ENCISION INC
Form 10-Q
January 31, 2011
Table of Contents

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, 2010

OR

o 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 x No o

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 o No o

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

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

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	**6,455,100 Shares**
(Class)	(outstanding at December 31, 2010)

Table of Contents

ENCISION INC.

FORM 10-Q

For the Three Months Ended December 31, 2010

INDEX

Table of Contents

PART I FINANCIAL INFORMATION

ITEM 1 CONDENSED INTERIM FINANCIAL STATEMENTS

Encision Inc.

Condensed Balance Sheets

(unaudited)

	December 31, 2010	March 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 54,504	$ 113,735
Accounts receivable, net of allowance for doubtful accounts of $17,000 at December 31, 2010 and $12,500 at March 31, 2010	1,112,125	1,286,075
Inventories, net of reserve for obsolescence of $60,000 at December 31, 2010 and $150,940 at March 31, 2010	2,475,893	2,476,823
Prepaid expenses	86,606	43,581
Total current assets	3,729,128	3,920,214
Equipment, at cost:		
Furniture, fixtures and equipment	2,487,529	2,394,028
Customer-site equipment	813,635	778,761
Accumulated depreciation	(2,163,000)	(2,024,448)
Equipment, net	1,138,164	1,148,341
Patents, net of accumulated amortization of $154,456 at December 31, 2010 and $143,909 at March 31, 2010	261,436	265,988
Other assets	26,285	24,268
TOTAL ASSETS	$ 5,155,013	$ 5,358,811
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 380,332	$ 684,102
Accrued compensation	284,443	404,789
Other accrued liabilities	350,517	276,529
Line of credit	447,367	
Total current liabilities	1,462,659	1,365,420
Long-term liabilities:		
Line of credit		350,000
Commitments and contingencies		
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; 6,455,100 shares issued and outstanding	19,756,526	19,677,322
Accumulated (deficit)	(16,064,172)	(16,033,931)
Total shareholders equity	3,692,354	3,643,391
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 5,155,013	$ 5,358,811

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

Table of Contents

Encision Inc.

Condensed Statements of Operations

(Unaudited)

Three Months Ended	December 31, 2010	December 31, 2009
NET SALES	$ 2,916,808	$ 3,260,316
COST OF SALES	1,095,667	1,251,710
GROSS PROFIT	1,821,141	2,008,606
OPERATING EXPENSES:		
Sales and marketing	963,540	1,146,245
General and administrative	340,571	361,305
Research and development	269,491	340,749
Total operating expenses	1,573,602	1,848,299
OPERATING INCOME	247,539	160,307
Interest expense, net	(14,010)	(9,213)
Other income (expense), net	393	(2,071)
Interest and other income (expense), net	(13,617)	(11,284)
INCOME BEFORE PROVISION FOR INCOME TAXES	233,922	149,023
Provision for income taxes		
NET INCOME	$ 233,922	$ 149,023
Net income per share basic	$ 0.04	$ 0.02
Net income per share diluted	$ 0.04	$ 0.02
Weighted average shares basic	6,455,100	6,455,100
Weighted average shares diluted	6,455,100	6,461,192

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

Table of Contents

Encision Inc.

Condensed Statements of Operations

(Unaudited)

Nine Months Ended	December 31, 2010	December 31, 2009
NET SALES	$ 8,695,228	$ 9,649,587
COST OF SALES	3,195,536	3,664,038
GROSS PROFIT	5,499,692	5,985,549
OPERATING EXPENSES:		
Sales and marketing	3,225,012	3,580,145
General and administrative	1,133,446	1,058,367
Research and development	1,136,040	946,591
Total operating expenses	5,494,498	5,585,103
OPERATING INCOME	5,194	400,446
Interest expense, net	(36,792)	(34,026)
Other income (expense), net	1,357	(7,642)
Interest and other income (expense), net	(35,435)	(41,668)
INCOME (LOSS) BEFORE PROVISION FOR INCOME TAXES	(30,241)	358,778
Provision for income taxes		
NET INCOME (LOSS)	$ (30,241)	$ 358,778
Net income (loss) per share basic	$ 0.00	$ 0.06
Net income (loss) per share diluted	$ 0.00	$ 0.06
Weighted average shares basic	6,455,100	6,455,100
Weighted average shares diluted	6,455,100	6,463,018

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

Table of Contents

Encision Inc.

