

MISONIX INC  
Form 10-Q  
February 06, 2018

**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, 2017**

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**

*(State or other jurisdiction of incorporation or organization)* *(IRS Employer Identification No.)*

**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 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post 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 |                   | (Do not check if a smaller reporting 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 February 6, 2018 there were 9,400,666 shares of the registrant's common stock, \$0.01 par value, outstanding.

MISONIX, INC.

|  | <b>Page</b> |
|--|-------------|
| <b><u>PART I — FINANCIAL INFORMATION</u></b>   |             |
| <u>Item 1. Financial Statements</u>  | 3           |
| <u>Consolidated Balance Sheets at December 31, 2017 (Unaudited) and June 30, 2017</u>                                  | 3           |
| <u>Consolidated Statements of Operations for the Three and Six Months ended December 31, 2017 and 2016 (Unaudited)</u> | 4           |
| <u>Consolidated Statement of Shareholders' Equity for the Six Months ended December 31, 2017 (Unaudited)</u>           | 5           |
| <u>Consolidated Statements of Cash Flows for the Six Months ended December 31, 2017 and 2016 (Unaudited)</u>           | 6           |
| <u>Notes to Consolidated Financial Statements (Unaudited)</u>  | 7           |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                   | 16          |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>  | 21          |
| <u>Item 4. Controls and Procedures</u>   | 21          |
| <b><u>PART II — OTHER INFORMATION</u></b>  |             |
| <u>Item 1. Legal Proceedings</u>   | 23          |
| <u>Item 1A. Risk Factors</u>   | 24          |
| <u>Item 6. Exhibits</u>  | 25          |
| <u>Signatures</u>  | 26          |

**PART I — FINANCIAL INFORMATION****Item 1. Financial Statements****Misonix, Inc. and Subsidiaries  
Consolidated Balance Sheets**

|  | December 31,<br>2017<br>(unaudited) | June 30,<br>2017 |
|--|-------------------------------------|------------------|
| Assets   |                                     |                  |
| Current assets:  |                                     |                  |
| Cash and cash equivalents  | \$ 12,102,430                       | \$ 11,557,071    |
| Accounts receivable, less allowance for doubtful accounts of \$96,868 and \$96,868, respectively                             | 4,326,379                           | 5,133,389        |
| Inventories, net   | 5,048,875                           | 4,992,434        |
| Prepaid expenses and other current assets  | 328,621                             | 918,899          |
| Total current assets   | 21,806,305                          | 22,601,793       |
| Property, plant and equipment, net of accumulated amortization and depreciation of \$8,437,445 and \$7,794,580, respectively | 3,887,265                           | 3,730,203        |
| Patents, net of accumulated amortization of \$1,057,851 and \$995,568, respectively  | 715,032                             | 719,136          |
| Goodwill   | 1,701,094                           | 1,701,094        |
| Intangible and other assets  | 262,264                             | 282,876          |
| Deferred income tax  | —                                   | 4,334,547        |
| Total assets   | \$ 28,371,960                       | \$ 33,369,649    |
| Liabilities and shareholders' equity   |                                     |                  |
| Current liabilities:   |                                     |                  |
| Accounts payable   | \$ 1,651,078                        | \$ 1,861,228     |
| Accrued expenses and other current liabilities   | 1,876,047                           | 3,346,138        |
| Total current liabilities  | 3,527,125                           | 5,207,366        |
| Deferred lease liability   | 4,677                               | 9,354            |
| Deferred income  | 2,165,993                           | 13,087           |
| Total liabilities  | 5,697,795                           | 5,229,807        |
| Commitments and contingencies (Note 9)   |                                     |                  |
| Shareholders' equity:  |                                     |                  |
|  | 94,007                              | 93,572           |

Edgar Filing: MISONIX INC - Form 10-Q

|   |               |               |
|---|---------------|---------------|
| Common stock, \$.01 par value-shares authorized 20,000,000; 9,400,666 and 9,357,166 shares issued and outstanding, respectively |               |               |
| Additional paid-in capital  | 38,502,821    | 36,808,810    |
| Accumulated deficit   | (15,922,663 ) | (8,762,540 )  |
| Total shareholders' equity  | 22,674,165    | 28,139,842    |
| Total liabilities and shareholders' equity  | \$ 28,371,960 | \$ 33,369,649 |

*See Accompanying Notes to Consolidated Financial Statements.*

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

|   | For the three months ended<br>December 31, |               | For the six months ended<br>December 31, |                 |
|---|--|---------------|--|-----------------|
|   | 2017                                       | 2016          | 2017                                     | 2016            |
| Revenues  | \$ 8,323,845                               | \$ 6,030,380  | \$ 15,604,568                            | \$ 12,202,005   |
| Cost of goods sold, exclusive of depreciation<br>from consigned product | 2,465,826                                  | 1,818,672     | 4,643,181                                | 3,730,679       |
| Gross profit  | 5,858,019                                  | 4,211,708     | 10,961,387                               | 8,471,326       |
| Operating expenses:   |  |               |  |                 |
| Selling expenses  | 3,919,515                                  | 3,271,134     | 7,490,228                                | 6,596,821       |
| General and administrative expenses                                     | 2,380,860                                  | 2,087,419     | 4,953,991                                | 4,019,240       |
| Research and development expenses                                       | 957,204                                    | 440,364       | 1,858,478                                | 932,448         |
| Total operating expenses  | 7,257,579                                  | 5,798,917     | 14,302,697                               | 11,548,509      |
| Loss from operations  | (1,399,560 )                               | (1,587,209 )  | (3,341,310 )                             | (3,077,183 )    |
| Other income (expense):   |  |               |  |                 |
| Interest income   | 45   | 19            | 58                                       | 38              |
| Royalty income and license fees   | 71,550                                     | 949,048       | 524,521                                  | 1,893,116       |
| Other   | (4,387 )                                   | (6,640 )      | (8,845 )                                 | (8,636 )        |
| Total other income  | 67,208                                     | 942,427       | 515,734                                  | 1,884,518       |
| Loss from operations before income taxes                                | (1,332,352 )                               | (644,782 )    | (2,825,576 )                             | (1,192,665 )    |
| Income tax expense / (benefit)  | 5,524,422                                  | (30,000 )     | 5,243,422                                | (56,000 )       |
| Net loss  | \$ (6,856,774 )                            | \$ (614,782 ) | \$ (8,068,998 )                          | \$ (1,136,665 ) |
| Net loss per share - Basic  | \$ (0.76 )                                 | \$ (0.07 )    | \$ (0.90 )                               | \$ (0.14 )      |
| Net loss per share - Diluted  | \$ (0.76 )                                 | \$ (0.07 )    | \$ (0.90 )                               | \$ (0.14 )      |
| Weighted average shares - Basic   | 8,977,984                                  | 8,374,900     | 8,968,195                                | 8,092,143       |
| Weighted average shares - Diluted                                       | 8,977,984                                  | 8,374,900     | 8,968,195                                | 8,092,143       |

