

Scio Diamond Technology Corp  
Form 10-Q  
February 12, 2016

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

**QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF  
<sup>X</sup>1934**

**For the quarterly period ended December 31, 2015**

**“ TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT OF 1934**

**For the transition period from            to**

**Commission file number: 000-54529**

**SCIO DIAMOND TECHNOLOGY CORPORATION**

(Exact name of registrant as specified in its charter)

**Nevada**

(State or other jurisdiction of incorporation or organization)

**45-3849662**

(I.R.S. Employer Identification No.)

**411 University Ridge Suite D**

**Greenville, SC 29601**

(Address of principal executive offices, including zip code)

**(864) 751-4880**

(Registrant's telephone number, including area code)

**Not Applicable**

(Former name, former address and former fiscal year, if changed since last report)

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. x Yes " No

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

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

Large Accelerated Filer "

Non-Accelerated Filer "

(Do not check if smaller reporting company)

Accelerated Filer "

Smaller Reporting Company x

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

The number of shares of common stock, \$0.001 par value, outstanding as of February 10, 2016 was 63,644,291

**SCIO DIAMOND TECHNOLOGY CORPORATION**

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### Special Note Regarding Forward-Looking Statements

Information included in this Quarterly Report on Form 10-Q contains forward-looking statements that reflect the views of the management of the Company with respect to certain future events. Forward-looking statements made by penny stock issuers such as the Company are excluded from the safe harbor in Section 21E of the Securities Exchange Act of 1934 (the "Exchange Act"). Words such as "expects," "should," "may," "will," "believes," "anticipates," "intends," "plans," "estimates" and similar expressions or variations of such words, and negatives thereof, are intended to identify forward-looking statements, but are not the exclusive means of identifying forward-looking statements in this report. These forward-looking statements are based on assumptions that may be incorrect, and there can be no assurance that matters anticipated in our forward-looking statements will come to pass.

Forward-looking statements are subject to certain risks and uncertainties which could cause actual results to differ materially from those anticipated. Such risks and uncertainties include, without limitation, those described under Risk Factors set forth in Part I, Item 1A of our Form 10-K for the fiscal year ended March 31, 2015 filed on June 29, 2015.

You are cautioned not to place undue reliance on forward-looking statements. You are also urged to review and consider carefully the various disclosures made in the Company's other filings with the Securities and Exchange Commission ("SEC"), including amendments to those filings, if any. Except as may be required by applicable laws, the Company undertakes no obligation to update publicly any forward-looking statements for any reason, even if new information becomes available or other events occur in the future.

**PART I - FINANCIAL INFORMATION****ITEM 1. UNAUDITED CONDENSED FINANCIAL STATEMENTS****SCIO DIAMOND TECHNOLOGY CORPORATION****CONDENSED BALANCE SHEETS****As of December 31, 2015 and March 31, 2015**

	December 31, 2015 (Unaudited)	March 31, 2015
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 104,184	\$ 767,214
Accounts receivable	245,098	243,929
Deferred contract costs	178,066	179,969
Inventory, net	164,547	295,760
Prepaid expenses	35,593	57,012
Prepaid rent	23,050	23,050
 Total current assets	 750,538	 1,566,934
 Property, plant and equipment		
Facility	904,813	904,813
Manufacturing equipment	3,412,777	2,927,761
Other equipment	75,924	71,059
Construction in progress	11,106	207,252
Total property, plant and equipment	4,404,620	4,110,885
Less accumulated depreciation	(2,002,705 )	(1,543,652 )
Net property, plant and equipment	2,401,915	2,567,233
 Intangible assets, net	 7,466,818	 8,047,948
Prepaid rent, noncurrent	1,950	19,238
Investment in joint venture – RCDC	89,409	30,041
 <b>TOTAL ASSETS</b>	 <b>\$ 10,710,630</b>	 <b>\$ 12,231,394</b>
 <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current Liabilities:		
Accounts payable	\$ 566,226	\$ 708,760
Customer deposits	9,864	38,603
Deferred revenue	215,480	215,375

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Accrued expenses	252,001	517,942
Current portion of notes payable	64,182	—
Current portion of capital lease obligations	167,614	—
<b>Total current liabilities</b>	<b>1,275,367</b>	<b>1,480,680</b>
Notes payable	2,227,551	2,500,000
Capital lease obligation, non-current	26,875	—
Other liabilities	95,950	118,092
<b>TOTAL LIABILITIES</b>	<b>3,625,743</b>	<b>4,098,772</b>
Common stock \$0.001 par value, 75,000,000 shares authorized; 63,644,291 and 56,531,499 shares issued and outstanding at December 31, 2015 and March 31, 2015, respectively	63,645	56,532
Additional paid-in capital	28,708,921	26,815,005
Accumulated deficit	(21,687,679 )	(18,738,915)
<b>Total shareholders' equity</b>	<b>7,084,887</b>	<b>8,132,622</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ 10,710,630</b>	<b>\$ 12,231,394</b>

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

## SCIO DIAMOND TECHNOLOGY CORPORATION

## CONDENSED STATEMENTS OF OPERATIONS

For the Three and Nine Months ended December 31, 2015 and 2014

(Unaudited)

	Three Months Ended December 31, 2015	Three Months Ended December 31, 2014	Nine Months Ended December 31, 2015	Nine Months Ended December 31, 2014
Revenue				
Product revenue, net	\$ 125,677	\$ 109,358	\$ 534,144	\$ 292,672
Licensing revenue	—	—	—	375,000
Revenue, net	125,677	109,358	534,144	667,672
Cost of goods sold				
Cost of goods sold	689,572	495,410	1,566,218	1,277,178
Gross deficit	(563,895 )	(386,052 )	(1,032,074 )	(609,506 )
General and administrative expenses				
Salaries and benefits	263,176	127,668	720,867	688,368
Professional and consulting fees	99,201	142,699	195,266	309,695
Rent, equipment lease and facilities expense	39,145	36,772	119,119	108,803
Marketing costs	18,292	13,198	74,938	32,065
Corporate general and administrative	72,678	100,334	304,856	282,593
Depreciation and amortization	198,621	199,931	595,503	600,179
Forgiveness of severance/legal liabilities	—	(165,453 )	(137,561 )	(165,453 )
Loss on impairment of in-process research and development	—	418,065	—	418,065
Loss from operations	(1,255,008 )	(1,259,266 )	(2,905,062 )	(2,883,821 )
Other expense				
Income from joint venture - RCDC	24,667	—	59,368	—
Interest expense	(31,740 )	(60,025 )	(103,070 )	(192,190 )
Net loss	\$ (1,262,081 )	\$ (1,319,291 )	\$ (2,948,764 )	\$ (3,076,011 )
Loss per share				



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Basic:

Weighted average number of shares outstanding	61,759,291	53,701,988	58,901,542	51,705,910
Loss per share	\$ (0.02	) \$ (0.02	) \$ (0.05	) \$ (0.06 )
Fully diluted:				
Weighted average number of shares outstanding	61,759,291	53,701,988	58,901,542	51,705,910
Loss per share	\$ (0.02	) \$ (0.02	) \$ (0.05	) \$ (0.06 )

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

**SCIO DIAMOND TECHNOLOGY CORPORATION**  
**CONDENSED STATEMENTS OF CASH FLOW**  
**For the Nine Months Ended December 31, 2015 and 2014**

(Unaudited)

	Nine Months Ended December 31, 2015	Nine Months Ended December 31, 2014
Cash flows from operating activities:		
Net loss	\$ (2,948,764	) \$ (3,076,011
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,046,032	1,111,209
Loss on impairment of in-process research and development	—	418,065
Expense for stock and inventory issued in exchange for services	—	34,200
Employee stock-based compensation	324,791	155,000
Income from joint venture – RCDC	(59,368	) —
Inventory write down	—	68,722
Changes in assets and liabilities:		
Decrease/(increase) in accounts receivable and deferred revenue	(1,064	) 10,866
Decrease in other receivables	—	89,192
Decrease/(increase) in prepaid expenses, rent, and deferred contract costs	34,760	(68,625
Decrease/(increase) in inventory and other assets	131,213	(131,107
Decrease in accounts payable	(153,641	) (104,441
Decrease in customer deposits	(28,739	) (127,459
Increase/(decrease) in accrued expenses	(265,941	) 76,866
Increase/(decrease) in other liabilities	(22,142	) 25,461
Net cash used in operating activities	(1,942,863	) (1,518,062
Cash flows from investing activities:		
Purchase of property, plant and equipment	(282,627	) (26,007
Investment in joint venture - RCDC	—	(1,000
Net cash used in investing activities	(282,627	) (27,007
Cash flows from financing activities:		
Proceeds from note payable	—	2,153,615
Proceeds from the exercise of stock options	11,238	—
Proceeds from sale of common stock	1,565,000	2,000,000
Payments on capital lease obligations	(5,511	) —
Payments on notes payable	(8,267	) (1,565,675
Net cash provided by financing activities	1,562,460	2,587,940

