

USA Compression Partners, LP
Form 8-K
January 16, 2018

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 8-K

**CURRENT REPORT
Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934**

Date of Report (date of earliest event reported): **January 15, 2018**

USA Compression Partners, LP

(Exact name of registrant as specified in its charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

1-35779
(Commission
File Number)

75-2771546
(I.R.S. Employer
Identification No.)

100 Congress Avenue

Suite 450

Austin, TX 78701

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Registrant's telephone number, including area code: **(512) 473-2662**

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

- Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
- Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
- Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
- Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Indicate by check mark whether the registrant is an emerging growth company as defined in Rule 405 of the Securities Act of 1933 (§230.405 of this chapter) or Rule 12b-2 of the Securities Exchange Act of 1934 (§240.12b-2 of this chapter).

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.

Item 1.01. Entry into a Material Definitive Agreement.

Contribution Agreement

On January 15, 2018, USA Compression Partners, LP (the Partnership) entered into a Contribution Agreement (the Contribution Agreement) with Energy Transfer Partners, L.P. (ETP), Energy Transfer Partners GP, L.P., the general partner of ETP (ETP GP), ETC Compression, LLC (ETC) and, together with ETP and ETP GP, the Contributors) and, solely for certain purposes therein, Energy Transfer Equity, L.P. (ETE), pursuant to which, among other things, ETP will contribute to the Partnership and the Partnership will acquire from ETP all of the issued and outstanding membership interests of CDM Resource Management LLC (CDM) and CDM Environmental & Technical Services LLC (CDM E&T) for aggregate consideration of approximately \$1.7 billion (the Consideration). The Consideration consists of (i) 19,191,351 common units representing limited partner interests in the Partnership (Common Units), with a value of approximately \$335 million, (ii) 6,397,965 units of a newly authorized and established class of units representing limited partner interests in the Partnership (Class B Units) and (iii) an amount in cash equal to \$1.225 billion, subject to certain adjustments (collectively, the Acquisition). The Acquisition is expected to close in the first half of 2018, subject to customary closing conditions, including (i) the concurrent closing of the GP Purchase (as defined below), pursuant to which, among other things, ETE and Energy Transfer Partners, L.L.C. will acquire all of the outstanding limited liability company interests in the General Partner, and (ii) the transactions contemplated by the Equity Restructuring Agreement (as defined below), including the Restructuring (as defined below), shall be able to be consummated immediately following the Closing (as defined below), and as otherwise described in the Contribution Agreement (the Closing).

Pursuant to the Contribution Agreement, in connection with the Closing, USA Compression GP, LLC, the general partner of the Partnership (the General Partner), will execute a Second Amended and Restated Agreement of Limited Partnership of the Partnership (the Amended and Restated Partnership Agreement) to, among other things, authorize and establish the rights and preferences of the Class B Units. The Class B Units will be a new class of partnership interests of the Partnership that will have substantially all of the rights and obligations of a Common Unit, except the Class B Units will not participate in distributions made prior to the one-year anniversary of the closing date of the Contribution Agreement (such date, the Class B Conversion Date) with respect to Common Units. The Class B Units will vote on an as-converted basis together with the Common Units as a single class and will have certain other class voting rights with respect to any matter on which unitholders of the Partnership are entitled to vote that adversely affects the rights or preferences of the Class B Units in relation to other classes of partnership interests in any material respect or as required by law. Following the Class B Conversion Date, each Class B Unit will automatically convert into one Common Unit.

The Contribution Agreement contains customary representations, warranties and covenants by the parties, which are qualified by information in a confidential disclosure letter provided by the parties. The Contribution Agreement also contains customary pre-closing covenants, including the obligation of the Partnership to conduct its business in the ordinary course consistent with past practice in all material respects and to refrain from taking specified actions, subject to certain exceptions. The Contribution Agreement also contains a closing condition in connection with the expiration or termination of applicable waiting periods under the Hart-Scott Rodino Antitrust Improvements Act of 1976, as amended. Pursuant to the Contribution Agreement, the Partnership has agreed to indemnify the Contributors and their respective affiliates, equity holders, members, directors, managers, officers, employees and agents against certain losses resulting from any breach of a representation, warranty, agreement or covenant of the Partnership. The Contributors have agreed to indemnify the Partnership and its affiliates (other than ETE and its affiliates), members, directors, managers, officers, employees and agents against certain losses resulting from any breach of a representation, warranty, agreement or covenant of the Contributors and for certain other matters.