Condensed Statements of Cash Flows

(Unaudited)

Nine Months Ended	December 31, 2010	December 31, 2009
Cash flows from operating activities:		
Net income (loss)	$ (30,241)	$ 358,778
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	195,623	178,251
Stock-based compensation expense related to stock options	79,204	80,765
Provision for doubtful accounts, net	4,500	1,500
Provision for inventory obsolescence, net	(90,940)	
Change in operating assets and liabilities:		
Accounts receivable	169,450	65,640
Inventories	91,870	153,477
Prepaid expenses and other assets	(45,042)	(57,792)
Accounts payable	(303,770)	(372,862)
Accrued compensation and other accrued liabilities	(46,358)	(48,103)
Net cash provided by operating activities	24,296	359,654
Cash flows from investing activities:		
Acquisition of property and equipment	(174,899)	(421,303)
Patent costs	(5,995)	(60,485)
Net cash (used in) investing activities	(180,894)	(481,788)
Cash flows from financing activities:		
Borrowings from credit facility	97,367	84,058
Net cash provided by financing activities	97,367	84,058
Net (decrease) in cash and cash equivalents	(59,231)	(38,076)
Cash and cash equivalents, beginning of period	113,735	84,658
Cash and cash equivalents, end of period	$ 54,504	$ 46,582

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

Table of Contents

ENCISION INC.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS

DECEMBER 31, 2010

(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 patients undergoing minimally-invasive surgery. We believe that our patented AEM® 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 $16,064,172 at December 31, 2010. Operating funds have been provided primarily by issuances of our common stock and warrants, the exercise of stock options to purchase our common stock and, in recent years, by operating profits. Should our liquidity be diminished in the future because of operating losses, we may be required to seek additional capital in the future. There are no assurances that additional capital will be available to us on terms acceptable to us, or at all.

Our strategic marketing and sales plan is designed to expand the use of our products in surgically active hospitals 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, 2010, filed on June 4, 2010.

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.

Fair Value of Financial Instruments. Our financial instruments consist of cash and cash equivalents, short-term trade receivables and payables and a line of credit. The carrying values of cash and cash equivalents, short-term trade receivables and payables approximate their fair value due to their short maturities. The interest rate associated with the line of credit is variable and based upon fluctuations of the prime rate, thus the carrying value approximates fair value.

Concentration of Credit Risk. Financial instruments, which potentially subject us to concentrations of credit risk, consist of cash and cash equivalents, accounts receivable, accounts payable and a line of credit. The carrying value of all financial instruments approximates fair value. The amount of cash on deposit with financial institutions does not exceed the $250,000 federally insured limit at December 31, 2010. However, we believe that in the event that cash on deposit exceeds $250,000, the financial institutions are 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, 2010 of $1,112,125 included no more than 4% from any one customer. The net accounts receivable balance at March 31, 2010 of $1,286,075 included no more than 4% from any one customer.

Warranty Accrual. 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, 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

Table of Contents

market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required. At December 31, 2010 and March 31, 2010, inventory consisted of the following:

	December 31, 2010	March 31, 2010
Raw materials	$ 1,723,147	$ 1,518,737
Finished goods	812,746	1,109,026
Total gross inventories	2,535,893	2,627,763
Less reserve for obsolescence	(60,000)	(150,940)
Total net inventories	$ 2,475,893	$ 2,476,823

Property and Equipment. Property and equipment are stated at cost, with depreciation computed over the estimated useful lives of the assets, generally three 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, 2010, 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.

Sales Recognition. Sales from product sales are 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.