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Change in cash and cash equivalents	(663,030	)	1,042,871
Cash and cash equivalents, beginning of period	767,214		47,987
Cash and cash equivalents, end of period	\$ 104,184		\$ 1,090,858

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

(continued)

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**SCIO DIAMOND TECHNOLOGY CORPORATION**  
**CONDENSED STATEMENTS OF CASH FLOW**  
**For the Nine Months Ended December 31, 2015 and 2014 (Unaudited)**  
**(Continued)**

	Nine Months Ended December 31, 2015	Nine Months Ended December 31, 2014
Supplemental cash flow disclosures:		
Cash paid for:		
Interest, includes capitalized interest of \$19,031 and \$0	\$ 102,890	\$ 48,000
Income taxes	\$ —	\$ —
Non-cash investing and financing activities:		
Payment of accrued expenses with stock	\$ —	\$ 55,657
Purchase of property, plant and equipment in accounts payable	\$ 11,107	\$ —
Re-classification of debt to capital lease due to completion of sale leaseback transaction	\$ 200,000	\$ —

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

**SCIO DIAMOND TECHNOLOGY CORPORATION**  
**CONDENSED STATEMENTS OF SHAREHOLDERS' EQUITY**  
**For the Nine Months Ended December 31, 2015**

**(Unaudited)**

	Common Stock Shares	Amount	Additional Paid in Capital	Accumulated Deficit	Total
Balance, April 1, 2015	56,531,499	\$56,532	\$26,815,005	\$(18,738,915)	\$8,132,622
Common stock issued for cash @ \$0.30 per share	5,216,667	5,217	1,559,783	—	1,565,000
Common stock issued upon exercise of stock options	11,125	11	11,227	—	11,238
Issuance of restricted stock to employees	1,335,000	—	—	—	—
Issuance of restricted stock to Renaissance Diamond Inc.	750,000	—	—	—	—
Cancellation of non-vested restricted stock	(200,000 )	—	—	—	—
Stock-based incentive compensation	—	1,885	322,906	—	324,791
Net loss for the nine months ended December 31, 2015	—	—	—	(2,948,764 )	(2,948,764)
Balance, December 31, 2015	63,644,291	\$63,645	\$28,708,921	\$(21,687,679)	\$7,084,887

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

NOTE 1 — ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

*Organization and Business*

Scio Diamond Technology Corporation (referred to herein as the “Company”, “we”, “us” or “our”) was incorporated under the laws of the State of Nevada as Krossbow Holding Corp. on September 17, 2009. The Company’s focus is on man-made diamond technology development and commercialization.

*Going Concern*

The Company has generated little revenue to date and consequently its operations are subject to all risks inherent in the establishment and commercial launch of a new business enterprise. . The Company continues to develop its diamond technology while operating its factory to maximize revenue. The Company experienced a process water leak in our facility in mid-December 2015 causing damage to our diamond growers and a temporary interruption in production. The factory was operating again within a number of days, and is currently operating in excess of 80% of capacity. The delay in resuming full production capacity is due to the lead time on the ordering of certain parts, and full operations may not resume until the end of February 2016. The shutdown had a significant negative impact on revenue for December 2015 and January 2016 and delays the Company’s attainment of its near-term business objectives. The Company is working with its insurance carrier to cover the expense related to the production shutdown and the cost of the business interruption.

These factors raise substantial doubt about the Company’s ability to continue as a going concern. Management has responded to these circumstances by implementing to following strategies and actions:

- Initiated efforts with insurance carrier to cover expense related to production shutdown, lost inventory and cost of the business interruption;
- Continuing efforts to solicit investment in the Company in the form of private placements of common shares to accredited investors not to exceed the shares authorized;
- Continuing efforts to solicit investment in the Company in the form of secured and unsecured debt;
- Recently expanded and continue to optimize production of existing manufacturing capabilities to increase product revenues;
- Continuing to focus efforts on new business development opportunities to generate revenues and expand and diversify the customer base;
- Continuing development of white gemstone material to expand our product offerings and enhance our product marketability; and

Continuing to explore strategic joint ventures and technology licensing agreements to expand Company revenue and cash flow.

Historically, these actions have been sufficient to provide the Company with the liquidity it needs to meet its obligations and continue as a going concern. There can be no assurance, however, that the Company will successfully implement these plans on a going forward basis. If necessary, the Company will pursue further issuances of equity securities, and future credit facilities or corporate borrowings. Additional issuances of equity or convertible debt securities will result in dilution to our current stockholders. The financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

#### *Accounting Basis*

The accompanying unaudited financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations.

In the opinion of management, the accompanying unaudited financial statements contain all adjustments (consisting only of normal recurring accruals) necessary to present fairly the Company's financial position as of December 31, 2015 and March 31, 2015 and the results of operations and cash flows for the three and nine month interim periods ended December 31, 2015 and 2014. The interim amounts have not been audited, and the results of operations for the interim periods herein are not necessarily indicative of the results of operations to be expected for future periods or the year. The balance sheet at March 31, 2015 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements. These financial statements should be read in conjunction with the Company's audited financial statements and notes thereto included in the Form 10-K Annual Report of the Company for the year ended March 31, 2015.

In accordance with Accounting Standards Codification ("ASC") 323, Investments—Equity Method and Joint Ventures, the Company uses the equity method of accounting for investments in corporate joint ventures for which the Company has the ability to exercise significant influence but does not control and is not the primary beneficiary. Significant influence typically exists if the Company has a 20% to 50% ownership interest in the venture unless predominant evidence to the contrary exists. Under this method of accounting, the Company records its proportionate share of the net earnings or losses of equity method investees and a corresponding increase or decrease to the investment balances. Cash payments to equity method investees such as additional investments, loans and advances and expenses incurred on behalf of investees, as well as payments from equity method investees such as dividends, distributions and repayments of loans and advances are recorded as adjustments to investment balances. When the Company's carrying value in an equity method investee is reduced to zero, no further losses are recorded in the Company's financial statements unless the Company guaranteed obligations of the equity method investee or has committed additional funding. When the equity method investee subsequently reports income, the Company will not record its share of such income until it equals the amount of its share of losses not previously recognized. The Company evaluates its equity method investments for impairment whenever events or changes in circumstances indicate that the carrying amounts of such investments may not be recoverable.

#### *Basic and Diluted Net Loss per Share*

Net loss per share is presented under two formats: basic net loss per common share, which is computed using the weighted average number of common shares outstanding excluding non-vested restricted stock, during the period, and diluted net loss per common share, which is computed using the weighted average number of common shares outstanding, and the weighted average dilutive potential common shares outstanding, computed using the treasury stock method. Currently, for all periods presented, diluted net loss per share is the same as basic net loss per share as the inclusion of weighted average shares of non-vested restricted stock and common stock issuable upon the exercise of options and warrants would be anti-dilutive.

The following table summarizes the number of securities outstanding at each of the periods presented, which were not included in the calculation of diluted net loss per share as their inclusion would be anti-dilutive:



	December 31,	
	2015	2014
Common stock options	1,027,708	232,500
Warrants to purchase common stock	675,545	5,566,795
Non-vested restricted stock	1,885,000	—

*Allowance for Doubtful Accounts*

An allowance for uncollectible accounts receivable is maintained for estimated losses from customers' failure to make payment on accounts receivable due to the Company. Management determines the estimate of the allowance for uncollectible accounts receivable by considering a number of factors, including: (1) historical experience, (2) aging of accounts receivable and (3) specific information obtained by the Company on the financial condition and the current credit worthiness of its customers. The Company has determined that an allowance was not necessary at December 31, 2015 or March 31, 2015.

*Inventories*

Inventories are stated at the lower of average cost or market. The carrying value of inventory is reviewed and adjusted based upon slow moving, obsolete items and management's assessment of current market conditions. Inventory costs include material, labor, and manufacturing overhead including depreciation and are determined by the "first-in, first-out" (FIFO) method. The components of inventories are as follows:

	December 31, 2015	March 31, 2015
Raw materials and supplies	\$ 16,615	\$ 58,390
Work in process	18,084	31,371
Finished goods	138,232	205,999
Inventory reserve	(8,384 )	—
	\$ 164,547	\$ 295,760

At December 31, 2015, the Company maintains an inventory reserve for instances where finished good inventory may yield lower than expected results. During the nine months ended December 31, 2014, we experienced selling prices lower than cost and as a result we recorded a lower of cost or market write down of \$68,722 to the value of our inventory which was included in cost of goods sold. The estimation of the total write-down involved management judgments and assumptions including assumptions regarding future selling price forecasts, the estimated costs to complete, disposal costs and a normal profit margin.

