ENCISION INC
Form 10QSB
February 13, 2006

U. S. Securities and Exchange Commission

Washington, D.C. 20549

Form 10-QSB

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

For the quarterly period ended December 31, 2005

For the transition period from to

Commission file number 0-28604

ENCISION INC.

(Exact name of small business issuer 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)

Check whether the issuer (1) filed all reports required to be filed by Section 13 of 15(d) of the Exchange Act during the past 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 ý No o

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No ý

State 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	**6,398,146 Shares**
Class	(outstanding at January 31, 2006)

Transitional Small Business Disclosure Format

Yes o No ý

ENCISION INC.

FORM 10-QSB

For the Quarter Ended December 31, 2005

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PART I **FINANCIAL INFORMATION**

ITEM 1 **CONDENSED INTERIM FINANCIAL STATEMENTS**

ENCISION INC.

CONDENSED BALANCE SHEETS

	December 31, 2005 (unaudited)	March 31, 2005 (audited)
ASSETS		
Cash and cash equivalents	$ 725,847	$ 1,472,385
Accounts receivable, net of allowance for doubtful accounts of $50,500 and $19,000, respectively	1,006,946	866,710
Inventory, net of reserve for obsolescence of $45,000 and $65,000, respectively	1,625,892	1,210,582
Prepaid expenses	138,396	103,150
Total current assets	3,497,081	3,652,827
EQUIPMENT, at cost:		
Furniture, fixtures and equipment	969,060	860,352
Customer-site equipment	589,199	540,692
Less - accumulated depreciation	(1,209,500)	(1,085,130)
Equipment, net	348,759	315,914
PATENTS, net of accumulated amortization of $89,300 and $80,183, respectively	154,869	117,764
OTHER ASSETS	23,483	20,210
Total assets	$ 4,024,192	$ 4,106,715
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 491,943	$ 532,657
Accrued compensation	130,927	138,042
Other accrued liabilities	628,409	462,489
Total current liabilities	1,251,279	1,133,188
SHAREHOLDERS EQUITY:		
Preferred stock, no par value, 10,000,000 shares authorized, no shares issued or outstanding		
Common stock, no par value, 100,000,000 shares authorized, 6,398,146 (December 31, 2005) and 6,313,146 (Mar. 31, 2005) shares outstanding	18,920,885	18,824,935
Accumulated (deficit)	(16,147,972)	(15,851,408)
Total shareholders equity	2,772,913	2,973,527
Total liabilities and shareholders equity	$ 4,024,192	$ 4,106,715

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

ENCISION INC.

CONDENSED STATEMENTS OF OPERATIONS

(Unaudited)

	For the Three Months Ended December 31,	
	2005	**2004**
REVENUE, NET	$ 2,116,936	$ 2,097,841
COST OF SALES	851,478	913,728
Gross profit	1,265,458	1,184,113
OPERATING EXPENSES:	924,958	799,552
Sales and marketing	280,927	260,367
General and administrative	218,667	267,141
Research and development	1,424,552	1,327,060
Total operating expenses	(159,094)	(142,947)
(LOSS) FROM OPERATIONS		
OTHER INCOME (EXPENSE):		
Interest income	7,910	4,177
Other (expense), net	(2,569)	(4,548)
NET (LOSS)	$ (153,753)	$ (143,318)
NET (LOSS) PER SHARE:		
Basic and diluted net (loss) per common share	$ (0.02)	$ (0.02)
Weighted average shares used in computing basic and diluted net (loss) per common share	6,391,389	6,267,474

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

ENCISION INC.

CONDENSED STATEMENTS OF OPERATIONS

(Unaudited)

	For the Nine Months Ended December 31,	
	2005	2004
REVENUE, NET	$ 6,708,017	$ 5,927,055
COST OF SALES	2,681,293	2,531,576
Gross profit	4,026,724	3,395,479
OPERATING EXPENSES:		
Sales and marketing	2,724,507	2,278,484
General and administrative	884,672	950,653
Research and development	722,969	657,552
Total operating expenses	4,332,148	3,886,689
(LOSS) FROM OPERATIONS	(305,424)	(491,210)
OTHER INCOME (EXPENSE):		
Interest income	21,081	8,572
Other (expense), net	(12,221)	(8,031)
NET (LOSS)	$ (296,564)	$ (490,669)
NET (LOSS) PER SHARE:		
Basic and diluted net (loss) per common share	$ (0.05)	$ (0.08)
Weighted average shares used in computing basic and diluted net (loss) per common share	6,359,797	6,082,323

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

ENCISION INC.

CONDENSED STATEMENTS OF CASH FLOWS

(Unaudited)

	For the Nine Months Ended December 31,	
	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss)	$ (296,564)	$ (490,669)
Adjustments to reconcile net (loss) to net cash (used in) operating activities -		
Depreciation and amortization	133,487	141,213
Provision for bad debts	31,500	(20,500)
Inventory reserves	(20,000)	(15,000)
Changes in operating assets and liabilities -		
Accounts receivable	(171,736)	(62,630)
Inventory	(395,310)	(36,609)
Other assets	(38,519)	(59,932)
Accounts payable	(40,714)	38,536
Accrued compensation and other accrued liabilities	158,805	68,687
Net cash (used in) operating activities	(639,051)	(436,904)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment in equipment	(157,215)	(116,407)
Patent costs	(46,222)	
Net cash (used in investing activities)	(203,437)	(116,407)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from the exercise of stock options	95,950	484,047
Net cash provided by financing activities	95,950	484,047
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(746,538)	(69,264)
CASH AND CASH EQUIVALENTS, beginning of period	1,472,385	1,356,607
CASH AND CASH EQUIVALENTS, end of period	$ 725,847	$ 1,287,343

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

ENCISION INC.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS

DECEMBER 31, 2005

(Unaudited)

(1) ORGANIZATION AND NATURE OF BUSINESS

Encision Inc. (the Company) is a medical device company that designs, develops, manufactures and markets patented surgical instruments that provide greater safety to patients undergoing minimally-invasive surgery. The Company believes its 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. The Company s sales to date have been made principally in the United States.

