K12 INC
Form 10-Q
April 25, 2018
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 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 March 31, 2018

OR

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

For the transition period from to

Commission File Number: 001-33883

K12 Inc.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	95-4774688 (I.R.S. Employer Identification No.)
2300 Corporate Park Drive Herndon, VA (Address of Principal Executive Offices)	 20171 (Zip Code)

(703) 483-7000

(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 (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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 (Do not check if a smaller reporting company)	Smaller reporting company
	Emerging growth company

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

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

As of April 19, 2018, the Registrant had 41,172,030 shares of common stock, $0.0001 par value per share outstanding.

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For the Quarterly Period Ended March 31, 2018

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited).

K12 INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

	March 31, 2018	June 30, 2017 (audited)
	(In thousands except share and per share data)	
ASSETS		
Current assets		
Cash and cash equivalents	$ 227,907	$ 230,864
Accounts receivable, net of allowance of $9,978 and $14,791 at March 31, 2018 and June 30, 2017, respectively	207,998	192,205
Inventories, net	18,051	30,503
Prepaid expenses	14,422	8,006
Other current assets	13,767	12,004
Total current assets	482,145	473,582
Property and equipment, net	29,468	26,297
Capitalized software, net	55,729	62,695
Capitalized curriculum development costs, net	53,299	59,213
Intangible assets, net	18,694	20,226
Goodwill	90,197	87,214
Deposits and other assets	31,592	6,057
Total assets	$ 761,124	$ 735,284
LIABILITIES, REDEEMABLE NONCONTROLLING INTEREST AND STOCKHOLDERS' EQUITY		
Current liabilities		
Current portion of capital lease obligations	$ 13,727	$ 11,880
Accounts payable	17,548	30,052
Accrued liabilities	13,304	21,622
Accrued compensation and benefits	29,489	29,367
Deferred revenue	49,039	24,830
Total current liabilities	123,107	117,751
Capital lease obligations, net of current portion	13,983	10,025
Deferred rent, net of current portion	3,511	4,157
Deferred tax liability	11,572	16,726
Other long-term liabilities	9,519	11,579

Total liabilities	161,692	160,238
Commitments and contingencies	—	—
Redeemable noncontrolling interest	—	700
Stockholders' equity		

As a result of our failure to make certain payments, we and our subsidiaries are currently in default under various obligations, and we cannot determine the remedies our creditors may exercise.

We failed to make the payment in respect of the January 1, 2010 interest payment on our 14% Convertible Notes due January 1, 2014, referred to as the 14% convertible notes. In addition, we failed to make certain payments to Xergi, A/S, referred to as Xergi, under our Cooperation Agreement, dated April 23, 2009, referred to as the Cooperation Agreement, among us, our subsidiary, Microgy, Inc., Xergi and Danish Biogas Technology, A/S, referred to as DBT. Our subsidiary, Microgy Holdings, LLC, referred to as Microgy Holdings, failed to make the payments in respect to the December 1, 2009 interest payments on the remaining Texas tax-exempt bonds and California tax-exempt bonds on which it and its subsidiaries are obligated from its own funds. In

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addition, our subsidiary, Microgy Grand Island, LLC, failed to make payments in respect to the December 1, 2009 interest payments on the Nebraska tax-exempt bonds on which it is obligated from its own funds, and has other creditors which remain unpaid. We have been given notice of default under the indenture for the 14% convertible notes, but neither the holders nor the trustee thereunder have taken any further action with respect to such default. We have been given notice of default under the indentures for the Texas and California tax-exempt bonds, and the holders of the Texas and California tax-exempt bonds have accelerated the obligations associated with the bonds in full, but have not taken any further action to enforce their rights in any collateral. We have not been given notice of default under the indenture for the Nebraska tax-exempt bonds, and neither the holders nor the trustee thereunder have taken any action with respect to such default. Finally, we have been given notice of material breach of the Cooperation Agreement, but neither Xergi nor DBT has taken any further action with respect to such breach. We currently have outstanding past due and unpaid obligations of $560,000 in respect of the 14% convertible notes, $23,088,000 in respect of the Texas tax-exempt bonds plus accrued interest from December 1, 2009, $8,356,000 in respect of the California tax-exempt bonds plus accrued interest from December 1, 2009, and $300,000 in respect of payments owed to Xergi under the Cooperation Agreement, and $1,334,000 in dividends on our series A preferred stock, among other amounts owed to other creditors. We currently do not have sufficient funds to pay any of these amounts.

