NOCOPI TECHNOLOGIES INC/MD/
Form 10-Q
September 11, 2015

United States

Securities and Exchange Commission

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2015

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**.

For the transition period from ________________ to ______________

Commission File Number: 000-20333

NOCOPI TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

Maryland	**87-0406496**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

480 Shoemaker Road, Suite 104, King of Prussia, PA 19406

(Address of principal executive offices) (Zip Code)

(610) 834-9600

(Registrant s telephone number, including area code)

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 þ No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer (Do not check if a smaller reporting company)	¨	Smaller reporting company	þ

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 58,599,016 shares of common stock, par value $0.01, as of August 15, 2015

NOCOPI TECHNOLOGIES, INC.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

Nocopi Technologies, Inc.

Statements of Operations*

(unaudited)

	Three Months ended June 30 2015	Three Months ended June 30 2014	Six Months ended June 30 2015	Six Months ended June 30 2014
Revenues				
Licenses, royalties and fees	$ 78,800	$ 77,500	$ 156,900	$ 157,500
Product and other sales	237,900	158,600	348,200	263,500
	316,700	236,100	505,100	421,000
Cost of revenues				
Licenses, royalties and fees	23,800	19,300	42,000	36,500
Product and other sales	88,200	65,200	143,800	120,500
	112,000	84,500	185,800	157,000
Gross profit	204,700	151,600	319,300	264,000
Operating expenses				
Research and development	31,100	30,400	64,000	61,000
Sales and marketing	55,300	46,600	105,200	94,200
General and administrative	67,900	59,200	151,400	113,600
	154,300	136,200	320,600	268,800
Net income (loss) from operations	50,400	15,400	(1,300)	(4,800)
Other income (expenses)				
Interest income				300
Interest expense, bank charges and financing cost	(5,100)	(5,300)	(10,300)	(10,600)
	(5,100)	(5,300)	(10,300)	(10,300)
Net income (loss)	$ 45,300	$ 10,100	$ (11,600)	$ (15,100)

Basic and diluted net income (loss) per common share	$ .00	$ .00	$ (.00)	$ (.00)
Weighted average common shares outstanding				
Basic	58,599,016	58,599,016	58,599,016	58,599,016
Diluted	58,600,367	58,600,830	58,599,016	58,599,016

*See accompanying notes to these financial statements.

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Nocopi Technologies, Inc.

Balance Sheets*

	June 30 2015 (unaudited)	December 31 2014 (audited)
Assets		
Current assets		
Cash	$ 103,400	$ 28,000
Accounts receivable less $5,000 allowance for doubtful accounts	225,800	287,800
Inventory	36,300	43,500
Prepaid and other	21,700	18,800
Total current assets	387,200	378,100
Fixed assets		
Leasehold improvements	19,700	19,700
Furniture, fixtures and equipment	177,600	176,800
	197,300	196,500
Less: accumulated depreciation and amortization	180,800	178,400
	16,500	18,100
Total assets	$ 403,700	$ 396,200
Liabilities and Stockholders' Deficiency		
Current liabilities		
Demand loans	$ 46,000	$ 63,000
Convertible debentures	105,000	102,900
Accounts payable	167,300	160,300
Accrued expenses	429,400	383,000
Deferred revenue	73,500	93,400
Total current liabilities	821,200	802,600
Convertible debentures, net of unaccreted discount of $900 at June 30, 2015 and $1,400 at December 31, 2014	32,300	31,800
Stockholders' deficiency		
Common stock, $0.01 par value, Authorized 75,000,000 shares, Issued and outstanding 58,599,016 shares	586,000	586,000
Paid-in capital	12,408,500	12,408,500
Accumulated deficit	(13,444,300)	(13,432,700)
Total stockholders' deficiency	(449,800)	(438,200)
Total liabilities and stockholders' deficiency	$ 403,700	$ 396,200

*See accompanying notes to these financial statements.

Nocopi Technologies, Inc.

