
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549**

FORM 10-Q

Quarterly report under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2017

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

COMMISSION FILE NO. 1-11602

PEN INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

47-1598792

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

**701 Brickell Ave., Suite 1550
Miami, FL**

(Address of principal executive offices)

33131

(Zip Code)

(844) 273-6462

(Registrant's telephone number, including area code)

Former name or former address, if changed since last report: **Not applicable** .

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "accelerated filer", "large accelerated filer", "smaller reporting company" and "emerging growth 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

Emerging growth company

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

As of November 13, 2017, the registrant had 1,686,486 shares of Class A common stock, par value \$.0001 per share (including 37,778 shares that are subject to forfeiture) and 1,420,176 shares of Class B common stock, par value \$.0001 per share, issued and outstanding.

PEN INC.

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FORWARD-LOOKING STATEMENTS

This Form 10-Q contains certain forward-looking statements that we believe are within the meaning of the federal securities laws. For this purpose, any statements that are not statements of historical fact may be deemed to be forward-looking statements, including the statements under “Management’s Discussion and Analysis of Financial Condition and Results of Operations” regarding our strategy, future operations, future expectations or future estimates, financial position and objectives of management. Those statements in this Form 10-Q containing the words “believes,” “anticipates,” “plans,” “expects” and similar expressions constitute forward-looking statements, although not all forward-looking statements contain such identifying words. These forward-looking statements are based on our current expectations and are subject to a number of risks, uncertainties and assumptions relating to our operations, results of operations, competitive factors, shifts in market demand and other risks and uncertainties.

Although we believe that the assumptions underlying our forward-looking statements are reasonable, any of the assumptions could be inaccurate and actual results may differ from those indicated by the forward-looking statements included in this Form 10-Q. In light of the significant uncertainties inherent in the forward-looking statements included in this Form 10-Q, you should not consider the inclusion of such information as a representation by us or anyone else that we will achieve such results. Moreover, we assume no obligation to update these forward-looking statements to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking statements.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PEN INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	<u>September 30, 2017</u> (unaudited)	<u>December 31, 2016</u>
ASSETS		
CURRENT ASSETS:		
Cash	\$ 73,927	\$ 189,128
Accounts receivable, net	819,306	722,845
Accounts receivable - related party	14,226	10,474
Inventory	1,133,502	1,035,499
Prepaid expenses and other current assets	42,314	75,080
Total Current Assets	<u>2,083,275</u>	<u>2,033,026</u>
OTHER ASSETS:		
Property, plant and equipment, net	400,778	709,627
Other assets	89,325	51,078
Total Other Assets	<u>490,103</u>	<u>760,705</u>
Total Assets	<u>\$ 2,573,378</u>	<u>\$ 2,793,731</u>
LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES:		
Bank revolving line of credit	\$ 689,232	\$ 979,688
Current portion of notes payable	79,979	90,449
Accounts payable	1,606,816	1,078,527
Accounts payable - related parties	20,887	52,887
Deferred revenue	70,180	-
Accrued expenses	649,331	904,166
Total Current Liabilities	<u>3,116,425</u>	<u>3,105,717</u>
LONG-TERM LIABILITIES:		
Notes payable, net of current portion	<u>227,397</u>	<u>266,110</u>
Total Long-Term Liabilities	<u>227,397</u>	<u>266,110</u>
Total Liabilities	<u>3,343,822</u>	<u>3,371,827</u>
Commitments and Contingencies (See Note 11)		
STOCKHOLDERS' DEFICIT:		
Preferred stock, \$0.0001 par value, 20,000,000 shares authorized; no shares issued and outstanding	-	-
Class A common stock: \$0.0001 par value, 7,200,000 shares authorized; 1,648,708 and 1,367,431 issued and outstanding at September 30, 2017 and December 31, 2016, respectively	165	136
Class B common stock: \$0.0001 par value, 2,500,000 shares authorized; 1,420,176 and 1,402,104 issued and outstanding at September 30, 2017 and December 31, 2016, respectively	142	140
Class Z common stock: \$0.0001 par value, 300,000 shares authorized; 0 and 262,631 shares issued and outstanding at September 30, 2017 and December 31, 2016, respectively	-	26
Additional paid-in capital	5,480,924	5,321,769
Accumulated deficit	<u>(6,251,675)</u>	<u>(5,900,167)</u>
Total Stockholders' Deficit	<u>(770,444)</u>	<u>(578,096)</u>
Total Liabilities and Stockholders' Deficit	<u>\$ 2,573,378</u>	<u>\$ 2,793,731</u>

See accompanying condensed notes to unaudited consolidated financial statements.

PEN INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Three Months Ended		For the Nine Months Ended	
	September 30,		September 30,	
	2017	2016	2017	2016
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
REVENUES:				
Products (including related party sales of \$26,093 and \$52,328 and \$138,004, and \$148,624 for the three and nine months ended September 30, 2017 and 2016, respectively)	\$ 1,772,960	\$ 1,781,755	\$ 5,523,785	\$ 5,391,305
Contract services	255,301	225,083	723,435	804,522
Total Revenues	2,028,261	2,006,838	6,247,220	6,195,827
COST OF REVENUES:				
Products	1,121,039	1,116,987	3,237,221	3,175,629
Contract services	274,240	258,768	787,443	864,905
Total Cost of Revenues	1,395,279	1,375,755	4,024,664	4,040,534
GROSS PROFIT	632,982	631,083	2,222,556	2,155,293
OPERATING EXPENSES:				
Selling and marketing expenses	20,933	57,942	257,803	177,274
Salaries, wages and related benefits	253,615	375,794	820,051	1,241,033
Research and development	82,544	71,921	297,697	236,534
Professional fees	135,261	118,818	536,284	364,450
General and administrative expenses	188,760	242,380	653,008	738,909
Total Operating Expenses	681,113	866,855	2,564,843	2,758,200
LOSS FROM OPERATIONS	(48,131)	(235,772)	(342,287)	(602,907)
OTHER (EXPENSE) INCOME:				
Interest expense	(20,124)	(26,000)	(54,038)	(82,270)
Loss on disposal of fixed assets	(122,050)	-	(122,050)	-
Other income, net	65,575	50,870	166,867	228,649
Total Other (Expense) Income	(76,599)	24,870	(9,221)	146,379
NET LOSS	\$ (124,730)	\$ (210,902)	\$ (351,508)	\$ (456,528)
NET LOSS PER COMMON SHARE:				
Basic	\$ (0.04)	\$ (0.07)	\$ (0.12)	\$ (0.15)
Diluted	\$ (0.04)	\$ (0.07)	\$ (0.12)	\$ (0.15)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:				
Basic	3,062,759	3,020,062	3,051,826	3,006,837
Diluted	3,062,759	3,020,062	3,051,826	3,006,837

See accompanying condensed notes to unaudited consolidated financial statements.

PEN INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Nine Months Ended	
	September 30,	
	2017	2016
	(unaudited)	(unaudited)
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	\$ (351,508)	\$ (456,528)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Change in inventory obsolescence reserve	50,390	34,184
Bad debt expense	-	12,034
Depreciation and amortization expense	100,325	136,598
Amortization of deferred lease incentives	5,346	9,623
Gain on sale of property and equipment, net	(527)	(21,866)
Gain on settlement of accounts payable	-	(33,511)
Gain on settlement of accrued salary	-	(36,973)
Loss on disposal of property and equipment	122,050	-
Stock-based compensation	140,160	151,856
Change in operating assets and liabilities:		
Accounts receivable	(96,461)	452,113
Accounts receivable - related party	(3,752)	(28,352)
Inventory	(148,393)	(212,461)
Prepaid expenses and other assets	(5,481)	76,634
Accounts payable	545,714	41,557
Accounts payable - related parties	(32,000)	14,823
Accrued expenses	(112,462)	70,420
Deferred revenue	70,180	(21,692)
NET CASH PROVIDED BY OPERATING ACTIVITIES	283,581	188,459
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales of property and equipment	87,000	21,866
Purchases of property, plant and equipment	-	(4,000)
NET CASH PROVIDED BY INVESTING ACTIVITIES	87,000	17,866
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from bank lines of credit	4,964,067	5,193,000
Repayment of bank lines of credit	(5,383,241)	(5,522,951)
Repayment of bank loans	(56,138)	(55,785)
Proceeds from sale of common stock	-	50,000
Payment of issuance costs related to sale of common stock	-	(2,000)
Repayment of loan to third party	(10,470)	(4,394)
NET CASH USED IN FINANCING ACTIVITIES	(485,782)	(342,130)
NET DECREASE IN CASH	(115,201)	(135,805)
CASH, beginning of period	189,128	262,519
CASH, end of period	\$ 73,927	\$ 126,714
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the period for interest		
Interest	\$ 55,554	\$ 82,270
Income taxes	\$ -	\$ -
SUPPLEMENTAL DISCLOSURE OF NON-CASH		
INVESTING AND FINANCING ACTIVITIES:		
Reclassification of accrued salary to notes payable - long-term	\$ 17,425	\$ 51,239
Accrued director fees settled with common stock	\$ 19,000	\$ -

See accompanying condensed notes to unaudited consolidated financial statements.

PEN INC. AND SUBSIDIARIES
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2017
(UNAUDITED)

NOTE 1 – ORGANIZATION AND BASIS OF PRESENTATION

Organization

PEN Inc. (“we”, “us”, “our”, “PEN” or the “Company”), a Delaware corporation, develops and sells a portfolio of nano-layer coatings, nano-based cleaners, and nano-composite products based on its proprietary technology, and performs nanotechnology product research and development generating revenues through performing contract services.