*See Accompanying Notes to Consolidated Financial Statements.*

**Misonix, Inc. and Subsidiaries**  
**Consolidated Statement of Shareholders' Equity**  
**(Unaudited)**

|  | Common Stock,<br>\$.01 Par Value |           | Additional<br>paid-in<br>capital | Accumulated<br>deficit | Total<br>stockholders'<br>equity |
|--|----------------------------------|-----------|----------------------------------|------------------------|----------------------------------|
|  | Number<br>of shares              | Amount    |                                  |                        |                                  |
| Balance, June 30, 2017                       | 9,357,166                        | \$ 93,572 | \$ 36,808,810                    | \$ (8,762,540 )        | \$ 28,139,842                    |
| Implementation of new accounting<br>standard |                                  |           |                                  | 908,875                | 908,875                          |
| Net loss                                     |                                  |           |                                  | (8,068,998 )           | (8,068,998 )                     |
| Proceeds from exercise of stock<br>options   | 43,500                           | 435       | 224,117                          |                        | 224,552                          |
| Stock-based compensation                     |                                  |           | 1,469,894                        |                        | 1,469,894                        |
| Balance, December 31, 2017                   | 9,400,666                        | \$ 94,007 | \$ 38,502,821                    | \$ (15,922,663 )       | \$ 22,674,165                    |

*See Accompanying Notes to Consolidated Financial Statements.*



**Misonix, Inc. and Subsidiaries**  
**Consolidated Statements of Cash Flows**  
**(Unaudited)**

|   | For the six months ended<br>December 31, |                 |
|---|--|-----------------|
|   | 2017                                     | 2016            |
| Operating activities  |  |                 |
| Net loss  | \$ (8,068,998 )                          | \$ (1,136,665 ) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: |  |                 |
| Depreciation and amortization and other non-cash items                                    | 677,292                                  | 482,042         |
| Disposals of property, plant and equipment  | 128,746                                  | —               |
| Deferred income tax expense / (benefit)   | 5,243,422                                | (56,000 )       |
| Stock-based compensation  | 1,469,894                                | 83,865          |
| Deferred lease liability  | (4,677 )                                 | 46              |
| Changes in operating assets and liabilities:  |  |                 |
| Accounts receivable   | 807,010                                  | 99,259          |
| Inventories   | (839,361 )                               | (116,874 )      |
| Prepaid expenses and other assets   | 610,890                                  | 189,522         |
| Deferred income   | 2,152,906                                | (23,920 )       |
| Accounts payable, accrued expenses  | (1,680,241 )                             | 377,394         |
| Net cash provided by (used in) operating activities                                       | 496,883                                  | (101,331 )      |
| Investing activities  |  |                 |
| Acquisition of property, plant and equipment  | (117,897 )                               | (167,548 )      |
| Acquisition of patents  | (58,179 )                                | (155,175 )      |
| Net cash used in investing activities   | (176,076 )                               | (322,723 )      |
| Financing activities  |  |                 |
| Proceeds from exercise of stock options   | 224,552                                  | 140,847         |
| Proceeds from the sale of common stock  | —  | 4,000,000       |
| Net cash provided by financing activities   | 224,552                                  | 4,140,847       |
| Net increase in cash and cash equivalents   | 545,359                                  | 3,716,793       |
| Cash and cash equivalents at beginning of period  | 11,557,071                               | 9,049,327       |
| Cash and cash equivalents at end of period  | \$ 12,102,430                            | \$ 12,766,120   |
| Supplemental disclosure of cash flow information:   |  |                 |
| Cash paid for:  |  |                 |
| Income taxes  | \$ 895                                   | \$ 2,053        |
| Supplemental disclosure of non-cash information:  |  |                 |
| Transfer of inventory to property, plant and equipment                                    | \$ 782,920                               | \$ 953,288      |
| Adoption of new accounting standard on deferred taxes                                     | \$ 908,875                               | \$ —            |

*See Accompanying Notes to Consolidated Financial Statements.*

6

**Misonix, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

**For the Three and Six Months Ended December 31, 2017 and 2016 (unaudited)**

**1. Basis of Presentation, Organization and Business and Summary of Significant Accounting Policies**

**Basis of Presentation**

These consolidated financial statements of Misonix, Inc. (“Misonix” or the “Company”) include the accounts of Misonix and its 100% owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, these financial statements do not include all the information and footnotes required by U.S. GAAP for complete financial statements. As such, they should be read with reference to the Company’s Annual Report on Form 10-K for the fiscal year ended June 30, 2017, which provides a more complete explanation of the Company’s accounting policies, financial position, operating results, business properties and other matters. In the opinion of management, these financial statements reflect all adjustments considered necessary for a fair statement of interim results.

**Organization and Business**

Misonix designs, manufactures, develops and markets therapeutic ultrasonic devices. These products are used for precise bone sculpting, removal of soft tumors, and tissue debridement in the fields of orthopedic surgery, plastic surgery, neurosurgery, podiatry and vascular surgery. In the United States, the Company sells its products through a network of commissioned agents assisted by Company personnel. Outside of the United States, the Company sells to distributors who then resell the product to hospitals. The Company operates as one business segment.

***High Intensity Focused Ultrasound Technology***

The Company sold its rights to the high intensity focused ultrasound technology to SonaCare Medical, LLC (“SonaCare”) in May 2010. The Company may receive up to approximately \$5.8 million in payment for the sale. SonaCare will pay the Company 7% of the gross revenues received from its sales of the (i) prostate product in Europe and (ii) kidney and liver products worldwide, until the Company has received payments of \$3 million, and thereafter 5% of the gross revenues, up to an aggregate payment of \$5.8 million, all subject to a minimum annual royalty of \$250,000. Cumulative payments through December 31, 2017 were \$2,292,579.

### **Major Customers and Concentration of Credit Risk**

Total royalties from Medtronic Minimally Invasive Therapies (“MMIT”) related to their sales of the Company’s ultrasonic cutting and sculpting products, which use high frequency sound waves to coagulate and divide tissue for both open and laparoscopic surgery, were \$524,000 and \$1,885,788 for the six months ended December 31, 2017 and 2016, respectively. Accounts receivable from MMIT royalties were \$925,000 at June 30, 2017. The license agreement with MMIT expired in August 2017.

At December 31, 2017 and June 30, 2017, the Company’s accounts receivable with customers outside the United States were approximately \$627,000 and \$860,000, respectively, none of which is over 90 days.

## **Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and judgments that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates and assumptions are used for but not limited to establishing the allowance for doubtful accounts, valuation of inventory, depreciation, asset impairment evaluations and establishing deferred tax assets and related valuation allowances, and stock-based compensation. Actual results could differ from those estimates.