Statements of Cash Flows*

(unaudited)

	Six Months ended June 30			
	2015		2014	
Operating Activities				
Net loss	$	(11,600)	$	(15,100)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities				
Depreciation and amortization		2,400		1,700
Accretion of interest convertible debentures		2,600		2,100
		(6,600)		(11,300)
(Increase) decrease in assets				
Accounts receivable		62,000		(28,400)
Inventory		7,200		(1,400)
Prepaid and other		(2,900)		19,500
Increase (decrease) in liabilities				
Accounts payable and accrued expenses		53,400		3,500
Deferred revenue		(19,900)		7,000
		99,800		200
Net cash provided by (used in) operating activities		93,200		(11,100)
Investment Activities				
Additions to fixed assets		(800)		(20,000)
Net cash used in investing activities		(800)		(20,000)
Financing Activities				
Repayment of borrowings under promissory note				(12,500)
Repayment of demand loans		(17,000)		
Net cash used in financing activities		(17,000)		(12,500)
Increase (decrease) in cash		75,400		(43,600)
Cash at beginning of year		28,000		52,900
Cash at end of period	$	103,400	$	9,300
Supplemental Disclosure of Cash Flow Information				
Cash paid for interest			$	300
Supplemental Disclosure of Non Cash Investing Activities				

Write-off of fully depreciated leasehold improvements and furniture, fixtures and equipment		
Accumulated depreciation and amortization	$	(82,900)
Leasehold improvements	$	72,500
Furniture, fixtures and equipment	$	10,400

*See accompanying notes to these financial statements.

NOCOPI TECHNOLOGIES, INC.

NOTES TO FINANCIAL STATEMENTS

(UNAUDITED)

Note 1. Financial Statements

The accompanying unaudited condensed financial statements have been prepared by Nocopi Technologies, Inc. (the Company). These statements include all adjustments (consisting only of normal recurring adjustments) which management believes necessary for a fair presentation of the statements and have been prepared on a consistent basis using the accounting policies described in the summary of Accounting Policies included in the Company's 2014 Annual Report on Form 10-K. Certain financial 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 accompanying disclosures are adequate to make the information presented not misleading. The Notes to Financial Statements included in the 2014 Annual Report on Form 10-K should be read in conjunction with the accompanying interim financial statements. The interim operating results for the three months and six months ended June 30, 2015 may not be necessarily indicative of the operating results expected for the full year.

The Company follows Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 220 in reporting comprehensive income. Comprehensive income is a more inclusive financial reporting methodology that includes disclosure of certain financial information that historically has not been recognized in the calculation of net income. Since the Company has no items of other comprehensive income, comprehensive income (loss) is equal to net income (loss).

Note 2. Going Concern

Since its inception, the Company has incurred significant losses and, as of June 30, 2015, had accumulated losses of $13,444,300. For the six months ended June 30, 2015, the Company had a net loss from operations of $1,300. At June 30, 2015, the Company had negative working capital of $434,000 and a stockholders deficiency of $449,800. For the year ended December 31, 2014, the Company s net income from operations was $29,000. Due in part to uncertainties in the US economy, the Company, which is substantially dependent on its licensees to generate licensing revenues, may incur operating losses and experience negative cash flow in the future. Achieving profitability and positive cash flow depends on the Company s ability to generate and sustain significant increases in revenues and gross profits from its traditional business. There can be no assurances that the Company will be able to generate sufficient revenues and gross profits to return to and sustain profitability and positive cash flow in the future.

During 2013 and 2014, the Company sold convertible debentures totaling $110,000 to eight investors and received an unsecured loan of $3,000 from an individual. Receipt of funds from these investors and from the demand loan holder has permitted the Company to continue in operation to the current date. Management of the Company believes that it may need additional capital in the future both to fund investments needed to increase its operating revenues to levels that will sustain its operations and to fund operating deficits that it believes may occur until revenue increases from traditional and new product lines can be realized. There can be no assurances that the Company will be successful in obtaining sufficient additional capital, or if it does, that the additional capital will enable the Company to impact its revenues so as to have a material positive effect on the Company s operations and cash flow. The Company believes that without additional capital, whether in the form of debt, equity or both, it may be forced to cease operations at an undetermined future date.

Note 3. Stock Based Compensation

The Company follows FASB ASC 718, *Compensation Stock Compensation*, and uses the Black-Scholes option pricing model to calculate the grant-date fair value of an award.