Pursuant to the terms of the Contribution Agreement, the Partnership has agreed to enter into a Registration Rights Agreement with ETE, ETP and USA Compression Holdings, LLC (USAC Holdings) at the Closing, pursuant to which, among other things, the Partnership will give ETE, ETP and USAC Holdings certain rights to require the Partnership to file and maintain the effectiveness of a registration statement with respect to the re-sale of the Common Units owned by such party (including, in the case of ETP, Common Units issuable upon the conversion of the Class B Units), and under certain circumstances, to require the Partnership to initiate underwritten offerings for such Common Units. In

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addition, at the Closing, the Partnership will enter into a Transition Services Agreement with ETP, CDM and CDM E&T, pursuant to which ETP and its affiliates will provide certain transition services to the Partnership and its affiliates for a period of 90 days following the Closing.

The foregoing description of the Contribution Agreement does not purport to be complete and is qualified in its entirety by reference to the complete text of such agreement, a copy of which is filed as Exhibit 2.1 to this Current Report on Form 8-K and is incorporated herein by reference.

The Contribution Agreement contains representations and warranties by each of the parties to the Contribution Agreement, which were made only for purposes of the Contribution Agreement and as of specified dates. The representations, warranties and covenants in the Contribution Agreement were made solely for the benefit of the parties to the Contribution Agreement; may be subject to limitations agreed upon by the contracting parties, including being qualified by confidential disclosures made for purposes of allocating contractual risk between the parties to the Contribution Agreement instead of establishing these matters as facts; and may be subject to standards of materiality applicable to the contracting parties that differ from those applicable to investors. Investors should not rely on the representations, warranties and covenants or any descriptions thereof as characterizations of the actual state of facts or condition of the Partnership, ETP or any of their respective subsidiaries or affiliates. Moreover, information concerning the subject matter of the representations, warranties and covenants may change after the date of the Contribution Agreement, which subsequent information may or may not be fully reflected in the Partnership's or ETP's public disclosures.

Equity Restructuring Agreement

On January 15, 2018, and in connection with the execution of the Contribution Agreement, the Partnership entered into an Equity Restructuring Agreement (the Equity Restructuring Agreement) with the General Partner and ETE, pursuant to which, among other things, the Partnership, the General Partner and ETE have agreed to cancel the Partnership's incentive distribution rights (the Cancellation) and convert the Partnership's General Partner Interest (as defined in the Equity Restructuring Agreement) into a non-economic general partner interest (the Conversion and, together with the Cancellation, the Restructuring), in exchange for the Partnership's issuance of 8,000,000 Common Units to the General Partner, effective at the Closing. In addition, at any time after one year following the Closing, ETE will have the right to contribute (or cause any of its subsidiaries to contribute) to the Partnership all of the outstanding equity interests in any of its subsidiaries that owns the General Partner Interest in exchange for \$10,000,000 (the GP Contribution); provided that the GP Contribution will occur automatically if at any time following the Closing (i) ETE or one of its subsidiaries (including ETP) owns, directly or indirectly, the General Partner Interest and (ii) ETE and its subsidiaries (including ETP) collectively own less than 12,500,000 Common Units. The closing of the Restructuring is subject to the concurrent closing of the Acquisition and the GP Purchase (as defined below).

The foregoing description of the Equity Restructuring Agreement does not purport to be complete and is qualified in its entirety by reference to the complete text of such agreement, a copy of which is filed as Exhibit 2.2 to this Current Report on Form 8-K and is incorporated herein by reference.

Series A Preferred Unit and Warrant Purchase Agreement

On January 15, 2018, the Partnership entered into a Series A Preferred Unit and Warrant Purchase Agreement (the Purchase Agreement) with certain investment funds managed or sub-advised by EIG Global Energy Partners (EIG) and other investment vehicles unaffiliated with EIG (collectively, the Purchasers) to issue and sell in a private placement (the Private Placement) \$500 million in the aggregate of (i) newly authorized and established Series A Perpetual Preferred Units representing limited partner interests in the Partnership (the Preferred Units) and (ii) warrants to purchase Common Units (the Warrants). The Partnership will issue 500,000 Preferred Units to the Purchasers at a price of \$1,000 per Preferred Unit (the Preferred Unit Purchase Price), less a 1.0% structuring and origination fee, for total net proceeds, before expenses, of \$495 million. In addition, the Partnership will pay a 1.0% commitment fee to the Purchasers at the Closing, as well as reimburse the Purchasers for up to \$400,000 of certain expenses incurred in connection with the transaction. The Partnership will also issue two tranches of Warrants to the Purchasers, which will include Warrants to purchase 5,000,000 Common Units with a strike price of \$17.03 and Warrants to purchase

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10,000,000 Common Units with a strike price of \$19.59. The Warrants may be exercised by the holders thereof at any time beginning on the one year anniversary of the closing date and before the tenth anniversary of the closing date. Upon exercise of the Warrants, the Partnership may, at its option, elect to settle the Warrants in Common Units on a net basis. The Purchase Agreement contains customary representations, warranties and covenants of the Partnership and the Purchasers. The closing of the Private Placement is subject to customary closing conditions.