Through our wholly-owned subsidiary, PEN Brands LLC, formerly known as Nanofilm, Ltd., we develop, manufacture and sell consumer and institutional products using nanotechnology to deliver unique performance attributes at the surfaces of a wide variety of substrates. These products are marketed internationally primarily to customers in the optical industry. On May 2, 2017, Nanofilm, Ltd. changed its name to PEN Brands LLC.

Through our wholly-owned subsidiary, Applied Nanotech, Inc., we primarily perform design and development services for ourselves and for governmental and private customers.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”) for interim financial information. Accordingly, they do not include all the information and disclosures required by US GAAP for annual financial statements. In the opinion of management, such statements include all adjustments (consisting only of normal recurring items) which are considered necessary for a fair presentation of the unaudited consolidated financial statements of the Company as of September 30, 2017 and for the three and nine months ended September 30, 2017 and 2016. The results of operations for the three and nine months ended September 30, 2017 are not necessarily indicative of the operating results for the full year ending December 31, 2017 or any other period. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related disclosures of the Company as of December 31, 2016 and for the year then ended, which were filed with the Securities and Exchange Commission on Form 10-K on March 29, 2017.

Going Concern

These consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. As reflected in the consolidated financial statements filed with our Form 10-K on March 29, 2017, the Company had a net loss of \$556,001 and \$1,869,247 for the years ended December 31, 2016 and 2015. Additionally, the Company had a net loss of \$124,730 and \$351,508 for the three and nine months ended September 30, 2017. Furthermore, the Company had an accumulated deficit, a stockholders’ deficit and a working capital deficit of \$6,251,675, \$770,444 and \$1,033,150, respectively, at September 30, 2017. These factors raise substantial doubt about the Company’s ability to continue as a going concern within one year after the date that the financial statements are issued. Management cannot provide assurance that the Company will ultimately achieve profitable operations or become cash flow positive, or raise additional debt and/or equity capital. During 2016 and continuing in the first three quarters of 2017, management has taken measures to reduce operating expenses. Although the Company has historically raised capital from sales of equity and from the issuance of promissory notes, there is no assurance that it will be able to continue to do so. If the Company is unable to raise additional capital or secure additional lending in the near future, management expects that the Company will need to curtail its operations. These unaudited consolidated financial statements do not include any adjustments related to the recoverability and classification of assets or the amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The Company's consolidated financial statements include the financial statements of its wholly-owned subsidiaries, Applied Nanotech, Inc., PEN Brands LLC and PEN Technology LLC. On December 15, 2016, PEN Technology LLC was merged into PEN Brands LLC. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates for the three and nine months ended September 30, 2017 and 2016 include estimates for allowance for doubtful accounts on accounts receivable, the estimates for obsolete inventory, the estimates for cooperative advertising liability, the useful life of property and equipment, assumptions used in assessing impairment of long-term assets, estimates of current and deferred income taxes and deferred tax valuation allowances, the fair value of non-cash equity transactions, and the fair value of equity incentives.

Fair Value of Financial Instruments and Fair Value Measurements

The Company adopted the guidance of Accounting Standards Codification ("ASC") 820 for fair value measurements which clarifies the definition of fair value, prescribes methods for measuring fair value, and establishes a fair value hierarchy to classify the inputs used in measuring fair value as follows:

Level 1-Inputs are unadjusted quoted prices in active markets for identical assets or liabilities available at the measurement date.

Level 2-Inputs are quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, inputs other than quoted prices that are observable, and inputs derived from or corroborated by observable market data.

Level 3-Inputs are unobservable inputs which reflect the reporting entity's own assumptions on what assumptions the market participants would use in pricing the asset or liability based on the best available information.

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, accounts receivable, loans and lines of credit, accounts payable, accrued expenses, and other payables approximate their fair market value based on the short-term maturity of these instruments.

The Company analyzes all financial and non-financial instruments with features of both liabilities and equity under the Financial Accounting Standards Board ("FASB") accounting standard for such instruments. Under this standard, financial and non-financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company accounts for three instruments at fair value using level 3 valuation.

Description	At September 30, 2017			At December 31, 2016		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Stock Appreciation Rights Plan A	-	-	\$ 54,538	-	-	\$ 53,108
Equity Credits Issued	-	-	\$ 2,278	-	-	\$ 2,278

A rollforward of the level 3 valuation of these three financial instruments is as follows:

	Stock Appreciation Rights Plan A	Equity Credits Issued
Balance at December 31, 2016	\$ 53,108	\$ 2,278
Change in fair value included in net loss	1,430	-
Balance at September 30, 2017	<u>\$ 54,538</u>	<u>\$ 2,278</u>

ASC 825-10 “Financial Instruments”, allows entities to voluntarily choose to measure certain financial assets and liabilities at fair value (fair value option). The fair value option may be elected on an instrument-by-instrument basis and is irrevocable, unless a new election date occurs. If the fair value option is elected for an instrument, unrealized gains and losses for that instrument should be reported in earnings at each subsequent reporting date. The Company did not elect to apply the fair value option to any outstanding instruments.

Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, the Company considers all highly liquid instruments with a maturity of three months or less at the purchase date and money market accounts to be cash equivalents. The cash balance included \$10,003 which is restricted in its use as it serves as collateral for a credit card.

Accounts Receivable

The Company recognizes an allowance for losses on accounts receivable in an amount equal to the estimated probable losses net of recoveries. The allowance is based on an analysis of historical bad debt experience, current receivables aging, and expected future write-offs, as well as an assessment of specific identifiable customer accounts considered at risk or uncollectible. The expense associated with the allowance for doubtful accounts is recognized as general and administrative expense.

Inventory

Inventory is stated at the lower of cost or net realizable value. Cost is determined using the first-in, first-out (FIFO) method. At September 30, 2017 and December 31, 2016, inventory consisted of the following:

	September 30, 2017	December 31, 2016
Raw materials	\$ 660,800	\$ 927,833
Work in process	136	-
Finished goods	<u>753,983</u>	<u>338,643</u>
	1,414,919	1,266,528
Less: reserve for obsolescence	<u>(281,417)</u>	<u>(231,027)</u>
Inventory, net	<u>\$ 1,133,502</u>	<u>\$ 1,035,499</u>

Effective January 1, 2017, the Company adopted FASB Accounting Standards Update (“ASU”) No. 2015-11, “Simplifying the Measurement of Inventory,” (“ASU 2015-11”) which requires an entity to measure most inventory at the lower of cost and net realizable value, thereby simplifying the current guidance under which an entity must measure inventory at the lower of cost or market. The adoption of this standard did not have a material impact on the Company’s unaudited consolidated financial statements.

Property and Equipment

Property and equipment are stated at cost and are depreciated using the straight-line method over their estimated useful lives, which range from three to ten years. Leasehold improvements are depreciated over the shorter of the useful life or lease term including scheduled renewal terms. Maintenance and repairs are charged to expense as incurred. When assets are retired or disposed of, the cost and accumulated depreciation are removed from the accounts, and any resulting gains or losses are included in other income or expense in the year of disposition. The Company examines the possibility of decreases in the value of these assets when events or changes in circumstances reflect the fact that their recorded value may not be recoverable.

Impairment of Long-Lived Assets

In accordance with ASC Topic 360, the Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be fully recoverable, or at least annually. The Company recognizes an impairment loss when the sum of expected undiscounted future cash flows is less than the carrying amount of the asset. The amount of impairment is measured as the difference between the asset's estimated fair value and its book value. The Company did not record any impairment charge for the three and nine months ended September 30, 2017 and 2016.

Revenue Recognition

Pursuant to the guidance of ASC Topic 605, the Company recognizes sales when persuasive evidence of an arrangement exists, delivery has occurred or services have been provided, the purchase price is fixed or determinable and collectability is reasonably assured.

Types of revenue:

- Net product sales by our subsidiary PEN Brands LLC.
- Reimbursements under agreements to perform contract services related to new products and product development for government agencies and others by our subsidiary, Applied Nanotech. We do not perform contracts that are contingent upon successful results. Larger projects are sometimes broken down in phases to allow the customer to determine at the end of each phase if they wish to move to the next phase. The agreements with federal government agencies generally provide that, upon completion of a technology development program, the funding agency is granted a royalty-free license to use any technology developed during the course of the program for its own purposes, but not any preexisting technology that we use in connection with the program. We retain all other rights to use, develop, and commercialize the technology. Agreements with nongovernmental entities generally allow the entity the first opportunity to license the technology from us upon completion of the project.
- Product sales and other miscellaneous revenues from our subsidiary, Applied Nanotech such as the sale of conductive inks, graphene foils and thermal management materials.

Revenue recognition criteria:

- Net product sales by our subsidiary PEN Brands LLC, are recognized when the product is shipped to the customer and title is transferred.
- Revenue from contract services performed under government contracts is recognized when it is earned pursuant to the terms of the contract. These projects are usually billed monthly based on costs, hours, or some other measure of activity during the month and revenue is recognized as services are provided. If there is substantive acceptance terms then revenue will not be recognized until acceptance occurs. The recognition of revenue may not correspond with the billings allowable under the contract. To the extent that billings exceed revenue earned, a portion of the revenue is deferred until it is earned.