The Company achieved profitable operations in fiscal years 2004 and 2003. However, in each fiscal year prior to 2003 and in the fiscal year 2005, the Company had incurred losses and had an accumulated deficit of $16,147,972 at December 31, 2005. Operations have been financed primarily through issuance of common stock.

During fiscal years 2004 and 2003, the Company achieved annual net income for the first time in its history. The Company s strategic marketing and sales plan is designed to expand the use of the Company s products in surgically active hospitals in the United States. Management expects these efforts to result in continued revenue increases for fiscal 2006.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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 revenue and expense during the reporting period. Actual results could differ from those estimates.

Revenue Recognition

Revenue from product sales is recorded when the Company ships the product and title has passed to the customer, provided that the Company has evidence of a customer arrangement and can conclude that collection is probable. The Company s shipping policy is FOB Shipping Point. The Company recognizes revenue from sales to stocking distributors when there is no right of return, other than for normal warranty claims. The Company has no ongoing obligations related to product sales, except for normal warranty.

Cash and Cash Equivalents

For purposes of reporting cash flows, the Company considers all cash and highly liquid investments with an original maturity of three months or less to be cash equivalents.

Fair Value of Financial Instruments

The Company s financial instruments consist of cash and cash equivalents and short-term trade receivables and payables. The carrying values of cash and cash equivalents and short-term receivables and payables approximate their fair value due to their short maturities.

Concentration of Credit Risk

The Company has no significant off-balance sheet concentrations of credit risk such as foreign exchange contracts, options contracts or other foreign hedging arrangements. The Company maintains the majority of its cash balances with two financial institutions in the form of demand deposits and money market funds.

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, the Company may be exposed to credit risk generally associated with the

healthcare industry. The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments.

The net accounts receivable balance at December 31, 2005 of $1,006,946 included $104,265, or approximately 10% from three customers. The net accounts receivable balance at March 31, 2005 of $866,710 included $73,339, or approximately 8%, from one customer.

Warranty Accrual

The Company provides for the estimated cost of product warranties at the time revenue is recognized. While the Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its component suppliers, the Company s 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 the Company s 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. The Company reduces 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. Inventory consisted of the following:

	December 31, 2005	March 31, 2005
Raw materials	$ 1,163,902	$ 738,850
Finished goods	506,990	536,732
	1,670,892	1,275,582
Less - Reserve for obsolescence	(45,000)	(65,000)
	$ 1,625,892	$ 1,210,582

Property and Equipment

Property and equipment are stated at cost, with depreciation computed primarily on a double-declining basis over the estimated useful life of the asset, generally three to five years. Company-owned AEM Monitors at customer sites are depreciated on a double-declining basis for a period of 5 years. 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 (17 years in the United States). Capitalized costs are expensed if patents are not granted. The Company reviews the carrying value of its 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.

Accrued Liabilities

The Company has accrued $197,000 related to warranty claims, $119,866 related to sales commissions and $125,202 related to rent normalization and has included these amounts in accrued liabilities in the accompanying balance sheets as of December 31, 2005.

Income Taxes

The Company accounts for income taxes under the provisions of Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes (SFAS No. 109). SFAS No. 109 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. SFAS No. 109 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. During fiscal year 2005, no tax benefit was obtained from the Company s loss. As a result, no tax benefit is reflected in the accompanying statements of operations. During the first nine months of fiscal year 2006, no tax benefit was obtained from the Company s loss. As a result, no tax benefit is reflected in the accompanying statements of operations. Should the Company achieve sufficient, sustained income in the future, the Company may conclude that some or all of the valuation allowance should be reversed.

Research and Development Expenses

The Company expenses research and development costs for products and processes as incurred.

Stock-Based Compensation

The Company has adopted the disclosure-only provisions of SFAS No. 123, Accounting for Stock-Based Compensation (SFAS No. 123), and applies Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB No. 25), and related interpretations in accounting for stock options granted to employees. If the Company had accounted for its stock-based compensation plans in accordance with SFAS 123, the Company s net income or loss and pro forma net income or loss per basic and diluted common share for the three months ended December 31, 2005 would have been reported as follows:

Three months ended December 31, 2005		
Net (Loss)		
As Reported	$	(153,753)
Stock-based compensation based upon estimated fair values		(53,672)
Pro forma	$	(207,425)
Pro Forma Net (Loss) Per Basic and Diluted Common Share		
As Reported	$	(0.02)
Pro Forma	$	(0.03)

Three months ended December 31, 2004		
Net (Loss)		
As Reported	$	(143,318)
Stock-based compensation based upon estimated fair values		(44,543)
Pro forma	$	(187,861)
Pro Forma Net (Loss) Per Basic and Diluted Common Share		
As Reported	$	(0.02)
Pro Forma	$	(0.03)

Segment Reporting

The Company has concluded that it has one operating segment.

Basic and Diluted Income and Loss per Common Share

Net income or loss per share is calculated in accordance with SFAS No. 128, Earnings Per Share (SFAS No. 128). Under the provisions of SFAS No. 128, 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.

For the nine month period ended December 31, 2005, the Company had currently-exercisable stock options outstanding that could create future dilution to the Company s common shareholders and are not currently classified as outstanding common shares of the Company. The common stock number is based on specific conversion or issuance assumptions pursuant to the corresponding terms of each instrument. Potential stock issuance excluded from earnings per share because their effect was anti-dilutive was 516,217 for the nine months ended December 31, 2005.