## **Loss Per Share**

Diluted EPS for the three and six months ended December 31, 2017 and 2016 as presented is the same as basic EPS as the inclusion of the effect of common share equivalents then outstanding would be anti-dilutive. Accordingly, excluded from the calculation of diluted EPS are outstanding options to purchase 375,000 and 521,000 shares of common stock for the three months ended December 31, 2017 and 2016, respectively, and outstanding options to purchase 1,366,736 and 1,734,649 shares of common stock for the six months ended December 31, 2017 and 2016, respectively.

## **Recent Accounting Pronouncements**

In May 2014, the Financial Accounting Standards Board (the "FASB") issued guidance on revenue from contracts with customers. The underlying principle is that an entity will recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. The guidance provides a five-step analysis of transactions to determine when and how revenue is recognized. Other major provisions include capitalization of certain contract costs, consideration of time value of money in the transaction price, and allowing estimates of variable consideration to be recognized before contingencies are resolved, in certain circumstances. The guidance also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. This guidance permits the use of either the retrospective or cumulative effect transition method and is effective for the Company beginning in fiscal 2019; early adoption is permitted beginning in 2018. We have not yet selected a transition method and are currently evaluating the impact of the guidance on the Company's financial condition, results of operations and related disclosures. The FASB has also issued the following additional guidance clarifying certain issues on revenue from contracts with customers: Revenue from Contracts with Customers - Narrow-Scope Improvements and Practical Expedients and Revenue from Contracts with Customers - Identifying Performance Obligations and Licensing. The Company has engaged a consulting firm to assist with in evaluating this guidance to determine the impact it will have on its financial statements, and expects to complete its evaluation and implementation of necessary procedures and changes, if any,

prior to June 30, 2018.

In February 2016, the FASB issued guidance on lease accounting requiring lessees to recognize a right-of-use asset and a lease liability for long-term leases. The liability will be equal to the present value of lease payments. This guidance must be applied using a modified retrospective transition approach to all annual and interim periods presented and is effective for the Company beginning in fiscal 2020. The Company is currently in the early stages of evaluating this guidance to determine the impact it will have on its financial statements.

In August 2016, the FASB issued guidance on the Statement of Cash Flows Classification of certain cash receipts and cash payments (a consensus of the Emerging Issues Task Force). This guidance addresses the following eight specific cash flow issues: Debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies (including bank-owned life insurance policies); distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. This guidance will be effective for the Company beginning in fiscal 2019. The Company is currently in the early stages of evaluating this guidance to determine the impact it will have on its financial statements.

In January 2017, the FASB issued ASU No. 2017-01, *Business Combinations: Clarifying the Definition of a Business* (“ASU 2017-01”). ASU 2017-01 clarifies the definition of a business for determining whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. ASU 2017-01 is effective for annual periods and interim periods within those annual periods beginning after December 15, 2017, and early adoption is permitted. The Company is in the process of evaluating the impact of the adoption of ASU 2017-01 on its consolidated financial statements.

There are no other recently issued accounting pronouncements that are expected to have a material effect on the Company's financial position, results of operations or cash flows.

### **Recently Adopted Accounting Pronouncements**

In March 2016, the FASB issued Accounting Standards Update No. 2016-09 "Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting" intended to simplify several aspects of accounting for share-based payment transactions. The Company adopted these amendments beginning in the first quarter of fiscal 2018. The guidance requires that all excess tax benefits and tax deficiencies previously recorded as additional paid-in capital be prospectively recorded in income tax expense. The guidance allows for an increase in the threshold for net share settlement up to the maximum statutory rate in employees' applicable jurisdictions without triggering liability classification. The adoption of this guidance had an immaterial impact on income taxes on the Company's Consolidated Statement of Operations for the three and six months ended December 31, 2017. The Company elected to apply the presentation requirement for cash flows related to excess tax benefits prospectively, which had an immaterial impact on both net cash from operating activities and net cash used in financing activities for the three and six months ended December 31, 2017. The presentation requirements for cash flows related to employee taxes paid for withheld shares had no impact on any of the periods presented on the Company's Consolidated Statements of Cash Flows since such cash flows have historically been presented as a financing activity. Finally, the Company has elected to account for forfeitures as they occur, rather than estimate expected forfeitures. As a result, the Company recorded the cumulative impact of \$908,875 as an increase to Deferred Income Taxes with a corresponding decrease to Accumulated Deficit.

### **2. Fair Value of Financial Instruments**

We follow a three-level fair value hierarchy that prioritizes the inputs to measure fair value. This hierarchy requires entities to maximize the use of "observable inputs" and minimize the use of "unobservable inputs." The three levels of inputs used to measure fair value are as follows:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect assumptions that market participants would use in pricing an asset or liability.

At December 31, 2017 and June 30, 2017, all of our cash and cash equivalents, trade accounts receivable and trade accounts payable were short term in nature, and their carrying amounts approximate fair value.

### 3. Inventories

Inventories are summarized as follows:

|                        | December<br>31,<br>2017 | June 30,<br>2017 |
|------------------------|-------------------------|------------------|
| Raw material           | \$2,489,274             | \$2,409,148      |
| Work-in-process        | 1,076,545               | 741,994          |
| Finished goods         | 2,000,748               | 3,267,232        |
|                        | 5,566,567               | 6,418,374        |
| Less valuation reserve | 517,692                 | 1,425,940        |
|                        | \$5,048,875             | \$4,992,434      |



#### 4. Property, Plant and Equipment

Depreciation and amortization of property, plant and equipment was \$615,000 and \$429,000 for the six months ended December 31, 2017 and 2016, respectively. Inventory items included in property, plant and equipment are depreciated using the straight line method over estimated useful lives of 3 to 5 years. Depreciation of generators which are consigned to customers was expensed over a 5 year period during the six months ended December 31, 2017 and was expensed over a 3 year period for the six months ended December 31, 2016, and depreciation was charged to selling expenses.

#### 5. Goodwill

Goodwill is not amortized. We review goodwill for impairment annually and whenever events or changes indicate that the carrying value of an asset may not be recoverable. These events or circumstances could include a significant change in the business climate, legal factors, operating performance indicators, competition, or sale or disposition of significant assets or products. Application of these impairment tests requires significant judgments, including estimation of cash flows, which is dependent on internal forecasts, estimation of the long term rate of growth for the Company's business, the useful lives over which cash flows will occur and determination of the Company's weighted average cost of capital. The Company primarily utilizes the Company's market capitalization and a discontinued cash flow model in determining the fair value which consists of Level 3 inputs. Changes in the projected cash flows and discount rate estimates and assumptions underlying the valuation of goodwill could materially affect the determination of fair value at acquisition or during subsequent periods when tested for impairment. The Company completed its annual goodwill impairment tests for fiscal 2017 and 2016 as of June 30 of each year. There were no triggering events identified during the quarter ended December 31, 2017.