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 statement of operations.

Stock-based compensation expense recognized under ASC 718 for the three and nine months ended December 31, 2010 was $26,544 and $79,204, respectively, and for the three and nine months ended December 31, 2009 was $33,993 and $80,765, respectively, which consisted of stock-based compensation expense related to grants of employee stock options.

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 and do not believe the future adoption of any such pronouncements may be expected to cause a material impact on our financial condition or the results of our operations.

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 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 income (loss) per share:

Table of Contents

	Three Months Ended		Nine Months Ended	
	December 31, 2010	December 31, 2009	December 31, 2010	December 31, 2009
Net income (loss)	$ 233,922	$ 149,023	$ (30,241)	$ 358,778
Weighted-average shares basic	6,455,100	6,455,100	6,455,100	6,455,100
Effect of dilutive potential common shares		6,092		7,918
Weighted-average shares diluted	6,455,100	6,461,192	6,455,100	6,463,018
Net income (loss) per share basic	$ 0.04	$ 0.02	$ 0.00	$ 0.06
Net income (loss) per share diluted	$ 0.04	$ 0.02	$ 0.00	$ 0.06
Antidilutive employee stock options	545,000	552,667	545,000	552,667

Note 4. COMMITMENTS AND CONTINGENCIES

We currently lease our facilities at 6797 Winchester Circle, Boulder, Colorado under noncancelable lease agreements through July 31, 2014. The minimum future lease payment, by fiscal year, as of December 31, 2010 is as follows:

Fiscal Year	Amount
2011(three months remaining)	$ 61,816
2012	254,629
2013	262,281
2014	270,221
2015	90,966
Total	$ 939,913

Our minimum future equipment lease payments with General Electric Capital Corporation as of December 31, 2010, by fiscal year, are as follows:

Fiscal Year	Amount
2011(three months remaining)	$ 25,468
2012	101,873
2013	101,873
2014	8,488
Total	$ 237,702

On November 4, 2009, we signed a second amendment to our credit facility agreement with Silicon Valley Bank (Silicon), effective November 10, 2009. The terms of the credit facility include a line of credit for $2,000,000 for two years at an interest rate calculated at Silicon s prime rate, which was 4% at December 31, 2010, plus 1.25%, subject to increase upon a default. The credit facility is secured by any and all of our properties, rights and assets. Our borrowing under the credit facility is limited by our eligible receivables and inventory at the time of borrowing. The credit facility requires us to meet certain financial covenants. At December 31, 2010 we were in compliance with our financial covenants. At December 31, 2010, we had borrowed $447,367 from the credit facility and, under our eligible receivables and inventory limit, had an additional $993,000 available to borrow.

Aside from the operating leases and credit facility commitments, 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 as of December 31, 2010. FDA inspections are conducted periodically at the discretion of the FDA. Our latest inspection by the FDA occurred in November 2009.

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, based on estimated fair values. The following table summarizes stock-based compensation expense related to employee stock options and employee stock purchases for the three and nine months ended December 31, 2010 and 2009, which was allocated as follows:

	Three Months Ended		Nine Months Ended	
	December 31, 2010	December 31, 2009	December 31, 2010	December 31, 2009
Cost of sales	$ 823	$ 810	$ 2,469	$ 2,430
Sales and marketing	3,268	5,562	9,804	16,310
General and administrative	18,731	23,445	55,765	49,497
Research and development	3,722	4,176	11,166	12,528
Stock-based compensation expense	$ 26,544	$ 33,993	$ 79,204	$ 80,765

The Black-Scholes 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. No stock options were granted during the three and nine months ended December 31, 2010.

As of December 31, 2010, $316,000 of total unrecognized compensation costs related to nonvested stock options is expected to be recognized over a period of five years.

Table of Contents

Note 6. RELATED PARTY TRANSACTION

We paid consulting fees of $15,096 and $47,480 to an entity owned by one of our directors during the three and nine months ended December 31, 2010, respectively, and $18,035 and $47,225 during the three and nine months ended December 31, 2009, respectively.