Recent Accounting Pronouncements

Inventory Costs

In November 2004, the FASB issued FASB Statement No. 151, which revised ARB No.43, relating to inventory costs. This revision is to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage). This Statement requires that these items be recognized as a current period charge regardless of whether they meet the criterion specified in ARB 43. In addition, this Statement requires the allocation of fixed production overheads to the costs of conversion be based on normal capacity of the production facilities. This Statement is effective for financial statements for fiscal years beginning after June 15, 2005. Earlier application is permitted for inventory costs incurred during fiscal years beginning after the date this Statement was issued. The Company believes this Statement will have no impact on the financial statements of the Company once adopted.

Exchanges of Nonmonetary Assets

In December 2004, the FASB issued FASB Statement No. 153. This Statement addresses the measurement of exchanges of nonmonetary assets. The guidance in APB Opinion No. 29, Accounting for Nonmonetary Transactions, is based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. The guidance in that Opinion, however, included certain exceptions to that principle. This Statement amends Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. This Statement is effective for financial statements for fiscal years beginning after June 15, 2005. Earlier application is permitted for nonmonetary asset exchanges incurred during fiscal years beginning after the date of this Statement is issued. The Company believes this Statement will have no impact on the financial statements of the Company once adopted.

Share-Based Payments

In December 2004, the FASB issued a revision to FASB Statement No. 123, Accounting for Stock Based Compensation. This Statement supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and its related implementation guidance. This Statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity s equity instruments or that may be settled by the issuance of those equity instruments. This Statement focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. This Statement does not change the accounting guidance for share-based payment transactions with parties other than employees provided in Statement 123 as originally issued and EITF Issue No. 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services. This Statement does not address the accounting for employee share ownership plans, which are subject to AICPA Statement of Position 93-6, Employers Accounting for Employee Stock Ownership Plans.

A public entity will initially measure the cost of employee services received in exchange for an award of liability instruments based on its current fair value; the fair value of that award will be re-measured subsequently at each reporting date through the settlement date. Changes in fair value during the requisite service period will be recognized as compensation cost over that period. A nonpublic entity may elect to measure its liability awards at their intrinsic value through the date of settlement.

The grant-date fair value of employee share options and similar instruments will be estimated using the option-pricing models adjusted for the unique characteristics of those instruments (unless observable market prices for the same or similar instruments are available).

Excess tax benefits, as defined by this Statement, will be recognized as an addition to paid-in-capital. Cash retained as a result of those excess tax benefits will be presented in the statement of cash flows as financing cash inflows. The write-off of deferred tax assets relating to unrealized tax benefits associated with recognized compensation cost will be recognized as income tax expense unless there are excess tax benefits from previous awards remaining in paid-in capital to which it can be offset.

The notes to the financial statements of both public and nonpublic entities will disclose information to assist users of financial information to understand the nature of share-based payment transactions and the effects of those transactions on the financial statements.

The effective date for public entities that file as small business issuers will be as of the beginning of the first interim or annual reporting period that begins after December 15, 2005. The Company intends to comply with this Statement at the scheduled effective date for the relevant financial statements of the Company.

Accounting Changes and Error Corrections

In May 2005, the FASB issued FASB Statement 154, Accounting Changes and Error Corrections. This Statement replaces APB Opinion No. 20, Accounting Changes, and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements, and changes the requirements for the accounting for and reporting of a change in accounting principle. This Statement applies to all voluntary changes in accounting principle. The Company believes this Statement will have no impact on the financial statements of the Company.

(3) COMMITMENTS AND CONTINGENCIES

The Company currently leases its facilities under noncancelable lease agreements through August 14, 2009 at 6797 Winchester Circle, Boulder, Colorado. The minimum future lease payments which are as follows as of December 31, 2005:

Year ended March 31,		
2006	$	43,413
2007		154,179
2008		166,930
2009		172,685
2010		65,566
	$	602,773

The Company is subject to regulation by the United States Food and Drug Administration (FDA). The FDA provides regulations governing the manufacture and sale of the Company s products and regularly inspects the Company and other manufacturers to determine their compliance with these regulations. As of December 31, 2005 the Company believes it was in substantial compliance with all known regulations. FDA inspections are conducted periodically at the discretion of the FDA. The Company was last inspected in May 2005 and was notified of six potential deficiencies from that inspection, none of which the Company believes to be material.

The results of operations for the quarter ended December 31, 2005 should not be taken as an indication of the results of operations for all or any part of the balance of the year.

(4) BASIS OF PRESENTATION

The condensed interim financial statements included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes 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 the Company s Annual Report to the Securities and Exchange Commission for the fiscal year ended March 31, 2005, filed on Form 10-KSB on June 29, 2005.

The accompanying condensed interim financial statements have been prepared, in all material respects, in conformity with the standards of accounting measurements set forth in Accounting Principles Board Opinion No. 28 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 accounting principles generally accepted in the United States of America. 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.

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 the Company s strategies and expectations about new and existing products, market demand, acceptance of new and existing products, 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 the Company on the date of this document, and the Company assumes no obligation to update such forward looking statements. Readers of this Form 10-QSB are strongly encouraged to review the section entitled *Factors Which May Affect Future Performance and Financial Condition.*

General

Encision Inc. (Encision or the Company), 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. The Company believes its 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.

Encision was 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.

Encision s 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 Encision s shielded and monitored instruments, surgeons are able to perform electrosurgical procedures more safely and effectively than is possible using conventional instruments. In addition, the 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 all groups involved in minimally-invasive surgery. 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.

Adding further credibility to the benefits of Encision s AEM technology are the Company s supplier agreements with Novation and Premier, two of the largest Group Purchasing Organizations (GPO) in the United States. Together, Novation and Premier represent over 3,000 hospitals and over 50% of all surgery in the U.S. Management believes that these GPO supplier agreements give further indication that AEM technology is gaining broader acceptance in the market. Management believes that having the nation s leading medical purchasing groups recognize the value of the Company s 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 the Company expects these relationships to expand the market

visibility of AEM technology and smooth the procurement process for new hospital customers.

