MISONIX INC
Form 10-Q
February 06, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2018

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: **1-10986**

MISONIX, INC.

(Exact name of registrant as specified in its charter)

New York	**11-2148932**
	(IRS Employer Identification No.)

(State or other jurisdiction of incorporation or organization)

1938 New Highway	**11735**
Farmingdale, New York	*(Zip code)*

(Address of principal executive offices)

(631) 694-9555

(Registrant's telephone number, including area code)

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 No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Indicate the number of shares outstanding of the issuer's common stock as of the latest practicable date: As of January 24, 2019, there were 9,587,303 shares of the registrant's common stock, $0.01 par value, outstanding.

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MISONIX, INC.

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

Misonix, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets

	December 31, 2018 (Unaudited)	June 30, 2018
Assets		
Current assets:		
Cash and cash equivalents	$10,173,286	$10,979,455
Accounts receivable, less allowance for doubtful accounts of $250,000 and $200,000, respectively	5,709,298	5,245,549
Inventories, net	5,711,528	5,019,886
Prepaid expenses and other current assets	601,752	611,647
Total current assets	22,195,864	21,856,537
Property, plant and equipment, net of accumulated amortization and depreciation of $9,720,862 and $9,023,235, respectively	4,473,859	4,188,378
Patents, net of accumulated amortization of $1,132,901 and $1,063,393, respectively	763,044	757,447
Goodwill	1,701,094	1,701,094
Contract assets	960,000	—
Intangible and other assets	451,315	517,295
Total assets	$30,545,176	$29,020,751
Liabilities and shareholders’ equity		
Current liabilities:		
Accounts payable	$3,592,287	$1,794,098
Accrued expenses and other current liabilities	2,264,112	2,411,172
Deferred income	$5,993	13,303
Total current liabilities	5,862,392	4,218,573
Non current liabilities	401,000	401,000
Total liabilities	$6,263,392	$4,619,573
Commitments and contingencies		
Shareholders' equity:		
Common stock, $.01 par value-shares authorized 40,000,000; 9,584,178 and 9,430,466 shares issued and outstanding in each period	95,842	94,305

Additional paid-in capital	42,143,359	39,772,973
Accumulated deficit	(17,957,417)	(15,466,100)
Total shareholders' equity	24,281,784	24,401,178
Total liabilities and shareholders' equity	$30,545,176	$29,020,751

See Accompanying Notes to Consolidated Financial Statements.

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Misonix, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations
(Unaudited)

	For the three months ended December 31,		For the six months ended December 31,	
	2018	2017	2018	2017
Revenues				
Product	$10,176,453	$8,323,845	$19,537,617	$ 15,604,568
Total revenue	10,176,453	8,323,845	19,537,617	15,604,568
Cost of goods sold	3,048,079	2,465,826	5,798,622	4,643,181
Gross profit	7,128,374	5,858,019	13,738,995	10,961,387
Operating expenses:				
Selling expenses	4,800,643	3,919,515	9,535,648	7,490,228
General and administrative expenses	2,347,184	2,380,860	5,530,568	4,953,991
Research and development expenses	839,219	957,204	2,143,984	1,858,478
Total operating expenses	7,987,046	7,257,579	17,210,200	14,302,697
Loss from operations	(858,672)	(1,399,560)	(3,471,205)	(3,341,310)
Other income (expense):				
Domestic:				
Consumables	$5,477,995	$4,623,545	$854,450	18.5 %
Equipment	600,559	776,878	(176,319)	-22.7%
Total	$6,078,554	$5,400,423	$678,131	12.6 %
International:				
Consumables	$2,092,400	$1,538,519	$553,881	36.0 %
Equipment	2,005,499	1,384,903	620,596	44.8 %
Total	$4,097,899	$2,923,422	$1,174,477	40.2 %

<u>Revenues</u>

Total revenue increased 22.3% or $1.9 million to $10.2 million in the second quarter of fiscal 2019, from $8.3 million in the second quarter of fiscal 2018. The largest portion of the revenue increase was due to the continued growth of consumables in the domestic and international markets as expected. Domestic sales of BoneScalpel and SonicOne were strong, and the exceptional growth is in the wound franchise continued.