At June 30, 2015, the Company had no exercisable or non-exercisable options to purchase the Company s common stock outstanding. The Company s stock option plan terminated in 2009 and no further stock options could be granted under the plan; however, stock options granted before the termination date could have been exercised through their expiration dates. All remaining options granted under the plan expired in February 2014. There was no unrecognized portion of expense related to stock option grants at June 30, 2015.

NOCOPI TECHNOLOGIES, INC.

NOTES TO FINANCIAL STATEMENTS

(UNAUDITED)

Note 4. Promissory Note

In 2008, the Company negotiated a $100,000 revolving line of credit with a bank to provide a source of working capital. The line of credit was secured by all the assets of the Company and bore interest at the bank s prime rate plus 0.5%. During the term of the line of credit, the interest rate applicable to the Company s line of credit was 3.75%. During the year ended December 31, 2009, the Company borrowed the entire $100,000 available under the line of credit. Until the third quarter of 2010, the Company had been required to pay interest only on borrowings under the line of credit. During the third quarter of 2010, the Company was notified by the bank that the line of credit was not being renewed and was offered repayment terms, which the Company accepted, to repay the outstanding loan balance in forty-eight equal monthly installments of $2,083, plus interest at the bank s prime rate plus 0.5%, which was 3.75% throughout the repayment term, beginning in October 2010. In early July 2014, the Company repaid $6,250, the then remaining outstanding balance of the note.

Note 5. Demand Loans

At June 30, 2015, the Company had unsecured loans totaling $46,000 from three individuals outstanding. The loans bear interest at 8%. During the first six months of 2015, the Company repaid $17,000 of the unsecured loans.

Note 6. Convertible Debentures

At June 30, 2015, the Company had convertible debentures totaling $138,300 outstanding, of which $105,000 are due during the third quarter of 2015 and $33,300 are due during the third quarter of 2016. The convertible debentures bear interest at 7%. At option of the lender, the debentures and accrued interest are convertible in whole or part into common stock of the Company at $0.05 per share. The Company also granted warrants to purchase 691,365 shares of the Company s common stock at $0.02 per share to the holders of the debentures. The warrants are exercisable two years after issuance and expire seven years after issuance.

The fair value of the warrants was determined using the Black-Scholes pricing model. The relative fair value of the warrants was recorded as a discount to the notes payable with an offsetting credit to additional paid-in capital since the

Company determined that the warrants were an equity instrument in accordance with FASB ASC 815. The debt discount related to the warrant issuances is being accreted through interest expense over the term of the notes payable. For the three months and six months ended June 30, 2015, approximately $1,200 and $2,600, respectively, was accreted through interest expense. For the three months and six months ended June 30, 2014, approximately $1,100 and $2,100, respectively, was accreted through interest expense.

The following table summarizes the Company s warrant position at June 30, 2015 and December 31, 2014:

	Number of Shares	**Exercise Price**		**Weighted Average Exercise Price**
Outstanding warrants - December 31, 2014	802,365	$0.01 to $0.07	$	0.025
Warrants expired	46,000	$0.06 and $0.07	$	0.068
Outstanding warrants June 30, 2015	756,365	$0.01 to $0.07	$	0.022
Weighted average remaining contractual life (years)	5.01			
Exercisable warrants June 30, 2015	65,000	$0.01 to $0.07	$	0.045
Weighted average remaining contractual life (years)	1.58			

NOCOPI TECHNOLOGIES, INC.

NOTES TO FINANCIAL STATEMENTS

(UNAUDITED)

Note 7. Other Income (Expenses)

Other income (expenses) in the three months and six months ended June 30, 2015 and 2014 includes interest on unsecured loans from five individuals, on convertible debentures held by ten investors and, in 2014, on funds borrowed under the Company s promissory note with a bank.

Note 8. Income Taxes

There is no provision for income taxes for the three months ended June 30, 2015 and 2014 due to the availability of net operating loss carryforwards. There is no income tax benefit for the losses for the six months ended June 30, 2015 and 2014 because the Company has determined that the realization of the net deferred tax asset is not assured. The Company has created a valuation allowance for the entire amount of such benefits.

There was no change in unrecognized tax benefits during the period ended June 30, 2015 and there was no accrual for uncertain tax positions as of June 30, 2015.

Tax years from 2011 through 2014 remain subject to examination by U.S. federal and state jurisdictions.

