

ENCISION INC  
Form 10-Q  
February 14, 2017

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

Form 10-Q

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

For the quarterly period ended December 31, 2016

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: 001-11789

ENCISION INC.  
(Exact name of registrant as specified in its charter)

**Colorado** **84-1162056**  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

6797 Winchester Circle  
Boulder, Colorado 80301  
(Address of principal executive offices)

(303) 444-2600  
(Registrant's telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

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, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

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Non-accelerated filer  
(Do not check if a smaller reporting company)  Smaller reporting company

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 each of the issuer's classes of common equity, as of the latest practicable date:

Common Stock, no par value 10,683,355 Shares  
(Class) (outstanding at January 31, 2017)

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ENCISION INC.

FORM 10-Q

For the Three and Nine Months Ended December 31, 2016

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PART I. FINANCIAL INFORMATION

## ITEM 1 - CONDENSED INTERIM FINANCIAL STATEMENTS

Encision Inc.  
Condensed Balance Sheets  
(unaudited)

	December 31, 2016	March 31, 2016
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$63,867	\$292,840
Restricted cash	25,000	25,000
Accounts receivable, net of allowance for doubtful accounts of \$20,000 at December 31, 2016 and \$9,000 at March 31, 2016	1,078,673	839,850
Inventories, net of reserve for obsolescence of \$170,000 at December 31, 2016 and \$410,000 at March 31, 2016	1,135,975	1,730,747
Prepaid expenses	137,264	91,989
Total current assets	2,440,779	2,980,426
Equipment, at cost:		
Furniture, fixtures and equipment	3,160,388	3,950,710
Accumulated depreciation	(2,647,395 )	(3,389,533 )
Equipment, net	512,993	561,177
Patents, net of accumulated amortization of \$195,433 at December 31, 2016 and \$153,494 at March 31, 2016	257,875	252,889
Other assets	16,392	15,926
<b>TOTAL ASSETS</b>	<b>\$3,228,039</b>	<b>\$3,810,418</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$508,417	\$355,890
Accrued compensation	220,733	246,203
Other accrued liabilities	234,682	257,506
Line of credit	283,670	387,491
Deferred rent	30,384	30,384
Total current liabilities	1,277,886	1,277,474
Long-term liability:		
Deferred rent	48,109	70,896
Total liabilities	1,325,995	1,348,370
Commitments and contingencies (Note 4)		
Shareholders' equity:		
Preferred stock, no par value: 10,000,000 shares authorized; none issued and outstanding	—	—
Common stock and additional paid-in capital, no par value: 100,000,000 shares authorized; 10,683,355 shares issued and outstanding at December 31 and March 31, 2016	23,734,776	23,682,365
Accumulated (deficit)	(21,832,732)	(21,220,317)
Total shareholders' equity	1,902,044	2,462,048
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$3,228,039</b>	<b>\$3,810,418</b>

The accompanying notes to financial statements are an integral part of these condensed statements.

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Encision Inc.  
Condensed Statements of Operations  
(Unaudited)

	Three Months Ended		Nine Months Ended	
	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
NET REVENUE	\$2,229,870	\$2,292,663	\$6,657,875	\$7,047,424
COST OF REVENUE	1,165,414	1,118,658	3,394,204	3,519,205
GROSS PROFIT	1,064,456	1,174,005	3,263,671	3,528,219
OPERATING EXPENSES:				
Sales and marketing	638,735	626,001	1,882,337	1,952,191
General and administrative	383,106	354,397	1,087,239	1,087,641
Research and development	300,392	339,746	880,760	929,400
Total operating expenses	1,322,233	1,320,144	3,850,336	3,969,232
OPERATING LOSS	(257,777 )	(146,139 )	(586,665 )	(441,013 )
Interest expense, net	(15,093 )	(10,047 )	(44,681 )	(27,448 )
Other income (expense), net	(1,295 )	(43,843 )	18,931	(129,075 )
Interest expense and other income (expense), net	(16,388 )	(53,890 )	(25,750 )	(156,523 )
LOSS BEFORE PROVISION FOR INCOME TAXES	(274,165 )	(200,029 )	(612,415 )	(597,536 )
Provision for income taxes	—	—	—	—
NET LOSS	\$(274,165 )	\$(200,029 )	\$(612,415 )	\$(597,536 )
Net loss per share—basic and diluted	\$(0.03 )	\$(0.02 )	\$(0.06 )	\$(0.06 )
Weighted average shares—basic and diluted	10,678,344	10,673,225	10,674,548	10,673,225

The accompanying notes to financial statements are an integral part of these condensed statements.