- Revenue from contract services performed under non-governmental contracts is recognized when it is earned pursuant to the terms of the contract. Each contract is unique and tailored to the needs of the customer and goals of the project. Some contracts may call for a monthly payment for a fixed period of time. Other contracts may be for a fixed dollar amount with an unspecified time period, although there is frequently a targeted completion date. These contracts generally involve some sort of up-front payment. Some contracts may call for the delivery of samples, or may call for the transfer of equipment or other items developed during the project to the customer. These projects are usually billed monthly based on costs, hours, or some other measure of activity during the month and revenue is recognized as services are provided. If there are substantive acceptance terms then revenue will not be recognized until acceptance occurs.
- Revenue from other product sales is recognized at the time the product shipped. The Company's subsidiary Applied Nanotech's primary business is contract services, not the sale of products. Product sales are generally insignificant in number, and are generally limited to the sale of conductive inks, graphene foils, thermal management materials, samples, proofs of concepts, prototypes, or other items resulting from its contract services.
- Other miscellaneous revenue is recognized as deemed appropriate given the facts of the situation and is generally not material.

Sales Incentives and Consideration Paid to Customers

The Company accounts for certain promotional costs such as sales incentives and cooperative advertising as a reduction of sales. For the three months ended September 30, 2017 and 2016 the Company recorded \$29,526 and \$40,471, respectively and \$103,031 and \$106,262 for the nine months ended September 2017 and 2016 respectively, as a reduction of sales related to these costs.

The Company has recently become aware of industry trends related to cooperative advertising, such that, during the quarter ended September 30, 2017, management now believes it has sufficient data and experience to effect a change in accounting estimate. As a result, the Company recorded a one-time adjustment to reduce its cooperative advertising liability by approximately \$346,000 to \$100,000 as of September 30, 2017 with a corresponding \$346,000 increase to product revenue for the three and nine months ended September 30, 2017.

Cost of Sales

Cost of sales includes inventory costs, materials and supplies costs, internal labor and related benefits, subcontractor costs, depreciation, overhead and shipping and handling costs incurred.

Shipping and Handling Costs

Shipping and handling costs incurred relating to the purchase of inventory are included in inventory which is charged to cost of sales as product are sold. Shipping and handling costs incurred for product shipped to customers are included in cost of sales. For the three months ended September 30, 2017 and 2016 shipping and handle costs amounted to \$39,102 and \$46,255, respectively, and were \$136,260 and \$140,059 for the nine months ended September 30, 2017 and 2016, respectively.

Research and Development

Research and development costs incurred in the development of the Company's products and under other Company sponsored research and development projects are expensed as incurred. Costs such as direct labor, direct costs, and other allocated costs incurred to perform research and development service pursuant to government and private research projects are included in cost of sales. Research and development costs incurred in the development of the Company's products for the three months ended September 30, 2017 and 2016 were \$82,544 and \$71,921, respectively, and were \$297,697 and \$236,534 for the nine months ended September 30, 2017 and 2016, respectively, and are included in operating expenses on the accompanying unaudited consolidated statements of operations.

Advertising Costs

The Company participates in various advertising programs. All costs related to advertising of the Company's products are expensed in the period incurred. Advertising costs charged to operations for the three months ended September 30, 2017 and 2016 were \$0 and \$5,193, respectively, and were \$14,626 and \$23,624 for the nine months ended September 30, 2017 and 2016, respectively, and are included in selling and marketing on the unaudited consolidated accompanying statements of operations. These costs are included in sales and marketing on the consolidated accompanying statements of operations. These advertising expenses do not include cooperative advertising and sales incentives which have been deducted from sales.

Federal and State Income Taxes

The Company accounts for income tax using the liability method prescribed by ASC 740, "Income Taxes". Under this method, deferred tax assets and liabilities are determined based on the difference between the financial reporting and tax bases of assets and liabilities using enacted tax rates that will be in effect in the year in which the differences are expected to reverse. The Company records a valuation allowance to offset deferred tax assets if based on the weight of available evidence, it is more-likely-than-not that some portion, or all, of the deferred tax assets will not be realized. The effect on deferred taxes of a change in tax rates is recognized as income or loss in the period that includes the enactment date.

The Company follows the accounting guidance for uncertainty in income taxes using the provisions of ASC 740 "Income Taxes". Using that guidance, tax positions initially need to be recognized in the financial statements when it is more likely than not the position will be sustained upon examination by the tax authorities. As of September 30, 2017 and December 31, 2016, the Company had no uncertain tax positions that qualify for either recognition or disclosure in the financial statements. Tax years that remain subject to examination are the years ending on and after December 31, 2013. The Company does not expect any significant changes in its unrecognized tax benefits within twelve months of the reporting date. The Company recognizes interest and penalties related to uncertain income tax positions in other expense. However, no such interest and penalties were recorded as of September 30, 2017 or December 31, 2016.

Stock-Based Compensation

Stock-based compensation is accounted for based on the requirements of the Share-Based Payment Topic of ASC 718 which requires recognition in the financial statements of the cost of employee and director services received in exchange for an award of equity instruments over the period the employee or director is required to perform the services in exchange for the award (presumptively, the vesting period). The ASC also requires measurement of the cost of employee and director services received in exchange for an award based on the grant-date fair value of the award.

Pursuant to ASC Topic 505-50, for share-based payments to consultants and other third-parties, compensation expense is determined at the "measurement date." The expense is recognized over the service period of the award. Until the measurement date is reached, the total amount of compensation expense remains uncertain. The Company initially records compensation expense based on the fair value of the award at the reporting date.

Loss Per Share of Common Stock

ASC 260 "Earnings Per Share", requires dual presentation of basic and diluted earnings per share ("EPS") with a reconciliation of the numerator and denominator of the basic EPS computation to the numerator and denominator of the diluted EPS computation. Basic EPS excludes dilution. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. Basic net loss per common share is computed by dividing net loss available to common shareholders by the weighted average number of shares of common shares outstanding during the period. Diluted net loss per common share is computed by dividing net loss by the weighted average number of shares of common stock, common stock equivalents and potentially dilutive securities outstanding during each period. As of September 30, 2017, and December 31, 2016, 37,778 contingently issuable common shares that are issuable based on certain market conditions (see Note 8) are not included in the potential dilutive shares in calculating the diluted EPS. Additionally, potentially dilutive common shares consist of common stock options and warrants (using the treasury stock method).

These common stock equivalents may be dilutive in the future. Potentially dilutive common shares were excluded from the computation of diluted shares outstanding as they would have an anti-dilutive impact on the Company's net losses and consisted of the following:

	<u>September 30, 2017</u>	<u>December 31, 2016</u>
Stock options	20,370	20,483
Stock warrants	712	712
Restricted Stock	<u>37,778</u>	<u>37,778</u>
Total	<u><u>58,860</u></u>	<u><u>58,973</u></u>

Additionally, there are an unknown quantity of common stock equivalents that result from a potential conversion of equity credits and stock appreciation rights (See Notes 8 and 9).

Net loss per share for each class of common stock is as follows:

	Three Months Ended	Three Months Ended	Nine Months Ended	Nine Months Ended
<u>Net (loss) income per common shares outstanding:</u>	<u>September 30, 2017</u>	<u>September 30, 2016</u>	<u>September 30, 2017</u>	<u>September 30, 2016</u>
Class A common stock	\$ (0.11)	\$ (0.07)	\$ (0.13)	\$ (0.15)
Class B common stock	\$ (0.11)	\$ (0.07)	\$ (0.12)	\$ (0.15)
Class Z common stock	\$ -	\$ (0.07)	\$ -	\$ (0.15)
<u>Weighted average shares outstanding:</u>				
Class A common stock	1,645,033	1,358,234	1,502,367	1,346,656
Class B common stock	1,417,726	1,399,197	1,411,890	1,399,550
Class Z common stock	-	262,631	137,569	262,631
Total weighted average shares outstanding	<u><u>3,062,759</u></u>	<u><u>3,020,062</u></u>	<u><u>3,051,826</u></u>	<u><u>3,006,837</u></u>

Segment Reporting

The Company uses “the management approach” in determining reportable operating segments. The management approach considers the internal organization and reporting used by the Company’s chief operating decision maker for making operating decisions and assessing performance as the source for determining the Company’s reportable segments. The Company’s chief operating decision maker is the Chairman and chief executive officer (“CEO”) of the Company, who reviews operating results to make decisions about allocating resources and assessing performance for the entire Company. The Company classified the reportable operating segments into (i) the development, manufacture and sale of consumer and institutional products using nanotechnology to deliver unique performance attributes at the surfaces of a wide variety of substrates (the “Product segment”) and (ii) nanotechnology design and development services for our future products and for government and private entities and sales of products developed for third parties (the “Contract services segment”).

Recently Issued Accounting Pronouncements

In March 2016, the FASB issued ASU No. 2016-09 (“ASU 2016-09”) to amend the accounting guidance for share-based payment accounting. The areas for simplification in ASU 2016-09 involve several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 is effective for annual periods beginning after December 15, 2016. The adoption of this standard did not have a material impact on the Company’s unaudited consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, “Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting” (“ASU 2017-09”). ASU 2017-09 provides clarity on the accounting for modifications of stock-based awards. ASU 2017-09 requires adoption on a prospective basis in the annual and interim periods beginning after December 15, 2017 for share-based payment awards modified on or after the adoption date. The Company is currently evaluating the effect that adopting this new accounting guidance will have on its unaudited consolidated financial statements and related disclosures.