Note 9. Earnings (Loss) per Share

In accordance with FASB ASC 260, *Earnings per Share*, basic earnings (loss) per common share is computed using net earnings (loss) divided by the weighted average number of common shares outstanding for the periods presented. The computation of diluted earnings per common share involves the assumption that outstanding common shares are increased by shares issuable upon exercise of those stock options and warrants for which the market price exceeds the exercise price. The number of shares issuable upon the exercise of such stock options and warrants is decreased by shares that could have been purchased by the Company with related proceeds. For the three months ended June 30, 2015 and 2014, the number of incremental common shares resulting from the assumed conversion of warrants was

1,351 and 1,814, respectively. Because the Company reported a net loss for the six months ended June 30, 2015 and 2014, common stock equivalents, consisting of stock options and warrants, were anti-dilutive.

Note 10. Major Customer and Geographic Information

The Company s revenues, expressed as a percentage of total revenues, from non-affiliated customers that equaled 10% or more of the Company s total revenues were:

	Three Months ended June 30		**Six Months ended June 30**	
	2015	**2014**	**2015**	**2014**
Customer A	64%	57%	59%	50%
Customer B	16%	16%	20%	18%

The Company s non-affiliate customers, whose individual balances amounted to more than 10% of the Company s net accounts receivable, expressed as a percentage of net accounts receivable, were:

	June 30 2015	**December 31 2014**
Customer A	80%	46%
Customer B		35%

The Company performs ongoing credit evaluations of its customers and generally does not require collateral. The Company also maintains allowances for potential credit losses. The loss of a major customer could have a material adverse effect on the Company s business operations and financial condition.

NOCOPI TECHNOLOGIES, INC.

NOTES TO FINANCIAL STATEMENTS

(UNAUDITED)

The Company s revenues by geographic region are as follows:

	Three Months ended June 30		Six Months ended June 30	
	2015	**2014**	**2015**	**2014**
North America	$ 109,000	$ 99,800	$ 198,600	$ 201,800
Asia	207,700	136,300	306,500	219,200
	$ 316,700	$ 236,100	$ 505,100	$ 421,000

Note 11. Subsequent Events

In July 2015, the Company repaid, with interest, a $10,000 convertible debenture that had matured.

In July 2015, the Company repaid $13,000 of the principal of the outstanding demand loans.

In July 2015, the Company s common stock private placement was extended to December 31, 2016 by its Board of Directors.

During the third quarter of 2015, the Company s Board of Directors approved and the holders of $95,000 of convertible debentures maturing during the third quarter of 2015 accepted an offer of extension whereby the maturity dates of the convertible debentures are extended for two years and the conversion rate of the debentures and accrued interest into Common Stock of the Company is reduced from $0.05 to $0.025.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Information

This Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 (the Exchange Act), regarding, among other things, anticipated improvements in operations, the Company s plans, earnings, cash flow and expense estimates, strategies and prospects, both business and financial. All statements other than statements of current or historical fact contained in this report are forward-looking statements. The words believe, expect, anticipate, should, plan, wi estimate, potential, continue and similar expressions, as they relate to the Company, are intended to ide forward-looking statements.

The Company has based these forward-looking statements largely on its current expectations and projections about future events, financial trends, market opportunities, competition, and the adequacy of the Company s available cash resources, which the Company believes may affect its financial condition, results of operations, business strategy and financial needs. This Form 10-Q also contains forward-looking statements attributed to third parties. All such statements can be affected by inaccurate assumptions, including, without limitation, with respect to risks, uncertainties, anticipated operating efficiencies, new business prospects and the rate of expense increases. In light of these risks, uncertainties and assumptions, the forward-looking statements in this report may not occur and actual results could differ materially from those anticipated or implied in the forward-looking statements. For these reasons, and because of the uncertainty relating to the current financial conditions in today s economic environment and the potential reduction in demand for the Company s products, you should not consider this information to be a guarantee by the Company or any other person that its objectives and plans will be achieved. When you consider these forward-looking statements, you should keep in mind the Risk Factors and other cautionary statements set forth in this Item 2 and elsewhere in this Form 10-Q. The Company s forward-looking statements speak only as of the date made. The Company undertakes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

The following Management s Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Condensed Financial Statements and related notes included elsewhere in this report as well as with the Company s audited Financial Statements and Notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2014 filed with the Securities and Exchange Commission (the SEC) on September 11, 2015 and keeping in mind this cautionary statement regarding forward-looking information.