Encision Inc.  
Condensed Statements of Cash Flows  
(Unaudited)

	Nine Months Ended	
	December	December
	31, 2016	31, 2015
Operating activities:		
Net loss	\$(612,415)	\$(597,536)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	168,357	243,867
Share-based compensation expense	52,411	56,396
Provision for (recovery from) doubtful accounts, net	11,000	(4,500 )
(Recovery from) provision for inventory obsolescence, net	(240,000)	40,762
Changes in operating assets and liabilities:		
Accounts receivable	(249,823)	107,910
Inventories	834,772	295,958
Prepaid expenses and other assets	(45,741 )	(16,996 )
Accounts payable	152,527	(232,709)
Accrued compensation and other accrued liabilities	(71,081 )	(160,351)
Net cash generated by (used in) operating activities	7	(267,199)
Investing activities:		
Acquisition of property and equipment	(104,057)	(36,104 )
Patent costs	(21,102 )	(20,125 )
Net cash (used in) investing activities	(125,159)	(56,229 )
Financing activities:		
Paydown of credit facility, net change	(103,821)	(171,986)
Net cash (used in) financing activities	(103,821)	(171,986)
Net decrease in cash and cash equivalents	(228,973)	(151,442)
Cash and cash equivalents, beginning of period	292,840	258,656
Cash and cash equivalents, end of period	\$63,867	\$107,214

The accompanying notes to financial statements are an integral part of these condensed statements.

ENCISION INC.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS

DECEMBER 31, 2016  
(Unaudited)

Note 1. ORGANIZATION AND NATURE OF BUSINESS

Encision Inc. is a medical device company that designs, develops, manufactures and markets patented surgical instruments that provide greater safety to, and saves lives of, patients undergoing minimally-invasive surgery. We believe that our patented AEM<sup>®</sup> (Active Electrode Monitoring) surgical instrument technology is changing the marketplace for electrosurgical devices and instruments by providing a solution to a patient safety risk in laparoscopic surgery. Our sales to date have been made principally in the United States.

We have an accumulated deficit of \$21,832,732 at December 31, 2016. Operating funds have been provided primarily by issuances of our common stock and warrants, a line of credit, and the exercise of stock options to purchase our common stock. Should our liquidity be diminished in the future because of operating losses, we may be required to seek additional capital.

Our strategic marketing and sales plan is designed to expand the use of our products in surgically active hospitals and surgery centers in the United States.

Note 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation. The condensed interim financial statements included herein have been prepared by us, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles accepted in the United States ("GAAP") have been condensed or omitted pursuant to such rules and regulations, although we believe that the disclosures made are adequate to make the information presented not misleading. The condensed interim financial statements and notes thereto should be read in conjunction with the financial statements and the notes thereto included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2016, filed on June 14, 2016.

The accompanying condensed interim financial statements have been prepared, in all material respects, in conformity with the standards of accounting measurements and reflect, in the opinion of management, all adjustments necessary to summarize fairly the financial position and results of operations for such periods in accordance with GAAP. All adjustments are of a normal recurring nature. The results of operations for the most recent interim period are not necessarily indicative of the results to be expected for the full year.

Use of Estimates in the Preparation of Financial Statements. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions. Such estimates and assumptions affect the reported amounts of assets and liabilities as well as disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of sales and expense during the reporting period. Actual results could differ from those estimates. In the quarter ended December 31, 2016, we changed the method of apportioning overhead costs to certain inventory with a higher turnover rate than inventory in general. The effect of this change in estimate was an approximately \$127 thousand and \$190 thousand decrease in operating and net income for the three and nine month periods ended December 31, 2016, respectively. The effect on both basic earnings per share and diluted earnings per share was a decrease of \$0.01 and \$0.02 for the three and nine months ended December 31, 2016,



respectively.

Cash and Cash Equivalents. For purposes of reporting cash flows, we consider all cash and highly liquid investments with an original maturity of three months or less to be cash equivalents. Restricted cash is cash that was deposited to obtain a letter of credit for our importing and exporting activities.

Fair Value of Financial Instruments. Our financial instruments consist of cash and cash equivalents, short-term trade receivables, payables and a line of credit. The carrying values of cash and cash equivalents, short-term trade receivables, payables and line of credit approximate their fair value due to their short maturities.