Note 7. SUBSEQUENT EVENTS

Except for the disclosure that follows, we evaluated all of our activity 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.

On January 21, 2011, we and Boston Scientific Corporation (BSC) entered into a Development, License and Non-Commercial Supply Agreement (the Agreement), whereby we (i) will perform development services for BSC for the development of electrosurgical instruments (the Developed Products), (ii) grants a non-exclusive, worldwide, royalty-free, irrevocable and perpetual license to BSC for the use of our AEM technology and other intellectual property developed by us in connection with the Agreement (collectively, the Licensed IP) to the extent the Licensed IP is incorporated into or necessary for the manufacture, use or sale of the Developed Products, and (iii) will manufacture and supply BSC with the Developed Products pursuant to the terms of the Agreement. The initial term the Agreement commences on January 21, 2011 (the Effective Date) and will continue until the later of two years from the Effective Date or the expiration of sixty (60) business days after the termination of the last effective Statement of Work under the Agreement. We and BSC may mutually agree in writing to extend the term for additional one-year periods prior to the expiration of the then current term. In consideration for the license of the Licensed IP, BSC will pay us a one-time license fee. In addition, if BSC decides to commercialize the Developed Products, BSC will pay us a one-time commercialization license fee plus a negotiated royalty fee. For development services, BSC will pay us for services actually rendered on an hourly basis in accordance with the Agreement and the applicable Statement of Work. If BSC decides to commercialize the Developed Products with us pursuant to the Agreement, BSC and we will negotiate in good faith for the consideration to be paid to us for the supply of the Developed Product. The Agreement is subject to early termination by either party pursuant to the terms of the Agreement. Pursuant to the Agreement, each party agrees to indemnify the other party against losses relating to the material breach of the Agreement or the other party s negligence.

Table of Contents

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, 2010.

General

Encision Inc., a medical device company based in Boulder, Colorado, has developed and launched innovative technology that is emerging as a standard of care in minimally-invasive surgery. We believe that our patented AEM® Surgical Instruments are changing the marketplace for electrosurgical devices and laparoscopic instruments by providing a solution to a well documented patient safety risk in laparoscopic surgery.

We were founded to address market opportunities created by the increase in minimally-invasive surgery (MIS) and surgeons preference for using electrosurgery devices in these procedures. The product opportunity was created by surgeons continued widespread demand for using monopolar electrosurgery instruments, which, when used in laparoscopic surgery, are susceptible to causing inadvertent collateral tissue damage outside the surgeon s field of view. 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 and creates liability exposure for surgeons and hospitals that do not adequately address the issue.

Our patented AEM technology provides surgeons with the desired tissue effects, while preventing stray electrosurgical energy that can cause unintended and unseen tissue injury. AEM Laparoscopic Instruments are equivalent to conventional instruments in functionality, 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 and effectively than when using conventional instruments. In addition, our AEM instruments are cost competitive with conventional non-shielded, non-monitored instruments. The result is advanced patient safety at comparable cost and with no change in surgeon technique.

AEM technology has been recommended and endorsed by sources from various groups involved in MIS. Surgeons, nurses, biomedical engineers, the medicolegal community, malpractice insurance carriers and electrosurgical device manufacturers advocate the use of AEM technology. Recommendations from the malpractice insurance and medicolegal communities complement the broad clinical endorsements AEM technology has garnered over the past few years.

We also have supplier agreements with Novation and Premier, two of the largest Group Purchasing Organizations (GPOs) in the United States. Together, Novation and Premier represent over 3,000 hospitals which perform over 50% of all surgery in the U.S. We believe that these GPO supplier agreements give further indication that AEM technology is gaining broader acceptance in the market. We believe that having the

nation s leading medical purchasing groups recognize the value of our technology reflects the potential impact that AEM products can have in the market and in advancing patient safety in surgery nationwide. These agreements do not involve purchase commitments, but we expect these relationships to expand the market visibility of AEM technology and to ease the procurement process for new hospital customers.