In July 2017, the FASB issued ASU No. 2017-11, “Earnings Per Share (Topic 260) and Derivatives and Hedging (Topic 815) - Accounting for Certain Financial Instruments with Down Round Features,” (“ASU 2017-11”). Equity-linked instruments, such as warrants and convertible instruments may contain down round features that result in the strike price being reduced on the basis of the pricing of future equity offerings. Under ASU 2017-11, a down round feature will no longer require a freestanding equity-linked instrument (or embedded conversion option) to be classified as a liability that is remeasured at fair value through the income statement (i.e. marked-to-market). However, other features of the equity-linked instrument (or embedded conversion option) must still be evaluated to determine whether liability or equity classification is appropriate. Equity classified instruments are not marked-to-market. For earnings per share (“EPS”) reporting, the ASU requires companies to recognize the effect of the down round feature only when it is triggered by treating it as a dividend and as a reduction of income available to common shareholders in basic EPS. The amendments in this ASU are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted, including adoption in any interim period. The Company is currently evaluating the effect that adopting this new accounting guidance will have on its unaudited consolidated financial statements.

There are no other recently issued accounting standards that apply to us or that are expected to have a material impact on our results of operations, financial condition, or cash flows.

Reclassifications

Certain prior period amounts in the unaudited consolidated financial statements have been reclassified for comparative purposes to conform to the fiscal 2017 presentation. These reclassifications have no impact on the previously reported net loss.

NOTE 3 – BANK LOANS AND LINES OF REVOLVING CREDIT FACILITY

In April 2014, our subsidiary, PEN Brands LLC entered into a \$1,500,000 revolving credit line agreement (the “Revolving Note”) with Mackinac Commercial Credit, LLC (the “Lender”) with draws limited to a borrowing base as defined in the Revolving Note. The unpaid principal balance of this Revolving Note is payable on demand, is secured by all of PEN Brands LLC’s assets, and bears interest computed at a rate of interest (the “Effective Rate”) which is equal to 7.0% above the LIBOR Rate, as defined, payable monthly. PEN Brands LLC will pay to Lender a late charge of 5.0% of any monthly payment not received by Lender within 10 calendar days after its due date. The Company may, at any time or from time to time upon three business days’ written notice to Lender, prepay the Note in whole provided that if (i) Borrower prepays the Revolving Note in full and terminates the Revolving Note, or (ii) Lender terminates the Revolving Note after default, then Borrower will pay a termination premium equal to 2.0% of the maximum loan amount. On May 1, 2015, PEN Brands LLC and the Lender entered into an amendment to the Loan and Security Agreement extending the outside maturity date to April 4, 2016 and permitting advances against an expanded borrowing base. The borrowing base was increased by \$450,000 through October 31, 2015, with this amount reducing by \$7,500 monthly thereafter. In addition, PEN Inc., the parent company, guaranteed PEN Brands LLC’s obligations to the Lender. On April 4, 2016, the maturity date under the Loan & Security Agreement between PEN Brands LLC and the Lender was automatically extended for a one-year renewal term.

Without the Lender’s consent, so long as the obligation remains outstanding, in addition to other covenants as defined in the Revolving Note, PEN Brands LLC shall not a) merge or consolidate with any other company, except for the combination that closed in August 2014 and shall not suffer a change of control; b) make any capital expenditures, as defined, materially affecting the business; c) declare or pay cash dividends upon any of its stock, or distribute any of its property, make any loans, make investments, redeem, retire or acquire any of its stock, d) become liable for the indebtedness of anyone else, as defined, and e) incur indebtedness, other than trade payables.

On April 3, 2017, PEN Brands LLC and the Lender executed a second amendment to the Revolving Note that extended the maturity date to April 4, 2018, with a one-year renewal option. The second amendment also reduced the interest rate to 3.0% above the Prime Rate, as reported in the Wall Street Journal.

At September 30, 2017 and December 31, 2016, the Company had \$689,232 and \$979,688, respectively, which includes accrued interest of \$10,324 and \$17,494, respectively, in amounts outstanding under the Revolving Note with availability of up to \$810,768 as of September 30, 2017, depending on the borrowing base at the time of the request for the advance. The weighted average interest rate during the nine months ended September 30, 2017 and 2016 was approximately 6.8% and 8.1%, respectively.

See Note 12 – Subsequent Events for additional details on the Revolving Note.

NOTE 4 – NOTES PAYABLE

In January 2017, we issued a promissory note in the principal amount of \$17,425 to a departing employee representing the amount of his accrued and unpaid salary. The note does not bear interest and is due in January 2027.

NOTE 5 – RELATED PARTY TRANSACTIONS

Sales to Related Party

During the three and nine months ended September 30, 2017 and 2016, the Company engaged in certain sales transactions with a company which is a shareholder and related to a director of the Company. Sales to the related party totaled \$26,093 and \$52,328 for the three months ended September 30, 2017 and 2016, respectively. and totaled \$138,004 and \$148,624 for the nine months ended September 30, 2017 and 2016. Accounts receivable from the related party totaled \$14,227 at September 30, 2017 and \$10,474 at December 31, 2016. As of May 23, 2017, that director no longer served on the Company’s Board and the shareholder was no longer an affiliate.

Other

A board member is a principal in DHJH Holdings LLC, the firm that provided the services of the Company's chief financial officer from May 2016 through February 2017. The Company recognized no fees and expenses during the three months ended September 30, 2017 and 2016 and \$0 and \$13,195 in fees and expenses during the nine months ended September 30, 2017 and 2016, respectively.

As of September 30, 2017, the Company included the following within accounts payable-related parties: \$1,000 of director fees and \$19,887 due to certain of the Company's executives.

NOTE 6 - STOCKHOLDERS' EQUITY

Description of Preferred and Common Stock

On December 11, 2015, the Board of Directors of the Company approved a reverse stock split of the issued and outstanding shares of the Company's common stock at the ratio of 1-for-180 (the "Reverse Stock Split") and authorized an amendment of the Company's Amended and Restated Certificate of Incorporation, as amended, to effect the Reverse Stock Split, to reduce the number of authorized shares of common stock, and to set a par value of \$0.0001 per share after the Reverse Stock Split. On January 26, 2016, each one hundred eighty (180) shares of the Company's (i) Class A Common Stock ("Class A common stock"), (ii) Class B Common Stock and (iii) Class Z Common Stock, then issued and outstanding were automatically combined into one (1) validly issued, fully paid and non-assessable share of Class A Common Stock, Class B Common Stock and Class Z Common Stock, respectively, without any further action by the Company or the holder. Additionally, the authorized number of shares of common stock were reduced to 10,000,000 comprised of 7,200,000 shares of Class A Common Stock, 2,500,000 shares of Class B Common Stock ("Class B common stock"), and 300,000 shares of Class Z Common Stock ("Class Z common stock"). The par value of each class of common stock remained the same at \$0.0001 per common share. All share and per share data in the accompanying unaudited consolidated financial statements have been retroactively restated to reflect the effect of the Reverse Stock Split and authorized shares. The Company is also authorized to issue 20,000,000 shares of Preferred Stock, par value \$0.0001 per share ("preferred stock").

Preferred Stock

The preferred stock may be issued in one or more series. The Company's board of directors are authorized to issue the shares of preferred stock in such series and to fix from time to time before issuance thereof the number of shares to be included in any such series and the designation, powers, preferences and relative, participating, optional or other rights, and the qualifications, limitations or restrictions thereof, of such series.

Common Stock – General

The rights of each share of Class A common stock, each share of Class B common stock and each share of Class Z common stock are the same with respect to dividends, distributions and rights upon liquidation.

Class A Common Stock

Holders of the Class A common stock are entitled to one vote per share in the election of directors and other matters submitted to a vote of the stockholders.

Class B Common Stock

Conversion Rights. Shares of Class B common stock can be converted, one-for-one, into shares of Class A common stock at any time at the option of the holder. Shares of Class B common stock will automatically be converted into shares of Class A common stock if the shares of Class B common stock are not owned by the Company's chief executive officer, his spouse, or their descendants and their spouses, or by entities or trusts wholly-owned by them.

Voting Rights. Holders of PEN Class B common stock are entitled to 100 votes per share in the election of directors and other matters submitted to a vote of the stockholders.

Class Z Common Stock

Conversion Rights. Shares of Class Z common stock can be converted, one-for-one, into shares of Class A common stock at any time at the option of the holder. Shares of Class Z common stock will automatically be converted into shares of Class A common stock if the shares of Class Z common stock are not owned by Zeiss or an entity wholly owned by the ultimate parent of Zeiss.

Voting Rights. Holders of PEN Class Z common stock do not vote in the election of directors or otherwise, but they do have the right to designate a director to the PEN Board, have anti-dilution rights described below and have consent rights with respect to certain amendments to PEN's certificate of incorporation.

Other Rights. The Class Z common stock has anti-dilutive rights that, subject to limited exceptions, permit holders of Class Z common stock to purchase additional shares or equity rights issued by PEN (on the same terms as made available to third parties by PEN) to maintain their economic ownership percentage. The holders of Class Z common stock are also entitled to receive a copy of any notice sent to the holders of Class A common stock or Class B common stock, as and when the notice is sent to such holders.