#### 6. Patents

The costs of acquiring or processing patents are capitalized at cost. These amounts are being amortized using the straight-line method over the estimated useful lives of the underlying assets, which is approximately 17 years. Patents totaled \$715,032 and \$719,136 at December 31, 2017 and June 30, 2017, respectively. Amortization expense for the six months ended December 31, 2017 and 2016 was \$61,000 and \$53,000, respectively. The following is a schedule of estimated future patent amortization expenses by fiscal year as of December 31, 2017:

|      |          |
|------|----------|
| 2018 | \$60,839 |
| 2019 | 112,556  |
| 2020 | 89,127   |

Edgar Filing: MISONIX INC - Form 10-Q

|            |           |
|------------|-----------|
| 2021       | 82,956    |
| 2022       | 54,032    |
| Thereafter | 315,522   |
|            | \$715,032 |

## 7. Accrued Expenses and Other Current Liabilities

The following summarizes accrued expenses and other current liabilities:

|                          | December<br>31,<br>2017 | June 30,<br>2017 |
|--------------------------|-------------------------|------------------|
| Accrued vacation         | \$203,346               | \$715,245        |
| Accrued bonus            | 250,000                 | 343,400          |
| Accrued commissions      | 610,192                 | 751,000          |
| Professional fees        | 133,487                 | 662,537          |
| Litigation settlement    | —                       | 500,000          |
| Deferred income          | 19,236                  | 27,901           |
| Trade payables and other | 659,786                 | 346,055          |
|                          | \$1,876,047             | \$3,346,138      |

## 8. Stock-Based Compensation Plans

### Stock Option Awards

For the six months ended December 31, 2017 and 2016, the compensation cost relating to stock option awards that has been charged against income for the Company's stock option plans was \$1,016,026 and \$83,865 respectively, which included a charge to modify certain stock options of \$81,765 and a reversal of stock compensation from prior periods due to forfeitures of unvested options of \$616,239, for the six months ended December 31, 2016. As of December 31, 2017, there was approximately \$5,787,705 of total unrecognized compensation cost related to non-vested share-based compensation arrangements to be recognized over a weighted-average period of 3.0 years.

Stock options typically expire 10 years from the date of grant and vest over service periods, which typically are 4 years. All options are granted at fair market value, as defined in the applicable plans.

The fair value of each option award was estimated on the date of grant using the Black-Scholes option valuation model that uses the assumptions noted in the following table. The expected volatility represents the historical price

changes of the Company's stock over a period equal to that of the expected term of the option. The Company uses the simplified method for determining the option term. The risk-free rate was based on the U.S. Treasury yield curve in effect at the time of grant. The expected dividend yield is based upon historical and projected dividends. The Company has historically not paid dividends, and is not expected to do so in the near term.

The weighted average fair value at date of grant for options granted during the six months ended December 31, 2017 was \$5.50. There were options to purchase 305,500 and 327,500 shares granted during the six months ended December 31, 2017 and 2016, respectively. The fair value was estimated based on the weighted average assumptions of:

|                                 | For six months<br>ended<br>December 31, |        |
|---------------------------------|---|--------|
|                                 | 2017                                    | 2016   |
| Risk-free interest rates        | 1.98 %                                  | 1.80 % |
| Expected option life in years   | 5.95                                    | 6.25   |
| Expected stock price volatility | 57.42%                                  | 54.68% |
| Expected dividend yield         | 0 %                                     | 0 %    |

A summary of option activity under the Company's equity plans as of December 31, 2017, and changes during the six months ended December 31, 2017 is presented below:

|   | Outstanding<br>Shares | Average<br>Exercise<br>Price | Aggregate<br>Intrinsic<br>Value |
|---|-----------------------|------------------------------|---------------------------------|
| Outstanding at June 30, 2017                | 1,191,236             | \$ 7.66                      | \$2,748,956                     |
| Granted                                     | 305,500               | \$ 10.10                     |                                 |
| Exercised                                   | (43,500 )             | \$ 5.16                      |                                 |
| Forfeited                                   | (11,500 )             | \$ 7.45                      |                                 |
| Expired                                     | (75,000 )             | \$ 4.87                      |                                 |
| Outstanding as of December 31, 2017         | 1,366,736             | \$ 8.44                      | \$2,090,727                     |
| Vested and exercisable at December 31, 2017 | 589,484               | \$ 7.08                      | \$1,651,775                     |

The total fair value of shares vested during the six months ended December 31, 2017 was \$924,483. The number and weighted-average grant-date fair value of non-vested stock options at the beginning of fiscal 2018 was 673,875 and \$4.77, respectively. The number and weighted-average grant-date fair value of stock options which vested during the six months ended December 31, 2017 was 193,123 and \$4.79, respectively.

### Restricted Stock Awards

On December 15, 2016, the Company issued 400,000 shares of restricted stock to its Chief Executive Officer. These awards vest over a period of up to five years, subject to meeting certain service, performance and market conditions. These awards were valued at approximately \$3.6 million and compensation expense recorded in the six months ended December 31, 2017 related to these awards was \$453,868. As of December 31, 2017, 26,800 shares from this set of awards have vested.

## 9. Commitments and Contingencies

### Leases

The Company has entered into several non-cancellable operating leases for the rental of certain manufacturing and office space, equipment and automobiles expiring in various years through 2021. The principal building lease provides for a monthly rental of approximately \$26,000. The Company also leases certain office equipment and automobiles

under operating leases expiring through March 2019.

### **Class Action Securities Litigation**

On September 19, 2016, Richard Scalfani, an individual shareholder of Misonix, filed a lawsuit against the Company and its former CEO and CFO in the U.S. District Court for the Eastern District of New York, alleging violations of the federal securities laws. The complaint alleges that the Company's stock price was artificially inflated between November 5, 2015 and September 14, 2016 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. Scalfani filed the action seeking to represent a putative class of all persons (other than defendants, officers and directors of the Company, and their affiliates) who purchased publicly traded Misonix securities between November 5, 2015 and September 14, 2016. Scalfani was seeking an unspecified amount of damages for himself and for the putative class under the federal securities laws. On March 24, 2017, the Court appointed Scalfani and another individual Misonix shareholder, Tracey Angiuoli, as lead plaintiffs for purposes of pursuing the action on behalf of the putative class. The lead plaintiffs, on behalf of the putative class, and the Company reached a settlement in principle under which the Company would pay \$500,000 to resolve the matter. The district court approved the settlement and dismissed the lawsuit with prejudice in an order dated December 16, 2017. The Company has paid its \$250,000, representing its insurance retention. The balance was paid by the Company's insurance carrier.

### **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.

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 \$2.8 million, of which approximately \$0.1 million and \$0.3 million was charged to general and administrative expenses during the three and six months ended December 31, 2017, respectively, compared with \$0.6 million and \$1.4 million for the three and six months ended December 31, 2016.