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Pursuant to the Purchase Agreement, the Amended and Restated Partnership Agreement to be executed at Closing will, among other things, authorize and establish the rights and preferences of the Preferred Units. The Preferred Units will be a new class of partnership interests that will rank senior to all classes or series of limited partner interests of the Partnership with respect to distribution rights. The Preferred Units will generally have no voting rights but will have certain class voting rights with respect to a limited number of matters, including any amendment to the Amended and Restated Partnership Agreement that would be materially adverse to any of the rights, preferences or privileges of the Preferred Units.

Upon issuance, the Preferred Units will entitle the Purchasers to receive cumulative quarterly distributions at a rate of 9.75% per annum, subject to increase in certain limited circumstances. While the Preferred Units are outstanding, the Partnership will be prohibited from paying distributions on any junior securities, including the Common Units, prior to paying the quarterly distribution payable to the holders of the Preferred Units, including any previously accrued and unpaid distributions. For the remainder of the quarter in which the closing date occurs and for the four full quarters following the closing date, the quarterly distribution for the Preferred Units may be paid, at the option of the Partnership, in (i) cash or (ii) a combination of additional Preferred Units (PIK Units) and cash. If the Partnership pays any distributions in PIK Units, the number of PIK Units to be issued shall equal the quotient of (A) the amount of the quarterly distribution to be paid in PIK Units, divided by (B) the Preferred Unit Purchase Price; provided, that the portion of the distribution rate paid in PIK Units shall not exceed the rate calculated by multiplying the distribution rate by a ratio of 4.75/9.75. Beginning with the fifth full quarter following the closing date, all distributions on the Preferred Units shall be paid in cash.

The Preferred Units will have a perpetual term, unless converted or redeemed as described below. The Preferred Units (including any PIK Units) will be convertible into Common Units at the election of the holders as follows: (1) from and after the third anniversary of the Closing, 33 1/3% of the Preferred Units issued on the date of the Closing, plus all of the PIK Units issued as quarterly distributions on such Preferred Units, shall be convertible; (2) from and after the fourth anniversary of the Closing, 66 2/3% of the Preferred Units issued on the date of the Closing, plus all of the PIK Units issued as quarterly distributions on such Preferred Units, shall be convertible; and (3) from and after the fifth anniversary of the Closing (or, if earlier, certain failures of the Partnership to pay quarterly distributions), all of the Preferred Units shall be convertible. Each Preferred Unit will be convertible into a number of Common Units equal to the Preferred Unit Purchase Price (plus accrued and unpaid distributions) divided by \$20.0115.

To the extent the holders of the Preferred Units have not elected to convert their Preferred Units by the fifth anniversary of the issue date, the Partnership will have the option to redeem all or any portion of the Preferred Units, in an amount not less than \$25 million, for cash at a price equal to 105% of the sum of the Preferred Unit Purchase Price and any accrued and unpaid distributions. In addition, at any time on or after the tenth anniversary of the issue date, the holders of the Preferred Units will have the right to require the Partnership to redeem all or any portion of the Preferred Units, in an amount not less than \$25 million, for cash at a price equal to the Preferred Unit Purchase Price plus any accrued and unpaid distributions. If a holder of the Preferred Units exercises its redemption right, the Partnership may elect to pay up to 50% of such amount in Common Units based on a 7.0% discount to the volume-weighted average trading price of the Common Units for the 30 trading days immediately prior to such redemption; provided, that the Common Units received do not equal more than 15% of the total number of issued and outstanding Common Units (including the Common Units issued in such redemption).

Upon certain events involving a Series A Change of Control (as defined in the Amended and Restated Partnership Agreement) the holders of the Preferred Units shall be entitled to elect to take one of the following actions: (i) convert the Preferred Units into a number of Common Units equal to, for each Preferred Unit converted, the Preferred Unit Purchase Price (plus the value of any accrued and unpaid distributions) divided by \$20.0115; (ii) require the Partnership to redeem the Preferred Units for an amount equal to the sum of (A) the Preferred Unit Purchase Price (plus the value of any accrued and unpaid distributions) multiplied by 105% and (B) all additional quarterly distributions that would have been paid for each Preferred Unit if the Preferred Units remained outstanding until the fourth anniversary of the closing date; or (iii) upon request of the holders, if the Partnership will not be the surviving entity of the Series A Change of Control or it will be the surviving entity but its Common Units will cease to be listed or admitted to trading on a national securities exchange, require the Partnership to use its commercially reasonable efforts to deliver a mirror security to the Preferred Units in the surviving entity or its parent entity on substantially similar terms as the Preferred Units.