Results of Operations

The Company s revenues are derived from (i) royalties paid by licensees of the Company s technologies; (ii) fees for the provision of technical services to licensees; and (iii) the direct sale of (a) products incorporating the Company s technologies, such as inks, security paper and pressure sensitive labels, and (b) equipment used to support the application of the Company s technologies, such as ink-jet printing systems. Royalties consist of guaranteed minimum royalties payable by the Company s licensees and/or additional royalties, which typically vary with the licensee s sales or production of products incorporating the licensed technology. Technical services, in the form of on-site or telephone consultations by members of the Company s technical staff, may be offered to licensees of the Company s technologies. The consulting fees are billed at agreed upon per diem or hourly rates at the time the services are rendered. Service fees and sales revenues vary directly with the number of units of service or product provided.

The Company recognizes revenue on its lines of business as follows:

a)

License fees and royalties are recognized when the license term begins. Upon inception of the license term, revenue is recognized in a manner consistent with the nature of the transaction and the earnings process, which generally is ratably over the license term;

b)

Product sales are recognized (i) upon shipment of products; (ii) when the price is fixed or determinable; and (iii) when collectability is reasonably assured; and

c)

Fees for technical services are recognized when (i) the service has been rendered; (ii) an arrangement exists; (iii) the price is fixed or determinable based upon a per diem or hourly rate; and (iv) collectability is reasonably assured.

The Company believes that, as fixed cost reductions beyond those it has achieved in recent years may not be achievable, its operating results are substantially dependent on revenue levels. Because revenues derived from licenses and royalties carry a much higher gross profit margin than other revenues, operating results are also substantially affected by changes in revenue mix.

Both the absolute amounts of the Company s revenues and the mix among the various sources of revenue are subject to substantial fluctuation. The Company has a relatively small number of substantial customers rather than a large number of small customers. Accordingly, changes in the revenue received from a significant customer can have a substantial effect on the Company s total revenue and on its revenue mix and overall financial performance. Such changes may result from a customer s product development delays, engineering changes, changes in product marketing strategies and the like. In addition, certain customers have, from time to time, sought to renegotiate certain provisions of their license agreements and, when the Company agrees to revise terms, revenues from the customer may be affected. The addition of a substantial new customer or the loss of a substantial existing customer may also have a substantial effect on the Company s total revenue, revenue mix and operating results.

Revenues for the second quarter of 2015 were $316,700 compared to $236,100 in the second quarter of 2014, an increase of $80,600, or approximately 34%. Licenses, royalties and fees increased by $1,300, or approximately 2%, to $78,800 in the second quarter of 2015 from $77,500 in the second quarter of 2014. The increase in licenses, royalties and fees is due primarily to higher licensing revenues from a licensee in the entertainment and toy products market whose license commenced in 2012 offset in part by lower consulting revenue received from a customer. There can be no assurances that the marketing and product development activities of the Company s licensees or other businesses in the entertainment and toy products market will produce a significant increase in revenues for the Company, nor can the timing of any potential revenue increases be predicted, particularly given the uncertain economic conditions being experienced worldwide.

Product and other sales increased by $79,300, or approximately 50%, to $237,900 in the second quarter of 2014 from $158,600 in the second quarter of 2014. Sales of ink increased in the second quarter of 2015 compared to the second quarter of 2014 due primarily to higher ink shipments to a third party authorized printer used by two of the Company s major licensees in the entertainment and toy products market. In the second quarter of 2015, the Company derived revenues of approximately $267,800 from its licensees and their authorized printers in the entertainment and toy products market compared to revenues of approximately $181,100 in the second quarter of 2014.

For the first six months of 2015, revenues were $505,100, representing an increase of $84,100, or approximately 20%, from revenues of $421,000 in the first six months of 2014. Licenses, royalties and fees of $156,900 in the first six months of 2015 approximated licenses, royalties and fees of $157,500 in the first six months of 2014. As in the second quarter of 2015, higher licensing revenues from a licensee in the entertainment and toy products market whose license commenced in 2012 were offset in by lower consulting revenue received from a customer.