Domestic equipment revenues were below expectations due to timing issues with customers, while international equipment revenues were above expectations with continued momentum in China and other key markets.

The revenue increase is principally attributable to a 22.9% or $1.4 million increase in consumables revenue, in addition to a 20.6% or $0.4 million increase in equipment revenue.

There was no license revenue during the second quarter of fiscal 2019 or fiscal 2018.

Gross profit

Gross profit from product revenue in the second quarter of fiscal 2019 was 70.0% of revenue, compared with the gross profit margin of 70.4% in the second quarter of fiscal 2018.

Selling expenses

Selling expenses increased by $0.9 million, or 22.5% to $4.8 million in the second quarter of fiscal 2019 from $3.9 million in the prior year period. The increase is principally related to higher compensation costs and travel related expenses resulting from the continued buildout of the Company's direct sales force.

General and administrative expenses

General and administrative expenses were $2.3 million, roughly flat with $2.4 million in the second quarter of fiscal 2018. Higher salaries and benefits were largely offset by lower non-cash compensation costs.

Research and development expenses

Research and development expenses decreased by $0.1 million or 12% to $0.8 million in the second quarter of fiscal 2019 from $1.0 million in the prior year period. The Company is investing in the design and development of its next generation platform product, Nexus, which is expected to be available in fiscal 2019. During the second quarter of fiscal 2019 and fiscal 2018, approximately $0.3 million and $0.6 million, respectively, was charged to research and development expenses related to this product.

Other income (expense)

Other income was $18,339 in the second quarter of fiscal 2019 compared with $67,208 in the prior year period. This decrease related to lower royalty income.

Income taxes

For the three months ended December 31, 2018 and 2017, the Company recorded an income tax expense of $0 and $5.5 million, respectively. For the three months ended December 31, 2018 and 2017, the effective rate of 0% and 414.6%, respectively, varied from the U.S. federal statutory rate due to changes in the Company's projected pretax book income.

The income tax expense for the second quarter of fiscal 2018 included a one-time charge of $1,764,039 to revalue the Company's deferred tax assets as of December 31, 2017 to give effect to the reduction in corporate tax rates to 21% effective January 1, 2018, as a result of the Tax Cuts and Jobs Act of 2017, enacted on December 22, 2017. Income tax expense also included a $3,988,532 charge to record a full valuation allowance against the Company's remaining deferred tax assets. In accordance with the guidance of ASC Topic 740, management concluded that in its judgment, the Company's deferred tax assets at December 31, 2017 are not more likely-than-not realizable.

Income tax expense for the quarter ended December 31, 2018 includes a $228,000 valuation allowance against the Company's deferred tax assets recorded in the quarter. In accordance with the guidance of ASC Topic 740, management concluded that in its judgment, the Company's deferred tax assets at December 31, 2018 are not more likely-than-not realizable. The components of the tax provision are as follows:

	For the three months ended December 31, 2018	2017
Income tax benefit	$(228,000)	$(228,149)
Reduction of deferred tax assets relating to Tax Legislation	—	1,764,039
Valuation allowance on deferred tax assets	228,000	3,988,532
Net income tax expense	$—	$5,524,422

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Six months ended December 31, 2018 and 2017

Our revenues by category for the six months ended December 31, 2018 and 2017 are as follows:

	For the six months ended		Net change	
	December 31,			
	2018	2017	$	%
Total				
Consumables	$13,915,047	$11,505,826	$2,409,221	20.9 %
Equipment	5,622,570	4,098,742	1,523,828	37.2 %
Total	$19,537,617	$15,604,568	$3,933,049	25.2 %
Domestic:				
Consumables	$10,308,167	$8,722,636	$1,585,531	18.2 %
Equipment	1,179,711	1,329,930	(150,219)	-11.3%
Total	$11,487,878	$10,052,566	$1,435,312	14.3 %
International:				
Consumables	$3,606,880	$2,783,190	$823,690	29.6 %
Equipment	4,442,859	2,768,812	1,674,047	60.5 %
Total	$8,049,739	$5,552,002	$2,497,737	45.0 %

Revenues

Total revenue increased 25.2% or $3.9 million to $19.5 million during the first half fiscal 2019, from $15.6 million in the prior year period. The largest portion of the revenue increase was due to the continued growth of consumables in the domestic and international markets as expected. Domestic sales of BoneScalpel and SonicOne were strong, and the exceptional growth is in the wound franchise continued.