We cannot predict what actions our creditors may take. Relevant agreements with Texas and California bondholders, entered into prior to the acceleration of obligations underlying the bonds, provide for cross-collateralization of all of the assets associated with our Huckabay Ridge facility, our Rio Leche and Cnossen projects in Texas, and our Riverdale and Hanford projects in California. The Nebraska tax-exempt bonds are secured by the assets associated with our Grand Island facility. Our other obligations are unsecured. The holders of the Texas, California and Nebraska tax-exempt bonds may take steps to foreclose on their collateral, although to date none has done so. Our creditors could also seek to initiate involuntary proceedings under the United States Bankruptcy Code, or we may determine that it is in our best interest to initiate such proceedings voluntarily. While we are in discussions with some of these creditors and other parties with respect to these obligations, we cannot assure you that any such discussions will result in a favorable resolution of these obligations. The foregoing circumstances, and the actions our creditors may elect to take with respect to them, are likely to result in a material adverse effect on our business as well as a material impairment of the value of your investment in our securities.

Our sole operating business, Microgy, has limited operating history from which to evaluate its business and products.

Our sole operating business, Microgy, was formed in 1999 and remains in the early stages of its development. Microgy is developing facilities that use environmentally friendly anaerobic digestion and other technologies to produce biogas from animal and organic wastes. Although Microgy has developed and operates three single digester facilities in Wisconsin and the multi-digester Huckabay Ridge facility, Microgy still has limited experience in the construction and operation of multiple digester facilities such as those Microgy is currently constructing or intends to construct, and limited experience in gas conditioning or the sale of gas as a commodity. In addition, Microgy experienced challenges during the startup and initial operation of the Huckabay Ridge facility that resulted in outages for corrective measures. We took advantage of such an outage to complete comprehensive upgrades to process-instrumentation and controls, the gas conditioning system, and the gas-collection system in order to achieve anticipated performance levels. While we gained valuable knowledge as to our processes and incorporated the lessons learned into future projects, we cannot assure you that similar challenges will not be encountered with respect to future facilities. Because of Microgy s limited experience, there is a risk that Microgy may never be profitable.

Microgy cannot predict when any facility will be completed, what Microgy s costs will be or, consequently, whether Microgy or any facility developed by Microgy will be profitable.

Development of Microgy s facilities is an inherently risky activity, subject to significant uncertainties and a lengthy development cycle. Uncertainties and risks include those relating to costs and availability of supplies and

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labor, costs and quality of facility components and installation services, fluctuations in the prices available for the sale of facility output and timing of completion of construction and commencement of commercial operations. Furthermore, obtaining the large number of agreements, permits and approvals necessary to develop, install, operate and manage any of Microgy s facilities, as well as to market the energy and other co-products and to provide necessary related resources and services, involves a long development cycle and decision-making process. Microgy is required to enter into or obtain some or all of the following in connection with the development of its facilities:

Off-take interconnection agreements;

Site agreements;

Supply contracts;

Design/build or other construction-related agreements;

Off-take agreements for gas produced;

Power sales contracts for facilities dedicated to the generation of electricity;

Agreements for the sale of greenhouse gas sequestration credits or other tradable environmental attributes;

Various co-product sales agreements;

Waste disposal agreements;

Environmental and other permits and licenses;

Government approvals; and

Financing commitments required for the successful completion of facilities under consideration. Microgy s failure to accomplish any of these objectives could materially increase the cost, or prevent the successful completion of, development or operation of facilities and incur the loss of any investment made. Many of these objectives are dependent upon decisions by third parties. Delays in such parties decision-making process are outside of our control and may have a negative impact on our development costs, cost of operations, receipt of revenue and revenue projections. We expect that, in some cases, it may take a year or more to obtain decisions on permits and approvals and to negotiate and close these complex agreements. Such delays could harm our operating results and financial condition.

As a result of the foregoing uncertainties we are unable to project with certainty Microgy s organizational, structural, staffing or other overhead costs, the construction or operating costs associated with any facility, or whether any facility, or Microgy as a whole, will generate a profit. If Microgy fails to generate a profit, your investment in our securities will be materially, adversely affected.

If we are unable to obtain needed financing for Microgy s facilities, the value of our Microgy investment may be reduced significantly.