*Property, Plant and Equipment*

Depreciation of property, plant and equipment is on a straight line basis beginning at the time it is placed in service, based on the following estimated useful lives:

	Years
Machinery and equipment	3 to 15
Furniture and fixtures	3 to 10
Engineering equipment	5 to 12

Leasehold improvements which are included in facility fixed assets on the balance sheet are depreciated over the lesser of the remaining term of the lease or the life of the asset (generally three to seven years).

Expenditures for major renewals and betterments that extend the useful lives of property and equipment are capitalized. Expenditures for maintenance and repairs are charged to expense as incurred.

#### *Intangible Assets*

Acquired in-process research and development costs are considered to have an indefinite useful life until such time as they are put into service at which time they will be amortized on a straight-line basis over the shorter of their economic or legal useful life. Management evaluates indefinite life intangible assets for impairment on an annual basis and on an interim basis if events or changes in circumstances between annual impairment tests indicate that the asset might be impaired. The ongoing evaluation for impairment of its indefinite life intangible assets requires significant management estimates and judgment. Management reviews definite life intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. There were no impairment charges during the three and nine months ended December 31, 2015. During the three months ended December 31, 2014, management evaluated assets included in IPRD and determined that certain projects would no longer be pursued for further development resulting in an impairment charge of \$418,065 being recognized during the three and nine months ended December 31, 2014.

#### *Stock-based Compensation*

Stock-based compensation expense for the value of stock options is estimated on the date of the grant using the Black-Scholes option-pricing model. The Black-Scholes model takes into account implied volatility in the price of the Company's stock, the risk-free interest rate, the estimated life of the equity-based award, the closing market price of the Company's stock on the grant date and the exercise price. The estimates utilized in the Black-Scholes calculation involve inherent uncertainties and the application of management judgment.

*Concentration of Credit Risk/Revenue Concentrations*

During the three and nine months ended December 31, 2015, the Company sold a significant amount of its production to the RCDC joint venture and had a receivable from RCDC at December 31, 2015 of \$215,613. The Company expects this concentration of sales to RCDC to continue in the future.

*Revenue Recognition*

We recognize product revenue when persuasive evidence of an arrangement exists, delivery of products has occurred, the sales price is fixed or determinable, and collectability is reasonably assured. For our Company, this generally means that we recognize revenue when we or our fabrication vendor has shipped finished product to the customer. Our sales terms do not allow for a right of return except for matters related to any manufacturing defects on our part. The Company has an allowance for returns of \$22,050 at December 31, 2015. This allowance has reduced reported revenues and is considered an accrued expense in the balance sheet.

For product sales to our joint venture partners for further processing and finishing, we currently defer all revenues when products are shipped. We currently recognize revenue at the earlier of when the joint venture partner sells the finished goods manufactured from our materials or we are paid for our goods. Licensing and development revenues are recognized in the month as detailed in appropriate licensing and development contracts. In the event that licensing funds are received prior to the contractual commitment, the Company will recognize deferred revenue (liability) for the amount received.

*Recent Accounting Pronouncements*

On May 28, 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. The guidance supersedes the revenue recognition guidance in Topic 605, "Revenue Recognition", and most industry-specific guidance throughout the Industry Topics of the Codification. The guidance also supersedes some cost guidance included in Subtopic 605-35, "Revenue Recognition- Contract-Type and Production-Type Contracts". On July 9, 2015, the FASB voted to defer the effective date of the pronouncement by one year. ASU 2014-9, as amended, is effective for annual periods, and interim periods within those years, beginning after December 31, 2017. An entity is required to apply the amendments using one of the following two methods: i) retrospectively to each prior period presented with three possible expedients: a) for completed contracts that begin and end in the same reporting period no restatement is required, b) for completed contract with variable consideration an entity may use the transaction

price at completion rather than restating estimated variable consideration amounts in comparable reporting periods and c) for comparable reporting periods before date of initial application reduced disclosure requirements related to transaction price; ii) retrospectively with the cumulative effect of initially applying the amendment recognized at the date of initial application with additional disclosures for the differences of the prior guidance to the reporting periods compared to the new guidance and an explanation of the reasons for significant changes. We are required to adopt ASU 2014-09, as amended, in the first quarter of fiscal 2019, and we are currently assessing the impact of this pronouncement on our financial statements.

In August 2014, the FASB issued ASU No. 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern, which requires management to assess, at each annual and interim reporting period, the entity's ability to continue as a going concern within one year after the date that the financial statements are issued and provide related disclosures. The ASU is effective for our fiscal year ending March 31, 2017, with early adoption permitted. The Company is in the process of assessing the impact of this standard on our financial statements or disclosures.

In July 2015, the FASB issued ASU No. 2015-11, Simplifying the Measurement of Inventory, ("ASU 2015-11"). This new guidance requires an entity to measure inventory at the lower of cost and net realizable value. Currently, entities measure inventory at the lower of cost and market. ASU 2015-11 replaces market with net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory measured under last-in, first-out or the retail inventory method. ASU 2015-11 requires prospective adoption for inventory measurements for fiscal years beginning after December 15, 2016, and interim periods within those years for public business entities. Early application is permitted. ASU 2015-11 is therefore effective in our fiscal year beginning April 1, 2017. We are evaluating the effect that ASU 2015-11 will have on our financial statements and related disclosures.

There are currently no other accounting standards that have been issued but not yet adopted by the Company that will have a significant impact on the Company's financial position, results of operations or cash flows upon adoption.

NOTE 2 — INTANGIBLE ASSETS

Acquired in-process research and development costs are considered to have an indefinite useful life until such time as they are put into service at which time they will be amortized on a straight-line basis over the shorter of their economic or legal useful life.

Intangible assets consist of the following:

	Life	December 31, 2015	March 31, 2015
Patents, gross	6.75 – 19.46	\$ 8,135,063	\$ 8,135,063
In-process research and development	Indefinite	1,832,370	1,832,370
		9,967,433	9,967,433
Accumulated amortization		(2,500,615 )	(1,919,485)
Net intangible assets		\$ 7,466,818	\$ 8,047,948

Total amortization expense for the three and nine months ending December 31, 2015 was \$193,710 and \$581,130, respectively. The amortization expense for the three and nine months ended December 31, 2014 was \$193,710 and \$581,258, respectively.

Total annual amortization expense of finite lived intangible assets is estimated to be as follows:

Fiscal Year Ending	
Three months ending March 31, 2016	\$ 193,710
March 31, 2017	774,840
March 31, 2018	774,840
March 31, 2019	774,840
March 31, 2020	595,159
Thereafter	\$ 2,521,059

## NOTE 3 — NOTES PAYABLE

On December 16, 2014 the Company entered into a Loan Agreement (the “HGI Loan Agreement”) and a Security Agreement (the “HGI Security Agreement”) with Heritage Gemstone Investors, LLC (“HGI”) providing for a \$2,000,000 secured non-revolving line of credit (the “HGI Loan”). The HGI Loan, which is represented by a Promissory Note dated as of December 15, 2014 (the “HGI Note”), matures on December 15, 2017. Borrowings accrue interest at the rate of 7.25% per annum and the Company intends to make monthly interest payments. On December 18, 2014, \$2,000,000 was drawn on the HGI Loan. The Company utilized funds drawn on the HGI Loan to repay its existing indebtedness and to continue to fund its ongoing operations. The HGI Loan Agreement contains a number of restrictions on the Company’s business, including restrictions on its ability to merge, sell assets, create or incur liens on assets, make distributions to its stockholders and sell, purchase or lease real or personal property or other assets or equipment. The HGI Loan Agreement contains standard provisions relating to a default and acceleration of the Company’s payment obligations thereunder upon the occurrence of an event of default, which includes, among other things, the failure to pay principal, interest, fees or other amounts payable under the agreement when due; failure to comply with specified agreements, covenants or obligations; cross-default with other indebtedness; the making of any material false representation or warranty; commencement of bankruptcy or other insolvency proceedings by or against the Company; and failure by the Company to maintain a book net worth of at least \$4,000,000 at all times. The Company’s obligations under the HGI Loan Agreement are not guaranteed by any other party. The Company may prepay borrowings without premium or penalty upon notice to HGI as provided in the HGI Loan Agreement. The HGI Loan Agreement requires the Company to enter into the HGI Security Agreement. Under the HGI Security Agreement, the Company grants HGI a first priority security interest in the Company’s inventory, equipment, accounts and other rights to payments and intangibles as security for the HGI Loan.