Domestic equipment revenues were below expectations due to timing issues with customers, while international equipment revenues were above expectations with continued momentum in China and other key markets.

The revenue increase is principally attributable to a 20.9% or $2.4 million increase in consumables revenue, in addition to a 37.2% or $1.5 million increase in equipment revenue.

There was no license revenue during the first half of fiscal 2019 or fiscal 2018.

Gross profit

Gross profit from product revenue in the first half of fiscal 2019 was 70.3% of revenue, compared with the gross profit margin of 70.2% in the first half of fiscal 2018.

Selling expenses

Selling expenses increased by $2.0 million, or 27.3% to $9.5 million in the first half of fiscal 2019 from $7.5 million in the prior year period. The increase is principally related to higher compensation costs and travel related expenses resulting from the continued buildout of the Company's direct sales force, along with higher trade show and sales training expenses.

General and administrative expenses

General and administrative expenses increased by $0.6 million, or 11.6% to $5.5 million in the first half of fiscal 2019 from $5.0 million in the prior year period. This increase is principally related higher compensation and benefit expenses and a $150,000 severance charge.

Research and development expenses

Research and development expenses increased by $0.3 million or 15% to $2.1 million in the first half of fiscal 2019 from $1.9 million in the prior year period. The Company is investing in the design and development of its next generation platform product, Nexus, which is expected to be available in fiscal 2019. During the first half of fiscal 2019 and 2018, approximately $1.0 million and $ $1.1 million, respectively, was charged to research and development expenses related to this product.

Other income (expense)

Other income was $19,888 in the first half of fiscal 2019 compared with $0.5 million in the prior year period. This decrease related to the royalty income from MMIT in the prior year. This royalty agreement expired in August 2017.

Income taxes

For the six months ended December 31, 2018 and 2017, the Company recorded an income tax expense of $0 and 5,243,422, respectively. For the six months ended December 31, 2018 and 2017, the effective rate of 0% and 185.6%, respectively, varied from the U.S. federal statutory rate due to changes in the Company’s projected pretax book income.

The income tax expense for the first half of fiscal 2018 included a one-time charge of $1,764,039 to revalue the Company’s deferred tax assets as of December 31, 2017 to give effect to the reduction in corporate tax rates to 21% effective January 1, 2018, as a result of the Tax Cuts and Jobs Act of 2017, enacted on December 22, 2017. Income tax expense also includes a $3,988,532 charge to record a full valuation allowance against the Company’s remaining deferred tax assets. In accordance with the guidance of ASC Topic 740, management concluded that in its judgment, the Company’s deferred tax assets at December 31, 2017 are not more likely-than-not realizable.

Income tax expense for the six months ended December 31, 2018 includes a $655,000 valuation allowance against the Company’s deferred tax assets recorded in the quarter. In accordance with the guidance of ASC Topic 740, management concluded that in its judgment, the Company’s deferred tax assets at December 31, 2018 are not more likely-than-not realizable. The components of the tax provision are as follows:

	For the six months ended December 31,	
	2018	2017
Income tax benefit	$(655,000)	$(509,149)
Reduction of deferred tax assets relating to Tax Legislation	—	1,764,039
Valuation allowance on deferred tax assets	655,000	3,988,532
Net income tax expense	$—	$5,243,422

Liquidity and Capital Resources

Working capital at December 31, 2018 was $16.3 million. For the six months ended December 31, 2018, cash used in operations was $1.1 million, mainly due the loss from operations during the period.

Cash used in investing activities during the six months ended December 31, 2018 was $0.6 million, primarily consisting of the purchase of property, plant and equipment along with filing for additional patents.

Cash provided by financing activities during the six months ended December 31, 2018 was $0.9 million, resulting from stock option exercises.