At the Closing, pursuant to a Board Representation Agreement, the Purchasers will receive certain designation rights with respect to the board of directors of the General Partner (the Board). As long as the Purchasers own (a) Preferred Units, (b) Common Units resulting from the conversion or redemption of the Preferred Units, (c) Warrants and/or (d) Common Units resulting from the exercise of the Warrants (such amounts in (a), (b), (c) and (d), collectively, the Election Units) that comprise in the aggregate, more than 5% of the then-outstanding Common Units (the Minimum Unit Threshold) (assuming for purposes of this calculation that all Preferred Units are converted into Common Units and all Warrants are net exercised for Common Units), EIG Management Company, LLC, as representative of the Purchasers, will have the right to designate, subject to the consent of ETE if the limited partners of the Partnership are not entitled to vote in the election of directors of the General Partner, one person to serve on the Board (an EIG Director). The Purchasers' right to appoint an EIG Director shall terminate at such time as the Purchasers, together with their affiliates, own less than the Minimum Unit Threshold; provided however that if the ownership of the Purchasers and their affiliates of Election Units increases above the Minimum Unit Threshold, then such director designation right will be reinstated. In addition, if after the time that the limited partners of the Partnership become entitled to vote in the election of directors of the General Partner, the Purchasers, together with their affiliates, own Election Units that comprise, in the aggregate, more than 15% of the then-outstanding Common Units (assuming for purposes of this calculation that all Preferred Units are converted into Common Units and all Warrants are net exercised for Common Units), they will have the right to designate such number of persons, including any EIG Director, to serve on the Board that results in the Purchasers having Board representation in the same proportion as the number of Common Units owned by the Purchasers and their affiliates bears to the total number of then-outstanding Common Units. The Purchasers' right to designate proportional representatives to the Board shall terminate at such time as the Purchasers, together with their affiliates, own Election Units that comprise, in the aggregate, less than 15% of the then-outstanding Common Units; provided however that if the ownership of the Purchasers and their affiliates increases above 15% of the then-outstanding Common Units, then such director designation rights will be reinstated.

Pursuant to the terms of the Purchase Agreement, the Partnership has agreed to enter into a Registration Rights Agreement with the Purchasers at the Closing, pursuant to which, among other things, the Partnership will give the Purchasers certain rights to require the Partnership to file and maintain the effectiveness of a registration statement with respect to the re-sale of the Preferred Units and the Common Units that are issuable upon conversion or redemption of the Preferred Units or upon exercise of the Warrants, and under certain circumstances, to require the Partnership to initiate underwritten offerings for the Common Units that are issuable upon conversion or redemption of the Preferred Units or upon exercise of the Warrants.

The foregoing description of the Purchase Agreement does not purport to be complete and is qualified in its entirety by reference to the complete text of the Purchase Agreement, a copy of which is filed as Exhibit 10.1 to this Current Report on Form 8-K and is incorporated herein by reference.

The Purchase Agreement contains representations and warranties by each of the parties to the Purchase Agreement, which were made only for purposes of the Purchase Agreement and as of specified dates. The representations, warranties and covenants in the Purchase Agreement were made solely for the benefit of the parties to the Purchase Agreement; may be subject to limitations agreed upon by the contracting parties, including being qualified by confidential disclosures made for purposes of allocating contractual risk between the parties to the Purchase Agreement instead of establishing these matters as facts; and may be subject to standards of materiality applicable to the contracting parties that differ from those applicable to investors. Investors should not rely on the representations, warranties and covenants or any descriptions thereof as characterizations of the actual state of facts or condition of the Partnership, the Purchasers or any of their respective subsidiaries or affiliates. Moreover, information concerning the subject matter of the representations, warranties and covenants may change after the date of the Purchase Agreement, which subsequent information may or may not be fully reflected in the Partnership's or any of the Purchaser's public disclosures, as applicable.

Bridge Commitment

In connection with the Acquisition, the Partnership obtained a commitment (the Bridge Commitment) from JPMorgan Chase Bank, N.A. and Barclays Bank PLC to provide senior unsecured bridge loans (the Bridge Loan), in an aggregate amount up to \$725 million (the Committed

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Amount). The Bridge Commitment will expire upon the earliest to occur of (1) the Outside Date as defined in the Contribution Agreement (as the same may be extended thereunder), (2) the consummation of the Acquisition without use of the Bridge Loan or (3) September 30, 2018. The Bridge Loan is available to backstop a portion of the Acquisition purchase price that the Partnership expects to fund with the net proceeds of other debt financing.

