markets that are growing more rapidly than the Company's traditional television market. Direct marketing techniques will be used to reach new and current consumers such as promotions mailed to targeted consumers, Web site specials, promotions to other Web site customers, and direct e-mail promotions to new customers.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Liquidity and Financial Resources (continued)

In addition, the Company added a significant Private Label customer of Hydron based formulas, with a proprietary nutritional complex of additives, that began ordering in the second quarter, 2001. This customer competes in the multi-Level Marketing category and has been successful for 13 years.

The Company is also pursuing international distribution agreements that will expand the company's distribution around the world. Finally, the Company will continue to develop proprietary technology that it believes will improve its long-term success in this category.

As noted in the year end Report of Independent Certified Public Accountants, dated March 18, 2002, the Company experienced losses from operations in 2001, 2000, and 1999. These matters raise substantial doubt about the Company's ability to continue as a going concern. There can be no assurances that Management's Plan will be successful and the Company's actual results could differ materially. No estimate has been made should Management's plan be unsuccessful.

The effect of inflation has not been significant upon either the operations or financial condition of the Company.

Cautionary Statement Regarding Forward Looking Statements

Certain statements contained in this Report on Form 10-Q are forward looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including statements regarding the Company's expectations, hopes, intentions, beliefs or strategies regarding the future. Forward looking statements include the Company's liquidity, anticipated cash needs and availability, and the anticipated expense levels under the heading "Management's Discussion and Analysis of Financial

Condition and Results of Operations." All forward looking statements included in this document are based on information available to the Company on the date of this Report, and the Company assumes no obligation to update any such forward looking statement. It is important to note the Company's actual results could differ materially from those expressed or implied in such forward looking statements. You should also consult the Company's Annual Report on Form 10-K for the year ended December 31, 1998 as well as those factors listed from time to time in the Company's other reports filed with the Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934 and the Securities Act of 1933.

Part II - Other Information

Item 6. Exhibits and Reports on Form 8-K

Current report on Form 8-K
None.

SIGNATURES

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

HYDRON TECHNOLOGIES, INC.

By: /s/ William A. Fagot

William A. Fagot
Chief Financial Officer

Dated: May 14, 2002