Also on December 16, 2014, the Company entered into an agreement for the sale and lease of diamond growing equipment (the "Grower Sale-Lease Agreement") with HGI to allow for the expansion of current growers and the purchase of new growers. Pursuant to the Grower Sale-Lease Agreement, the Company agreed to a sale-leaseback arrangement for certain diamond growers produced by the Company during the term of the Grower Sale-Leaseback Agreement by which the Company will sell diamond growers to HGI and then lease the growers back from HGI. The term of the Grower Sale-Leaseback Agreement is ten years. For the new and upgraded growers, the direct profit margin generated from the growers as defined in the Grower Sale-Lease Agreement will be split between the Company and HGI in accordance with the Grower Sale-Lease Agreement. The Grower Sale-Lease Agreement requires the Company to operate and service the growers, and requires HGI to up-fit certain existing growers and to make capital improvements to the new growers under certain circumstances. At the end of the Grower Sale-Leaseback Agreement, the Company takes ownership of the leased equipment. The Company will also have the right to repurchase the leased growers upon the occurrence of certain events prior to the expiration of the Grower Sale-Leaseback Agreement.

As of December 31, 2015, HGI has advanced the Company \$300,000 that funded improvements to our current growers that expanded manufacturing capacity in our production facility and the Company considers this advance as notes payable. The Company has completed the grower expansion and the assets have been placed in service.

Payments to HGI for the portion of notes payable that funded capital improvements are contingent on the direct profit margin generated by the upgraded equipment and are expected to continue for three years. The Company has estimated our expected payments to HGI for the direct profit sharing related to these borrowings and determined that the current portion of this note payable is \$64,182 at December 31, 2015, which is considered a current liability. During the three and nine months ended December 31, 2015, the Company paid \$8,267 in principal on the HGI notes payable and \$3,734 in interest.

#### NOTE 4 – CAPITAL LEASES

As discussed in Note 3, the Company entered in the Grower Sale-Lease Agreement with HGI on December 16, 2014. HGI has advanced the Company \$200,000 for the purchase of new grower equipment under the Sale-Leaseback Agreement. The Company considered this advance as a notes payable at March 31, 2015. The sale and leaseback transaction occurred during the nine months ended December 31, 2015, and the Company has put the assets into service. Since the sale and leaseback has occurred, the Company has reclassified the \$200,000 from notes payable to capital lease obligations. The value of the assets sold and leased back was \$200,000 and the Company did not recognize any gain or loss on the sale and lease back transaction.

Payments to HGI under the capital lease are contingent on the direct profit margin generated by the equipment as defined in the Grower Sale-Lease Agreement and will continue until the lease obligation is satisfied. The Company



has estimated our expected payments to HGI for the direct profit margin sharing related to the equipment under capital lease and determined that the current portion of this capital lease obligation is \$167,614 at December 31, 2015, which is considered a current liability. During the three and nine months ended December 31, 2015, the Company paid \$5,511 in capital lease obligation and \$2,490 in interest.

NOTE 5 — CAPITAL STOCK

The authorized capital of the Company is 75,000,000 common shares with a par value of \$ 0.001 per share.

During the nine months ended December 31, 2015, the Company sold and issued 5,216,667 shares of common stock at a price of \$0.30 to accredited investors. The Company raised \$1,565,000 in this offering and did not incur any material expenses related to the offering.

The Company had 63,644,291 shares of common stock issued and outstanding as of December 31, 2015, which includes 1,885,000 shares of non-vested restricted stock.

The Company had 675,545 warrants outstanding with a weighted average exercise price of \$0.94 per share as of December 31, 2015. During the nine months ended December 31, 2015, 4,891,250 warrants expired and none were issued. The balance of the warrants will expire in 2017 and 2018, unless they are exercised by the warrant holders.

#### NOTE 6 — SHARE-BASED COMPENSATION

The Company currently has one equity-based compensation plan under which stock-based compensation awards can be granted to directors, officers, employees and consultants providing bona fide services to or for the Company. The Company's 2012 Share Incentive Plan was adopted on May 7, 2012 (the "2012 Share Incentive Plan" or "Plan") and allows the Company to issue up to 5,000,000 shares of its common stock pursuant to awards granted under the 2012 Share Incentive Plan. The Plan permits the granting of stock options, stock appreciation rights, restricted or unrestricted stock awards, phantom stock, performance awards, other stock-based awards, or any combination of the foregoing. The only awards that have been issued under the Plan are stock options and restricted stock. Because the Plan has not been approved by our shareholders, all such stock option awards are non-qualified stock options.

On May 7, 2015, the Board of Directors of the Company approved restricted stock awards for Mr. Gerald McGuire, the Company President and Chief Executive Officer and Mr. Jonathan Pfohl, the Company Chief Financial Officer. Messrs. McGuire and Pfohl were granted 400,000 and 385,000 restricted shares of stock, respectively, that will vest on July 1, 2018. The restricted shares are valued at \$1.03, the closing price of the Company's stock on May 7, 2015. Also on May 7, 2015, the Board of Directors granted Renaissance Diamond Inc. a restricted stock award of 200,000 shares that have subsequently been cancelled.

On July 1, 2015, the Renaissance Diamond Inc. was granted restricted stock awards for 550,000 shares that only vest based on the attainment of specific future performance criteria.

On August 14, 2015, the Board of Directors of the Company approved restricted stock awards for Mr. McGuire and Mr. Pfohl. Messrs. McGuire and Pfohl were granted 400,000 and 150,000 restricted shares of stock, respectively, that will vest on July 1, 2018. The restricted shares are valued at \$0.85, the closing price of the Company's stock on August 14, 2015.

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The Company recognizes compensation expense for the restricted stock awards to Company executives on a straight line basis over the vesting period. The Company recognized \$103,904 and \$237,007 in compensation expenses for these awards during the three months and nine months ended December 31, 2015, respectively. For the restricted stock awards to Renaissance Diamond, Inc., the Company does not anticipate recognizing any financial impact for these restricted stock awards until it is deemed likely that the performance criteria will be met.

The following sets forth the restricted stock outstanding as of December 31, 2015:

Restricted Stock	Shares
Restricted stock outstanding March 31, 2015	—
Granted	2,085,000
Vested	—
Expired/cancelled	(200,000 )
Restricted stock outstanding December 31, 2015	1,885,000

On May 7, 2015, the Board of Directors granted Renaissance Diamond Inc. non-qualified stock options for 333,333 shares of common stock. These options will vest on June 29, 2016 if the RCDC joint venture attains specific performance criteria. The strike price of these options will be set at fifty percent of the market closing price upon vesting. The options will need to be exercised within 60 days of vesting. The Company does not anticipate recognizing any financial impact for these options until it is deemed likely that the performance criteria will be met.

In addition, on May 7, 2015, the Company granted seven non-executive employees options to purchase a total of 685,000 shares of the Company's stock. The vesting schedule for these options call for 33.3% to vest upon the first, second and third anniversaries of the grant date. The exercise price of \$1.03 per share is equal to the closing price of a share of the Company's common stock on the date of grant. Using the Black-Scholes option pricing model, management has estimated these options had a value of \$0.98 per option on the date of the grant. The Black-Scholes model assumptions used were: Expected dividend yield, 0.00%; Risk-free interest rate, 2.18%; Expected life in years, 10.0; Expected volatility, 124.3%; Forfeiture rate, 25.0%. None of these options were vested upon issuance and the Company recognized \$32,919 and \$87,784 in compensation costs for these options during the three and nine months ending December 31, 2015, respectively.

The following sets forth the employee options to purchase shares of the Company's stock issued and outstanding as of December 31, 2015 and does not include options granted to Renaissance Diamond Inc.:

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term
Employee options outstanding March 31, 2015	232,500	\$ 0.35	1.45
Granted	685,000	1.03	9.36
Exercised	(11,125 )	0.51	—
Expired/cancelled	(212,000)	0.83	—
Employee options outstanding December 31, 2015	694,375	\$ 0.87	7.38
Exercisable at December 31, 2015	12,000	\$ 0.33	0.73

A summary of the status of non-vested employee options as of December 31, 2015 and changes during the nine months ended December 31, 2015 is presented below.