Issuances of Common Stock

Common Stock Issued for Services

On February 24, 2017, the Company issued an aggregate of 3,846 shares of Class A common stock and 2,564 shares of Class B common stock to the Company's directors as payment for their service on the Company's board. These shares were valued on the date of grant at \$1.56 per share based on the quoted price of the stock for a total value of \$10,000 recognized as stock-based compensation expense.

On April 28, 2017, the Company issued an aggregate of 10,000 shares of Class A common stock and 12,308 shares of Class B common stock to the Company's directors as payment for their service on the Company's board. The shares issued included 4,617 Class A and 3,078 Class B shares as compensation for attendance at the meeting on that date and the rest were issued in payment of \$19,000 in accrued director fees from a prior year. These shares are valued on the date of grant of April 28, 2017 at \$1.30 per share based on the quoted price of the stock for a total value of \$29,000 with \$10,000 recognized as stock-based compensation expense.

On July 28, 2017, the Company issued an aggregate of 4,800 shares of Class A common stock and 3,200 shares of Class B common stock to the Company's directors as payment for their service on the Company's board. These shares were valued on the date of grant at \$1.25 per share based on the quoted closing price of the stock for a total value of \$10,000 recognized as stock-based compensation expense.

Stock Options

Stock options outstanding are to purchase Class A common stock. Stock option activities for the nine months ended September 30, 2017 are summarized as follows:

	<u>Number of Options</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Term (Years)</u>	<u>Aggregate Intrinsic Value</u>
Outstanding December 31, 2016	20,483	\$ 41.77		
Exercised	-	-		
Expired	(113)	230.40		
Outstanding September 30, 2017	<u>20,370</u>	<u>\$ 40.72</u>	<u>3.26</u>	<u>\$ -</u>
Exercisable September 30, 2017	<u>10,370</u>	<u>\$ 77.28</u>	<u>2.72</u>	<u>\$ -</u>

Contingently Issuable Class A Common Shares

On August 27, 2014, the Company entered into a Restricted Stock Agreement with Dr. Zvi Yaniv, the former Chief Operating Officer and President, of Applied Nanotech, and a current employee of the Company granting Dr. Yaniv 37,778 shares of Class A common stock, subject to forfeiture. All these shares become vested and not subject to forfeiture on the earlier of a change of control of the Company, Dr. Yaniv's death, or if more than 180 days after closing, the average trading price of the shares during a measurement period of ten consecutive trading days reaches certain price thresholds. At an \$18.00 price, 5,554 shares vest, with additional tranches of 5,556 shares vesting if the price reaches \$27.00, \$36.00, \$45.00 and \$54.00. The last 10,000 shares vest at a \$63.00 price threshold.

Any shares that have not vested five years after the effective date will be forfeited. The Company also entered into a Piggyback Registration Rights Agreement that will allow Dr. Yaniv, subject to other customary terms and conditions, to register shares that are no longer subject to forfeiture if the Company is registering its shares. Pursuant to ASC 718-10 and related subsections, these shares were valued on the date of grant of August 27, 2014 at \$13.12 per share for a total value of \$495,720. The Company estimates the fair value of the awards with market conditions using a Binomial simulation, which utilizes several assumptions including the risk-free interest rate, the volatility of the Company's stock and the exercise behavior of award recipients. The grant-date fair value of \$495,720 of the awards will be recognized over the requisite service period of 3 years, which represents the derived service period for the stock grant as determined by the Binomial simulation method. For the three months ended September 30, 2017 and 2016, in connection with the amortization of the fair value of this stock grant, the Company recorded stock-based compensation of \$27,540 and \$41,310 respectively, and \$110,160 and \$123,930, for the nine months ended September 30, 2017 and 2016, respectively. At September 30, 2017, there is no unamortized stock-based compensation expense to be recognized in future periods.

Conversion of Class Z Common Stock

On May 23, 2017, Zeiss converted 262,631 shares of Class Z common stock into 262,631 shares of Class A common stock. Immediately thereafter, Zeiss sold 262,631 shares of Class A common stock to certain buyers which included the Company's Chief Executive Officer for an aggregate of \$100,000. In addition, pursuant to the certificate of incorporation, Zeiss' Board representation automatically terminated and, as a result, Zeiss ceased to be a related party as of May 23, 2017.

NOTE 7 – CONCENTRATIONS

Concentrations of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of trade accounts receivable and cash deposits and investments in cash equivalent instruments.

Lender Concentration

The Company relies primarily on one lender under a \$1,500,000 Revolving Note.

Customer Concentrations

Customer concentrations for the nine months ended September 30, 2017 and 2016 are as follows:

	Revenues	
	For the Nine Months Ended	
	September 30,	
	2017	2016
Customer A	32%	32%
Customer B	12%	14%
Total	44%	46%

	Accounts Receivable	
	As of	As of
	September 30, 2017	December 31, 2016
Customer A	43%	14%
Customer B	14%	16%
Customer C	*%	15%
Total	57%	45%

*Less than 10%

A reduction in sales from or loss of such customers would have a material adverse effect on our consolidated results of operations and financial condition.

Geographic Concentrations of Sales

For the nine months ended September 30, 2017 and 2016, total sales in the United States represent approximately 88% and 91% of total consolidated revenues, respectively. No other geographical area accounting for more than 10% of total sales during the nine months ended September 30, 2017 and 2016.

Vendor Concentrations

Vendor concentrations for inventory purchases for the nine months ended September 30, 2017 and 2016 are:

	For the Nine Months Ended September 30,	
	2017	2016
Vendor A	26%	31%
Vendor B	*%	11%
Vendor C	12%	*%
Total	38%	42%

*Less than 10%

NOTE 8 – EQUITY CREDITS

In 1997, PEN Brands LLC established The Equity Credit Incentive Program. This program enabled select employees the opportunity to purchase equity credits that increase in value based upon an increase in PEN Brands LLC's revenue over a base year of 1996. Eligible credits can be redeemed after two years at the equity credit value for that year. Under certain circumstances, the equity credits are convertible into PEN Brands LLC equity on a one-for-one basis. During the three months ended September 30, 2017, no equity credits were forfeited and no units were redeemed. As of September 30, 2017 and December 31, 2016, 8,250 equity credits were issued and outstanding with an aggregate redemption value of \$2,278. At September 30, 2017 and December 31, 2016, \$2,278 was accrued, and included in accrued expenses, representing the redemption value associated with the equity credits outstanding.

Under the terms of the Plan, when the Company completes a registered offering of its common stock, the equity credit participants will have the option to convert the equity credits into Class A common shares of the Company, or in the case of our President, into shares of Class B common stock.

NOTE 9 – STOCK APPRECIATION PLAN

From June 1, 1988, until December 31, 1997, when the plan was terminated, PEN Brands LLC had in place a Stock Appreciation Rights Plan A (the "Plan"), intended to provide employees, directors, members of a technical advisory board and certain independent contractors selected by the Board with equity-like participation in the growth of PEN Brands LLC. The maximum number of stock appreciation rights that could be granted by the Board was 1,000,000.

There were 235,782 fully vested stock appreciation rights ("SARS") outstanding under the terms of the Plan at September 30, 2017 and December 31, 2016. The SARS unit value is based on the book value of the Company as of the last fiscal year end multiplied by a SARS multiplier stipulated in the SARS plan. However, in the event of an initial public offering ("IPO") of PEN Brands, the SARS are redeemable based on a value equal to offering price of the stock in an IPO times the total outstanding shares of the Company just subsequent to the completion of the IPO, multiplied by the SARS multiplier. The SARS multiplier is to be adjusted, as the Board determines, to reflect changes in the capitalization of PEN Brands LLC. Generally, the SARS are redeemable in cash, at their then fair value as computed pursuant to the Plan, in the event of termination of employment or business relationship, death, permanent and total disability, or sale of PEN Brands (as defined). Upon an IPO, SARS are to be redeemed by applying 70% of the redemption value to purchase common shares, with the remaining 30% being distributed in cash to the participant.

The business combination completed in August 2014 did not qualify as an IPO under the Plan; however, a future underwritten registered offering may qualify.

The accrued redemption value associated with the stock appreciation rights amounted to \$54,538 and \$53,108, at September 30, 2017 and December 31, 2016, respectively. If the Company completes an IPO, the value of SARS calculated based on the IPO formula may cause a material increase in the value of the liability.

NOTE 10 – SEGMENT REPORTING

The Company's principal operating segments coincide with the types of products to be sold. The products from which revenues are derived are consistent with the reporting structure of the Company's internal organization. The Company's two reportable segments for the three and nine months ended September 30, 2017 and 2016 were the Product segment and ii) the Contract services segment (formerly the research and development segment). The Company's chief operating decision-maker has been identified as the Chairman and CEO, who reviews operating results to make decisions about allocating resources and assessing performance for the entire Company. Segment information is presented based upon the Company's management organization structure as of September 30, 2017 and the distinctive nature of each segment. Future changes to this internal financial structure may result in changes to the reportable segments disclosed. There are no inter-segment revenue transactions and, therefore, revenues are only to external customers. As the Company primarily generates its revenues from customers in the United States, no geographical segments are presented.

Segment operating profit is determined based upon internal performance measures used by the chief operating decision-maker. The Company derives the segment results from its internal management reporting system. The accounting policies the Company uses to derive reportable segment results are the same as those used for external reporting purposes. Management measures the performance of each reportable segment based upon several metrics, including net revenues, gross profit and operating loss. Management uses these results to evaluate the performance of, and to assign resources to, each of the reportable segments. The Company manages certain operating expenses separately at the corporate level and does not allocate such expenses to the segments. Segment income from operations excludes interest income/expense and other income or expenses and income taxes according to how a particular reportable segment's management is measured. Management does not consider impairment charges, and unallocated costs in measuring the performance of the reportable segments.