The Company has focused its marketing strategies to date on expanding the market awareness of the AEM technology and its broad independent endorsements, and has continued efforts to improve and expand the AEM product line. Accordingly, the Company is currently focusing on modernizing its accepted AEM instruments to include ergonomics and user functionalities for which surgeons have been expressing a preference. During the three months ended December 31, 2005, the Company announced enTouch , an ergonomically-designed handle for its articulating instruments, and further new additions to the AEM product line are planned for introduction in fiscal year 2007.

When a hospital changes to AEM technology it provides recurring revenue to the Company from sales of replacement instruments. Management believes that there is no directly competing technology to supplant AEM products once the hospital has changed. The replacement market of reusable and disposable AEM products in changed hospitals represents over 90% of Encision s revenue over the past nine months and this revenue stream is expected to grow as the base of newly changed hospitals continues to grow. In addition, the Company intends to develop disposable versions of more of its AEM products in order to meet market demands and expand the Company s revenue opportunities.

The Company achieved profitable operations in fiscal years 2004 and 2003. However, in each fiscal year prior to 2003 and in the fiscal year 2005, the Company incurred losses and had an accumulated deficit of $16,147,972 at December 31, 2005. Operations have been financed primarily through issuance of common stock.

During the nine months ended December 31, 2005, the Company used $639,051 of cash in its operations and used $157,215 for investments in equipment. As of December 31, 2005, the Company had $725,847 in cash and cash equivalents available to fund future operations, a decrease of $746,538 from March 31, 2005. The Company s working capital was $2,245,802 at December 31, 2005.

Historical Perspective

The Company was organized in 1991 and spent several years developing the AEM monitoring system and protective sheaths to adapt to conventional electrosurgical instruments. During this period, the Company conducted product trials and applied for patents with the United States Patent Office and with international patent agencies. Patents were issued in 1994, 1996, 1997, 1998 and 2002.

As the Company evolved, it was clear to the Company that its active electrode monitoring 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 the Company s patented, integrated electrosurgical instruments was a complex and difficult task. As a result, instruments with integrated 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 the Company did not have adequate comparable surgical instrument options to match what the surgeon demanded. As of fiscal 2001, a sufficiently broad product line was available to provide hospital operating rooms with AEM instruments in most of the designs common for laparoscopic surgery.

The launch of an expanded line of AEM instruments was accomplished over the past two years. The Company is now turning its focus to developing next generation versions of its AEM instruments to better meet market demands, particularly demand for improved ergonomics and simplified user functionalities. This coincides with the independent endorsements for AEM technology. Recommendations from the malpractice insurance and medicolegal communities complement the broad clinical endorsements AEM technology has garnered over the past few years. During the three months ended December 31, 2005, the Company recently announced the introduction of enTouch, an ergonomically-designed handle for its articulating instruments, and further new additions to the AEM product line are planned for introduction in fiscal year 2007.

Outlook

Installed Base of AEM Monitoring Equipment: The Company believes that the installed base of AEM monitors has the potential for increasing as the inherent risks associated with monopolar laparoscopic electrosurgery become more widely acknowledged and as the Company focuses on increasing its sales efficiency. The Company expects that the replacement sales of electrosurgical instruments and accessories will increase as additional hospitals adopt AEM technology. The Company anticipates that the efforts to improve the quality of sales representatives carrying the AEM product line, along with increased marketing efforts and the introduction of next generation products, may provide the basis for increased revenue and returning to profitable operations. However these measures, or any others that the Company may adopt, may not result in either increased revenue or returning to profitable operations. Furthermore, most of the Company s next generation products are in the early stages of development. Further additions to the AEM

product line are planned for introduction in fiscal year 2007.

The Company believes the unique performance of the AEM technology and its breadth of independent endorsements provides an opportunity for continued market share growth. In the Company s view, market awareness and clinical credibility of the AEM technology, as well as awareness of its endorsements are continually improving, and the Company expects that this will benefit the Company s sales efforts for the remainder of fiscal 2006. The Company s objective in the remainder of fiscal 2006 is to maintain expense controls while optimizing sales execution in the field, expand market awareness of the AEM technology and maximize the number of additional hospital accounts to AEM instruments, while retaining existing hospital customers. In addition, acceptance of AEM products depends on surgeons preference for the Company s instruments, which depends on factors such as ergonomics and ease of use in addition to the technological advantage of AEM products. If surgeons prefer other instruments to the Company s, the Company s business results will suffer.

Possibility of Continued Operating Losses: The Company achieved profitable operations in fiscal years 2004 and 2003. However, in fiscal years prior to 2003 and in the fiscal year 2005 the Company incurred losses and had an accumulated deficit of $16,147,972 at December 31, 2005. The Company has made strides toward improving its operating results. Due to the ongoing need to develop, optimize and train the direct sales managers and the independent sales representative network, the need to support development of refinements to the Company s product line and the need to increase sustained revenues to a level adequate to cover fixed and variable operating costs, the Company may operate at a net loss from time to time. Sustained losses, or an inability of the Company to generate sufficient cash flow from operations to fund its obligations, may result in a need to raise additional capital.

Revenue Growth: The Company expects to generate increased revenue in the U.S. from sales to new hospital customers and expanded sales in existing hospitals as the network of direct and independent sales representatives become more efficient. The Company believes that the visibility and credibility of the independent clinical endorsements for AEM technology will contribute to new hospital accounts and increased revenues in fiscal 2006. The Company also expects 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 and increased revenues. The Company also expects to increase market share gains through promotional programs of placing Company-owned AEM monitors at no charge into hospitals that commit to standardize on AEM instruments. However all of these efforts to increase market share and grow revenues will depend in part on the Company s ability to expand the efficiency and effective coverage range of its direct and independent sales representatives.