### **Former Chinese Distributor – Litigation**

On April 5, 2017, the Company's former distributor in China, Cikel (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 remaining in the case is for breach of contract against the Company. 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. The case is at its earliest stages; there has been no discovery and there is no trial date. The Company is not able either to estimate the amount of potential loss it may recognize, if any, from these claims or to identify any changes in corporate governance procedures it may undertake, if any, as a result of these claims.



## 10. Related Party Transactions

OrthoXact Proprietary Limited (“OrthoXact”) (formerly Applied BioSurgical) is an independent distributor for the Company in South Africa. The chief executive officer of OrthoXact is also the brother of Stavros G. Vizirgianakis, the CEO of Misonix, Inc.

Set forth below is a table showing the Company’s net revenues for the six months ended December 31 and accounts receivable at December 31 for the indicated time periods below with OrthoXact:

|                     | For the six months<br>ended<br>December 31, |           |
|---------------------|---|-----------|
|                     | 2017  | 2016      |
| Sales               | \$436,551                                   | \$278,036 |
| Accounts receivable | \$172,292                                   | \$274,641 |

## 11. Income Taxes

For the three and six months ended December 31, 2017 and 2016, the Company recorded income tax expense (benefit), as follows:

|   | For the three months<br>ended<br>December 31, |              | For the six months ended<br>December 31, |              |
|---|---|--------------|--|--------------|
|   | 2017  | 2016         | 2017                                     | 2016         |
| Income tax benefit  | \$ (228,149 )                                 | \$ (30,000 ) | \$ (509,149 )                            | \$ (56,000 ) |
| Provisional reduction of deferred tax asset relating to Tax Legislation | 1,764,039                                     | —            | 1,764,039                                | —            |
| Valuation allowance on deferred tax asset                               | 3,988,532                                     | —            | 3,988,532                                | —            |
| Net income tax expense (benefit)  | \$ 5,524,422                                  | \$ (30,000 ) | \$ 5,243,422                             | \$ (56,000 ) |

For the six months ended December 31, 2017 and 2016, the effective rate of 185.6% and (4.7)%, respectively, varied from the U.S. federal statutory rate primarily due to the recording of a full valuation allowance on the remaining deferred tax assets, permanent book tax differences relating principally to stock compensation expense and tax credits, and the impact of the Tax Cuts and Jobs Act of 2017.

### **Tax Cuts and Jobs Act of 2017**

The Tax Cuts and Jobs Act of 2017 (the “Tax Legislation”), enacted on December 22, 2017, contains significant changes to U.S. tax law, including lowering the U.S. corporate income tax rate to 21%, implementing a territorial tax system, and imposing a one-time tax on deemed repatriated earnings of foreign subsidiaries.

The Tax Legislation reduces the U.S. statutory tax rate from 35% to 21%, effective January 1, 2018. U.S. tax law requires that taxpayers with a fiscal year that begins before and ends after the effective date of a rate change calculate a blended tax rate based on the pro rata number of days in the fiscal year before and after the effective date. As a result, for the fiscal year ending June 30, 2018, the Company’s statutory income tax rate will be 29.03%. For the fiscal year ending June 30, 2019, the Company’s statutory income tax rate will be 22.62%.

On December 22, 2017, the SEC staff issued Staff Accounting Bulletin No. 118 (“SAB 118”), which provides guidance on accounting for the tax effects of the Tax Legislation. SAB 118 provides a measurement period that should not extend beyond one year from the Tax Legislation enactment date for companies to complete the accounting under ASC 740, Income Taxes. In accordance with SAB 118, a company must reflect the income tax effects of those aspects of the Tax Legislation for which the accounting under ASC 740 is complete. To the extent that a company’s accounting for certain income tax effects of the Tax Legislation is incomplete but it is able to determine a reasonable estimate, it must record a provisional estimate in the financial statements. During the three months ended December 31, 2017, using the information available at the time, the Company recorded a provisional \$1,764,039 discrete tax expense representing the expense of remeasuring its U.S. deferred tax assets at the lower 21% statutory tax rate. The Company may make additional adjustments in fiscal 2018 as further information is identified to properly record this adjustment.

### **Valuation Allowance on Deferred Tax Assets**

Deferred tax assets refer to assets that are attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets in essence represent future savings of taxes that would otherwise be paid in cash. The realization of the deferred tax assets is dependent upon the generation of sufficient future taxable income, including capital gains. If it is determined that the deferred tax assets cannot be realized, a valuation allowance must be established, with a corresponding charge to net income.

In accordance with ASC Topic 740, the Company establishes valuation allowances for deferred tax assets that, in its judgment are not more likely-than-not realizable. The guidance requires entities to evaluate all available positive and negative evidence, including cumulative results in recent periods, weighted based on its objectivity, in determining whether its deferred tax assets are more likely than not realizable.

The Company regularly assesses its ability to realize its deferred tax assets. While the Company had positive cumulative pretax income as of June 30, 2017, based on actual results to date and the Company's current forecast for fiscal 2018 it expects to be in a cumulative pretax loss position as of June 30, 2018. Management evaluated available positive evidence, including the continued growth of the Company's revenues and gross profit margins, its recent SonaStar technology sale to its Chinese partner and the reduction in investigative and professional fees recognized in fiscal 2017, along with available negative evidence, including the Company's continuing investment in building its next generation Nexus platform and its continuing investment in building a direct sales force, while at the same time paying commissions to its domestic sales distributors. After weighing both the positive and negative evidence, management concluded that the Company's deferred tax assets are not more likely-than-not realizable. Accordingly, the Company recorded a full valuation allowance of \$3,988,532 against its remaining deferred tax assets at December 31, 2017. The Company will continue to assess its ability to utilize its net operating loss carryforwards, and will reverse this valuation allowance when sufficient evidence is achieved to allow the realizability of such deferred tax assets.

As of December 31, 2017 and June 30, 2017, the Company has no material unrecognized tax benefits or accrued interest and penalties.

## **12. Licensing Agreements for Medical Technology**

On October 19, 2017, the Company entered into a License and Exclusive Manufacturing Agreement (the “Agreement”) with Hunan Xing Hang Rui Kang Bio-technologies Co., Ltd., a Chinese corporation (the “Licensee”) under which Misonix has licensed certain manufacturing and distribution rights to its SonaStar product line in China, Hong Kong and Macau (the “Territory”) in exchange for payments totaling at least \$11,000,000.

Pursuant to the Agreement, Licensee is obligated to pay the Company: (i) initial amounts consisting of upfront fees and stocking orders totaling \$5,000,000, payable in five (5) equal monthly installments of \$1,000,000 each; (ii) royalty payments from the sale of SonaStar products in the Territory, including minimum royalty payments of \$2,000,000 per calendar year in each of 2019, 2020, and 2021; and (iii) reimbursement of technology transfer costs in an amount up to \$1,000,000. The Agreement also provides that Misonix will supply SonaStar products to Licensee at agreed prices during the transition period prior to Licensee’s commencement of manufacturing.