Non-vested Shares	Shares	Weighted Average Grant-Date Fair Value
Non-vested at March 31, 2015	209,375	0.21
Granted	685,000	0.98
Vested	—	—
Expired/cancelled: non-vested	(212,000)	0.76
Non-vested at December 31, 2015	682,375	\$ 0.81

The following table summarizes information about employee stock options outstanding by price range as of December 31, 2015:

Exercise Price	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
\$ 1.03	535,000	9.36	\$ 1.03	—	\$ —
\$ 0.33	159,375	0.73	0.33	12,000	0.33
	694,375	7.38	\$ 0.87	12,000	\$ 0.33

At December 31, 2015, unrecognized compensation costs related to non-vested employee awards was \$467,465. Of this unrecognized compensation cost, \$30,949 is only expected to be recognized if certain performance criteria are attained over a weighted average period of 0.73 years.

#### NOTE 7 — RELATED PARTIES

On August 7, 2015, the Company reached an amendment to the separation, waiver and release agreement executed on December 4, 2012 with our former Chief Executive Officer Mr. Joseph Lancia. This amendment allowed for no further severance payments to Mr. Lancia and resulted in the Company reversing \$137,561 in previously accrued severance liabilities. The Company included this adjustment as a forgiveness of severance liability in the statement of operations for the nine months ended December 31, 2015.

During the three and nine months ended December 31, 2015, the Company sold product to the RCDC joint venture valued at \$0 and \$184,000, respectively. The Company defers recognition of revenues and expenses on these sales to RCDC until finished goods are sold by RCDC or RCDC pays the Company for its purchases. For the three and nine months ended December 31, 2015, the Company recognized \$0 and \$183,895 in revenue for product sold to RCDC. As of December 31, 2015, the Company has deferred \$215,480 of revenue and \$178,066 of expenses related to our sales to RCDC. In addition, at December 31, 2015, the Company had a receivable from RCDC of \$215,613. Additional detail on the RCDC joint venture is provided in Note 9.

The Company has granted Renaissance Diamond Inc., our partner in the RCDC joint venture, restricted stock awards totaling 750,000 shares that only vests based on the attainment of specific performance criteria. Since 200,000 of the restricted shares have been cancelled, there were 550,000 non-vested restricted shares were held by Renaissance Diamond Inc. at December 31, 2015.

#### NOTE 8 – LITIGATION

We are subject, from time to time, to various claims, lawsuits or actions that arise in the ordinary course of business. As of December 31, 2015 there were no material outstanding claims by the Company or against the Company.

On May 16, 2014, the Company received a subpoena issued by the SEC ordering the provision of documents and related information concerning various corporate transactions between the Company and its predecessors and other persons and entities. The Company continues to cooperate with this inquiry.

#### NOTE 9 — INVESTMENT IN RCDC JOINT VENTURE

On December 18, 2014 the Company entered into an arrangement with Renaissance Diamonds, Inc. (“Renaissance”) through the execution of a limited liability company agreement (the “LLC Agreement”) of Renaissance Created Diamond Company, LLC, a Florida limited liability company (“RCDC”), pursuant to which the Company and Renaissance are each 50% members of RCDC.

The LLC Agreement provides that RCDC is a manager-managed limited liability company, and each of the Company and Renaissance will appoint one manager, with both such managers appointing a third manager. The managers will manage the day-to-day operations of RCDC, subject to certain customary limitations on managerial actions that require the consent of the Company and Renaissance, including but not limited to making or guaranteeing loans,

distributing cash or other property to the members of RCDC, entering into affiliate transactions, amending or modifying limited liability company organizational documents, and entering into major corporate events, such as a merger, acquisition or asset sale. The arrangement was entered into in order to facilitate the development of procedures and recipes for, and to market and sell, lab-grown fancy-colored diamonds. Pursuant to the LLC Agreement, the arrangement will last three years, unless terminated earlier, with the option to automatically renew for additional two-year periods. The Company made an initial \$1,000 investment in RCDC and was granted a 50% equity stake. RCDC has the right of first refusal to purchase diamond gemstones from the Company, including rough diamond preforms or processed stones. RCDC purchases rough diamond material produced by the Company finishes the rough gemstones and, in turn, sells the finished stones to various retailers and other participants in the market for gemstones. Profits generated by RCDC's operations will be distributed between the Company and Renaissance according to the terms of the LLC Agreement.

Through December 31, 2015 the operations of RCDC have been focused on the development and processing of diamond material into finished gemstone material and establishing sales and distribution channels for the finished goods. During the three and nine months ended December 31, 2015, the Company sold product to RCDC valued at \$0 and \$184,000, respectively. The Company defers recognition of revenues and expenses on these sales to RCDC until finished goods are sold by RCDC or RCDC pays the Company for its purchases. For the three and nine months ended December 31, 2015, the Company recognized \$0 and \$183,895 in revenue for product sold to RCDC. As of December 31, 2015, the Company has deferred \$215,480 of revenue and \$178,066 of expenses related to our sales to RCDC. The Company anticipates recognizing this deferred revenue and expense at the earlier date of RCDC selling through its inventory or the Company collects its receivables from RCDC.

The Company utilizes the equity method of accounting for its investment in RCDC. As such, the Company recognized \$24,667 and \$59,368 as its proportional shares of RCDC's net income during the three and nine months ended December 31, 2015, respectively, as other income.

Rollforward of the Company's ownership interest in the joint venture for the nine months ended December 31, 2015:

Balance of ownership interest in joint venture at March 31, 2015	\$	30,041
Aggregate fiscal 2016 equity gain – share of joint venture income		59,368
Balance of ownership interest in joint venture at December 31, 2015	\$	89,409
Cumulative recognized income on ownership interest in joint venture at December 31, 2015	\$	89,409

Selected financial results for RCDC for the nine months ended December 31, 2015 are as follows:

Revenues	\$499,222
Expenses	380,486
Net Income	\$118,736
Total Assets	\$615,821
Total Liabilities	\$437,002
Total Partners Capital	178,819
Total Liabilities and Partner Capital	\$615,821

***END NOTES TO FINANCIALS***



## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### **CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS**

Information included in this Quarterly Report Form 10-Q contains forward-looking statements that reflect the views of the management of the Company with respect to certain future events. Forward-looking statements made by penny stock issuers such as the Company are excluded from the safe harbor in Section 21E of the Securities Exchange Act of 1934. Words such as "expects," "should," "may," "will," "believes," "anticipates," "intends," "plans," "seeks," "estimates" and expressions or variations of such words, and negatives thereof, are intended to identify forward-looking statements, but are not the exclusive means of identifying forward-looking statements in this report. These forward-looking statements are based on assumptions that may be incorrect, and there can be no assurance that matters anticipated in our forward-looking statements will come to pass.

Forward-looking statements are subject to certain risks and uncertainties which could cause actual results to differ materially from those anticipated. Such risk and uncertainties include, without limitation, those described below under Item 1A - Risk Factors and the following: (1) the Company has limited cash resources and if it is not able to obtain further financing required for continuing operations, marketing, product development, and research its business operations will fail, (2) the Company has not generated substantial revenues, and as a result, faces a high risk of business failure, (3) the Company experienced a production shutdown in December 2015 that has limited recent production and revenue (4) the Company's lack of diversification and dependence on material customers increases the risks associated with the Company's business and an investment in the Company, and the Company's financial condition may deteriorate rapidly if it fails to succeed in developing the Company's business and expanding our customer base, (5) the Company may not effectively execute the Company's business plan or manage the Company's potential future business development, (6) the Company's business could be impaired if it fails to comply with applicable regulations, (7) the Company has had significant turnover in management and may not be able to attract and maintain key management personnel to manage the Company or laboratory scientists to carry out the Company's business operations, which could have a material adverse effect on the Company's business, (8) the market for lab-grown diamond may not develop as anticipated, (9) competition may adversely affect our business, (10) the Company may expend a substantial amount of time and resources in connection with the Securities and Exchange Commission's ("SEC") recent subpoena, potential inquiries or legal actions in connection with its filings with the SEC or otherwise, which may impair the Company's ability to raise capital and to operate its business, (11) the Company needs to raise additional capital and may only issues common shares up to the shares authorized under its articles of incorporation without shareholder approval, and (12) such other risks and uncertainties as have been disclosed or are hereafter disclosed from time to time in the Company's filings with the SEC, including, without limitations described under Risk Factors set forth in Part I, Item 1A of the Company's Form 10-K for the fiscal year ended March 31, 2015.

You are cautioned not to place undue reliance on forward-looking statements. You are also urged to review and consider carefully the various disclosures made in the Company's other filings with the Securities and Exchange

Commission, including any amendments to those filings. Except as may be required by applicable laws, the Company undertakes no obligation to update publicly any forward-looking statements for any reason, even if new information becomes available or other events occur in the future.