Because we have not yet generated sufficient positive cash flow, and do not expect to do so until at least 2012, we do not have adequate funds on hand to complete construction of the facilities we currently have planned. We are seeking and will require corporate, project or group financing to fund the cost of any development we may decide to pursue for Microgy s facilities. This financing may be difficult or impossible for us to obtain particularly in the current economic environment, in which capital raising activities are especially challenging. If we are unable to obtain such financing, the value of our Microgy investment may be reduced significantly, and we may be required to substantially curtail our business or completely cease construction or operation of any facilities. The availability of additional financing will depend on prospective lenders or investors review of our financial capabilities as well as specific facilities and other factors, including their

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assessment of our ability to construct and manage each facility successfully and the current state of the economy. Such financing may not be available to us on acceptable terms, or at all. If we are unable to obtain the required financing, we will have to reduce the number of projects we construct and may even have to curtail or cease our business operations, which would have a material adverse effect on your investment in our securities.

If Microgy is unable to obtain sufficient manure and substrate for its facilities at an acceptable cost, such facilities, and Microgy as a whole, will likely not be profitable.

The performance of Microgy s facilities is dependent on the availability of large quantities of animal manure and substrates derived from animal and other organic waste resources to produce raw energy and meet performance standards in the generation of renewable natural gas. A substantial portion of the gas production of Microgy s facilities is derived from the co-digestion contribution enabled by substrate. While Microgy has or is expected to have agreements relating to the supply of manure and substrate, these agreements may not cover all of Microgy s requirements for such resources, and Microgy will be subject to the ability of the counterparties to such agreements to perform their obligations thereunder. Lack of manure or substrate or adverse changes in the nature or quality of such waste resources or the cost to supply or transport them would seriously affect the ability of Microgy s facilities to produce gas at profitable levels and, consequently, its ability to develop and finance facilities and to operate efficiently and generate income. As a result, its revenue and financial condition would be materially and negatively affected. We cannot assure you that the waste resources Microgy s facilities require will be available in the future in acceptable quantity or quality, for free or at prices that make them affordable or accessible.

Microgy is expected to derive a significant portion of its revenues from the sale of renewable natural gas; as a result it may have some exposure to volatility in the commodity price of natural gas.

Microgy is expected to derive a significant portion of its revenues from the sale of renewable natural gas. Microgy typically enters into medium to long-term off-take arrangements for the gas produced by its facilities as part of the planning and development of such facilities, and may enter into other hedging arrangements, in order to mitigate the associated commodity price risk. Furthermore, our subsidiary, Microgy Holdings, is required by the terms of its tax-exempt bonds to maintain certain gas price protection arrangements for specified periods of time. We believe that these arrangements will be considered normal purchases and sales and will not be subject to derivative accounting. However, there may be times when such off-take and hedging arrangements expire or otherwise terminate before new arrangements are put in place, and such arrangements are subject to the creditworthiness of the counterparties to them. In addition, we cannot assure you that any such risk management vehicles will always be available or successful. Because renewable natural gas commands a premium over, but still tracks prices for, conventional natural gas, Microgy will be exposed, to the extent not covered by long-term contracts, to market risk with respect to the commodity pricing of conventional natural gas. Historically, natural gas prices have been volatile and Microgy expects such volatility to continue.

We expect revenues from sales of greenhouse gas sequestration credits and other environmental attributes, but the market for such attributes is nascent and may not develop in a manner that allows us to profit from the sales of such credits to the level projected, or at all.

The multiple digester facilities that we plan to implement through Microgy Holdings and our other subsidiaries are expected to produce greenhouse gas sequestration credits and other marketable environmental attributes. While there exist trading markets for these attributes, and additional trading markets or other commercial avenues may develop, the existing trading markets are new and experience thin trading and price volatility, which can hinder sales of credits and make their value unpredictable. The quantity of credits that may be generated are a function of the carbon credit offset characteristics as determined by protocols used to document and verify the carbon offset value. These protocols continue to evolve, and changes in these protocols could substantially diminish further carbon credit eligibility. Furthermore, much of the participation in these markets is voluntary, in response to social and environmental concerns, as opposed to being driven by regulatory

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requirements. While many states and the federal government are pursuing or are considering carbon emissions limits and related initiatives that may spur greater development of and participation in these markets, we are unable to determine the effect of these initiatives on these markets. We cannot assure you that these trading markets will develop further, or even that they will continue to exist. In addition, many of our agreements with our business partners and investors require us to share such credits or any revenues we derive from sales of such credits, and agreements we negotiate in the future may also include such requirements. As a result of the foregoing, we may recognize significantly smaller revenues than we anticipate from the sale of greenhouse gas sequestration credits or other environmental attributes.