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As of December 31, 2018, the Company had cash and cash equivalents of approximately $10.2 million and believes it has sufficient cash to finance operations for at least the next 12 months.

Relating to the internal investigation described herein, the Company has incurred approximately $3.4 million in investigative costs through December 31, 2018. Further, the Company could be subject to fines or penalties related to potential violations of the FCPA.

The Company is investing in the design and development of its next generation platform product, Nexus, which is expected to be available in fiscal 2019 of which $1.0 million in development costs have been incurred during the six months ended December 31, 2018.

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on the Company's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to the Company.

Other

In the opinion of management, inflation has not had a material effect on the operations of the Company.

Recent Accounting Pronouncements

See Note 1 to our condensed consolidated financial statements included herein.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market Risk:

The principal market risks (i.e., the risk of loss arising from adverse changes in market rates and prices) to which the Company is exposed are interest rates on cash and cash equivalents.

Interest Rate Risk:

The Company earns interest on cash balances and pays interest on any debt incurred. In light of the Company's existing cash, results of operations and projected borrowing requirements, the Company does not believe that a 10% change in interest rates would have a significant impact on its consolidated financial position.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) that are designed to provide reasonable assurance that information required to be disclosed in reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and that such information is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

All internal control systems, no matter how well designed and tested, have inherent limitations, including, among other things, the possibility of human error, circumvention or disregard. Therefore, even those systems of internal control that have been determined to be effective can provide only reasonable assurance that the objectives of the control system are met and may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

We carried out an evaluation, under the supervision and with the participation of management, of the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2018. Based on that evaluation, and having concluded that the material weakness in our internal control over financial reporting initially reported in our Annual Report on Form 10-K for the fiscal year ended June 30, 2018 and in our subsequent Quarterly Report on Form 10-Q for the quarter ended September 30, 2018, has been remediated (as described below), our CEO and CFO have concluded that our disclosure controls and procedures were effective as of December 31, 2018.

Remediation of Previous Material Weaknesses in Internal Control Over Financial Reporting

Our annual report on Form 10-K for the fiscal year ended June 30, 2018 and subsequent quarterly report on Form 10-Q for the fiscal quarter ended September 30, 2018 (collectively, the “Prior Reports”) disclosed and described in detail material weaknesses in internal control with respect to the approval of journal entries. As a result, the foregoing Prior Reports contained conclusions by our CEO and CFO that our disclosure controls and procedures and internal control over financial reporting were not effective, as of the respective dates of such Prior Reports. As further described in the Prior Reports, we have implemented a series of remedial actions to address these control deficiencies. We have since successfully completed the testing of these remediated controls and our conclusions with respect to disclosure controls and procedures and internal control at December 31, 2018 are provided above.

Changes in Internal Control over Financial Reporting

Other than the remediation of the material weakness in internal control described above, there were no changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended December 31, 2018 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II — OTHER INFORMATION

Item 1. Legal Proceedings

Former Chinese Distributor - FCPA

With the assistance of outside counsel, the Company conducted a voluntary investigation into the business practices of the independent Chinese entity that previously distributed its products in China and the Company's knowledge of those business practices, which may have implications under the FCPA, as well as into various internal controls issues identified during the investigation (the "Investigation").

On September 27, 2016 and September 28, 2016, the Company voluntarily contacted the SEC and the DOJ, respectively, to advise both agencies of these potential issues. The Company has provided and will continue to provide documents and other information to the SEC and the DOJ, and is cooperating fully with these agencies in their ongoing investigations of these matters.

Although the Company's Investigation is complete, additional issues or facts could arise which may expand the scope or severity of the potential violations. The Company has no current information derived from the Investigation or otherwise to suggest that its previously reported financial statements and results are incorrect.