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 product line. Accordingly, we are currently focusing on updating our accepted AEM instruments to include ergonomics and user functionalities for which surgeons have been expressing a preference. We plan to introduce new additions to the AEM product line in fiscal year 2011.

When a hospital changes to AEM technology, we receive recurring sales from sales of replacement instruments. We believe that there is no directly competing technology to supplant AEM products once a hospital switches to our products. The replacement market of reusable and disposable AEM products in hospitals that use our AEM technology represented over 90% of our sales during the three and nine months ended December 31, 2010. This sales stream is expected to grow as the base of hospitals that switch to AEM technology continues to grow. In addition, we intend to 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 $16,064,172 at December 31, 2010. Operating funds have been provided primarily by issuances of our common stock and warrants, the exercise of stock options to purchase our common stock and, in recent years, by operating profits. Should our liquidity be diminished in the future because of operating losses, we may be required to seek additional capital in the future.

During the nine months ended December 31, 2010, we provided $24,296 of cash from our operations and used $174,899 for investments in property and equipment. As of December 31, 2010, we had $54,504 in cash and cash equivalents available to fund future operations, a decrease of $59,231 from March 31, 2010. As of December 31, 2010, we borrowed $447,367 from our $2,000,000 amended credit facility, an increase of $97,367 from March 31, 2010. Our working capital was $2,266,469 at December 31, 2010 compared to $2,554,794 at March 31, 2010.

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. During this period, we conducted product trials and applied for patents with the United States Patent Office and international patent agencies. Patents were issued to us in 1994, 1996, 1997, 1998, 2002 and 2009.

As we evolved, it became clear to us that our AEM technology needed to be integrated into the standard laparoscopic instrument design. As the development program proceeded, it also became apparent that the merging of electrical and mechanical engineering skills in the instrument development process for our patented, integrated electrosurgical instruments was a complex and difficult task. As a result, instruments with integrated

Table of Contents

AEM technology were not completed for several years. Prior to offering a full range of laparoscopic electrosurgical instrumentation, it was difficult for hospitals to commit to the AEM solution, as we did not have adequate comparable surgical instrument options to meet surgeons demands. As of fiscal year 2005, a sufficiently broad product line was available to provide hospital operating rooms with AEM instruments in most of the designs common for laparoscopic surgery.

After the launch of this line of AEM instruments over the past four years, we are now turning our focus to developing next generation versions of our AEM instruments to better meet market demands, particularly the demand for improved ergonomics and simplified user functionalities. This strategy coincides with the independent endorsements of our AEM technology and the recommendations from the malpractice insurance and medicolegal communities.

Outlook

Installed Base of AEM Monitoring Equipment: We believe that sales of our installed base of AEM monitors will increase sales as the inherent risks associated with monopolar laparoscopic electrosurgery become more widely acknowledged and as we focus on increasing our sales efficiency. We expect that the replacement sales of electrosurgical instruments and accessories will also increase as additional hospitals adopt AEM technology. We anticipate that the efforts to improve the quality 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. Furthermore, most of our next generation products are in the early stages of development.

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 continually improving, and we expect this awareness to benefit our sales efforts for the remainder of fiscal year 2011. Our objectives in the remainder of fiscal year 2011 are to maintain expense controls while optimizing sales execution, to expand market awareness of the AEM technology and to maximize the number of additional hospital accounts switching to AEM instruments while retaining existing hospital customers. In addition, acceptance of AEM products depends on surgeons preference for our instruments, which depends on factors such as ergonomics and ease of use in addition to the technological and safety advantagesof AEM products. If surgeons prefer other instruments to our instruments, our business results will suffer.

Possibility of Operating Losses: We have an accumulated deficit of $16,064,172 at December 31, 2010. Operating funds have been provided primarily by issuances of our common stock and warrants, the exercise of stock options to purchase our common stock and, in recent years, by operating profits. Should our liquidity be diminished in the future because of operating losses, we may be required to seek additional capital in the future. 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.

