ENCISION INC
Form 10-Q
February 14, 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 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

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)

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
ASSETS		
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
TOTAL ASSETS	$3,228,039	$3,810,418
LIABILITIES AND SHAREHOLDERS' EQUITY		
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
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$3,228,039	$3,810,418

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

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 31, 2016	December 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® (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
Total	$747,602

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 3%, 2% and 1% during years one, two and three, respectively. As of December 31, 2016, we had $283,670 of borrowings from the credit facility and had an additional $406,592 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 December 31, 2016. FDA inspections are conducted periodically at the discretion of the FDA. Our latest inspection by the FDA occurred in October 2015.

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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 nine months ended December 31, 2016 and 2015, which was allocated as follows:

	Three Months Ended		Nine Months Ended	
	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
Cost of sales	$819	$ 573	$2,073	$ 1,716
Sales and marketing	3,406	2,955	9,484	8,866
General and administrative	12,231	14,226	36,999	42,674
Research and development	1,542	1,047	3,855	3,140
Stock-based compensation expense	$17,998	$ 18,801	$52,411	$ 56,396

Share-based compensation cost for stock options is measured at the grant date, based on the fair value as calculated by the Black-Scholes-Merton ("BSM") option-pricing model. The BSM option-pricing model requires the use of actual employee exercise behavior data and the application of a number of assumptions, including expected volatility, risk-free interest rate and expected dividends. There were 105,000 and 285,000 stock options granted, and 11,000 and 11,000 forfeited during the three and nine months ended December 31, 2016, respectively. Share-based compensation cost for RSUs is measured based on the closing fair market value of the Company's common stock on the date of grant. There were 10,130 RSUs exercised and 10,508 forfeited during the three and nine months ended December 31, 2016.

As of December 31, 2016, $230,000 of total unrecognized compensation costs related to nonvested stock options is expected to be recognized over a period of five years.

Note 6. RELATED PARTY TRANSACTION

We paid consulting fees of $16,309 and $57,484 to an entity owned by one of our directors during the three and nine months ended December 31, 2016, respectively, and $22,054 and $63,780 during the three and nine months ended December 31, 2015.

Note 7. SUBSEQUENT EVENTS

We evaluated all of our activity as of the date the condensed interim financial statements were issued and concluded that no subsequent events have occurred that would require recognition in our financial statements or disclosed in the notes to our financial statements.

ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Certain statements contained in this section on Management's Discussion and Analysis are not historical facts, including statements about our strategies and expectations with respect to new and existing products, market demand, acceptance of new and existing products, marketing efforts, technologies and opportunities, market and industry segment growth, and return on investments in products and markets. These statements are forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and involve substantial risks and uncertainties that may cause actual results to differ materially from those indicated by the forward looking statements. All forward looking statements in this section on Management's Discussion and Analysis are based on information available to us on the date of this document, and we assume no obligation to update such forward looking statements. Readers of this Form 10-Q are strongly encouraged to review the section entitled "Risk Factors" in our Form 10-K for the fiscal year ended March 31, 2016.

General

Encision Inc., a medical device company based in Boulder, Colorado, has developed and markets innovative technology that provides unprecedented outcomes and patient safety in minimally-invasive surgery. We believe that our patented Active Electrode Monitoring ("AEM®") AEM EndoShield™. Burn Protection System is changing the marketplace for electrosurgical devices and laparoscopic instruments by providing a solution to a well-documented hazard unique to laparoscopic surgery. The Center for Medicare and Medicaid Services ("CMS") recently published its Hospital-Acquired Condition Reduction Program effective October 1, 2015. At that time, the program began to levy as much as a 1% penalty on Medicare reimbursements to hospitals in the lower quadrant of performance for selected quality indicators, including accidental puncture and laceration ("APL"). Examples of APL include the use of a cautery device (electrosurgery) or scissors to dissect a tissue plane that errantly causes an injury to underlying bowels.