## **GENERAL**

We were incorporated on September 17, 2009 in the State of Nevada under the name Krossbow Holdings Corporation (“Krossbow”). Krossbow did not implement its original business plan and decided to acquire existing technology to seek to efficiently and effectively produce man-made diamond. In connection with this change in business purpose, Krossbow changed its name to Scio Diamond Technology Corporation to reflect its new business direction.

On August 5, 2011, Edward S. Adams and Michael R. Monahan acquired control of the Company through the purchase of shares of the Company's issued and outstanding common stock from Jason Kropp, Krossbow's sole director and executive officer at that time. Messrs. Monahan and Adams served on the Company's Board of Directors until their resignations from the Board on June 30, 2013, and June 23, 2014, respectively. Additionally, on August 5, 2011, the Company executed an Asset Purchase Agreement with another privately-held Nevada corporation that also had the name "Scio Diamond Technology Corporation" ("Private Scio"). Under the terms of the Asset Purchase Agreement, the Company purchased the name "Scio Diamond Technology Corporation" and acquired other rights from Private Scio for 13,000,000 newly issued shares of common stock of the Company.

On August 31, 2011, the Company acquired certain assets of ADI, consisting primarily of diamond growing machines and intellectual property related thereto, for which the Company paid ADI an aggregate of \$2,000,000. In connection with the ADI Asset Purchase, the Company also agreed to provide certain current and former stockholders of ADI qualifying as accredited investors, the opportunity to acquire up to approximately 16 million shares of common stock of the Company for \$0.01 per share.

On June 5, 2012, the Company acquired substantially all of the assets of ADGC, consisting primarily of lab-grown diamond gemstone-related know-how, inventory, and various intellectual property, in exchange for \$100,000 in cash and the opportunity for certain current and former stockholders of ADGC qualifying as accredited investors to acquire up to approximately 1 million shares of common stock of the Company for \$0.01 per share.

In December 2011, the Company began a build-out of its Greenville, South Carolina production facility. Construction was largely completed in March 2012 and equipment was moved from ADI's former facility in Massachusetts to South Carolina over the first calendar quarter of 2012. The Company began initial production with ten diamond growing machines in July 2012. Our initial production was focused on industrial cutting tool products supplied to a single customer. Since March 2013, the Company has expanded its product focus to include gemstone diamond material.

On September 16, 2013, the Company entered into the Grace Rich Agreements to form a joint venture with operations in the People's Republic of China to deploy at least 100 Scio designed diamond growing machines. Under the Grace Rich Agreements, the Company has agreed to license its proprietary technology for the manufacture of diamond gemstones of agreed upon specifications. In exchange for the license, the Company will receive licensing and development revenue and a 30% ownership position in the joint venture. In addition to the licensed technology, the Grace Rich Agreements include obligations for the Company to provide and be compensated for technology consulting services to the joint venture to support the start-up of operations. The Company is not required to make any on-going funding contributions to the joint venture and its ownership stake cannot be reduced from 30%.

On December 16, 2014, the Company entered into the Grower Sale-Lease Agreement with HGI. Pursuant to the Grower Sale-Lease Agreement, the Company agreed to a sale-leaseback arrangement for certain diamond growers

produced by the Company during the term of the Grower Sale-Leaseback Agreement by which the Company will sell diamond growers to HGI and then lease the growers back from HGI. The direct profit margin generated from the growers will be split between the Company and HGI in accordance with the Grower Sale-Lease Agreement. The Grower Sale-Lease Agreement requires the Company to operate and service the growers, and requires HGI to up-fit certain existing growers and to make capital improvements to the new growers under certain circumstances. The Company will also have the right to repurchase the leased growers upon the occurrence of certain events.

On December 18, 2014, the Company entered into an arrangement with Renaissance creating RCDC. The Company and Renaissance are each 50% members of RCDC. The arrangement was entered into in order to facilitate the development of procedures and recipes for, and to market and sell, lab-grown fancy-colored diamonds. RCDC will purchase rough diamond material from the Company and process and finish the material into finished gemstones for sale to various retailers and other participants in the market for gemstones. Profits generated by RCDC's operations will be distributed between the Company and Renaissance according to the terms of the LLC Agreement.

*Business Overview*

The Company's primary mission is the development of profitable and sustainable commercial production of its diamond materials, which are suitable for known, emerging and anticipated industrial, technology and consumer applications. The Company intends to pursue progressive development of its core diamond materials technologies and related intellectual property that the Company hopes will evolve into product opportunities across various applications. We believe these opportunities may be monetized through a combination of end product sales, joint ventures and licensing arrangements with third parties, and through continued development of intellectual property. Anticipated application opportunities for the Company's diamond materials include the following: precision cutting devices, diamond gemstone jewelry, power switches, semiconductor processors, optoelectronics, geosciences, water purification, and MRI and other medical science technology.

While the Company's product offerings continue to include industrial products, as of December 31, 2015 substantially all of the Company's production capacity is being sold as gemstone materials. As of December 31, 2015, we had generated \$3,560,426 in net revenue since inception from sales of our diamond materials and licensing of our technology.

**RESULTS OF OPERATIONS**

*Three Month Period Ended December 31, 2015 Compared to the Three Month Period Ended December 31, 2014*

During the three months ended December 31, 2015, we recorded total revenue of \$125,677 compared to \$109,358 during the three months ended December 31, 2014. This \$16,319 increase was due to increased product sales and per unit prices. The Company projected this increase in revenue to be substantially higher; however, a water leak in our facility in mid-December 2015 caused damage to our diamond growers and temporarily halted production. Product that was growing at the time of the shutdown terminated early and was not marketable. Our cost of goods sold for the month reflects our actual manufacturing costs, but the Company did not receive the attendant benefits of generating material for sale. The factory has resumed operations, although a return to full operation may not occur until the end of February 2016. The Company is working with its insurance carrier to recover the expense related to the production shutdown and the cost of the business interruption. The Company is also working with all of its suppliers to expedite replacement equipment and restore the factory operation to full capacity as soon as possible. As of December 31, 2015, the Company has not recognized any financial impact of any potential insurance settlement in its financial statements. The Company received \$150,000 in advances towards its losses from its insurance carrier in January 2016 and anticipates the insurance settlement effecting the fiscal quarter ending March 31, 2016.

Cost of goods sold was \$689,572 for the three months ended December 31, 2015 versus \$495,410 for the three months ended December 31, 2014. Cost of goods sold includes direct and indirect labor costs of \$126,731 during the three months ended December 31, 2015 and \$86,247 during the three months ended December 31, 2014. Depreciation expense of \$162,062 and \$150,448 was recorded in cost of goods sold during the three months ended December 31, 2015 and 2014, respectively. Cost of goods sold includes inventory adjustments of \$149,455 that include the cost of inventory lost in the production shutdown.

Gross (deficit) was \$(563,895) for the three months ended December 31, 2015 versus \$(386,052) for the three months ended December 31, 2014. The increase in gross (deficit) for the three months ended December 31, 2015 is due to the increased revenue being offset by increases in cost of goods sold. While the Company is selling products at prices that exceed our per unit manufacturing costs, the Company continues to operate at a gross (deficit) due to relatively low production yields and quantities sold. The Company expects our gross (deficit) to improve as quantities sold increase in the future.

Salary and benefit expenses recognized as general and administrative expenses were \$263,176 and \$127,668 for the three months ended December 31, 2015 and 2014, respectively. This increase of \$135,508 is primarily the result of the Company recognizing \$136,823 in non-cash stock-based compensation expense during the three months ended December 31, 2015 while the Company did not incur any non-cash stock-based compensation expense during the three months ended December 31, 2014.

Professional and consulting fees were \$99,201 compared to \$142,699 for the three months ended December 31, 2015 and 2014, respectively. This decrease is primarily due to reduced legal expense incurred during the three months ended December 31, 2015. Corporate general and administrative expenses were \$72,678 and \$100,334 for the three months ended December 31, 2015 and 2014, respectively.

The other components of our general and administrative expenses were relatively consistent between the three months ended December 31, 2015 and 2014. Rent, equipment lease and facilities expenses were \$39,145 and \$36,772, respectively; marketing costs were \$18,292 and \$13,198, respectively; and depreciation and amortization expenses were \$198,621 and \$199,931, respectively.

We have continued to generate limited revenue to offset our expenses, and so we have incurred net losses. Our net loss for the three month period ended December 31, 2015 was \$1,262,081, compared to a net loss of \$1,313,291 during the three months ended December 31, 2014. Our net loss per share for the three month period ended December 31, 2015 was \$(0.02) per share, compared to a net loss per share of \$(0.02) for the three months ended December 31, 2014. The weighted average number of shares outstanding was 61,759,291 and 53,701,988, respectively, for the three month periods ended December 31, 2015 and 2014.