At this stage, the Company is unable to predict what, if any, action the DOJ or the SEC may take or what, if any, penalties or remedial measures these agencies may seek. Nor can the Company predict the impact on the Company as a result of these matters, which may include the imposition of fines, civil and criminal penalties, which are not currently estimable, as well as equitable remedies, including disgorgement of any profits earned from improper conduct and injunctive relief, limitations on the Company's conduct, and the imposition of a compliance monitor. The DOJ and the SEC periodically have based the amount of a penalty or disgorgement in connection with an FCPA action, at least in part, on the amount of profits that a company obtained from the business in which the violations of the FCPA occurred. During its distributorship relationship with the prior Chinese distributor from 2010 through 2016, the Company generated revenues of approximately $8 million.

Further, the Company may suffer other civil penalties or adverse impacts, including lawsuits by private litigants in addition to the lawsuits that already have been filed, or investigations and fines imposed by local authorities. The investigative costs to date are approximately $3.4 million, of which approximately $0.3 million and $0.4 million was charged to general and administrative expenses during the three and six months ended December 31, 2018, respectively, compared with $0.1 million and $0.3 million for the three and six months ended December 31, 2017.

Former Chinese Distributor – Litigation

On April 5, 2017, the Company's former distributor in China, Cicel (Beijing) Science & Technology Co., Ltd., filed a lawsuit against the Company and certain officers and directors of the Company in the United States District Court for the Eastern District of New York, alleging that the Company improperly terminated its contract with the former distributor. The complaint sought various remedies, including compensatory and punitive damages, specific performance and preliminary and post judgment injunctive relief, and asserted various causes of action, including breach of contract, unfair competition, tortious interference with contract, fraudulent inducement, and conversion. On October 7, 2017, the court granted the Company's motion to dismiss all of the tort claims asserted against it, and also granted the individual defendants' motion to dismiss all claims asserted against them. The only claim currently remaining in the case is for breach of contract against the Company; the plaintiff has moved to amend its complaint to add tort claims, which the Company has opposed. The Company believes it has various legal and factual defenses to the allegations in the complaint, and intends to vigorously defend the action. The case is at its earliest stages; discovery is just beginning and there is no trial date.

Stockholder Derivative Litigation

On June 6, 2017, Irving Feldbaum, an individual shareholder of Misonix, filed a lawsuit in the U.S. District Court for the Eastern District of New York. The complaint alleges claims against the Company's board of directors, its former CEO and CFO, certain of its former directors, and the Company as a nominal defendant for alleged violations of Section 14(a) of the Securities Exchange Act of 1934 and state law claims for breach of fiduciary duty, waste of corporate assets, and unjust enrichment. The complaint alleges that the Company incurred damages as a result of alleged false and misleading statements in the Company's securities filings concerning the Company's business, operations, and prospects and the Company's internal control over financial reporting. The complaint also alleges that the Company's February 4, 2016 Proxy Statement contained false and misleading statements regarding executive compensation. The complaint seeks the recovery of damages on behalf of the Company and the implementation of changes to corporate governance procedures. On June 16, 2017, Michael Rubin, another individual shareholder of Misonix, filed a case alleging similar claims in the same district court. On July 21, 2017, the district court consolidated the two actions for all purposes. On July 16, 2018, the Company and counsel for Mr. Feldbaum and Mr. Rubin informed the District Court that the parties had reached a settlement in principle. There are aspects of the settlement that remain to be negotiated and documented, and the settlement is subject to approval by the District Court after notice to the Company's shareholders.

Item 1A. Risk Factors.

Risks and uncertainties that, if they were to occur, could materially adversely affect our business or that could cause our actual results to differ materially from the results contemplated by the forward-looking statements contained in this Report and other public statements were set forth in the Item 1A. – "Risk Factors" section of our Form 10-K for the fiscal year ended June 30, 2018. There have been no material changes from the risk factors disclosed in that Form 10-K.

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Item 6. Exhibits

Exhibit No.	Description
31.1	Chief Executive Officer—Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Chief Financial Officer—Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Chief Executive Officer—Certification pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Chief Financial Officer—Certification pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Scheme Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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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 its behalf by the undersigned thereunto duly authorized.

MISONIX, INC.

Dated: February 6, 2019 By: /s/ Stavros G. Vizirgianakis
Stavros G. Vizirgianakis
Chief Executive Officer

By: /s/ Joseph P. Dwyer
Joseph P. Dwyer
Chief Financial Officer

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