In October 1996, the Company entered into a license agreement with MMIT which expired August 2017, covering the further development and commercial exploitation of the Company’s medical technology relating to laparoscopic products, which uses high frequency sound waves to coagulate and divide tissue for both open and laparoscopic surgery. The MMIT license provided for exclusive worldwide marketing and sales rights for this technology. The Company received a 5% royalty on sales of these products by MMIT. Royalties from this license agreement were \$524,000 and \$1,886,000 for the six months ended December 31, 2017 and 2016, respectively. This royalty agreement expired in August 2017.

## **13. Segment Reporting**

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated on a regular basis by the chief operating decision-maker (“CODM”) in deciding how to allocate resources to an individual segment and in assessing performance of the segment. The Company has concluded that its Chief Executive Officer is the CODM as he is the ultimate decision maker for key operating decisions, determining the allocation of resources and assessing the financial performance of the Company. These decisions, allocations and assessments are performed by the CODM using consolidated financial information. Consolidated financial information is utilized by the CODM as the Company’s current product offering primarily consists of minimally invasive therapeutic ultrasonic medical devices. The Company’s products are relatively consistent and manufacturing

is centralized and consistent across product offerings. Based on these factors, key operating decisions and resource allocations are made by the CODM using consolidated financial data and as such the Company has concluded that it operates as one segment.

Worldwide revenue for the Company's products is categorized as follows:

|               | For the three months ended |              | For the six months ended |               |
|---------------|----------------------------|--------------|--------------------------|---------------|
|               | December 31,               |              | December 31,             |               |
|               | 2017                       | 2016         | 2017                     | 2016          |
| Domestic      | \$ 5,400,423               | \$ 4,117,238 | \$ 10,052,566            | \$ 8,003,795  |
| International | 2,923,422                  | 1,913,142    | 5,552,002                | 4,198,210     |
| Total         | \$ 8,323,845               | \$ 6,030,380 | \$ 15,604,568            | \$ 12,202,005 |

Substantially all of the Company's long-lived assets are located in the United States.

## 14. Severance

On August 26, 2016, the Company and the Company's former Chief Executive Officer, Michael McManus ("McManus") entered into a retirement agreement and general release (the "Retirement Agreement"). Pursuant to the Retirement Agreement, on September 2, 2016 Mr. McManus resigned as a Director and the Chairman of the Board of Directors of the Company and retired as President and Chief Executive Officer of the Company. Pursuant to the Retirement Agreement, the Company agreed to (i) pay Mr. McManus' salary through June 30, 2017 at the then current level; (ii) continue to pay premiums for Mr. McManus' and his dependents' coverage under the Company's medical, dental, vision, hospitalization, long term care and life insurance coverage through June 30, 2017 at the then current levels upon timely election by Mr. McManus under the law informally known as COBRA; and (iii) extend the exercisability of previously granted and then currently vested options to purchase shares of Common Stock through June 30, 2017. In addition, Mr. McManus had continued use of the vehicle provided him pursuant to his prior employment agreement through December 31, 2016. In connection with this Retirement Agreement, the Company recorded a charge of \$330,000 during the quarter ended September 30, 2016 to accrue for the cash portion of these benefits, which was paid during the fiscal year ended June 30, 2017. In addition, during the quarter ended June 30, 2016, the Company recorded a non-cash compensation expense of \$61,000 in connection with the modification of the terms of his vested stock options, and recorded a reduction in non-cash compensation expense of \$596,000 relating to the forfeiture of his unvested stock options.

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

This Management's Discussion and Analysis of Financial Condition and Results of Operations of Misonix and its subsidiaries, which we refer to as the "Company", "Misonix", "we", "our" and "us", should be read in conjunction with the accompanying unaudited financial statements included in Part I – Item 1 "Financial Statements" of this Report and Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K, filed with the Securities and Exchange Commission (the "SEC") on August 24, 2017, for the fiscal year ended June 30, 2017 ("2017 Form 10-K"). Item 7 of the 2017 Form 10-K describes the application of our critical accounting policies, for which there have been no significant changes during the three and six months ended December 31, 2017.

## Forward Looking Statements

With the exception of historical information contained in this Form 10-Q, content herein may contain "forward looking statements" that are made pursuant to the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995. These statements are based on management's current expectations and are subject to uncertainty and changes in circumstances. We cannot guarantee that any forward looking statements will be accurate, although we believe that we have been reasonable in our expectations and assumptions. Investors should realize that if underlying assumptions

prove inaccurate or unknown risks or uncertainties materialize, actual results could vary materially from our expectations and projections. These factors include general economic conditions, delays and risks associated with the performance of contracts, risks associated with international sales and currency fluctuations, uncertainties as a result of research and development, acceptable results from clinical studies, including publication of results and patient/procedure data with varying levels of statistical relevance, risks involved in introducing and marketing new products, regulatory compliance, potential acquisitions, consumer and industry acceptance, litigation and/or contemplated 510(k) filings, the ability to achieve and maintain profitability in our business lines, and other factors discussed in the 2017 Form 10-K, subsequent Quarterly Reports on Form 10-Q and Current Reports on Form 8-K. We disclaim any obligation to update any forward-looking statements.

## **Overview**

Misonix designs, manufactures, develops and markets therapeutic ultrasonic devices. These products are used for precise bone sculpting, removal of soft and hard tumors, and tissue debridement, orthopedic surgery, plastic surgery, and wound and burn care. In the United States, the Company sells its products through its direct sales force, in addition to a network of commissioned agents assisted by Company personnel. Outside of the United States, the Company generally sells to distributors who then resell the product to hospitals. The Company operates as one business segment.

In the United States, the Company is taking a more aggressive approach to taking market share, expanding the market and increasing its share of recurring disposable revenue by using a consignment model, whereby the Company will consign the equipment (which is defined as a generator, hand units and accessories) (the “Equipment”) and sell to customers higher margin disposable, single use items (the “Consumables”) on a recurring basis. Title remains with the Company with respect to consigned Equipment, which is depreciated and charged to selling expenses over a five year period beginning in fiscal 2017, and a three year period in fiscal 2016. Outside of the United States, the Company has principally not yet adopted a consignment model. The Company’s overall goal is to increase the utilization rate of Equipment which will increase the total number of procedures and maximize the sale of Consumables to our customers, with the goal of becoming the standard of care in the various segments we focus on.

## Results of Operations

The following discussion and analysis provides information which the Company’s management believes is relevant to an assessment and understanding of the Company’s results of operations and financial condition. This discussion should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere herein. Unless otherwise specified, this discussion relates solely to the Company’s continuing operations.

All of the Company’s revenues have been derived from the sale of medical device products, which include manufacture and distribution of ultrasonic medical device products.