In connection with financial closings on projects, we have pledged all of our interests in our facilities in Texas and California as security for the loans relating to Microgy Holdings tax-exempt bond financings in those jurisdictions, and our subsidiary, Microgy Grand Island, LLC, has entered into a financing lease with respect to the Grand Island facility. We are in default on these loans and the bondholders could seek to initiate foreclosure proceedings on these assets.

We have invested, and expect to invest, substantial funds and resources in the Huckabay Ridge facility and the other multi-digester, renewable natural gas facilities in Texas, California and Nebraska. In connection with initial financial closings on the projects, we pledged all of our interest in the Huckabay Ridge facility, as well as the Rio Leche, Cnossen and Mission facilities in Texas as collateral security for the loan to our subsidiary, Microgy Holdings, from the Gulf Coast Industrial Development Authority of Texas relating to the $60 million tax-exempt bond financing we completed in November 2006. The outstanding principal amount of these bonds has been reduced to $23,088,711. We pledged all of our interest in the Riverdale and Hanford facilities in California as collateral security for the loan to our subsidiary, Microgy Holdings, from the California Statewide Communities Development Authority relating to the $62.425 million tax-exempt bond financing we completed in September 2008. The outstanding amount of these bonds has been reduced to $8,355,699. Both the Texas and California bonds are now in default and have been accelerated. While these loans are non-recourse to Environmental Power, in certain circumstances Environmental Power is required to provide at least 20% of the construction costs of these facilities, as well as to cover any cost overruns in construction and certain other significant costs, which if applicable would represent a substantial investment of corporate resources. Because Microgy Holdings is in default on these loans, bondholders by foreclosure proceedings could seek to seize some or all of our investment in the Texas and California facilities, which if successful would have a material adverse effect on our business, financial condition and results of operations as well as your investment in our securities. In addition, our subsidiary, Microgy Grand Island, LLC, has entered into a $7.0 million sale and leaseback transaction with the City of Grand Island, Nebraska in connection with its tax-exempt bond financing in Nebraska to finance the construction of the Grand Island facility, and has guaranteed the City s obligations under the tax-exempt bonds. Environmental Power has equity contribution and support obligations with respect to the Grand Island facility that are substantially similar to those under the Texas and California financings. Microgy Grand Island is in default on its guarantee obligations to the City of Grand Island, and we may lose some or all of our investment in the Grand Island facility, which would have a material adverse effect on our business, financial condition and results of operations.

Microgy faces competition in the renewable energy market as well as for the resources necessary to operate its facilities.

Microgy plans to generate revenue from the development and ownership of facilities that market renewable green energy in addition to providing pollution control features to the agricultural and food industry markets.

Microgy s green competitors include other energy producers using biomass combustion, biomass anaerobic digestion, geothermal, solar, wind, new hydro and other renewable sources. These companies represent a significant class of competitors because they will compete with Microgy for sale of marketable renewable energy credits and participation in various renewable portfolios and other programs.

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Competition in the traditional energy business from electric utilities and other energy companies is well established, with many substantial entities having multi-billion dollar, multi-national operations. Many of these companies are beginning to compete in the alternative fuels and renewable energy business with the growth of the industry and the advent of many new technologies. Larger companies, due to their greater financial and other resources, will be better positioned than Microgy to develop new technologies and to install existing or more advanced renewable energy facilities, which could harm Microgy s business.

Microgy also faces many forms of competition with respect to the resources required to operate its facilities. Such competition includes other providers of pollution control, including environmental engineers, providers of pollution control systems, private companies, public companies, associations, cooperatives, government programs, foreign companies, and educational pilot programs. Furthermore, there are many companies that offer anaerobic digester systems. A number of these competitors have more mature businesses and have successfully installed anaerobic digester systems in the United States. Microgy may be forced to compete with any of these competitors for access to equipment, construction supplies, skilled labor for the construction and operation of its facilities and the supplies of manure and substrate required to operate its facilities. In addition, Microgy may also have to compete for access to substances that make desirable substrates with other users of these substances, such as recyclers of waste grease and producers of biodiesel and other biofuels. The effect of such competition could be reflected in higher costs associated with obtaining access to these resources, as well as an insufficient supply of these resources for the profitable operation of Microgy s facilities. If Microgy cannot obtain and maintain these supplies, or cannot obtain or maintain them at reasonable costs, the profitability of Microgy s business will be adversely affected.

Extreme weather events may have a material adverse effect on the operation on our facilities.