The Company also has longer term initiatives in place to improve the Company s prospects. The Company expects that development of next generation versions of its AEM products will better position the products in the marketplace and improve the Company s retention rate at hospitals that have changed to AEM technology, enabling the Company to grow its revenue. The Company may also explore overseas markets to assess opportunities for revenue growth internationally. Finally, the Company intends to explore opportunities to capitalize on its proven AEM technology via licensing arrangements and strategic alliances. These efforts to generate additional revenue and further the market penetration of the Company s products are longer term in nature and may not materialize. Even if the Company is able to successfully develop next generation products or identify potential international markets or strategic partners, the Company may not be able to capitalize on these opportunities.

Gross Profit and Gross Margins: Gross profit and gross margin 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 the Company are expected to improve at higher levels of production and sales.

Sales and Marketing Expenses: The Company continues its efforts to expand domestic and international distribution capability and it believes that sales and marketing expenses will decrease as a percentage of net revenue with increasing sales volume.

Research and Development Expenses: Research and development expenses are expected to increase modestly to support development of refinements to the Company s AEM product line, further expanding the instrument options for the surgeon. Further additions to the AEM product line are planned for introduction in fiscal year 2007.

Results of Operations

For the three months ended December 31, 2005 compared to the three months ended December 31, 2004.

Net revenue. Revenue for the quarter ended December 31, 2005, was $2,116,936 compared to $2,097,841 for the quarter ended December 31, 2004, an increase of 1%. The increase is attributable to the addition of some new hospital accounts, partially offset by business lost from hospitals that previously changed to AEM technology. The Company opened five new hospital accounts to AEM technology in the three months ended December 31, 2005 versus 12 new hospital accounts for AEM technology in the three months ended December 31, 2004. New hospital prospects remain strong. The Company has changed and added new sales managers and independent sales representatives in an effort to capitalize on identified market opportunities. It will take a number of months before new sales managers and new independent sales representatives generate new hospital accounts, but the Company expects that the combination of these new additions will provide the focus that is needed to achieve market gains.

Gross profit. Gross profit for the quarter ended December 31, 2005 of $1,265,458 increased by 7% from the quarter ended December 31, 2004 gross profit of $1,184,113. Gross profit as a percentage of revenue (gross margin) increased from 56% for the quarter ended December 31, 2004 to 60% in the quarter ended December 31, 2005. The increase in gross margin was primarily the result of additional absorption of manufactured and assembled costs due to higher levels of production and sales, and reduced inventory costs compared with one year ago. For the three months ended December 31, 2005, the Company provided $975 in AEM monitors at no charge to newly changed hospitals as part of a sales incentive program.

Sales and marketing expenses. Sales and marketing expenses of $924,958 for the quarter ended December 31, 2005 increased by 16% compared to $799,552 for the quarter ended December 31, 2004. The increase was a result of compensation for increased sales employees and increased commissions. Increased sales and marketing expenses were reduced by reduced sales samples cost.

General and administrative expenses. General and administrative expenses of $280,927 for the quarter ended December 31, 2005 increased by 8% compared to $260,367 for the quarter ended December 31, 2004. The increase is primarily the result of an increase in bad debt expense compared with one year ago s decrease in bad debt expense.

Research and development expenses. Research and development expenses of $218,667 for the quarter ended December 31, 2005 decreased by 18% compared to $267,141 for the quarter ended December 31, 2004. The decrease is a result of a reclassification to cost of sales of certain costs as engineering costs ($35,517), and decreases in outside services and relocation expenses incurred in connection with the Company s move to a new facility in 2004.

Net loss. Net loss was $(153,753) for the quarter ended December 31, 2005 compared to a net loss of $(143,318) for the quarter ended December 31, 2004. The net loss was a result of increased total operating expenses, as explained above, partially offset by an increase in gross profit.

For the nine months ended December 31, 2005 compared to the nine months ended December 31, 2004.

Net revenue. Revenue for the nine months ended December 31, 2005, was $6,708,017, compared to $5,927,055 for the nine months ended December 31, 2004, an increase of 13%. The increase is attributable to new hospital accounts, partially offset by business lost from hospitals that previously changed to AEM technology. The Company opened 29 new hospital accounts to AEM technology in the nine months ended December 31, 2005 versus 27 new hospital accounts for AEM technology in the nine months ended December 31, 2004.

Gross profit. The gross profit for the nine months ended December 31, 2005 of $4,026,724 increased by 19% from the nine months ended December 31, 2004 gross profit of $3,395,479. Gross profit as a percentage of revenue (gross margin) increased from 57% for the nine months ended December 31, 2004 to 60% in the nine months ended December 31, 2005. The increase in gross margin was primarily the result of additional absorption of manufactured and assembled costs due to higher levels of production and sales, and reduced inventory costs compared with one year ago. For the nine months ended December 31, 2005, the Company provided $48,507 in AEM monitors at no charge to newly changed hospitals as part of a sales incentive program.

Sales and marketing expenses. Sales and marketing expenses of $2,724,507 for the nine months ended December 31, 2005 increased by 20% compared to $2,278,484 for the nine months ended December 31, 2004. The increase was a result of compensation for increased sales employees, increased commissions as a result of higher revenue and increased marketing costs for the launch of the Company s new handle, enTouch. Increased sales and marketing expenses were reduced by reduced sales samples cost. Sales and marketing expenses for the nine months ended December 31, 2004 included costs related to the Company s resolution of an arbitration dispute with one of its distributors on July 23, 2004. The Company had previously notified the distributor that it was in breach of its Distributor Agreement with the Company in several respects, and that if the distributor did not cure the breaches the Agreement could be terminated. The distributor disputed the Company s position and asserted that the Company had breached the Agreement. The dispute was proceeding in arbitration pursuant to the terms of the Agreement when the parties agreed to settle the matter. As a result of the settlement, the Company paid a total of $201,000, including legal and arbitrator fees, and recognized the related expense during the first quarter of FY 2005

General and administrative expenses. General and administrative expenses of $884,672 for the nine months ended December 31, 2005 decreased by 7% compared to $950,653 for the nine months ended December 31, 2004. The decrease is the result of decreases in legal and tax fees compared with one year ago. An increased allowance for bad debts expense partially reduced decreased general and administrative expenses.

