ENCISION INC
Form 10-Q
November 13, 2017
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2017
OR
[_] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from __________ to________

Commission file number: 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 [_]
Non-accelerated filer [_]	Smaller reporting company [X]

(Do not check if a smaller reporting company) Emerging growth company [_]

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

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

Indicate the number of shares outstanding of 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 October 31, 2017)

ENCISION INC.

FORM 10-Q

For the Three and Six Months Ended September 30, 2017

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PART I FINANCIAL INFORMATION

ITEM 1 - CONDENSED INTERIM FINANCIAL STATEMENTS

Encision Inc.
Condensed Balance Sheets
(unaudited)

	September 30, 2017	March 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$128,762	$45,117
Restricted cash	25,000	50,000
Accounts receivable, net of allowance for doubtful accounts of $9,000 at September 30, 2017 and $33,000 at March 31, 2017	920,773	1,042,281
Inventories, net of reserve for obsolescence of $40,000 at September 30, 2017 and $50,000 at March 31, 2017	1,214,107	1,128,412
Prepaid expenses	152,949	62,290
Total current assets	2,441,591	2,328,100
Equipment, at cost:		
Furniture, fixtures and equipment	3,167,129	3,161,687
Accumulated depreciation	(2,771,394)	(2,693,302)
Equipment, net	395,735	468,385
Patents, net of accumulated amortization of $225,748 at September 30, 2017 and $212,345 at March 31, 2017	264,579	253,980
Other assets	17,690	16,450
TOTAL ASSETS	$3,119,595	$3,066,915
LIABILITIES AND SHAREHOLDERS’ EQUITY		
Current liabilities:		
Accounts payable	$405,684	$402,914
Accrued compensation	250,666	267,399
Other accrued liabilities	274,179	248,130
Line of credit	—	275,055
Deferred rent	30,384	30,384
Total current liabilities	960,913	1,223,882
Long-term liability:		
Deferred rent	25,320	40,512
Total liabilities	986,233	1,264,394
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 September 30, 2017 and March 31, 2017	23,785,323	23,752,131
Accumulated (deficit)	(21,651,961)	(21,949,610)
Total shareholders’ equity	2,133,362	1,802,521
TOTAL LIABILITIES AND SHAREHOLDERS’ EQUITY	$3,119,595	$3,066,915

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		Six Months Ended	
	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016
NET REVENUE	$2,162,579	$2,150,656	$4,526,175	$4,428,004
COST OF REVENUE	903,919	1,141,773	1,923,414	2,228,789
GROSS PROFIT	1,258,660	1,008,883	2,602,761	2,199,215
OPERATING EXPENSES:				
Sales and marketing	574,191	614,164	1,175,320	1,243,602
General and administrative	365,264	359,722	689,264	704,134
Research and development	189,855	278,716	411,189	580,367
Total operating expenses	1,129,310	1,252,602	2,275,773	2,528,103
OPERATING INCOME (LOSS)	129,350	(243,719)	326,988	(328,888)
Interest expense, net	(13,696)	(16,097)	(28,822)	(29,588)
Other income (expense), net	612	20,226	(517)	20,227
Interest expense and other income (expense), net	(13,084)	4,129	(29,339)	(9,361)
INCOME (LOSS) BEFORE PROVISION FOR INCOME TAXES	116,266	(239,590)	297,649	(338,249)
Provision for income taxes	—	—	—	—
NET INCOME (LOSS)	$116,266	$(239,590)	$297,649	$(338,249)
Net income (loss) per share—basic	$0.01	$(0.02)	$0.03	$(0.03)
Net income (loss) per share—diluted	$0.01	$(0.02)	$0.03	$(0.03)
Weighted average shares—basic	10,683,355	10,673,225	10,683,355	10,673,225
Weighted average shares—diluted	10,692,471	10,673,225	10,691,764	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)