Sales Growth: Our sales growth has decreased from weakness in the medical device industry as a result of a decrease in the number of laparoscopic procedures. We expect to generate increased sales in the U.S. from sales to new hospital customers and from expanded sales in existing hospitals 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 hospital accounts and increased sales in fiscal year 2011. We also expect that supplier agreements with Novation and Premier, which together

represent over 3,000 U.S. hospitals, will expose more hospitals to the benefits of AEM technology and may stimulate new hospital accounts. In the first quarter of our fiscal year 2011, we signed an agreement with HealthTrust Purchasing Group, LP, a group purchasing organization. Also, in the first quarter of our fiscal year 2011, we signed agreements with distributors in the United Kingdom, Ireland and Austria. We also expect to increase market share through promotional programs of placing our AEM monitors at no charge into hospitals that commit to standardize AEM instruments. However, all of these efforts to increase market share and grow sales will depend in part on our ability to expand the efficiency and effective coverage range of our direct and independent sales representatives.

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 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 and sales volume. Gross margins on products manufactured or assembled by us are expected to improve at higher levels of production and sales.

Manufacturing Equipment: As sales increase, we expect to increase gross profit and gross margins by manufacturing our scissor inserts internally. We began manufacturing our scissor inserts in the third quarter of fiscal year 2009.

Sales and Marketing Expenses: We continue our efforts to expand 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 development of refinements to our AEM product line, which will further expand the instrument options for surgeons.

Table of Contents

Results of Operations

For the three months ended December 31, 2010 compared to the three months ended December 31, 2009.

Net sales. Net sales for the quarter ended December 31, 2010 were $2,916,808 compared to $3,260,316 for the quarter ended December 31, 2009, a decrease of 11%. The decrease is attributable to weakness in the medical device industry and by business lost from hospitals that stopped using AEM technology. This was partially offset by addition of new hospital accounts. We opened six new hospital accounts for AEM technology in the three months ended December 31, 2010 and 2009.

Gross profit. Gross profit for the quarter ended December 31, 2010 of $1,821,141 represented a decrease of 9% from gross profit of $2,008,606 for the quarter ended December 31, 2009. Gross profit as a percentage of sales (gross margins) increased from 61.6% for the quarter ended December 31, 2009 to 62.4% for the quarter ended December 31, 2010. The gross profit margin increase from the third quarter of fiscal year 2010 was due to an increase, as a percentage of sales, of higher gross margin sales, especially our disposable scissor inserts, and the addition of our controlled environment room for product packaging that resulted in packaging cost savings.

Sales and marketing expenses. Sales and marketing expenses of $963,540 for the quarter ended December 31, 2010 represented a decrease of 16% from sales and marketing expenses of $1,146,245 for the quarter ended December 31, 2009. The decrease was the result of decreased compensation of our direct sales representatives, decreased commissions for independent sales representatives, decreased sample and travel and meal costs.

General and administrative expenses. General and administrative expenses of $340,571 for the quarter ended December 31, 2010 represented a decrease of 6% from general and administrative expenses of $361,305 for the quarter ended December 31, 2009. The decrease was the result of a decrease in compensation due to fewer employees and a decrease in outside consulting expense.

Research and development expenses. Research and development expenses of $269,491 for the quarter ended December 31, 2010 represented a decrease of 21% compared to $340,749 for the quarter ended December 31, 2009. The decrease was the result of a decrease in compensation due to fewer employees and a decrease in inventory usage. The decrease in such costs was partially offset by increased temporary help, outside services and test materials.

Net income. Net income was $233,922 for the quarter ended December 31, 2010 compared to net income of $149,023 for the quarter ended December 31, 2009. The net income increase was a result of a decrease in sales, offset by an increase in gross profit, as a percentage of sales, as well as by a larger decrease in operating expenses, as discussed above.

For the nine months ended December 31, 2010 compared to the nine months ended December 31, 2009.