Segment information available with respect to these reportable business segments for the three and nine months ended September 30, 2017 and 2016 was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Revenues:				
Product segment	\$ 1,772,960	\$ 1,781,755	\$ 5,523,785	\$ 5,391,305
Contract services segment	255,301	225,083	723,435	804,522
Total segment and consolidated revenues	\$ 2,028,261	\$ 2,006,838	\$ 6,247,220	\$ 6,195,827
Gross profit:				
Product segment	\$ 651,921	\$ 664,768	\$ 2,286,564	\$ 2,215,676
Contract services segment	(18,939)	(33,685)	(64,008)	(60,383)
Total segment and consolidated gross profit	\$ 632,982	\$ 631,083	\$ 2,222,556	\$ 2,155,293
Income (loss) from operations:				
Product segment	\$ 224,228	\$ 108,634	\$ 535,846	\$ 409,115
Contract services segment	(73,449)	(91,391)	(219,084)	(248,765)
Total segment income	150,779	17,243	316,762	160,350
Unallocated costs	(198,910)	(253,015)	(659,049)	(763,257)
Total consolidated loss from operations	\$ (48,131)	\$ (235,772)	\$ (342,287)	\$ (602,907)
Depreciation and amortization:				
Product segment	\$ 28,769	\$ 34,516	\$ 89,795	\$ 103,546
Contract services segment	2,679	7,826	10,530	33,052
Total segment depreciation and amortization	31,448	42,342	100,325	136,598
Unallocated depreciation	-	-	-	-
Total consolidated depreciation and amortization	\$ 31,448	\$ 42,342	\$ 100,325	\$ 136,598
Capital additions:				
Product segment	\$ -	\$ -	\$ -	\$ 4,000
Contract services segment	-	-	-	-
Total segment capital additions	-	-	-	4,000
Unallocated capital additions	-	-	-	-
Total consolidated capital additions	\$ -	\$ -	\$ -	\$ 4,000

	September 30, 2017	December 31, 2016
Segment total assets:		
Product segment	\$ 2,330,603	\$ 2,577,034
Contract services segment	169,937	146,193
Corporate	72,838	70,504
Total consolidated total assets	\$ 2,573,378	\$ 2,793,731

NOTE 11 - COMMITMENTS AND CONTINGENCIES

Equity Credits

Equity credits may become convertible into an unknown amount of capital stock of the Company to be determined by the Company's board of directors (See Note 8).

Stock Appreciation Rights

If the Company completes an IPO, the value of stock appreciation rights calculated based on the IPO formula may cause a material increase in the value of the liability (See Note 9).

Litigation

The Company may be, from time to time, subject to various administrative, regulatory, and other legal proceedings arising in the ordinary course of business. We are not currently a defendant in any proceedings. Our policy is to accrue costs for contingent liabilities, including legal proceedings or unasserted claims that may result in legal proceedings, when a liability is probable and the amount can be reasonably estimated.

On September 20, 2017, the Company entered into a three-year lease agreement for 22,172 square feet of office space in Brooklyn Heights, Ohio beginning September 20, 2017 and ending September 20, 2020. Monthly lease payments amount to \$8,688 for a total of approximately \$312,768 for the total term of the lease.

NOTE 12 - SUBSEQUENT EVENTS

Sale of Fixed Assets

Subsequent to September 30, 2017, the Company entered into an asset purchase agreement (the “Asset Purchase Agreement”) in which certain machinery and equipment of the Company has been sold to a third party for aggregate gross proceeds of \$85,000.

Amended Loan Agreement

On October 17, 2017, pursuant to the terms of the Revolving Note, the gross proceeds of \$85,000 in connection with the Asset Purchase agreement were applied to decrease the borrowing base of the Revolving Note. In connection with the sale of fixed assets, the Company amended the Revolving Note to establish a cash collateral account to be no less than \$85,000. Pursuant to this amendment, the Company entered into a loan agreement with two Company directors in the aggregate principal amount of \$85,000 in order to fund the cash collateral provision pursuant to the amended loan agreement. The loan bears no interest and is due when cash flow permits, or if earlier, upon the payment or refinancing of the loan from the Lender to PEN Brands.

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

The following is management's discussion and analysis of certain significant factors that have affected our financial position and operating results during the periods included in the accompanying unaudited consolidated financial statements.

OVERVIEW

PEN develops, commercializes and markets consumer and industrial products enabled by nanotechnology that solve everyday problems for customers in the optical, transportation, military, sports and safety industries. Our primary business is the formulation, marketing and sale of products enabled by nanotechnology including the ULTRA CLARITY brand eyeglass cleaner, CLARITY DEFOGIT brand defogging products and CLARITY ULTRASEAL nanocoating products for glass and ceramics. We also sell an environmentally friendly surface protector, fortifier, and cleaner. Our design center conducts development services for us and for government and private customers and develops and sells printable inks and pastes, thermal management materials, and graphene foils and windows.

Our principal operating segments coincide with our different business activities and types of products sold. This is consistent with our internal reporting structure. Our two reportable segments for the three and nine months ended September 30, 2017 were (i) the Product Segment and (ii) the Contract services Segment. For the three and nine months ended September 30, 2016, the Company operated the same two segments.

RESULTS OF OPERATIONS

The following comparative analysis on results of operations was based primarily on the comparative consolidated financial statements, footnotes and related information for the periods identified below and should be read in conjunction with the unaudited consolidated financial statements and the notes to those statements that are included elsewhere in this report. The results discussed below are for the three and nine months ended September 30, 2017 and 2016.

Comparison of Results of Operations for the Three and Nine Months ended September 30, 2017 and 2016

Revenues:

For the three and nine months ended September 30, 2017 and 2016, revenues consisted of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Sales:				
Product segment	\$ 1,772,960	\$ 1,781,755	\$ 5,523,785	\$ 5,391,305
Contract services segment	\$ 255,301	225,083	723,435	804,522
Total segment and consolidated sales	<u>\$ 2,028,261</u>	<u>\$ 2,006,838</u>	<u>\$ 6,247,220</u>	<u>\$ 6,195,827</u>

For the three months ended September 30, 2017, sales from the Product segment were essentially flat, decreasing by \$8,795 as compared to the three months ended September 30, 2016. For the nine months ended September 30, 2017 revenue from the Product segment increased slightly by \$132,480 or 2%, as compared to the nine months ended September 30, 2016. During the three and nine months ended September 30, 2017, we recorded a one-time adjustment to Product revenues as a result of our change in estimate related to our cooperative advertising liability, which resulted in an increase of \$346,353 to Product revenues on the statements of operations.

For the three months ended September 30, 2017, sales from the Contract services segment increased by \$30,218 or 13% as compared to the three months ended September 30, 2016 because of the final award of several new government contracts. For the nine months ended September 30, 2017 revenue from the Contract services segment decreased by \$81,087 or 10%, as compared to the nine months ended September 30, 2016 because of research contracts that were completed in prior periods that were not replaced.

Cost of revenues

Cost of revenues includes inventory costs, materials and supplies costs, internal labor and related benefits, subcontractor costs, depreciation, overhead and shipping and handling costs incurred and costs related to government and private research contracts in our Contract services segment.

For the three months ended September 30, 2017, cost of revenues was essentially flat, increasing by \$19,524 or 1% as compared to the three months ended September 30, 2016. For the nine months ended September 30, 2017, cost of revenues was essentially flat, decreasing \$15,870 or 0%. These changes consisted of the following:

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
Cost of revenues:				
Product segment	\$ 1,121,039	\$ 1,116,987	\$ 3,237,221	\$ 3,175,629
Contract services segment	274,240	258,768	787,443	864,905
Total segment and consolidated cost of revenues	<u>\$ 1,395,279</u>	<u>\$ 1,375,755</u>	<u>\$ 4,024,664</u>	<u>\$ 4,040,534</u>

Gross profit and gross margin

For the three months ended September 30, 2017, gross profit amounted to \$632,982 as compared to \$631,083 for the three months ended September 30, 2016, an increase of \$1,899. For the three months ended September 30, 2017 and 2016, gross margin was essentially unchanged at 31.2% and 31.4%, respectively. For the nine months ended September 30, 2017, gross profit amounted to \$2,222,556 as compared to \$2,155,293 for the nine months ended September 30, 2016, an increase of \$67,263 or 3%. For the nine months ended September 30, 2017 and 2016, gross margins were 35.6% and 34.8%, respectively, essentially unchanged.

Gross profit and gross margin by segment is as follows:

	<u>Three Months Ended September 30,</u>				<u>Nine Months Ended September 30,</u>			
	<u>2017</u>	<u>%</u>	<u>2016</u>	<u>%</u>	<u>2017</u>	<u>%</u>	<u>2016</u>	<u>%</u>
Gross profit:								
Product segment *	\$ 651,921	36.8%	\$ 664,768	37.3%	\$ 2,286,564	41.4%	\$ 2,215,676	41.1%
Contract services segment *	(18,939)	(7.4)%	(33,685)	(15.0)%	(64,008)	(8.8)%	(60,383)	(7.5)%
Total gross profit	<u>\$ 632,982</u>	<u>31.2%</u>	<u>631,083</u>	<u>31.4%</u>	<u>2,222,556</u>	<u>35.6%</u>	<u>2,155,293</u>	<u>34.8%</u>

* Gross margin % based on respective segments revenues.