*Nine Month Period Ended December 31, 2015 Compared to the Nine Month Period Ended December 31, 2014*

During the nine months ended December 31, 2015, we recorded product revenue of \$534,144 compared to \$292,672 during the nine months ended December 31, 2014. This \$241,472 increase was due to increased product sales and per unit prices. The Company received \$375,000 in development fees from the Grace Rich joint venture during the nine months ended December 31, 2014 that were not received during the nine months ended December 31, 2015 resulting in a decrease in total revenue for the comparable periods. Total revenue for the nine months ended December 31, 2015 was \$534,144, compared to \$667,672 in net revenue during the nine months ended December 31, 2014.

Cost of goods sold was \$1,566,218 for the nine months ended December 31, 2015 versus \$1,277,178 for the nine months ended December 31, 2014. The overall increase in cost of goods sold was due to increases in product sales during the nine months ended December 31, 2015 versus the nine months ended December 31, 2014. Cost of goods sold includes labor costs of \$342,806 during the nine months ended December 31, 2015 and \$306,533 during the nine months ended December 31, 2014. Depreciation expense of \$450,529 and \$451,194 was recorded in cost of goods sold during the nine months ended December 31, 2015 and 2014, respectively.

Gross (deficit) was \$(1,032,074) for the nine months ended December 31, 2015 versus \$(609,506) for the nine months ended December 31, 2014. The gross (deficit) for the nine months ended December 31, 2014 included \$375,000 of development fees that were not received during the comparable nine months ended December 31, 2015. Excluding these development fees results in a gross deficit for the nine months ended December 31, 2015 of \$(1,032,074) versus \$(984,506) for the nine months ended December 31, 2014.

Salary and benefit expenses recognized as general and administrative expenses were \$720,867 and \$688,368 for the nine months ended December 31, 2015 and 2014, respectively. The Company recognized \$324,791 in non-cash stock-based compensation expense during the nine months ended December 31, 2015. During the nine months ended December 31, 2014, the Company recognized \$305,077 in executive severance. Adjusting the relative periods for the non-cash stock-based compensation and the executive severance results in relatively consistent salary and benefit expense of \$396,076 and \$383,291 for the three months ended December 31, 2015 and 2014, respectively.

Professional and consulting fees were \$195,266 compared to \$309,695 for the nine months ended December 31, 2015 and 2014, respectively. The professional fees for the nine months ended December 31, 2015 and 2014 included reductions of \$66,000 and \$168,015 for payments made by our insurance carrier for past professional fees. Adjusting for these reductions, professional and consulting fees would be \$261,266 and \$477,710 for the three months ended December 31, 2015 and 2014 respectively. This decrease is primarily due to reduced legal expense due to the settlement of litigation in 2014.

Corporate general and administrative expenses were \$304,856 and \$282,593 for the nine months ended December 31, 2015 and 2014, respectively. This increase was primarily due to executive relocation costs of \$108,663 incurred during the nine months ended December 31, 2015.



During the nine months ended December 31, 2015, the Company reached an amendment to the separation, waiver and release agreement executed on December 4, 2012 with our former Chief Executive Officer, Mr. Joseph Lancia. This amendment allowed for no further severance payments to Mr. Lancia and resulted in the Company reversing \$137,561 in previously accrued severance liabilities.

The other components of our general and administrative expenses were relatively consistent between the nine months ended December 31, 2015 and 2014. Rent, equipment lease and facilities expenses were \$119,119 and \$108,803, respectively; marketing costs were \$74,938 and \$32,065, respectively; and depreciation and amortization expenses were \$595,503 and \$600,179, respectively.

We have continued to generate limited revenue to offset our expenses, and so we have incurred net losses. Our net loss for nine month period ended December 31, 2015 was \$2,948,764, compared to a net loss of \$3,076,011 during the nine months ended December 31, 2014. Our net loss per share for the nine month period ended December 31, 2015 was \$(0.05) per share, compared to a net loss per share of \$(0.06) for the nine months ended December 31, 2014. The weighted average number of shares outstanding was 58,901,542 and 51,705,910, respectively, for the nine month periods ended December 31, 2015 and 2014.

## **FINANCIAL CONDITION**

At December 31, 2015, we had total assets of \$10,710,630, compared to total assets of \$12,231,394 at March 31, 2015. We had cash of \$104,184 at December 31, 2015 compared to cash of \$767,214 at March 31, 2015.

Total liabilities at December 31, 2015 were \$3,625,743, compared to total liabilities of \$4,098,772 at March 31, 2015. Total liabilities at December 31, 2015 were comprised primarily of accounts payable, accrued expenses, customer deposits, deferred revenue, capital lease obligations and notes payables. The decrease in total liabilities is primarily due to our decreased accounts payable and accrued expenses.

The Company had negative working capital (defined as current assets less current liabilities) of \$(524,829) at December 31, 2015 versus positive working capital of \$86,254 at March 31, 2015. This decrease in working capital resulted from cash used in operations partially offset by the Company's recent equity capital raise. The production shutdown in December 2015 significantly contributed to this working capital decrease.

Total shareholders' equity was \$7,084,887 at December 31, 2015, compared to \$8,132,622 at March 31, 2015. Shareholders' equity decreased \$1,047,735 during the period due to our operating net loss and was offset by additional paid in capital from common stock issued as incentive compensation and our recent equity capital raise.

## **CASH FLOWS**

### *Operating Activities*

We have not generated positive cash flows from operating activities. For the nine months ended December 31, 2015, net cash flows used in operating activities were \$(1,942,863) compared to \$(1,518,062) for nine months ended December 31, 2014. The net cash flow used in operating activities for the nine months ended December 31, 2015 consists primarily of a net loss of \$(2,948,764) offset by depreciation and amortization of \$1,046,032, employee stock-based compensation of \$324,791, income from joint venture of \$(59,368), decrease in inventory and other assets \$131,213, decreases in accounts payable of \$(153,641), decrease in accrued expenses of \$(265,941), net decreases in other current assets of \$33,696, and a decrease in other current liabilities of \$(50,881).

### *Investing Activities*

For the nine month periods ended December 31, 2015 and 2014, net cash flows used in investing activities were \$(282,627), and \$(27,007), respectively. These amounts consist of cash payments for the purchase of property, plant and equipment. The increase in cash used during the nine months ended December 31, 2015 is due to the Company's capacity expansion program.

### *Financing Activities*

We have financed our operations primarily through the issuance of equity and debt securities. For the nine month periods ended December 31, 2015 and December 31, 2014, we generated \$1,562,460 and \$2,587,940, respectively, from financing activities.

### **LIQUIDITY AND CAPITAL RESOURCES**

We estimate that existing cash of \$104,184 as of December 31, 2015, is not adequate to meet our current obligations or fund our continuing operations. We expect that working capital requirements will continue to be funded through a combination of our existing funds, revenues generated from operations, further issuances of securities, further credit facilities or corporate borrowings, and expected proceeds from insurance. In addition, the Company's market opportunities continue to grow and as we expand our operations, we may need to raise additional capital to fund future operations. As of December 31, 2015, we had no additional lines of credit or other bank financing arrangements other than as described above. Generally, we have financed operations through December 31, 2015 through the proceeds of sales of our common stock and borrowings under our existing credit facilities.

During the nine months ending December 31, 2015, the Board of Directors approved the issuance and sale of up to 5,220,000 shares of common stock to accredited investors at a price of \$0.30. The Company closed the offering having issued 5,216,667 shares under this offering and raised \$1,565,000. The Company did not incur any material expenses related to the offering. These funds have been used to meet current operating requirements.

In January 2016, the Company received \$150,000 in advances on our insurance claim related to the December production shutdown. The Company anticipates additional insurance advances as the claims process is completed.

We expect that our short-term working capital requirements will continue to be funded through a combination of our existing funds, cash generated by operations and additional capital raises. The Company is pursuing further issuances of equity securities subject to our shares authorized, and future credit facilities or corporate borrowings. Our working capital requirements are expected to increase in line with the growth of our business.

Additional issuances of equity or convertible debt securities will result in dilution to our current stockholders. Such securities might have rights, preferences or privileges senior to our common stock. Additional financing may not be available upon acceptable terms, or at all. If adequate funds are not available or are not available on acceptable terms,

we may not be able to take advantage of prospective new business endeavors or opportunities, which could significantly and materially restrict our business operations and could result in the shutdown of operations.