Product and other sales increased by $84,700, or approximately 32%, to $348,200 in the first six months of 2015 from $263,500 in the first six months of 2014. Sales of ink increased in the first six months of 2015 compared to the first six months of 2014 due primarily to higher ink shipments to a third party authorized printer used by two of the Company s major licensees in the entertainment and toy products market offset in part by lower ink shipments to the Company s licensees in the retail receipt and document fraud market. The Company derived revenues of approximately $422,400 from licensees and their authorized printers in the entertainment and toy products market in the first six months of 2015 compared to revenues of approximately $310,400 in the first six months of 2014.

The Company s gross profit increased to $204,700 in the second quarter of 2015, or approximately 65% of revenues, from $151,600 in the second quarter of 2014 or approximately 64% of revenues. Licenses, royalties and fees have historically carried a higher gross profit than product and other sales. Such other sales generally consist of supplies or other manufactured products which incorporate the Company s technologies or equipment used to support the application of its technologies. These items (except for inks which are manufactured by the Company) are generally purchased from third-party vendors and resold to the end-user or licensee and carry a lower gross profit than licenses, royalties and fees. The higher gross profit in the second quarter of 2015 compared to the second quarter of 2014 results primarily from higher gross revenues from licenses, royalties and fees and product and other sales in the second quarter of 2015 compared to the second quarter of 2014 as well as gross profit improvements related to both the mix of products sold and favorable raw material prices in the second quarter of 2015 compared to the second quarter of 2014.

For the first six months of 2015, gross profit was $319,300, or approximately 63% of revenues, compared to $264,000, or approximately 63% of revenues, in the first six months of 2014. The higher gross profit in the first six months of 2015 compared to the first six months of 2014 results from the same positive factors as the increase in the second quarter of 2015 compared to the second quarter of 2014.

As the variable component of cost of revenues related to licenses, royalties and fees is a low percentage of these revenues and the fixed component is not substantial, period to period changes in revenues from licenses, royalties and fees can significantly affect both the gross profit from licenses, royalties and fees as well as overall gross profit. The gross profit from licenses, royalties and fees decreased to approximately 70% in the second quarter of 2015 compared to approximately 75% in the second quarter of 2014. The gross profit from licenses, royalties and fees decreased to approximately 73% of revenues from licenses, royalties and fees in the first six months of 2015 from approximately 77% in the first six months of 2014.

The gross profit, expressed as a percentage of revenues, of product and other sales is dependent on both the overall sales volumes of product and other sales and on the mix of the specific goods produced and/or sold. The gross profit from product and other sales increased to approximately 63% of revenues in the second quarter of 2015 compared to approximately 59% of revenues in the second quarter of 2014. This increase was due to favorable margins on certain products due to favorable mix of products sold and raw materials prices. For the first six months of 2015, the gross profit, expressed as a percentage of revenues, increased to approximately 59% of revenues from product and other sales compared to approximately 54% of revenues from product and other sales in the first six months of 2014.

Research and development expenses of $31,100 in the second quarter of 2015 and $64,000 in the first six months of 2015 were comparable to $30,400 in the second quarter of 2014 and $61,000 in the first six months of 2014.

Sales and marketing expenses increased to $55,300 in the second quarter of 2015 from $46,600 in the second quarter of 2014 and to $105,200 in the first six months of 2015 from $94,200 in the first six months of 2014. This increase is due primarily to higher commission expense on the higher level of sales in the second quarter and first six months of 2015 compared to the second quarter and first six months of 2014.

General and administrative expenses increased in the second quarter and first six months of 2015 to $67,900 and $151,400, respectively, from $59,200 and $113,600 in the second quarter and first six months of 2014, respectively, due primarily to higher audit expenses in the second quarter and first six months of 2015 compared to the second quarter and first six months of 2014 related to the Company s preparation of the comprehensive annual report on Form 10-K.

Other income (expenses) in the second quarter and first six months of 2015 and 2014 included interest on unsecured loans from five individuals, on convertible debentures held by ten investors and, in 2014, interest on funds borrowed under the Company s promissory note with a bank.