Item 3.02 Unregistered Sales of Equity Securities.

The description set forth under Item 1.01 above of the issuances by the Partnership to (i) ETP of Common Units and Class B Units in connection with the Acquisition, (ii) the General Partner of Common Units in connection with the Restructuring and (iii) the Purchasers of Preferred Units, PIK Units and Warrants in connection with the Private Placement is incorporated herein by reference. The foregoing transactions were undertaken in reliance on an exemption from the registration requirements of the Securities Act of 1933, as amended (the Securities Act) pursuant to Section 4(a)(2) thereof. The information contained in this Current Report on Form 8-K is not an offer to sell or the solicitation of an offer to buy any securities of the Partnership.

Item 5.01. Changes in Control of Registrant.

On January 15, 2018, and in connection with the execution of the Contribution Agreement, ETE entered into a Purchase Agreement (the GP Purchase Agreement) with Energy Transfer Partners, L.L.C. (together with ETE, the GP Purchasers), USAC Holdings and, solely for certain purposes therein, R/C IV USACP Holdings, L.P. and ETP, pursuant to which the GP Purchasers will acquire from USAC Holdings (i) all of the outstanding limited liability company interests in the General Partner and (ii) 12,466,912 Common Units (the GP Purchase) for cash consideration equal to \$250 million.

Item 7.01. Regulation FD Disclosure.

On January 16, 2018, the Partnership issued a press release announcing the entry into the Contribution Agreement, the Equity Restructuring Agreement, the Purchase Agreement and the Bridge Commitment. A copy of the press release is attached as Exhibit 99.1 to this Current Report on Form 8-K and is incorporated into this Item 7.01 by reference.

In connection with the transactions contemplated by the Contribution Agreement, the Equity Restructuring Agreement, the Purchase Agreement and the Bridge Commitment, the Partnership prepared an investor presentation dated January 16, 2018 that was used in presentations to potential investors in the Partnership. A copy of the investor presentation is attached as Exhibit 99.2 to this Current Report on Form 8-K and is incorporated into this Item 7.01 by reference.

In accordance with General Instruction B.2 of Form 8-K, the information furnished pursuant to Item 7.01 and the press release attached hereto as Exhibit 99.1 and the investor presentation attached hereto as Exhibit 99.2 relating to this Item 7.01 shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the Exchange Act), or otherwise subject to the liabilities of that section, nor shall such information be deemed incorporated by reference in any filing under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such a filing.

Item 9.01. Financial Statements and Exhibits.

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- 2.1* Contribution Agreement, dated as of January 15, 2018, by and among USA Compression Partners, LP, Energy Transfer Partners, L.P., Energy Transfer Partners GP, L.P., ETC Compression, LLC and, solely for certain purposes therein, Energy Transfer Equity, L.P.
- 2.2* Equity Restructuring Agreement, dated as of January 15, 2018, by and among Energy Transfer Equity, L.P., USA Compression Partners, LP and USA Compression GP, LLC.
- 10.1 Series A Preferred Unit and Warrant Purchase Agreement, dated January 15, 2018, among USA Compression Partners, LP and the purchasers party thereto.
- 99.1 Press Release, dated as of January 16, 2018.
- 99.2 Investor Presentation dated as of January 16, 2018.

* Schedules and exhibits to this Exhibit have been omitted pursuant to Regulation S-K Item 601(b)(2). The Partnership agrees to furnish supplementally a copy of any omitted schedule or exhibit to the SEC upon request.

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 hereunto duly authorized.

USA COMPRESSION PARTNERS, LP

By: USA Compression GP, LLC,
its general partner

Date: January 16, 2018

By: /s/ Christopher W. Porter
Name: Christopher W. Porter
Title: Vice President, General Counsel and
Secretary

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ONT STYLE="font-family: Times New Roman, Times, Serif; font-size: 10pt"> Domestic: Consumables \$5,477,995 \$4,623,545 \$854,450 18.5% Equipment 600,559 776,878 (17

Revenues

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 BoneScapel and SonicOne were strong, and the exceptional growth 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:

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	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

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 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.

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.

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, 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 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.

Item 6. Exhibits

Exhibit No.	Description
<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, 2019 By: /s/ Stavros G. Vizirgianakis
Stavros G. Vizirgianakis
Chief Executive Officer

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