We address market opportunities created by the increase in minimally-invasive surgery ("MIS") and surgeons' use of electrosurgery devices in these procedures. The product opportunity exists in that monopolar electrosurgery instruments used in laparoscopic procedures provide excellent clinical results, but are also susceptible to causing inadvertent collateral tissue damage outside the surgeon's field of view due to insulation failure and capacitive coupling. The risk of unintended electrosurgical burn injury to the patient in laparoscopic surgery has been well documented. This risk poses a threat to patient safety, including the risk of death, and creates liability exposure for surgeons and hospitals, as well as increased and preventable readmissions.

Our patented AEM technology provides surgeons with the desired tissue effects, while capturing stray electrosurgical energy that can cause unintended and unseen tissue injury that may result in death. AEM Surgical Instruments are equivalent to conventional instruments in size, shape, ergonomics, functionality and competitive pricing, but they incorporate "Active Electrode Monitoring" technology to dynamically and continuously monitor the flow of electrosurgical current, thereby helping to prevent patient injury. With our "shielded and monitored" instruments, surgeons are able to perform electrosurgical procedures more safely, effectively and economically than is possible using conventional instruments or alternative energy sources.

AEM technology has been recommended and endorsed by many groups involved in MIS. Surgeons, nurses, biomedical engineers, the medicolegal community, malpractice insurance carriers and electrosurgical device manufacturers advocate the use of AEM technology. We have focused our marketing strategies to date on expanding the market awareness of the AEM technology and our broad independent endorsements and have continued efforts to improve and expand the AEM technology penetration.

When a hospital or surgery center changes to AEM technology, we receive recurring revenue from sales of replacement instruments. We believe that there is no directly competing technology to supplant AEM products. The

replacement market of reusable and disposable AEM products in hospitals and surgery centers that use our AEM technology represented over 90% of our product revenue during the three months ended December 31, 2016. This revenue stream is expected to grow as the base of accounts using AEM technology expands. In addition, we intend to further develop disposable versions of more of our AEM products in order to meet market demands and expand our sales opportunities.

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, 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.

During the nine months ended December 31, 2016, we generated $7 of cash by our operations and used $104,057 for investments in property and equipment. As of December 31, 2016, we had $63,867 in cash and cash equivalents available to fund future operations, a decrease of $228,973 from March 31, 2016. Our working capital was $1,162,893 at December 31, 2016 compared to $1,702,952 at March 31, 2016.

Historical Perspective

We were organized in 1991 and spent several years developing the AEM monitoring system and protective sheaths to adapt to conventional electrosurgical instruments. We have invested heavily in an effort to protect our valuable technology, and, as a result of this effort, we have been issued 11 unexpired relevant patents that together form a significant intellectual property position. Our patents relate to the basic shielding and monitoring technologies that we incorporate into our AEM products.

Our AEM Surgical Instruments have been engineered to provide a seamless transition for surgeons switching from conventional laparoscopic instruments. AEM technology has been integrated into instruments that have the same look, feel and functionality as conventional instruments that surgeons have been using for years. The AEM product line encompasses the full range of instrument sizes, types and styles favored by surgeons. Additionally, we continue to improve quality and add to the product line. These additions include more disposable versions, the introduction of hand-activated instruments, our enhanced scissors, our e·Edge™ scissors, our EM3 AEM Monitor and our AEM EndoShield Burn Protection System. Hospitals can make a complete and smooth conversion to our product line, thereby advancing patient safety in MIS with optimal convenience.

Outlook

Installed Base of AEM Monitoring Equipment: We believe that sales of our installed base of AEM products will increase as the inherent risks associated with monopolar laparoscopic electrosurgery become more widely acknowledged and as we focus on increasing our sales efficiency and continue to enhance our product line. We expect that the replacement sales of electrosurgical instruments and accessories will also increase as additional facilities adopt AEM technology. We anticipate that the efforts to improve the productivity of sales representatives carrying the AEM product line, along with the introduction of next generation products, may provide the basis for increased sales and profitable operations. However, these measures, or any others that we may adopt, may not result in either increased sales or profitable operations.