### Three months ended December 31, 2017 and 2016

Our revenues by category for the three months ended December 31, 2017 and 2016 are as follows:

|             | For the three months ended |                   | Net change  |        |
|-------------|----------------------------|-------------------|-------------|--------|
|             | December 31, 2017          | December 31, 2016 | \$          | %      |
| Total       |                            |                   |             |        |
| Consumables | \$6,162,064                | \$4,908,885       | \$1,253,179 | 25.5 % |
| Equipment   | 2,161,781                  | 1,121,495         | 1,040,286   | 92.8 % |
| Total       | \$8,323,845                | \$6,030,380       | \$2,293,465 | 38.0 % |
| Domestic:   |                            |                   |             |        |
| Consumables | \$4,623,545                | \$3,844,609       | \$778,936   | 20.3 % |



Edgar Filing: MISONIX INC - Form 10-Q

|           |             |             |             |        |
|-----------|-------------|-------------|-------------|--------|
| Equipment | 776,878     | 272,629     | 504,249     | 185.0% |
| Total     | \$5,400,423 | \$4,117,238 | \$1,283,185 | 31.2%  |

International:

|             |             |             |             |       |
|-------------|-------------|-------------|-------------|-------|
| Consumables | \$1,538,519 | \$1,064,276 | \$474,243   | 44.6% |
| Equipment   | 1,384,903   | 848,866     | 536,037     | 63.1% |
| Total       | \$2,923,422 | \$1,913,142 | \$1,010,280 | 52.8% |

**Revenues**

Revenues increased 38.0% or \$2,293,465 to \$8,323,845 in the second quarter of fiscal 2018, from \$6,030,380 in fiscal 2017. Consumables revenue in the United States increased 20.3%, or \$778,936 for the second quarter, principally due to the strength in the Company's BoneScalpel product line, which grew 36% during the quarter. Domestic equipment revenues grew by 185.0% during the second quarter, resulting from strong SonaStar sales.

International revenue grew 52.8% during the second quarter, largely due to a 60% growth in SonaStar sales and a 26% growth in BoneScalpel sales.

**Gross profit**

Gross profit in the second quarter of fiscal 2018 was 70.4% of revenue, which increased from 69.8% in the second quarter of fiscal 2017. The increase resulted from a stronger mix of higher margin product.

**Selling expenses**

Selling expenses increased by \$648,381, or 19.8% to \$3,919,515 in the second quarter of fiscal 2018 from \$3,271,134 in the prior year period. The increase is principally related to higher compensation costs resulting from the continued buildout of the Company's direct sales force, along with higher commissions relating to the 38% increase in revenue.

**General and administrative expenses**

General and administrative expenses increased by \$293,441, or 14.1% to \$2,380,860 in the second quarter of fiscal 2018 from \$2,087,419 in the prior year period. This increase is principally related to an increase of non-cash compensation expense for the second quarter of fiscal 2018 of \$439,000 related to restricted stock and stock option grants to the Company's board of directors and its current CEO, a decrease in professional fees of \$266,000 and a decrease in accrued vacation costs of \$118,000. During the second quarter of the prior year, the Company was incurring higher costs for its internal investigation.

**Research and development expenses**

Research and development expenses increased by \$516,840, or 117.4% to \$957,204 in the second quarter of fiscal 2018 from \$440,364 in the prior year period. The Company is investing in the design and development of its next generation product, which is expected to be available in fiscal 2019. During the second quarter of fiscal 2018, approximately \$600,000 was charged to research and development expenses related to this product.

**Other income (expense)**

Other income decreased by \$875,219 to \$67,208 in the second quarter of fiscal 2018 from \$942,427 in the prior year period. The decrease is related to lower royalty income from MMIT. This royalty agreement expired in August 2017. There were no license fees recorded during the second quarter of fiscal 2018.

### **Income taxes**

For the three months ended December 31, 2017 and 2016, the Company recorded an income tax expense (benefit) of \$5,524,422 and (\$30,000), respectively. For the three months ended December 31, 2017 and 2016, the effective rate of 414.6% and (4.7%), 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 asset 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 (the "Tax Legislation"), 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. The components of the tax provision are as follows:

|   | For the three months<br>ended<br>December 31, |              |
|---|---|--------------|
|   | 2017  | 2016         |
| Income tax benefit  | \$ (228,149 )                                 | \$ (30,000 ) |
| Provisional reduction of deferred tax asset relating to Tax Legislation | 1,764,039                                     | —            |
| Valuation allowance on deferred tax asset                               | 3,988,532                                     | —            |
| Net income tax expense (benefit)  | \$ 5,524,422                                  | \$ (30,000 ) |

**Six months ended December 31, 2017 and 2016**

Our revenue by category for the six months ended December 31, 2017 and 2016 are as follows:

|                | For the six months ended |               | Net change   |        |
|----------------|--------------------------|---------------|--------------|--------|
|                | December 31,<br>2017     | 2016          | \$           | %      |
| Total          |                          |               |              |        |
| Consumables    | \$ 11,505,826            | \$ 9,453,080  | \$ 2,052,746 | 21.7 % |
| Equipment      | 4,098,742                | 2,748,925     | 1,349,817    | 49.1 % |
| Total          | \$ 15,604,568            | \$ 12,202,005 | \$ 3,402,563 | 27.9 % |
| Domestic:      |                          |               |              |        |
| Consumables    | \$ 8,722,636             | \$ 7,162,538  | \$ 1,560,098 | 21.8 % |
| Equipment      | 1,329,930                | 841,257       | 488,673      | 58.1 % |
| Total          | \$ 10,052,566            | \$ 8,003,795  | \$ 2,048,771 | 25.6 % |
| International: |                          |               |              |        |
| Consumables    | \$ 2,783,190             | \$ 2,290,542  | \$ 492,648   | 21.5 % |
| Equipment      | 2,768,812                | 1,907,668     | 861,144      | 45.1 % |
| Total          | \$ 5,552,002             | \$ 4,198,210  | \$ 1,353,792 | 32.2 % |

**Revenue**

Revenue increased 27.9% or \$3,402,563 to \$15,604,568 in the first half of fiscal 2018, from \$12,202,005 in fiscal 2017. Consumables revenue in the United States increased 21.8%, or \$1,560,098 for the period, principally due to the strength in the Company's BoneScalpel product line, which grew 36% during the first half of fiscal 2018. Domestic equipment revenue grew by 58.1% during the first half of fiscal 2018, resulting from strong SonaStar sales.

International revenue grew 32.2% during the first half of fiscal 2018, largely due to a 43% growth in SonaStar sales and a 18% growth in BoneScalpel sales.

**Gross profit**

Gross profit in the first half of fiscal 2018 was 70.2% of revenue, which increased from 69.4% in the first half of fiscal 2017. The increase resulted from a stronger mix of higher margin product.