Concentration of Credit Risk. Financial instruments, which potentially subject us to concentrations of credit risk, consist of cash and cash equivalents, accounts receivable and a line of credit. From time to time, the amount of cash on deposit with financial institutions may exceed the \$250,000 federally insured limit at December 31, 2016. We believe that cash on deposit that exceeds \$250,000 with financial institutions is financially sound and the risk of loss is minimal.

We have no significant off-balance sheet concentrations of credit risk such as foreign exchange contracts, options contracts or other foreign hedging arrangements. We maintain the majority of our cash balances with one financial institution in the form of demand deposits.

Accounts receivable are typically unsecured and are derived from transactions with and from entities in the healthcare industry primarily located in the United States. Accordingly, we may be exposed to credit risk generally associated with the healthcare industry. We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. The net accounts receivable balance at December 31, 2016 of \$1,078,673 and at March 31, 2016 of \$839,850 included no more than 5% from any one customer.

Warranty Accrual. We provide for the estimated cost of product warranties at the time sales are recognized and include it as other accrued liabilities. While we engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers, our warranty obligation is based upon historical experience and is also affected by product failure rates and material usage incurred in correcting a product failure. Should actual product failure rates or material usage costs differ from our estimates, revisions to the estimated warranty liability would be required.

Inventories. Inventories are stated at the lower of cost (first-in, first-out basis) or market. We reduce inventory for estimated obsolete or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required. At December 31, 2016 and March 31, 2016, inventory consisted of the following:

	December 31, 2016	March 31, 2016
Raw materials	\$822,741	\$1,469,630
Finished goods	483,234	671,117
Total gross inventories	1,305,975	2,140,747
Less reserve for obsolescence	(170,000 )	(410,000 )
Total net inventories	\$1,135,975	\$1,730,747

Property and Equipment. Property and equipment are stated at cost, with depreciation computed over the estimated useful lives of the assets, generally five to seven years. We use the straight-line method of depreciation for property and equipment. Leasehold improvements are depreciated over the shorter of the remaining lease term or the estimated useful life of the asset. Maintenance and repairs are expensed as incurred and major additions, replacements and improvements are capitalized.

Long-Lived Assets. Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. A long-lived asset is considered impaired when estimated future cash flows related to the asset, undiscounted and without interest, are insufficient to recover the carrying amount of the asset. If deemed impaired, the long-lived asset is reduced to its estimated fair value. Long-lived assets to be disposed of are reported at the lower of their carrying amount or estimated fair value less cost to sell.

Patents. The costs of applying for patents are capitalized and amortized on a straight-line basis over the lesser of the patent's economic or legal life (20 years from the date of application in the United States). Capitalized costs are expensed if patents are not issued. We review the carrying value of our patents periodically to determine whether the patents have continuing value and such reviews could result in the conclusion that the recorded amounts have been

impaired.

Income Taxes. We account for income taxes under the provisions of FASB Accounting Standards Codification ("ASC") Topic 740, "Accounting for Income Taxes" ("ASC 740"). ASC 740 requires recognition of deferred income tax assets and liabilities for the expected future income tax consequences, based on enacted tax laws, of temporary differences between the financial reporting and tax bases of assets and liabilities. ASC 740 also requires recognition of deferred tax assets for the expected future tax effects of all deductible temporary differences, loss carryforwards and tax credit carryforwards. Deferred tax assets are then reduced, if deemed necessary, by a valuation allowance for the amount of any tax benefits, which, more likely than not based on current circumstances, are not expected to be realized. As a result, no provision for income tax is reflected in the accompanying statements of operations. Should we achieve sufficient, sustained income in the future, we may conclude that some or all of the valuation allowance should be reversed. We are required to make many subjective assumptions and judgments regarding our income tax exposures. At December 31, 2016, we had no unrecognized tax benefits, which would affect the effective tax rate if recognized and had no accrued interest, or penalties related to uncertain tax positions.

Revenue Recognition. Revenue from product sales is recorded when we ship the product and title has passed to the customer, provided that we have evidence of a customer arrangement and can conclude that collection is probable. Our shipping policy is FOB Shipping Point. We recognize revenue from sales to stocking distributors when there is no right of return, other than for normal warranty claims. We have no ongoing obligations related to product sales, except for normal warranty obligations. Revenue from engineering services is recognized when the service is performed.

Research and Development Expenses. We expense research and development costs for products and processes as incurred.

Stock-Based Compensation. Stock-based compensation is presented in accordance with the guidance of ASC Topic 718, "Compensation – Stock Compensation" ("ASC 718"). Under the provisions of ASC 718, companies are required to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in our statements of operations.