We believe that the unique performance of the AEM technology and our breadth of independent endorsements provide an opportunity for continued market share growth. In our view, market awareness and awareness of the clinical credibility of the AEM technology, as well as awareness of our endorsements, are improving, and we expect this awareness to benefit our sales efforts for the remainder of fiscal year 2017. Our objectives for the remainder of fiscal year 2017 are to optimize sales execution, to expand market awareness of the AEM technology and to maximize the number of additional hospital and surgery center accounts switching to AEM instruments while retaining existing customers. In addition, acceptance of AEM products depends on surgeons' preference for our instruments, which depends on factors such as ergonomics, quality and ease of use in addition to the technological and safety advantages of AEM products. If surgeons prefer other instruments to our instruments, our business results will suffer.

The Patient Protection and Affordable Care Act included a provision that imposes a 2.3% excise tax on the sale of certain medical devices by a manufacturer, producer or importer of such devices in the United States. Effective January 1, 2016, the excise tax was suspended for two years. Most of our product revenue is subject to the tax. We include the medical device tax in other expense.

Possibility of Operating Losses: We have an accumulated deficit of $21,832,732 at December 31, 2016. A significant portion of our operating funds have been provided by issuances of our common stock and warrants, 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. We have made strides toward improving our operating results but due to the ongoing need to develop, optimize and train our direct sales managers and the independent sales representative network, the need to support the development of refinements to our product line, and the need to increase sustained sales to a level adequate to cover fixed and variable operating costs, we may operate at a net loss.

Sustained losses, or our inability to generate sufficient cash flow from operations to fund our obligations, may result in a need to raise additional capital.

Revenue Growth: We expect to generate increased product revenue in the U.S. from sales to new customers and from expanded sales to existing customers as the medical device industry stabilizes and our network of direct and independent sales representatives becomes more efficient. We believe that the visibility and credibility of the independent clinical endorsements for AEM technology will contribute to new accounts and increased product revenue in fiscal year 2017. We also expect to increase market share through promotional programs of placing our AEM monitors at no charge into hospitals that commit to standardize with AEM instruments. However, all of these efforts to increase market share and grow product revenue will depend in part on our ability to expand the efficiency and effective coverage range of our direct and independent sales representatives, as well as maintain and in some cases, improve the quality of our product offerings. Service revenue represents design, development and product supply revenue from our agreements with strategic partners.

We also have longer-term initiatives in place to improve our prospects. We expect that development of next generation versions of our AEM products will better position our products in the marketplace and improve our retention rate at hospitals and surgery centers that have changed to AEM technology, enabling us to grow our sales. We are exploring overseas markets to assess opportunities for sales growth internationally. Finally, we intend to explore opportunities to capitalize on our proven AEM technology via licensing arrangements and strategic alliances. These efforts to generate additional sales and further the market penetration of our products are longer term in nature and may not materialize. Even if we are able to successfully develop next generation products or identify potential international markets or strategic partners, we may not be able to capitalize on these opportunities.

Gross Profit and Gross Margins: Gross profit and gross margins can be expected to fluctuate from quarter to quarter as a result of product sales mix, sales volume and service revenue. Gross margins on products manufactured or assembled by us are expected to improve at higher levels of production and sales.

Sales and Marketing Expenses: We continue to refine our domestic and international distribution capability, and we believe that sales and marketing expenses will decrease as a percentage of net sales with increasing sales volume.

Research and Development Expenses: Research and development expenses are expected to increase to support quality improvement efforts and development of refinements to our AEM product line and new products, which will further expand options for surgeons and hospitals.

Results of Operations

For the quarter ended December 31, 2016 compared to the quarter ended December 31, 2015.

Net Revenue. Net revenue for the quarter ended December 31, 2016 was $2,229,870 compared to $2,292,663 for the quarter ended December 31, 2015, a decrease of 3%. The decrease of net revenue is attributable to business lost from hospitals that reduced, or stopped, using AEM technology during the quarter.