### **Selling expenses**

Selling expenses increased by \$893,407, or 13.5% to \$7,490,228 in the first half of fiscal 2018 from \$6,596,821 in the prior year period. The increase is principally related to higher compensation costs resulting from the continued buildout of the Company's direct sales force, along with higher commissions relating to the 27.9% increase in revenue.

### **General and administrative expenses**

General and administrative expenses increased by \$934,751, or 23.3% to \$4,953,991 in the first half of fiscal 2018 from \$4,019,240 in the prior year period. This increase is principally related to an increase of non-cash compensation expense for the first half of fiscal 2018 of \$743,000 related to restricted stock and stock option grants to the Company's board of directors and its current CEO. In addition, during the first half of fiscal 2017, the Company recorded a reduction in non-cash stock compensation expense of \$805,000, which includes a reversal of stock compensation previously recognized on the Company's prior CEO. Expense reductions for the first half of fiscal 2018 also included a reduction in professional fees of \$460,000 and a reduction in accrued vacation of \$153,000. The Company also incurred a charge of \$330,000 in the first half of the prior year relating to severance for its former chief executive officer.

**Research and development expenses**

Research and development expenses increased by \$926,030, or 99.3% to \$1,858,478 in the first half of fiscal 2018 from \$932,448 in the prior year period. The Company is investing in the design and development of its next generation product, which is expected to be available in fiscal 2019. For the first half of fiscal 2018, approximately \$1.1 million has been charged to research and development expenses related to this product.

**Other income (expense)**

Other income decreased by \$1,368,784 to \$515,734 in the first half of fiscal 2018 from \$1,884,518 in the prior year period. The decrease is related to lower royalty income from MMIT. This royalty agreement expired in August 2017.

**Income taxes**

For the six months ended December 31, 2017 and 2016, the Company recorded an income tax expense (benefit) of \$5,243,422 and (\$56,000), respectively. For the six months ended December 31, 2017 and 2016, the effective rate of 185.6% and (4.7%), 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 asset 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 Legislation, 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. The components of the tax provision are as follows:

|   | For the six months ended<br>December 31, |              |
|---|--|--------------|
|   | 2017                                     | 2016         |
| Income tax benefit  | \$ (509,149 )                            | \$ (56,000 ) |
| Provisional reduction of deferred tax asset relating to Tax Legislation | 1,764,039                                | —            |

|   |              |              |
|---|--------------|--------------|
| Valuation allowance on deferred tax asset | 3,988,532    | —            |
| Net income tax expense (benefit)          | \$ 5,243,422 | \$ (56,000 ) |

### Liquidity and Capital Resources

Working capital at December 31, 2017 was \$18,279,180. For the six months ended December 31, 2017, cash provided from operations was \$496,883, mainly due to \$2,152,906 of cash received from the Company's SonaStar technology agreement in China which was treated as deferred income, a reduction in accounts receivable of \$807,010, and a reduction of prepaid expenses and other assets of \$610,890, offset by a reduction in accounts payable and accrued expenses of \$1,680,241 and the Company's net loss.

Cash used in investing activities was \$176,076, primarily consisting of the purchase of property, plant and equipment along with filing for additional patents.

Cash provided by financing activities was \$224,552, resulting from stock option exercises.

As of December 31, 2017, the Company had cash and cash equivalents of approximately \$12.1 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 \$2.8 million in investigative costs through December 31, 2017 and is not expected to incur significant additional investigative costs to resolve this matter. Further, the Company could be subject to fines or penalties related to potential violations of the FCPA.

The Company has been receiving an annual royalty from MMIT which has averaged \$3.7 million per year over the last three fiscal years. This royalty ended in August 2017. Additionally, as described in Note 12 to the financial statements, in October 2017, the Company entered into a License and Exclusive Manufacturing Agreement which is providing minimum payments to the Company of \$11 million through 2021, of which \$3 million has been received as of December 31, 2017.

The Company is investing in the design and development of its next generation product, which is expected to be available in fiscal 2019 of which \$1.1 million in development costs have been incurred for the six months ended December 31, 2017.

#### 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 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, 2017. Based on this evaluation, our CEO and CFO have concluded that our disclosure controls and procedures were effective as of December 31, 2017.

#### **Changes in Internal Control over Financial Reporting**

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, 2017 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II — OTHER INFORMATION**

### **Item 1. Legal Proceedings**

#### **Class Action Securities Litigation**

On September 19, 2016, Richard Scalfani, an individual shareholder of Misonix, filed a lawsuit against the Company and its former CEO and CFO in the U.S. District Court for the Eastern District of New York, alleging violations of the federal securities laws. The complaint alleges that the Company's stock price was artificially inflated between November 5, 2015 and September 14, 2016 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. Scalfani filed the action seeking to represent a putative class of all persons (other than defendants, officers and directors of the Company, and their affiliates) who purchased publicly traded Misonix securities between November 5, 2015 and September 14, 2016. Scalfani was seeking an unspecified amount of damages for himself and for the putative class under the federal securities laws. On March 24, 2017, the Court appointed Scalfani and another individual Misonix shareholder, Tracey Angiuoli, as lead plaintiffs for purposes of pursuing the action on behalf of the putative class. The lead plaintiffs, on behalf of the putative class, and the Company reached a settlement in principle under which the Company would pay \$500,000 to resolve the matter. The district court approved the settlement and dismissed the lawsuit with prejudice in an order dated December 16, 2017. The Company has paid its \$250,000, representing its insurance retention. The balance was paid by the Company's insurance carrier.

#### **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.

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 revenue 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 \$2.8 million, of which approximately \$0.1 million and \$0.3 million was charged to general and administrative expenses during the three and six months ended December 31, 2017, respectively, compared with \$0.6 million and \$1.4 million for the three and six months ended December 31, 2016.

### **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 remaining in the case is for breach of contract against the Company. 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. The case is at its earliest stages; there has been no discovery and there is no trial date. The Company is not able either to estimate the amount of potential loss it may recognize, if any, from these claims or to identify any changes in corporate governance procedures it may undertake, if any, as a result of these claims.

### **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, 2017. There have been no material changes from the risk factors disclosed in that Form 10-K.



**Item 6. Exhibits**

| Exhibit No. | Description  |
|-------------|--|
| <u>10.1</u> | <u>License and Exclusive Manufacturing Agreement between Misonix, Inc. and Hunan Xing Hang Rui Kang Bio-technologies Co., Ltd. (confidential treatment requested for portions of this exhibit).</u>                                |
| <u>31.1</u> | <u>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.</u>                            |
| <u>31.2</u> | <u>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.</u>                            |
| <u>32.1</u> | <u>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.</u> |
| <u>32.2</u> | <u>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.</u> |
| 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   |

**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, 2018 By: /s/ Stavros G. Vizirgianakis  
Stavros G. Vizirgianakis  
Chief Executive Officer

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