Research and development expenses. Research and development expenses of $722,969 for the nine months ended December 31, 2005 increased by 10% compared to $657,552 for the nine months ended December 31, 2004. The increase is a result of increases in compensation for additional employees, inventory usage costs and test and prototype material costs to support development of refinements to the Company s product line. The expense was decreased by a reclassification to cost of sales of certain costs as engineering costs ($119,125).

Net loss. Net loss was $(296,564) for the nine months ended December 31, 2005 compared to a net loss of $(490,669) for the nine months ended December 31, 2004. The net loss was a result of an increase in total operating expenses, as explained above, that increased at a lower percentage than the percentage increase of gross profit.

Liquidity and Capital Resources

To date, operating funds have been provided primarily by sales of common stock and warrants to purchase the Company s common stock, which totaled $18,920,885 through December 31, 2005, and, to a lesser degree, funds provided by sales of the Company s products.

The Company s operations used $639,051 of cash in the nine months ended December 31, 2005 on sales of $6,708,017. Prior to fiscal 2003 and in fiscal 2005, the use of cash in the Company s operations resulted primarily from the funding of annual net losses. These amounts of cash generated from and used in operations are not indicative of the expected cash to be generated from or used in operations in fiscal year 2006 (FY 06). As of December 31, 2005, the Company had $725,847 in cash and cash equivalents available to fund future operations. Working capital was $2,245,802 at December 31, 2005 compared to $2,519,639 at March 31, 2005. Current liabilities were $1,251,279 at December 31, 2005, compared to $1,133,188 at March 31, 2005.

If the Company is not successful in obtaining profitability and positive cash flow, additional capital may be required to maintain ongoing operations. The Company has explored and is 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 a line 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 the Company will be able to obtain additional funding (if needed) through a sale of its common stock or loans from financial institutions or other third parties or through any of the actions discussed above. If the Company cannot sustain profitable operations and additional capital is unavailable, lack of liquidity could have a material adverse effect on its business viability, financial position, results of operations and cash flows.

The Company leases its facilities under a noncancelable lease agreement, the minimum future lease payments which are as follows as of December 31, 2005:

Year ended March 31,		
2006	$	43,413
2007		154,179
2008		166,930
2009		172,685
2010		65,566
	$	602,773

Capital expenditures in the nine months ended December 31, 2005 ($157,215) include the capitalization ($48,507) of AEM monitors placed in hospitals under various promotional programs. Placing Company-owned AEM monitors into hospitals at no charge to facilitate their use of AEM instruments is an initiative to accelerate new hospital accounts to AEM instruments. Under these promotional programs the Company maintains ownership of the AEM monitor and the cost is capitalized and depreciated as cost of sales over the projected five year life of the asset.

The Company s FY 06 operating plan is focused on increasing new hospital accounts to AEM products, retaining existing hospital customers, growing revenue, increasing gross profits and conserving cash. The Company also is investing in research and development efforts to develop next generation versions of the AEM product line. The Company can not predict with certainty the expected revenue, gross profit, net income or loss and usage of cash and cash equivalents for FY 06. However, management believes that its cash resources will be sufficient to fund its operations for at least the next twelve months under its current operating plan. If management is unable to manage the Company s business operations in line with budget expectations, it could have a material adverse effect on the Company s business viability, financial position, results of operations and cash flows.. If the Company is not successful in achieving profitability and positive cash flow, additional capital may be required to maintain ongoing operations.

Income Taxes

As of March 31, 2005, net operating loss carryforwards totaling approximately $16,100,000 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 ended March 31, 2008. The Company has not paid income taxes since its 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. The Company has established a valuation allowance for the entire amount of its deferred tax asset since inception due to its history of losses. Should the Company achieve sufficient, sustained income in the future, the Company 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

The Company s critical accounting policies have not changed from those reported in the Company s annual report on Form 10-KSB for the year ended March 31, 2005.

Factors Which May Affect Future Performance and Financial Condition:

You should carefully consider the risk factors described below. If any of the following risk factors actually occur, the Company s business, prospects, financial condition or results of operations would likely suffer. In such case, the trading price of the Company s common stock could fall resulting in the loss of all or part of your investment. You should look at all these risk factors in total. Some risk factors may stand on their own. Some risk factors may affect (or be affected by) other risk factors. You should not assume the Company has identified these connections. You should not assume that the Company will always update these and future risk factors

in a timely manner. The Company is not undertaking any obligation to update these risk factors to reflect events or circumstances after the date of this report or to reflect the occurrence of unanticipated events.

Among the factors that could cause future results and financial condition to be materially different from expectations are:

1. *Our products may not be accepted by the market*. The success of our products and our financial condition depends on the acceptance of AEM products by the medical community in commercially viable quantities during fiscal year 2006 and beyond. We cannot predict how quickly or how broadly AEM products will be accepted by the medical community. We need to continually educate the marketplace about the potential hazards involved in the use of conventional electrosurgical products during minimally-invasive surgical procedures and the expected benefits associated with the use of AEM products. If we are unsuccessful in educating the marketplace about our technology and the hazards of conventional instruments, we will not create sufficient demand by hospitals and surgeons for AEM products and our financial condition, results of operations and cash flows could be adversely affected.