Gross profit. Gross profit for the quarter ended December 31, 2016 of $1,064,456 represented a decrease of 9% from gross profit of $1,174,005 for the quarter ended December 31, 2015. Gross profit as a percentage of sales (gross margins) decreased from 51% for the quarter ended December 31, 2015 to 48% for the quarter ended December 31, 2016. Of the total overhead costs, higher overhead costs were applied to faster turnover inventory and lower overhead costs were applied to slower turnover inventory in the quarter ended December 31, 2016. The change in inventory apportionment resulted in a faster recognition of costs and a decreased gross margin of approximately 6%. The decreased difference to gross margin should reach equilibrium by the end of the March 31, 2017 quarter. The counter effect of the change is that inventory balances are decreased by a like amount so that there is no difference to our cash flow with respect to the change.

Sales and marketing expenses. Sales and marketing expenses of $638,735 for the quarter ended December 31, 2016 represented an increase of 2% from sales and marketing expenses of $626,001 for the quarter ended December 31, 2015. The increase was the result of an increase to compensation for one additional sales representative. The increase in expense was partially offset by a decrease to commissions and advertising.

General and administrative expenses. General and administrative expenses of $383,106 for the quarter ended December 31, 2016 represented an increase of 8% from general and administrative expenses of $354,397 for the quarter ended December 31, 2015. The increase was principally the result of legal fees as incurred in connection with a lawsuit that we are not a party to. While we are not a party to the lawsuit, we incurred these expenses while responding to subpoenas which were issued by the plaintiff and defendant in this case.

Research and development expenses. Research and development expenses of $300,392 for the quarter ended December 31, 2016 represented a decrease of 12% compared to $339,746 for the quarter ended December 31, 2015. The decrease was the result of decreased compensation and outside services. The decrease in expense was partially offset by an increase in test materials.

Other income and expense, net. Other income and expense, net includes medical device excise tax of $49,751 for the quarter ended December 31, 2015. Effective January 1, 2016, the excise tax was suspended for two years.

Net loss. Net loss was $274,165 for the quarter ended December 31, 2016 compared to net loss of $200,029 for the quarter ended December 31, 2015. The net loss increase was principally a result of lower revenue and gross profit and was partially offset by suspended medical device tax, as explained above.

For the nine months ended December 31, 2016 compared to the nine months ended December 31, 2015.

Net Revenue. Net revenue for the nine months ended December 31, 2016 was $6,657,875 compared to $7,047,424 for the nine months ended December 31, 2015, a decrease of 6%. The decrease of net revenue is attributable to business lost from hospitals that reduced, or stopped, using AEM technology during the nine months.

Gross profit. Gross profit for the nine months ended December 31, 2016 of $3,263,671 represented a decrease of 7% from gross profit of $3,528,219 for the nine months ended December 31, 2015. Gross profit as a percentage of sales (gross margins) was 49% and 50% for the nine months ended December 31, 2016 and 2015, respectively. Of the total overhead costs, higher overhead costs were applied to faster turnover inventory and lower overhead costs were applied to slower turnover inventory in the nine months ended December 31, 2016. The change in inventory apportionment resulted in a faster recognition of costs and a decreased gross margin of approximately 3%. The decreased difference to gross margin should reach equilibrium by the end of the March 31, 2017 quarter. The counter effect of the change is that inventory balances are decreased by a like amount so that there is no difference to our cash flow with respect to the change. Gross margin was benefitted in the nine months ended December 31, 2016 by lower costs for scrap and costs in manufacturing operations.

Sales and marketing expenses. Sales and marketing expenses of $1,882,337 for the nine months ended December 31, 2016 represented a decrease of 4% from sales and marketing expenses of $1,952,191 for the nine months ended December 31, 2015. The decrease was the result of decreased sales commissions. The decrease in expense was partially offset by an increase to compensation for one additional sales representative.