The net income of $45,300 in the second quarter of 2015 compared to net income of $10,100 in the second quarter of 2014 and the lower net loss of $10,100 in the first six months 2015 compared to the net loss of $15,100 in the first six months of 2014 resulted primarily from a higher gross profit on a higher level of revenues in the second quarter and first six months of 2015 compared to the second quarter and first six months of 2015 offset in part by higher overhead expenses in the second quarter and first six months of 2015 compared to the second quarter and first six months of 2014.

Plan of Operation, Liquidity and Capital Resources

During the first six months of 2015, the Company s cash increased to $103,400 at June 30, 2015 from $28,000 at December 31, 2014. During the first six months of 2015, the Company generated $93,200 from its operating activities, used $800 for capital equipment and repaid $17,000 to two individual lenders.

During the first six months of 2015, the Company s revenues increased primarily as a result of higher sales of ink to the authorized printer of four of the Company s licensees in the entertainment and toy products market and higher license fees from a licensee in the entertainment and toy products market. The Company s total overhead expenses increased in the first six months of 2015 compared to the total overhead expenses in the first six months of 2014 As a result of these factors, the Company s net loss declined in the first six months of 2015 compared to the first six months of 2014. The Company had positive operating cash flow of $93,200 during the first six months of 2015. At June 30, 2015, the Company had negative working capital of $434,000 and a stockholders deficiency of $449,800. For the full year of 2014, the Company had net income of $7,700 and had positive operating cash flow of $14,500. At December 31, 2014, the Company had negative working capital of $424,500 and a $438,200 stockholders deficiency.

During 2010, the Company accepted an offer by a bank to repay the then outstanding balance of $100,000 under its line of credit, received in 2008, with that bank in forty-eight equal monthly installments, plus interest, beginning in October 2010. The remaining outstanding balance was repaid in July 2014. Through June 30, 2015, the Company repaid $24,500 of $96,500 in unsecured loans borrowed from five individuals, converted $1,500 of the principal of the unsecured loans and approximately $1,200 of accrued interest into 44,216 shares of its common stock and exchanged $24,500 of the principal of the unsecured loans and approximately $3,800 of accrued interest for convertible debentures totaling approximately $28,300. In 2014 and 2013, the Company raised $110,000 through the sale of convertible debentures to eight investors. These borrowings and sales of common stock in recent years have allowed the Company to remain in operation through the current date. There can be no assurances that the Company will be able to secure sufficient additional funding through investments or borrowings that will allow the Company to fund losses that it presently believes may continue during 2015. The Company believes that without additional investment, it may be forced to cease operations at an undetermined date in the future.

The Company s plan of operation for the twelve months beginning with the date of this quarterly report consists of concentrating available human and financial resources to continue to capitalize on the specific business relationships the Company has developed in the entertainment and toy products market including two licensees with a significant presence in the entertainment and toy products market that have been marketing products incorporating the Company s technologies since 2012. These two licensees in the entertainment and toy products market are well known and highly regarded participants in this market. The Company believes that these two licensees will expand their offerings incorporating the Company s technologies currently being marketed and will introduce new products incorporating available technologies covered by the license agreements that are not currently being marketed by them. The Company plans to continue developing applications for these licensees while expanding its licensee base in the entertainment and toy market. The Company has additional licensees marketing or developing products incorporating the Company s technologies in certain niche markets of the overall entertainment and toy products market. The Company maintains its presence in the retail loss prevention market and believes that revenue growth in this market can be achieved through increased security ink sales to its licensees in this market. The Company will continue to adjust its production and technical staff as necessary. The Company will also, subject to available financial resources, invest in capital equipment needed to support potential growth in ink production requirements beyond its current capacity. Additionally, the Company will pursue opportunities to market its current technologies in specific security and non-security markets. There can be no assurances that these efforts will enable the Company to generate additional revenues and positive cash flow.

The Company has received and continues to seek additional capital, in the form of debt, equity or both, to support its working capital requirements. There can be no assurances that the Company will be successful in raising additional capital, or that such additional capital, if obtained, will enable the Company to generate additional revenues and positive cash flow.

The Company generates a significant portion of its total revenues from licensees in the entertainment and toy products market. These licensees generally sell their products through retail outlets. During the year, such sales may be adversely affect