## **MATERIAL COMMITMENTS AND ARRANGEMENTS**

On December 16, 2014, the Company entered into an agreement for the sale and lease of growers with HGI. Pursuant to the Grower Sale-Lease Agreement, the Company agreed to a sale-leaseback arrangement for certain diamond growers during the term of the Grower Sale-Leaseback Agreement by which the Company will sell diamond growers to HGI and then lease the growers back from HGI. The direct profit margin generated from the growers will be split between the Company and HGI in accordance with the Grower Sale-Lease Agreement. The Grower Sale-Lease Agreement requires the Company to operate and service the growers, and requires HGI to up-fit certain existing growers and to make capital improvements to the new growers under certain circumstances. The Company will also have the right to repurchase the leased growers upon the occurrence of certain events.

On December 18, 2014 entered into an arrangement with Renaissance creating RCDC. The Company and Renaissance are each 50% members of RCDC. The arrangement was entered into in order to facilitate the development of procedures and recipes for, and to market and sell, lab-grown fancy-colored diamonds. RCDC will purchase rough Diamond material from the Company and process and finish the material into finished gemstones for sale to various retailers and other participants in the market for gemstones. Profits generated by RCDC's operations will be distributed between the Company and Renaissance according to the terms of the LLC Agreement.

## **OFF-BALANCE SHEET ARRANGEMENTS**

As of the date of this Quarterly Report, we do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

## **CRITICAL ACCOUNTING POLICIES**

We have adopted various accounting policies that govern the application of accounting principles generally accepted in the United States ("GAAP"). We describe our significant accounting policies in the notes to our audited financial statements filed with our Form 10-K for the fiscal year ended March 31, 2015.

Some of the accounting policies involve significant judgments and assumptions by us that have a material impact on the carrying value of our assets and liabilities. We consider these accounting policies to be critical accounting policies. The judgment and assumptions we use are based on historical experience and other factors that we believe to be reasonable under the circumstances. Because of the nature of the judgments and assumptions we make, actual results could differ from these judgments and estimates and could materially affect the carrying values of our assets and liabilities and our results of operations.

The following is a summary of the more judgmental estimates and complex accounting principles, which represent our critical accounting policies.

### *Revenue Recognition*

We recognize product revenue when persuasive evidence of an arrangement exists, delivery of products has occurred, the sales price is fixed or determinable, and collectability is reasonably assured. For our Company, this generally means that we recognize revenue when we or our fabrication vendor has shipped finished product to the customer. Our sales terms do not allow for a right of return except for matters related to any manufacturing defects on our part. When appropriate, the Company maintains an allowance for returns.

For product sales to our joint venture partners for further processing and finishing, we currently defer all revenues when products are shipped. We currently recognize revenue at the earlier of when the joint venture partner sells the finished goods manufactured from our materials or we are paid for our goods. Licensing and development revenues are recognized in the month as detailed in appropriate licensing and development contracts. In the event that licensing funds are received prior to the contractual commitment, the Company will recognize deferred revenue (liability) for the amount received.

### *Inventories*

Inventories are stated at the lower of average cost or market. The carrying value of inventory is reviewed and adjusted based upon slow moving, obsolete items and management's assessment of market conditions. Inventory costs include material, labor, and manufacturing overhead and are determined by the "first-in, first-out" (FIFO) method. The components of inventories include raw materials and supplies, work in process and finished goods.

The Company maintains an inventory reserve for instances where finished good inventory may yield lower than expected results. The Company has periodically experienced selling prices that were lower than cost and as a result has recorded a lower of cost or market write down to the value of our inventory. The estimation of the total write-down to inventory involves management judgments and assumptions, including assumptions regarding future selling price forecasts, the estimated costs to complete and disposal costs.

*Property, Plant and Equipment*

Depreciation of property, plant and equipment is on a straight-line basis beginning at the time it is placed in service, based on the following estimated useful lives:

	<b>Years</b>
Machinery and equipment	3 to 15
Furniture and fixtures	3 to 10
Engineering equipment	5 to 12

Leasehold improvements are depreciated at the lesser of the remaining term of the lease or the life of the asset (generally three to seven years).

Expenditures for major renewals and betterments that extend the useful lives of property and equipment are capitalized. Expenditures for maintenance and repairs are charged to expense as incurred.

*Intangible Assets*

Intangible assets, such as acquired in-process research and development (“IPRD”) costs, are considered to have an indefinite useful life until such time as they are put into service at which time they will be amortized on a straight-line basis over the shorter of their economic or legal useful life. Management’s estimate of useful life of any patents when placed in service is a critical judgment. Management evaluates indefinite life intangible assets for impairment on an annual basis and on an interim basis if events or changes in circumstances between annual impairment tests indicate that the asset might be impaired. The ongoing evaluation for impairment of its indefinite life intangible assets requires significant management estimates and judgment. Management reviews definite life intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

A substantial portion of the Company’s patent portfolio is considered in service due to the inherent value of the patents to our on-going manufacturing operations. Through December 31, 2015, the Company has allocated \$8,135,063 to patents that are being amortized over a period ranging from 6.75 years to 19.46 years corresponding to their remaining life.

The Company continues to classify the remaining patent portfolio as IPRD and believes that the IPRD has alternative future use and value. Applicable accounting guidance requires an indefinite life for IPRD assets until such time as the commercialization can be reasonably estimated, at which time the assets will be available for their intended use. At such time as those requirements are met, we believe that consideration of the legal life of the intellectual property protection should be of considerable importance in determining the useful life. Upon commercialization and determination of the useful life of the intellectual property assets, consideration will be given to the eventual expiration of the intellectual property rights underlying certain critical aspects of our manufacturing process.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Not applicable.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### *Disclosure Controls and Procedures*

Disclosure controls and procedures refer to controls and other procedures designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. As of December 31, 2015, we conducted an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Exchange Act Rule 13a-15. We applied our judgment in the process of reviewing these controls and procedures, which, by their nature, can provide only reasonable assurance regarding our control objectives. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of December 31, 2015; however, a significant deficiency was noted and is discussed below.



*Remediation of Significant Deficiency in Internal Controls over Financial Reporting*

In connection with the evaluation described above, management identified the following significant deficiency in our internal control over financial reporting, which is common in small companies. This deficiency, identified by our Chief Executive Officer and Chief Financial Officer as of December 31, 2015, is:

Due to our small size, we have limited segregation of duties in certain areas of our financial reporting and other accounting processes and procedures.

A material weakness (within the meaning of PCAOB Auditing Standard No. 5) is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of our financial reporting.

During the period covered by this quarterly report on Form 10-Q, we have not been able to remediate the significant deficiency identified above. In addition, we are taking additional steps during our fiscal year ending March 31, 2016:

Management is working with our outsourced accounting vendor to provide enhanced separation of duties amongst the personnel participating in our accounting function.

*Changes in Internal Controls*

Other than described above in connection with our ongoing remediation efforts, there were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that occurred during our quarter ended December 31, 2015, that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II - OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

We are subject, from time to time, to various claims, lawsuits or actions that arise in the ordinary course of business. As of December 31, 2015 there were no material outstanding claims by the Company or against the Company.

In May 2014, the Company received a subpoena issued by the SEC ordering the provision of documents and related information concerning various corporate transactions between the Company and its predecessors and other persons and entities. The Company is fully cooperating with this ongoing inquiry.

**ITEM 1A. RISK FACTORS**

Not applicable (the Company is a smaller reporting company).

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5. OTHER INFORMATION**

None.

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## ITEM 6. EXHIBITS

The following exhibits are filed as part of this Report:

- |      |  |
|------|--|
| 31.1 | Rule 13a-14(a) Certification of the Chief Executive Officer.*                            |
| 31.2 | Rule 13a-14(a) Certification of the Chief Financial Officer.*                            |
| 32   | Section 1350 Certifications of the Chief Executive Officer and Chief Financial Officer.* |

101 The following materials from the Quarterly Report on Form 10-Q for the quarter ended December 31, 2015, formatted in eXtensible Business Reporting Language (XBRL); (i) Balance Sheets; (ii) Statements of Operations; (iii) Statements of Shareholders' Equity; (iv) Statements of Cash Flow; and (v) Notes to the Unaudited Financial Statements\*

\*Filed herewith.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

### SCIO DIAMOND TECHNOLOGY CORPORATION.

Dated: February 12, 2016 /s/ *Gerald McGuire*  
By: Gerald McGuire  
Its: Chief Executive Officer

Dated: February 12, 2016 /s/ *Jonathan Pfohl*  
By: Jonathan Pfohl  
Its: Chief Financial Officer