General and administrative expenses. General and administrative expenses of $1,087,239 for the nine months ended December 31, 2016 represented a minimal decrease from general and administrative expenses of $1,087,641 for the nine months ended December 31, 2015. The decrease was the result of decreased compensation, investors' relation costs and outside services. The decrease in expense was partially offset by an increase of legal fees as a result of legal fees incurred in connection with a lawsuit that we are not a party to. While we are not a party to the lawsuit, we incurred these expenses while responding to subpoenas which were issued by the plaintiff and defendant in this case.

Research and development expenses. Research and development expenses of $880,760 for the nine months ended December 31, 2016 represented a decrease of 5% compared to $929,400 for the nine months ended December 31, 2015. The decrease was the result of decreased compensation and outside services. The decrease in expense was partially offset by an increase to test materials.

Other income and expense, net. Other income and expense, net includes medical device excise tax of $154,072 for the nine months ended December 31, 2015. Effective January 1, 2016, the excise tax was suspended for two years.

Net loss. Net loss was $612,415 for the nine months ended December 31, 2016 compared to net loss of $597,536 for the nine months ended December 31, 2015. The net loss increase was a result of lower revenue and gross profit and was partially offset by reduced total operating expenses and suspended medical device tax, as explained above.

The results of operations for the three and nine months ended December 31, 2016 are not indicative of the results of operations for all or any part of the balance of the fiscal year.

Liquidity and Capital Resources

To date, a significant portion of our operating funds have been provided by issuances of our common stock and warrants, the exercise of stock options to purchase our common stock and, in some years, by operating profits. Common stock and additional paid in capital totaled $23,734,776 from inception through December 31, 2016.

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 3%, 2% and 1% during years one, two and three, respectively. As of December 31, 2016, we had $283,670 of borrowings from the credit facility and had an additional $406,592 available to borrow.

Our operations generated $7 of cash during the nine months ended December 31, 2016 on net revenue of $6,657,875. Cash was principally generated by decreased inventories and increased accounts payable. Cash generated was principally offset by our net loss. The amounts of cash used by operations for the nine months ended December 31, 2016 are not indicative of the expected amounts of cash to be generated from or used in operations in fiscal year 2017. During the nine months ended December 31, 2016, we invested $104,057 in the acquisition of property and equipment. As of December 31, 2016, we had $63,867 in cash and cash equivalents available to fund future operations. Working capital was $1,162,893 at December 31, 2016 compared to $1,702,952 at March 31, 2016. The decrease of working capital at December 31, 2016 was the result of our net loss and a decrease of inventories. The decrease was partially offset by an increase of accounts receivable. Current liabilities were $1,277,886 at December 31, 2016, compared to $1,277,474 at March 31, 2016.

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
Total	$747,602

Aside from the operating lease and line of credit obligation, we do not have any material contractual commitments requiring settlement in the future.

As of December 31, 2016, the following table shows our contractual obligations for the periods presented:

	Payment due by period				
Contractual obligations	Totals	Less than 1 year	1-3 years	3-5 years	More than 5 years
Operating lease obligations	747,602	282,959	464,643	—	—
Line of credit obligation	283,670	283,670	—	—	—
	1,031,272	566,629	464,643	—	—

Our fiscal year 2017 operating plan is focused on increasing new accounts, retaining existing customers, growing revenue, increasing gross profits and conserving cash. We are investing in research and development efforts to develop next generation versions of the AEM product line. We have invested in manufacturing property and equipment to manufacture disposable scissors inserts internally and to reduce our cost of product revenue. We cannot predict with certainty the expected revenue, gross profit, net income or loss and usage of cash and cash equivalents for fiscal year 2017. 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 3%, 2% and 1% during years one, two and three, respectively. As of December 31, 2016, we had $283,670 of borrowings from the credit facility and had an additional $406,592 available to borrow. If we are unable to manage our business operations in line with budget expectations, it could have a material adverse effect on our business viability, financial position, results of operations and cash flows.