2. *We need to continually develop and train our network of direct and independent sales representatives and expand our distribution efforts in order to be successful.* Our attempts to develop and train a network of direct and independent sales representatives in the U.S. and to expand our international distribution efforts may take longer than expected and may result in considerable amounts of retraining effort as the direct and independent sales reps change their product lines, product focus and personnel. We may not be able to obtain full coverage of the U.S. by direct and independent sales representatives as quickly as anticipated. The independent sales representative network has inherent flaws and inefficiencies, which can include conflicts of interest and competing products. Optimizing the quality of the network and the performance of direct and independent sales representatives in the U.S. is an ongoing challenge. We may also encounter difficulties in developing our international presence due to regulatory issues and our ability to successfully develop international distribution options. Our inability to expand our network of direct and independent sales representatives and optimize their performance could adversely affect our financial results.

3. *We may need additional funding to support our operations.* We were formed in 1991 and have incurred losses of $16.1 million since that date. We have primarily financed research, development and operational activities with sales of our common stock. At December 31, 2005, we had $725,847 in cash available to fund future operations. We may find that investment in sales, marketing, research and development initiatives, merited by market opportunity, may result in the Company operating at a net loss from quarter to quarter. We may also find ourselves at a competitive disadvantage due to our constrained liquidity.

4. *We may not be able to compete successfully against current manufacturers of conventional (unshielded, unmonitored) electrosurgical instruments or against competitors who manufacture products that are based on surgical technologies that are alternatives to monopolar electrosurgery.* The electrosurgical products market is intensely competitive. We expect that manufacturers of unshielded, unmonitored electrosurgical instruments will

resist any loss of market share that might result from the presence of our shielded and monitored instruments in the marketplace. We also believe that manufacturers of products that are based upon surgical technologies that are alternatives to monopolar electrosurgery are our competitors. These technologies include bipolar electrosurgery, the harmonic scalpel and lasers. The alternative technologies may gain market share and new competitive technologies may be developed and introduced. Most of our competitors and potential competitors have significantly greater financial, technical, product development, marketing and other resources than we do. Most of our competitors also currently have substantial installed customer bases in the medical products market and have significantly greater market recognition than we have. As a result of these factors, our competitors may be able to respond more quickly to new or emerging technologies and changes in customer requirements or to devote greater resources to the development, promotion and sale of their products. It is possible that new competitors or new alliances among competitors may emerge and rapidly acquire significant market share. The competitive pressures we face may materially adversely affect our financial position, results of operations and cash flows, and this may hinder our ability to respond to competitive threats.

5. *If we do not continually enhance our products and keep pace with rapid technological changes, we may not be able to attract and retain customers.* Our future success and financial performance will depend in part on our ability to meet the increasingly sophisticated needs of customers through the timely development and successful introduction of product upgrades, enhancements and new products. These upgrades, enhancements and new products are subject to significant technical risks. The medical device market is subject to rapid technological change, resulting in frequent new product introductions and enhancements of existing products, as well as the risk of product obsolescence. While we are currently developing new products and enhancing our existing product lines, we may not be successful in completing the development of the new products or enhancements. In addition, we must respond effectively to technological changes by continuing to enhance our existing products to incorporate emerging or evolving standards. We may not be successful in developing and marketing product enhancements or new products that respond to technological changes or evolving industry standards. We may experience difficulties that could delay or prevent the successful development, introduction and marketing of those products, and our new products and product enhancements may not adequately meet the requirements of the marketplace and achieve commercially viable levels of market acceptance. If any potential new products, upgrades, or enhancements are delayed, or if any potential new products, upgrades, or enhancements experience quality problems or do not achieve such market acceptance, or if new products make our existing products obsolete, our financial position, results of operations and cash flows would be materially adversely affected.

6. *If government regulations change or if we fail to comply with existing and/or new regulations, we might miss market opportunities and experience increased costs and limited growth.* The research, manufacturing, marketing and distribution of our products in the United States and other countries are subject to extensive regulation by numerous governmental authorities including, but not limited to, the Food and Drug Administration. Under the Federal Food, Drug and Cosmetic Act, medical devices must receive clearance from the Food and Drug Administration through the Section 510(k) pre-market notification process or through the more lengthy pre-market approval process before they can be sold in the United States. The process of obtaining required regulatory approvals is lengthy and has required the expenditure of substantial resources. There can be no assurance that we will be able to continue to obtain the necessary approvals. As part of our strategy, we also intend to pursue commercialization of our products in international markets. Our products are subject to regulations that vary from country to country. The process of obtaining foreign regulatory approvals in certain countries can be lengthy and require the expenditure of substantial resources. We may not be able to obtain necessary regulatory approvals or clearances on a timely basis or at all, and delays in receipt of or failure to receive such approvals or clearances, or failure to comply with existing or future regulatory requirements would have a material adverse effect on our financial position, results of operations and cash flows.

7. *If we fail to comply with the extensive regulatory requirements governing the manufacturing of our products, we could be subject to fines, suspensions or withdrawals of regulatory approvals, product recalls, suspension of manufacturing, operating restrictions and/or criminal prosecution.* The manufacturing of our products is subject to extensive regulatory requirements administered by the Food and Drug Administration and other regulatory bodies. Inspection of our manufacturing facilities and processes can be conducted at any time, without prior notice, by the agencies. In addition, future changes in regulations or interpretations made by the Food and Drug Administration or other regulatory bodies, with possible retroactive effect, could adversely affect us. Changes in existing regulations or adoption of new regulations or policies could prevent us from obtaining, or affect the timing of, future regulatory approvals or clearances. We may not be able to obtain necessary regulatory approvals or clearances on a timely basis in the future, or at all. Delays in receipt of, failure to receive such approvals or clearances and/or failure to comply with existing or future regulatory requirements would have a material adverse effect on our financial position, results of operations and cash flows.