Net sales. Net sales for the nine months ended December 31, 2010 were $8,695,228 compared to $9,649,587 for the quarter ended December 31, 2009, a decrease of 10%. The decrease is attributable to weakness in the medical device industry and by business lost from hospitals that stopped using AEM technology. This was partially offset by addition of new hospital accounts. We opened 15 new hospital accounts for AEM technology in the nine months ended December 31, 2010 and 2009.

Gross profit. Gross profit for the nine months ended December 31, 2010 of $5,499,692 represented a decrease of 8% from gross profit of $5,985,549 for the quarter ended December 31, 2009. Gross profit as a percentage of sales (gross margins) increased from 62% for the nine months ended December 31, 2009 to 63.2% for the nine months ended December 31, 2010. The gross profit margin increase from the first nine months of fiscal year 2009 was due to an increase, as a percentage of sales, of higher gross margin sales and the addition of our controlled environment room for product packaging that resulted in packaging cost savings.

Sales and marketing expenses. Sales and marketing expenses of $3,225,012 for the nine months ended December 31, 2010 represented a decrease of 10% from sales and marketing expenses of $3,580,145 for the nine months ended December 31, 2009. The decrease was the result of decreased compensation of our direct sales representatives, decreased commissions for independent sales representatives, decreased sample and travel and meal costs.

General and administrative expenses. General and administrative expenses of $1,133,446 for the nine months ended December 31, 2010 represented an increase of 7% from general and administrative expenses of $1,058,367 for the nine months ended December 31, 2009. The increase was the result of an increase in outside consulting expense. The increase in such costs was partially offset by a decrease in legal costs.

Research and development expenses. Research and development expenses of $1,136,040 for the nine months ended December 31, 2010 represented an increase of 20% compared to $946,591 for the nine months ended December 31, 2009. The increase was the result of an increase in temporary help expense and outside services for the development of future new products and test materials. The increase in such costs was partially offset by decreased compensation, inventory usage and tooling costs.

Net loss. Net loss was $30,241 for the nine months ended December 31, 2010 compared to net income of $358,778 for the nine months ended December 31, 2009. The net income decrease was a result of a decrease in sales and gross profit and a slight decrease to operating expenses, as discussed above.

The results of operations for the three and nine months ended December 31, 2010 should not be taken as an indication of the results of operations for all or any part of the balance of the fiscal year.

Liquidity and Capital Resources

To date, operating funds have been provided primarily by issuances of our common stock and warrants, the exercise of stock options to purchase our common stock and, in recent years, by operating profits. To date, operating funds totaled $19,756,526 from our inception through December 31, 2010.

Table of Contents

On November 4, 2009, we signed a second amendment to our credit facility agreement with Silicon Valley Bank (Silicon), effective November 10, 2009. The terms of the credit facility include a line of credit for $2,000,000 for two years at an interest rate calculated at Silicon s prime rate, which was 4% at December 31, 2010, plus 1.25%, subject to increase upon a default. The credit facility is secured by any and all of our properties, rights and assets. Our borrowing under the credit facility is limited by our eligible receivables and inventory at the time of borrowing. The credit facility requires us to meet certain financial covenants. At December 31, 2010 we were in compliance with our financial covenants. At December 31, 2010, we had borrowed $447,367 from the credit facility and, under our eligible receivables and inventory limit, had an additional $993,000 available to borrow.

Our operations provided $24,296 of cash during the nine months ended December 31, 2010 on net sales of $8,695,228. Cash was provided principally by depreciation and amortization, a non-cash expense to our net income, and collections of our accounts receivable. Cash provided was partially offset by our accounts payable payments. The amounts of cash provided by operations for the nine months ended December 31, 2010 are not indicative of the expected amounts of cash to be generated from or used in operations in fiscal year 2011. During the nine months ended December 31, 2010, we invested $174,899 in the acquisition of property and equipment. As of December 31, 2010, we had $54,504 in cash and cash equivalents available to fund future operations and had borrowed $447,367 from our credit facility. Working capital was $2,266,469 at December 31, 2010 compared to $2,554,794 at March 31, 2010. Current liabilities were $1,462,659 at December 31, 2010, compared to $1,365,420 at March 31, 2010. The increase in current liabilities at December 31, 2010 was caused by including our line of credit as a current liability. The increase in current liabilities was partially offset by reducing the amounts outstanding under accounts payable and accrued compensation.