Microgy s facilities and sites are sensitive to extreme weather events. For instance, the anaerobic digestion process requires temperatures within a certain band, and extreme cold or heat may negatively impact the process or increase operating costs as a result of the need to counter such temperatures. Also, our sites contain retention ponds that have been designed with ample capacity to collect and retain storm water run-off, but, despite applying best maintenance practices, that capacity on rare occasions can be strained by severe rainfall. Thus, in August 2008, a 25-year record rainfall event caused a storm water retention pond breach and spill that required cleanup of a dry creek bed and reporting to the local environmental authorities, and earlier this year heavy rains saturated neighboring properties at Huckabay Ridge and thus significantly limited the ability of neighboring properties to utilize the plant s effluent, which we distribute pursuant to a commercial-fertilizer registration issued by the Texas State Chemist. While Microgy considers typical local weather conditions in the design of its facilities and maintains appropriate insurance to mitigate associated risks to the extent commercially feasible, Microgy cannot anticipate all unusual weather events, and such events have had and may in the future have a material adverse effect on the operation of its facilities.

It is possible that we may expend large sums of money on individual projects to bring Microgy s products to market and that the revenue that Microgy derives from these products from new projects may be insufficient to fund our operations.

Microgy s business approach to the renewable energy may not produce results as anticipated, be profitable or be readily accepted by the marketplace. We cannot estimate whether the gas produced by facilities based on Microgy s technology will materialize at anticipated prices, or whether satisfactory profit margins will be achieved. If such pricing levels are not achieved or sustained, or if Microgy s technologies and business approach to Microgy s markets do not achieve or sustain broad acceptance, our business, operating results and financial condition will be materially and negatively impacted.

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Because we have not filed patents to protect Microgy s intellectual property, we might not be able to prevent others from using Microgy s technology; conversely, others who have filed for patent or other protection might be able to prevent Microgy from using its technology.

Microgy has not filed any patent applications on any of its intellectual property. Should Microgy decide to file patent applications, we cannot assure you that any patent applications relating to Microgy s existing or future products or technologies will result in patents being issued, that any issued patents will afford adequate protection to Microgy, or that such patents will not be challenged, invalidated, infringed or circumvented. Furthermore, we cannot assure you that others have not developed, or will not develop, similar technologies that will compete with Microgy s without infringing upon Microgy s intellectual property rights or those of its licensor.

Third parties, including potential competitors, may already have filed patent applications relating to the subject matter of Microgy s current or future technology. In the event that any such patents are issued to such parties, such patents may preclude Microgy or its licensor from obtaining patent protection for its technologies, products or processes. In addition, such patents may hinder or prevent Microgy from commercializing its technology and could require Microgy to enter into licenses with such parties. We cannot assure you that any required licenses would be available to us on acceptable terms, or at all.

Microgy relies on confidentiality agreements and licensing agreements to maintain the proprietary nature of its technology. To compete effectively, Microgy may have to defend the rights to its intellectual property from time to time. Such defense costs may be significant and have a negative impact on our financial condition. In addition, we may lack the financial resources to adequately defend Microgy s intellectual property.

Microgy s facilities are likely to be subject to numerous governmental regulations.

We expect that Microgy s facilities are likely to be subject to various local, state and federal government regulations, including regulations covering air and water quality, solid waste disposal and related pollution issues. These regulations are mandated by the United States Environmental Protection Agency, or EPA, and state and local governments and are usually implemented through a permitting process, with ongoing compliance requirements thereafter. For example, grease-trap waste from restaurants and other food service providers is a desirable and highly available form of substrate for our facilities in Texas. However, the Texas environmental authorities required that we obtain a solid-waste permit for each of our planned facilities in Texas to the extent we desire to use grease-trap waste as substrate in the operation of such facilities. In addition, while we are authorized to distribute our effluent in Texas to neighboring properties pursuant to a commercial-fertilizer registration issued by the Texas State Chemist, the neighboring properties are still subject to regulations that require application of the effluent at agronomically sound rates. There are times when a customer has to curtail use of our liquid byproduct to prevent over-application, thereby necessitating that we find other outlets for the byproduct, potentially increasing operating costs, including provision for interim storage. We expect that all of our facilities will be required to obtain and comply with various environmental and other permits and approvals, which will vary from location to location. In addition, our activities will fall under a number of health and safety regulations and laws and regulations relating to farming and zoning. Compliance with these regulations and permitting requirements could delay the development of facilities and/or add to our operating costs on an interim or even a permanent basis and harm our financial condition or potentially require that we discontinue operations, depending upon the severity and duration of a particular compliance issue.