Income Taxes

As of March 31, 2016, net operating loss carryforwards totaling approximately $11.1 million are available to reduce taxable income in the future. The net operating loss carryforwards expire, if not previously utilized, at various dates beginning in the fiscal year ending March 31, 2019. We have not paid income taxes since our inception. The Tax Reform Act of 1986 and other income tax regulations contain provisions which may limit the net operating loss

carryforwards available to be used in any given year if certain events occur, including changes in ownership interests. We have established a valuation allowance for the entire amount of our deferred tax asset since inception due to our history of losses. Should we achieve sufficient, sustained income in the future, we may conclude that some or all of the valuation allowance should be reversed. If some or all of the valuation allowance were reversed, then, to the extent of the reversal, a tax benefit would be recognized which would result in an increase to net income.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, sales and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to bad debts, inventories, sales returns, warranty, contingencies and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. We believe the following critical accounting policies affect the more significant judgments and estimates used in the preparation of our financial statements.

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances would be required, which would increase our expenses during the periods in which any such allowances were made. The amount recorded as a provision for bad debts in each period is based upon our assessment of the likelihood that we will be paid on our outstanding receivables, based on customer-specific as well as general considerations. To the extent that our estimates prove to be too high, and we ultimately collect a receivable previously determined to be impaired, we may record a reversal of the provision in the period of such determination.

We provide for the estimated cost of product warranties at the time sales are recognized. While we engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers, we have experienced some costs related to warranties. The warranty accrual is based on historical experience and is adjusted based on current experience. Should actual warranty experience differ from our estimates, revisions to the estimated warranty liability would be required.

We reduce inventory for estimated obsolete or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based on 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. Any write-downs of inventory would reduce our reported net income during the period in which such write-downs were applied. To the extent that our estimates prove to be too high, and we ultimately utilize or sell inventory previously determined to be impaired, we may record a reversal of the provision in the period of such determination.

We recognize 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. 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. Should we maintain sufficient, sustained income in the future, we may conclude that all or some of the valuation allowance should be reversed.

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.

We amortize our patent costs over their estimated useful lives, which is typically the remaining statutory life. From time to time, we may be required to adjust these useful lives of our patents based on advances in technology, competitor actions, and the like. We review the recorded amounts of patents at each period end to determine if their carrying amount is still recoverable based on our expectations regarding sales of related products. Such an assessment, in the future, may result in a conclusion that the assets are impaired, with a corresponding charge against earnings.

We currently estimate forfeitures for stock-based compensation expense related to employee stock options and RSUs at 20% and evaluate the forfeiture rate quarterly. Other assumptions that are used in calculating stock-based compensation expense include risk-free interest rate, expected life, expected volatility and expected dividend.

ITEM 4 - CONTROLS AND PROCEDURES

(a) We have carried out an evaluation under the supervision and with the participation of our management, including our President and CEO and Principal Accounting and Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities and Exchange Act of 1934 (the "Exchange Act")). Based upon that evaluation, the President and CEO and the Principal Accounting and Financial Officer concluded that, as of December 31, 2016, our disclosure controls and procedures were effective.

(b) During the quarter ended December 31, 2016, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 6. Exhibits

The following exhibits are filed with this report on Form 10-Q or are incorporated by reference:

10.1	Employment Agreement, dated November 14, 2016, between Encision and Gregory J. Trudel †.
31.1	Certification of President and CEO under Rule 13a-14(a) of the Exchange Act (filed herewith).
31.2	Certification of Principal Financial and Accounting Officer under Rule 13a-14(a) of the Exchange Act (filed herewith).
32.1	Certifications of President and CEO and Principal Financial and Accounting Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).
101	The following materials from Encision Inc.'s Quarterly Report on Form 10-Q for the quarter ended December 31, 2016, formatted in XBRL (Extensible Business Reporting Language): (i) the unaudited Condensed Balance Sheets, (ii) the unaudited Condensed Statements of Income, (iii) the unaudited Condensed Statements of Cash Flows, and (iv) Notes to Condensed Financial Statements, tagged at Level I.

† Denotes management contract or compensatory plan or arrangement.

SIGNATURE

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.

Encision Inc.

February 14, 2017	/s/ Mala Ray
Date	Mala Ray
	Controller
	Principal Accounting Officer &
	Principal Financial Officer