Stock-based compensation expense recognized under ASC 718 for the three and nine months ended December 31, 2016 was \$17,998 and \$52,411, respectively, and for the three and nine months ended December 31, 2015 was \$18,801 and \$56,396, respectively, which consisted of stock-based compensation expense related to grants of employee stock options and restricted stock units ("RSUs").

Segment Reporting. We have concluded that we have one operating segment.

Recent Accounting Pronouncements. We have reviewed all recently issued, but not yet effective, accounting pronouncements. The Financial Accounting Standards Board issued Accounting Standards Update No. 2014-09 (Revenue from Contracts with Customers), which is effective for annual reporting periods beginning after December 15, 2017. The Company does not expect ASU 2014-09 to have a material/significant impact on its financial statements.

The Financial Accounting Standards Board has also issued Accounting Standards Update 2014-15, Presentation of Financial Statements — Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern (the ASU), which provides guidance on determining when and how to disclose going concern uncertainties in the financial statements. The ASU requires management to perform an assessment every reporting period (including interim periods) to determine whether there is substantial doubt about a company's ability to continue as a going concern and to provide related footnote disclosures. The ASU also defines that substantial doubt exists when relevant conditions and events, considered in the aggregate, indicate that it is probable that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued (or available to be issued). The ASU applies to all entities and is effective for annual periods ending after December 15, 2016, and interim periods thereafter, with early adoption permitted. We are currently evaluating this new guidance and the related impact on the financial statements.

In July 2015, the FASB issued Accounting Standards Update 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory, ("ASU 2015-11"). ASU 2015-11 affects reporting entities that measure inventory using first-in, first-out (FIFO) or average cost. Specifically, ASU 2015-11 requires that inventory be measured at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory measured using LIFO or the retail inventory method. ASU 2015-11 is effective for fiscal years beginning after December 15, 2016. Early adoption is permitted. The Company does not expect ASU 2015-11 to have a material/significant impact on its financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) ("ASU 2016-02"), which modified lease accounting for both lessees and lessors to increase transparency and comparability by recognizing lease assets and lease liabilities by lessees for those leases classified as operating leases under previous accounting standards and disclosing key information about leasing arrangements. ASU 2016-02 will be effective for the Company beginning in its third quarter of 2020 and early adoption is permitted. The Company is currently evaluating the timing of its

adoption and the impact of adopting the new lease standard on its consolidated financial statements.

Note 3. BASIC AND DILUTED INCOME AND LOSS PER COMMON SHARE

We report both basic and diluted net income (loss) per share. Basic net income or loss per common share is computed by dividing net income or loss for the period by the weighted average number of common shares outstanding for the period. Diluted net income or loss per common share is computed by dividing the net income or loss for the period by the weighted average number of common and potential common shares outstanding during the period if the effect of the potential common shares is dilutive. The shares used in the calculation of dilutive potential common shares exclude options and RSUs to purchase shares where the exercise price was greater than the average market price of common shares for the period.

The following table presents the calculation of basic and diluted net loss per share:

	Three Months Ended		Nine Months Ended	
	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
Net loss	\$(274,165 )	\$(200,029 )	\$(612,415 )	\$(597,536 )
Weighted-average shares — basic	10,678,344	10,673,225	10,674,548	10,673,225
Effect of dilutive potential common shares	—	—	—	—
Weighted-average shares — diluted	10,678,344	10,673,225	10,674,548	10,673,225
Net income (loss) per share — basic	\$(0.03 )	\$(0.02 )	\$(0.06 )	\$(0.06 )
Net income (loss) per share — diluted	\$(0.03 )	\$(0.02 )	\$(0.06 )	\$(0.06 )
Antidilutive employee stock options and RSUs	954,286	708,924	954,286	708,924

Note 4. COMMITMENTS AND CONTINGENCIES

Effective December 1, 2013, we extended our noncancelable lease agreement through July 31, 2019 for our facilities at 6797 Winchester Circle, Boulder, Colorado. The lease includes \$172,176 of leasehold improvements granted by the landlord. The \$172,176 was recorded on our condensed balance sheets as leasehold improvements and deferred rent. The leasehold improvements are being amortized over the lesser of the lease term or the assets life and the deferred rent is being amortized against rent expense over the lease term. The minimum future lease payment, by fiscal year, as of December 31, 2016 is as follows:

Fiscal Year	Amount
2017 (three months remaining)	69,183
2018	285,034
2019	293,585
2020	99,800