	Six Months Ended	
	September 30, 2017	September 30, 2016
Operating activities:		
Net income (loss)	$297,649	$(338,249)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	102,480	116,584
Share-based compensation expense	33,192	34,413
(Recovery from) provision for doubtful accounts, net	(24,000)	12,500
(Recovery from) provision for inventory obsolescence, net	(10,000)	40,000
Changes in operating assets and liabilities:		
Accounts receivable	145,508	(138,132)
Inventories	(75,695)	232,540
Prepaid expenses and other assets	(91,899)	(25,309)
Accounts payable	2,770	(66,669)
Accrued compensation and other accrued liabilities	(5,876)	(30,226)
Net cash generated by (used in) operating activities	374,129	(162,448)
Investing activities:		
Acquisition of property and equipment	(16,427)	(60,370)
Patent costs	(24,002)	(18,909)
Net cash (used in) investing activities	(40,429)	(79,279)
Financing activities:		
Paydown of credit facility, net change	(275,055)	(19,561)
Change in restricted cash	25,000	—
Net cash (used in) financing activities	(250,055)	(19,561)
Net increase (decrease) in cash and cash equivalents	83,645	(261,288)
Cash and cash equivalents, beginning of period	45,117	292,840
Cash and cash equivalents, end of period	$128,762	$31,552

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

ENCISION INC.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS

SEPTEMBER 30, 2017
(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® (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 $21,651,961 at September 30, 2017. A significant portion of our operating funds have been provided 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, 2017, filed on June 14, 2017.

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.

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 September 30, 2017. 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 September 30, 2017 of $920,773 and at March 31, 2017 of $1,042,281 included no more than 6% 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 September 30, 2017 and March 31, 2017, inventory consisted of the following:

	September 30, 2017	March 31, 2017
Raw materials	$944,323	$857,345
Finished goods	309,784	321,067
Total gross inventories	1,254,107	1,178,412
Less reserve for obsolescence	(40,000)	(50,000)
Total net inventories	$1,214,107	$1,128,412

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 September 30, 2017, 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 six months ended September 30, 2017 was $18,133 and $33,192, respectively, and for the three and six months ended September 30, 2016 was $17,378 and $34,413, 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.

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 and it has been adopted. 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. However, the ultimate impact of adopting ASU 2016-02 will depend on the Company's lease portfolio as of the adoption date.

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	Six Months Ended

	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016
Net income (loss)	$116,266	$(239,590)	$297,649	$(338,249)
Weighted-average shares — basic	10,683,355	10,673,225	10,683,355	10,673,225
Effect of dilutive potential common shares	9,116	—	8,409	—
Weighted-average shares — diluted	10,692,471	10,673,225	10,691,764	10,673,225
Net income (loss) per share — basic	$0.01	$(0.02)	$0.03	$(0.03)
Net income (loss) per share — diluted	$0.01	$(0.02)	$0.03	$(0.03)
Antidilutive employee stock options and RSUs	1,070,170	880,924	1,070,877	880,924

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 September 30, 2017 is as follows:

Fiscal Year	Amount
2018 (six months remaining)	$142,517
2019	293,585
2020	99,800
Total	$535,902

In March 2016, we entered into a loan and security agreement with Crestmark Bank. The loan is due on demand and has no financial covenants. Under the agreement, we were provided with a line of credit that is not to exceed the lesser of $1,000,000 or 85% of eligible accounts receivable. The interest rate is prime rate plus 2%, with a floor of 5.5%, plus a monthly maintenance fee of 0.4%, based on the average monthly loan balance. Interest is charged on a minimum loan balance of $500,000, a loan fee of 1% annually, and an exit fee of 2% and 1% during years two and three, respectively. As of September 30, 2017, we had no borrowings from the credit facility and had an additional $495,320 available to borrow.

Aside from the operating lease, we do not have any material contractual commitments requiring settlement in the future.

We are subject to regulation by the United States Food and Drug Administration ("FDA"). The FDA provides regulations governing the manufacture and sale of our products and regularly inspects us and other manufacturers to determine compliance with these regulations. We believe that we were in substantial compliance with all known regulations at September 30, 2017. FDA inspections are conducted periodically at the discretion of the FDA. Our latest inspection by the FDA occurred in October 2016.

Note 5. SHARE-BASED COMPENSATION

The provisions of ASC 718-10-55 requires the measurement and recognition of compensation expense for all share-based payment awards made to our employees and directors, including employee stock options and RSUs, based on estimated fair values. The following table summarizes stock-based compensation expense related to employee stock options, RSUs and employee stock purchases for the three and six months ended September 30, 2017 and 2016, which was allocated as follows:

	Three Months Ended		Six Months Ended	
	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016
Cost of sales	$623	$ 640	$1,078	$ 1,254
Sales and marketing	3,629	3,039	6,839	6,078
General and administrative	12,328	12,517		