For the three and nine months ended September 30, 2017, as compared to the comparable 2016 periods, margins were essentially unchanged.

The improvement in gross margin from the research development segment for the three months ended September 30, 2017 as compared to the three months ended September 30, 2016 was attributable to increased revenue and fixed costs that were unchanged.

Operating expenses

For the three months ended September 30, 2017, operating expenses decreased by \$185,742 or 21% compared to the three months ended September 30, 2016. Operating expenses decreased by \$193,357 or 7% for the period ended September 30, 2017, as compared to the nine months ended September 30, 2016. For the three and nine months ended September 30, 2017 and 2016, operating expenses consisted of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Selling and marketing expenses	\$ 20,933	\$ 57,942	\$ 257,803	\$ 177,274
Salaries, wages and related benefits	253,615	375,794	820,051	1,241,033
Research and development	82,544	71,921	297,697	236,534
Professional fees	135,261	118,818	536,284	364,450
General and administrative expenses	188,760	242,380	653,008	738,909
Total	\$ 681,113	\$ 866,855	\$ 2,564,843	\$ 2,758,200

- For the three months ended September 30, 2017, selling and marketing expenses decreased by \$37,009 or 64% as compared to the three months ended September 30, 2016 due to heavy spending earlier in the year. For the nine months ended September 30, 2017, sales and marketing expenses increased by \$80,529 or 45% as compared to the nine months ended September 30, 2016. The increase was due to increased spending for commissions, trade shows and social media.
- For the three months ended September 30, 2017, salaries, wages and related benefits decreased by \$122,179, or 33%, as compared to the three months ended September 30, 2016. For the nine months ended September 30, 2017, salaries, wages and related benefits decreased by \$420,982, or 34%, as compared to the nine months ended September 30, 2016. These decreases were attributable to personnel reductions related to our ongoing efforts to reduce costs.
- For the three months ended September 30, 2017, research and development costs increased by \$10,623 or 15%, as compared to the three months ended September 30, 2016. For the nine months ended September 30, 2017, research and development costs increased by \$61,163 or 26%, as compared to the nine months ended September 30, 2016. For the three and nine months ended September 30, 2017, these increases were attributable to further work on specialty coatings for new markets and evaluating different parameters and potential enhancements of the surface protector and fortifier product.
- For the three and nine months ended September 30, 2017, professional fees increased by \$16,443 or 14%, and \$171,834 or 47%, as compared to the three and nine months ended September 30, 2016, respectively. This increase is due to contract services related to the inventory build as well as other services related to the move of the product segment operations that occurred in September and October.
- For the three months ended September 30, 2017, general and administrative expenses decreased by \$53,620 or 22% as compared to the three months ended September 30, 2016. For the nine months ended September 30, 2017, general and administrative expenses decreased by approximately \$85,901 or 12% as compared to the nine months ended September 30, 2016. The decrease for the nine-month period in 2017 was attributable to several factors including the end of amortization of intangibles, and personnel reductions with associated general and administrative expenses.

Loss from operations

As a result of the factors described above, for the three months ended September 30, 2017, loss from operations amounted to \$(48,131) as compared to loss from operations of \$(235,772) for the three months ended September 30, 2016, a decrease of \$187,641 or 80%. For the nine months ended September 30, 2017, loss from operations amounted to \$(342,287) as compared to a loss from operations of \$(602,907) for the nine months ended September 30, 2016, an improvement of \$260,620 or 43%.

Other (income) expense

For the three months ended September 30, 2017, other expense was \$(76,599) as compared to other income of \$24,870 for the three months ended September 30, 2016, a decrease of \$101,469 or 408%. There was a decrease in interest expense of approximately \$5,876 attributable to a reduced interest rate on our revolving credit loan and an increase in other income of \$14,705 partially offset by a loss on disposal of fixed assets of \$122,050. For the nine months ended September 30, 2017 other expense was \$(9,221) as compared to other income of \$146,379 for the nine months ended 2016, a decrease of \$155,600, or 106%.

Net loss

As a result of the foregoing, for the three and nine months ended September 30, 2017, net loss amounted to \$(124,730) and \$(351,508) as compared to net loss of \$(210,902) and \$(456,528) for the three and nine months ended September 30, 2016. For the three-month period the loss was decreased by \$86,172 or 41%. For the nine-month period there was an improvement of \$105,020 or 23%.

For the three months ended September 30, 2017 and 2016, net (loss) amounted to \$(0.04) per common share (basic and diluted), and \$(0.07) per common share (basic and diluted), respectively. For the nine months ended September 30, 2017 and 2016, net (loss) amounted to \$(0.12) per common share (basic and diluted), and \$(0.15) per common share (basic and diluted), respectively.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity is the ability of an enterprise to generate adequate amounts of cash to meet its needs for cash requirements. We had working capital deficit of \$1,033,150 and \$73,927 of cash as of September 30, 2017 and working capital deficit of \$1,072,691 and \$189,128 of cash as of December 31, 2016.

The following table sets forth a summary of changes in our working capital from December 31, 2016 to September 30, 2017:

	<u>September 30, 2017</u>	<u>December 31, 2016</u>	<u>December 31, 2016 to September 30, 2017</u>	
			<u>Change in Working Capital</u>	<u>Percentage Change</u>
Working capital:				
Total current assets	\$ 2,083,275	\$ 2,033,026	\$ 50,249	2.47%
Total current liabilities	<u>3,116,425</u>	<u>3,105,717</u>	<u>10,708</u>	<u>0.34%</u>
Working capital deficit:	<u>\$ (1,033,150)</u>	<u>\$ (1,072,691)</u>	<u>\$ 60,957</u>	<u>2.81%</u>

The increase in current assets was a combination of increased accounts receivable, including those from a related party, and a decrease in pre-paid expenses. The increase in current liabilities was largely due to an increase in accounts payable related to the costs of the inventory build late in the second quarter.

Net cash provided by operating activities was \$283,581 for the nine months ended September 30, 2017 as compared to \$188,459 for the nine months ended September 30, 2016, an improvement of \$95,122 or 50%. Net cash provided by operating activities for the nine months ended September 30, 2017 primarily reflected a net loss of (\$351,508) adjusted for add-backs of \$417,744 and changes in operating assets of \$217,345.

We expect our cash used in operating activities to increase slightly due to the following:

- additional working capital to support increased sales; and
- an increase in advertising, commissions and sales promotions for existing and new brands as we expand within existing markets or enter new markets.

Net cash flow provided by investing activities was \$87,000 for the nine months ended September 30, 2017 as compared to \$17,866 for the nine months ended September 30, 2016. For the 2017 period, the increase was due to proceeds from the sale of property and equipment with no offsetting purchases. The 2016 period included proceeds from the sale of property and equipment of \$21,866, partially offset by the purchase of property and equipment of \$4,000.

Net cash used in financing activities of \$(485,782) was related to the pay down in obligations on a net basis for the nine months ended September 30, 2017 as compared to \$(342,130) in the same period in 2016. During the nine months ended September 30, 2017, we paid down the bank line of credit with proceeds of equipment sales, paid down an equipment loan by \$56,138 and paid down \$10,470 on a third-party note.

Future Liquidity and Capital Needs

Our principal future uses of cash are for working capital requirements, including sales and marketing expenses and reduction of accrued liabilities. Application of funds among these uses will depend on numerous factors including our sales and other revenues and our ability to control costs.

Revolving Credit Note

In April 2014, our subsidiary, PEN Brands LLC entered into a \$1,500,000 revolving credit line agreement (the “Revolving Note”) with Mackinac Commercial Credit, LLC (the “Lender”) with draws limited to a borrowing base as defined in the Revolving Note. The unpaid principal balance of this Revolving Note is payable on demand, is secured by all of PEN Brands LLC’s assets, and bears interest computed at a rate of interest (the “Effective Rate”) which is equal to 7.0% above the LIBOR Rate, as defined, payable monthly. PEN Brands LLC will pay to Lender a late charge of 5.0% of any monthly payment not received by Lender within 10 calendar days after its due date. The Company may, at any time or from time to time upon three business days’ written notice to Lender, prepay the Note in whole provided that if (i) Borrower prepays the Revolving Note in full and terminates the Revolving Note, or (ii) Lender terminates the Revolving Note after default, then Borrower will pay a termination premium equal to 2.0% of the maximum loan amount. On May 1, 2015, PEN Brands LLC and the Lender entered into an amendment to the Loan and Security Agreement extending the outside maturity date to April 4, 2016 and permitting advances against an expanded borrowing base. The borrowing base was increased by \$450,000 through October 31, 2015, with this amount reducing by \$7,500 monthly thereafter. In addition, the Company guaranteed PEN Brands LLC’s obligations to the Lender. On April 4, 2016, the maturity date under the Loan & Security Agreement between PEN Brands LLC and the Lender was automatically extended for a one-year renewal term.

Without the Lender’s consent, so long as the obligation remains outstanding, in addition to other covenants as defined in the Revolving Note, PEN Brands LLC shall not a) merge or consolidate with any other company, except for the combination that closed in August 2014 and shall not suffer a change of control; b) make any capital expenditures, as defined, materially affecting the business; c) declare or pay cash dividends upon any of its stock, or distribute any of its property, make any loans, make investments, redeem, retire or acquire any of its stock, d) become liable for the indebtedness of anyone else, as defined, and e) incur indebtedness, other than trade payables.