8. *Our current patents, trade secrets and know-how may not provide a competitive advantage, the pending applications may not result in patents being issued, and our competitors may design around any patents issued to us.* Our success will continue to depend in part on our ability to maintain patent protection for our products and processes, to preserve our trade secrets and to operate without infringing the proprietary rights of third parties. We have four issued U.S. patents on several technologies embodied in our AEM Monitoring System, AEM Instruments and related accessories and we have applied for additional U.S. patents. In addition, we have four issued foreign patents. The validity and breadth of claims coverage in medical technology patents involve complex legal and factual questions and may be highly uncertain. Also, patents may not protect our proprietary information and know-how or provide adequate remedies for us in the event of unauthorized use or disclosure of such information, and others may be able to develop, independently, such information. There has been substantial litigation regarding patent and other intellectual property rights in the medical device industry. Litigation may be necessary to enforce patents issued to us, to protect trade secrets or know-how owned by us, to defend us against claimed infringement of the rights of others or to determine the ownership, scope or validity of our proprietary rights or those of others. Any such claims may require us to incur substantial litigation expenses and to divert substantial time and effort of management personnel and could substantially decrease the amount of capital available for our operations. An adverse

determination in litigation involving the proprietary rights of others could subject us to significant liabilities to third parties, could require us to seek licenses from third parties, and could prevent us from manufacturing, selling or using our products. The occurrence of any such actual or threatened litigation or the effect on our business of such litigation may materially adversely affect our financial position, results of operations and cash flows. Additionally, our assessment that a patent is no longer of value could result in a significant charge against our earnings.

9. *We depend on single source suppliers for certain of the key components and sub-contractors to provide much of our products used in the manufacturing of our products. The loss of a supplier or limitation in supply from existing suppliers could have a material adverse effect on our ability to manufacture our products until a new source of supply is located.* Although we believe that there are alternative suppliers, any interruption in the supply of key components could have a material adverse effect on us. A sudden increase in customer demand may create a backorder situation as lead times for some of our critical materials are in excess of 12 weeks. We rely on subcontractors to provide products, either in the form of finished goods or sub-assemblies that we then assemble and test. While these sub-contractors reduce our total cost of manufacturing, they may not be as responsive to increased demand as we would be if we had our manufacturing capacity entirely in-house, which may limit our growth strategy and revenues.

10. *The potential fluctuation in future quarterly results may cause our stock price to fluctuate.* We expect that our operating results could fluctuate significantly from quarter to quarter in the future and will depend upon a number of factors, many of which are outside our control. These factors include the extent to which our AEM technology and related accessories gain market acceptance; our investments in marketing, sales, research and development and administrative personnel necessary to support growth; our ability to expand our market share; actions of competitors and general economic conditions. The market value of our common stock has dramatically fluctuated in the past and is likely to fluctuate in the future. Any deviation could have an immediate and significant negative impact on the market price of our stock.

11. *Our common stock is thinly traded, the prices at which it trades are volatile and the buying or selling actions of a few shareholders may adversely affect our stock price.* As of December 31, 2005, we had a public float, which is defined as shares outstanding minus shares held by our officers, directors, or holders of greater than 5% of our outstanding common stock, of 2,922,605 shares or 46% of the outstanding common stock. The average number of shares traded in any given day over the past year has been relatively small compared to the public float. Thus, the actions of a few shareholders either buying or selling shares of our common stock may adversely affect the price of the shares. Historically, thinly traded securities such as our common stock have experienced extreme price and volume fluctuations that do not necessarily relate to operating performance. In addition, as of December 31, 2005, Vern D. Kornelsen, one of our directors, and an entity controlled by Mr. Kornelsen owned an aggregate of 1,878,443 shares of our common stock, or approximately 29% of our common stock outstanding. As a result, Mr. Kornelsen may be able to exert substantial influence over matters requiring action by our shareholders, and in the event Mr. Kornelsen were to elect to sell some or all of the common stock he controls, it could have a significant adverse effect on the price of our common stock.

12. *Our insurance coverage for product liability claims is up to $5,000,000.* We face an inherent business risk of exposure to product liability claims in the event that the use of our products is alleged to have resulted in adverse effects to a patient. We maintain a general liability insurance policy up to the amount of $5,000,000 that includes coverage for product liability claims. Liability claims may be excluded from the policy, may exceed the coverage limits of the policy, or the insurance may not continue to be available on commercially reasonable terms or at all. Consequently, a product liability claim or other claim with respect to uninsured liabilities or in excess of insured liabilities could have a material adverse effect on our financial position, results of operations and cash flows.

13. *We depend on certain key personnel.* We are highly dependent on a limited number of key management personnel, particularly our President and CEO, John R. Serino and Chairman of the Board, Roger C. Odell. Our loss of key personnel to death, disability or termination, or our inability to hire and retain qualified personnel, could have a material adverse effect on our financial position, results of operations and cash flow.

ITEM 3 CONTROLS AND PROCEDURES

(a) The Company has carried out an evaluation under the supervision and with the participation of the Company s management, including the Company s Chief Executive Officer and Principal Accounting and Financial Officer, of the effectiveness of the Company s disclosure controls and procedures (as defined in Rules 13a-14(c) and 15d-14c 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 as of December 31, 2005 that the Company s disclosure controls and procedures were effective in ensuring that information required to be disclosed by the Company under the Exchange Act was recorded, processed, summarized and reported within the time periods specified under the Exchange Act rules and forms.

(b) During the quarter ended December 31, 2005, there were no changes in the Company s internal control over financial reporting or in other factors that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting, nor were there any significant deficiencies or material weaknesses in such disclosure controls and procedures or internal control over financial reporting requiring corrective actions. As a result no corrective actions were taken.

PART II. **OTHER INFORMATION**

ITEM 6 – EXHIBITS

31.1 Certification of Chief Executive Officer under Rule 13a-14(a)
31.2 Certification of Principal Financial and Accounting Officer under Rule 13a-14(a)
32.1 Certification of Periodic Reports pursuant to Sarbanes-Oxley Act of 2002

SIGNATURE

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, Encision has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Name	Title	Date
/s/ Marcia McHaffie Marcia McHaffie	Controller Principal Accounting Officer & Principal Financial Officer	February 13, 2006