If we are not successful in maintaining profitability and positive cash flow, additional capital may be required to maintain ongoing operations. We have explored and are continuing to explore options to provide additional financing to fund future operations as well as other possible courses of action. Such actions include, but are not limited to, securing additional lines of credit, sales of debt or equity securities (which may result in dilution to existing shareholders), licensing of technology, strategic alliances and other similar actions. There can be no assurance that we will be able to obtain additional funding (if needed), on acceptable terms or at all, through a sale of our common stock, loans from financial institutions or other third parties, or any of the actions discussed above. If we cannot sustain profitable operations, and additional capital is unavailable, lack of liquidity could have a material adverse effect on our business viability, financial position, results of operations and cash flows.

We currently lease our facilities at 6797 Winchester Circle, Boulder, Colorado under noncancelable lease agreements through July 31, 2014. The minimum future lease payment by fiscal year as of December 31, 2010 is as follows:

Fiscal Year		**Amount**
2011(three months remaining)	$	61,816
2012		254,629
2013		262,281
2014		270,221
2015		90,966
Total	$	939,913

Our minimum future equipment lease payments with General Electric Capital Corporation as of December 31, 2010, by fiscal year, are as follows:

Fiscal Year	**Amount**

2011(three months remaining)	$	25,468
2012		101,873
2013		101,873
2014		8,488
Total	$	237,702

As of December 31, 2010, 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**	
Line of credit obligations	$ 447,367	$ 447,367	$	$	$	
Operating lease obligations	1,177,615	354,661	664,433	158,521		
Total	$ 1,624,982	$ 802,028	$ 664,433	$ 158,521	$	

Aside from the operating leases and credit facility commitments, we do not have any material contractual commitments requiring settlement in the future.

Our fiscal year 2011 operating plan is focused on increasing new hospital accounts, retaining existing hospital customers, growing sales, 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 reduce our cost of sales. We cannot predict with certainty the expected sales, gross profit, net income or loss and usage of cash and cash equivalents for fiscal year 2011. However, we believe that our cash resources and credit facility will be sufficient to fund our operations for at least the next twelve months. 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. If we are not successful in continuing profitability and positive cash flow, additional capital may be required to maintain ongoing operations.

Table of Contents

Income Taxes

As of March 31, 2010, net operating loss carryforwards totaling approximately $14.5 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, 2011. 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 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 three 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 at 9% 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.

Table of Contents

ITEM 4 CONTROLS AND PROCEDURES

(a) We have carried out an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer 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 Chief Executive Officer and the Principal Accounting and Financial Officer concluded that, as of December 31, 2010, our disclosure controls and procedures were effective.

(b) During the quarter ended December 31, 2010, 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.

Table of Contents

PART II. OTHER INFORMATION

ITEM 6 EXHIBITS

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

3.1	Articles of Incorporation of the Company, as amended (incorporated by reference from the Company s Registration Statement #333-4118-D dated June 25, 1996).
3.2	Bylaws of the Company (incorporated by reference from Exhibit 3.1 of the Company s Current Report on Form 8-K dated October 30, 2007).
4.1	Form of certificate for shares of Common Stock (incorporated by reference from the Company s Registration Statement #333-4118-D dated June 25, 1996).
31.1	Certification of Chief Executive Officer 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 Chief Executive Officer and Principal Financial and Accounting Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).

Table of Contents

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.

January 31, 2011 Date	/s/ Marcia McHaffie Marcia McHaffie Controller Principal Accounting Officer & Principal Financial Officer