On April 3, 2017, PEN Brands LLC and the Lender executed a second amendment to the Revolving Note that extended the maturity date to April 4, 2018, with a one-year renewal option. The second amendment also reduced the interest rate to 3.0% above the Prime Rate, as reported in the Wall Street Journal.

At September 30, 2017 and December 31, 2016, the Company had \$689,232 and \$979,688, respectively, which includes accrued interest of \$10,324 and \$17,494, respectively, in amounts outstanding under the Revolving Note with availability of up to \$810,768 as of September 30, 2017, depending on the borrowing base at the time of the request for the advance. The weighted average interest rate during the nine months ended September 30, 2017 and 2016 was approximately 6.8% and 8.1%, respectively.

On October 17, 2017, pursuant to the terms of the Revolving Note, the gross proceeds of \$85,000 in connection with the Asset Purchase agreement were applied to decrease the borrowing base of the Revolving Note. In connection with the sale of fixed assets, the Company amended the Revolving Note to establish a cash collateral account to be no less than \$85,000. Pursuant to this amendment, the Company entered into a loan agreement with two Company directors in the aggregate principal amount of \$85,000 in order to fund the cash collateral provision pursuant to the amended loan agreement. The loan bears no interest and is due when cash flow permits, or if earlier, upon the payment or refinancing of the loan from the Lender to PEN Brands.

Equipment Financing

On February 10, 2015, PEN Brands entered into a \$373,000 promissory note (the "Equipment Note") with KeyBank, N.A. (the "Bank"). The unpaid principal balance of this Equipment Note is payable in 60 equal monthly installments payments of principal and interest through September 10, 2020. The Equipment Note is secured by certain equipment, as defined in the Equipment Note, and bears interest computed at a rate of interest of 4.35% per annum based on a year of 360 days. At September 30, 2017, the principal amount due under the Equipment Note amounted to \$204,546

Off-Balance Sheet Arrangements

We have not entered into any other financial guarantees or other commitments to guarantee the payment obligations of any third parties. We have not entered into any derivative contracts that are indexed to our shares and classified as shareholder's equity or that are not reflected in our consolidated unaudited financial statements. Furthermore, we do not have any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity. We do not have any variable interest in any unconsolidated entity that provides financing, liquidity, market risk or credit support to us or engages in leasing, hedging or research and development services with us.

ITEM 3. Quantitative and Qualitative disclosures about market risk

Not applicable to smaller reporting companies.

ITEM 4. Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as of the end of the period covered by this report (the "Evaluation Date"). Based upon this evaluation, our principal executive officer and principal financial officer concluded as of the Evaluation Date that our disclosure controls and procedures were effective such that the material information required to be included in our Securities and Exchange Commission ("SEC") reports is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms relating to the Company, including, our consolidated subsidiaries, and was made known to them by others within those entities, particularly during the period when this report was being prepared.

Our management, including our principal executive officer and principal financial officer, does not expect that our disclosure controls and procedures or our internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints and the benefits of controls must be considered relative to their costs. Due to the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been detected.

Changes in Internal Control

There were no changes identified in connection with our internal control over financial reporting during the three months ended September 30, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 1A. RISK FACTORS

Not required of smaller reporting companies.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

<u>Exhibit No.</u>	<u>Description</u>
10.1*	Third Amendment to Loan and Security Agreement and Loan Documents, dated October 17, 2017, between PEN Brands LLC and Mackinac Commercial Credit ABL Division of MBank.
31.1*	Rule 13a-14(a)/15d-14(a) Certificate of Chief Executive Officer
31.2*	Rule 13a-14(a)/15d-14(a) Certificate of Chief Financial Officer
32.1*	Section 1350 Certificate of Chief Executive Officer and Chief Financial Officer
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation
101.DEF	XBRL Taxonomy Extension Definition
101.LAB	XBRL Taxonomy Extension Labels
101.PRE	XBRL Taxonomy Extension Presentation Linkbase
*	Filed herewith.

SIGNATURES

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

PEN Inc.
(Registrant)

Date: November 14, 2017

/s/ Scott Rickert

Scott Rickert.
President and Chief Executive Officer

Date: November 14, 2017

/s/ Jacqueline M. Soptick

Jacqueline M. Soptick
Chief Accounting Officer

**THIRD AMENDMENT TO
LOAN AND SECURITY AGREEMENT AND LOAN DOCUMENTS**

THIS THIRD AMENDMENT TO LOAN AND SECURITY AGREEMENT AND LOAN DOCUMENTS (“Amendment”) is entered into as of October 17, 2017 (“Effective Date”), between **PEN BRANDS LLC**, an Ohio limited liability company f/k/a Nanofilm, Ltd. (“Borrower”) and **MACKINAC COMMERCIAL CREDIT ABL DIVISION OF MBANK**, a Michigan banking corporation and successor in interest to Mackinac Commercial Credit, LLC, a Michigan limited liability company (together with its successors and assigns, the “Lender”).

RECITALS

A. Lender and Borrower entered into a Loan and Security Agreement dated April 4, 2014, as amended by a First Amendment to Loan and Security Agreement dated effective as of April 4, 2015, and a Second Amendment to Loan and Security Agreement dated effective as of April 3, 2017 (as so amended, the “Loan Agreement”), together with various other documents, written agreements, certificates and instruments between Lender and Borrower, among others, in connection therewith (collectively, as amended or modified from time to time, the “Loan Documents”). All capitalized terms not defined herein shall have the same meanings ascribed to such terms in the Loan Agreement.

B. Lender and Borrower have agreed to modify the terms and conditions of the Loan Agreement and other Loan Documents and Borrower and Lender wish to set forth their agreement regarding the foregoing in this Amendment.

NOW, THEREFORE, in consideration of the mutual covenants, conditions, and provisions as hereinafter set forth, the parties hereto agree as follows:

1. Advances. Section 2.A of the Revolving Credit Loan Rider #1 is hereby amended and restated in its entirety to read as follows:

Advances. Subject to the terms of the Agreement, Lender may, in its sole discretion and upon Borrower’s request, make Advances to Borrower in an amount (hereinafter referred to as the “Gross Availability”) which is the lesser of (i) the **Maximum Loan Amount** as set forth on the Term Sheet or (ii) an amount equal to the sum of (w) the applicable **Percentage Advance Rate** as set forth on the Term Sheet times the face amount (less maximum discounts, credits and allowances which may be taken by or granted to Receivable Debtors in connection therewith) of Eligible Receivables; plus (x) the lesser of (1) the Inventory Cap as set forth on the Term Sheet, or (2) the sum of (A) the applicable Percentage Advance Rate as set forth on the Term Sheet times the value of Borrower’s Eligible Raw Materials (less freight and container costs) calculated at the lower of cost or market value, plus (B) the applicable Percentage Advance Rate as set forth on the Term Sheet times the value of Borrower’s Eligible Finished Goods (less freight and container costs) calculated at the lower of cost or market value; plus (y) the Borrowing Base; plus (z) the balance in the Borrowing Base Cash Collateral Account; which Advances Borrower may borrow, repay and reborrow during the term of the Agreement. All Advances and amounts payable pursuant to this Rider shall constitute part of the Obligations.

For purposes of this Section 2.A, the following terms shall have the meanings set forth below:

“Borrowing Base” means \$185,000, reducing by \$7,500 as of November 1, 2017, and on the first (1st) day of each calendar month thereafter; provided however, that the Borrowing Base shall be further reduced by \$85,000 upon consummation of the purchase of certain machinery and equipment pursuant to the terms and conditions of that certain Asset Purchase Agreement dated October 16, 2017 between Borrower and Span Packaging Services LLC, a Delaware limited liability company.

“ Borrowing Base Cash Collateral Account ” means a restricted deposit account held in the name of Borrower at mBank, a Michigan banking corporation, which shall not at any time, have a balance of less than \$85,000.00.

2. Representations . Borrower represents and warrants to Lender (and Lender relies upon such representations and warranties in entering into this Amendment) as follows:

(a) Organizational Documents; No Membership Changes . Since April 3, 2017, there have been no amendments to the Articles of Organization or Operating Agreement of the Borrower, other than to change the name of the Borrower to PEN Brands LLC;

(b) Representations Still True . The representations in the Loan Agreement and contained in all other Loan Documents remain true, and Borrower reaffirms such representations, in all respects as of the date hereof;

(c) No Events of Default . No Event of Default has occurred and is continuing as of the date hereof and no event or condition which, with the giving of notice, the lapse of time, or both, would constitute an Event of Default, has occurred and is continuing as of the date hereof; and

(d) Execution, Delivery and Performance . Execution, delivery and performance of this Amendment and any other documents and instruments required under this Amendment or the Loan Agreement are within Borrower’s powers, have been duly authorized, are not in contravention of law or the terms of the organizational documents of the Borrower, and do not require the consent or approval of any governmental body, agency, or authority, and this Amendment and any other documents and instruments required under this Amendment or the Loan Agreement when executed will be valid and binding in accordance with their terms.

3. Conditions to Effectiveness . The effectiveness of this Amendment shall be subject to satisfaction of the following conditions:

(a) Amendment Documents . Borrower shall have executed and delivered, or cause to be executed and delivered to Lender, this Amendment (including the acknowledgement and agreement to the amendments contained herein of the Guarantors), and all other documents and instruments required by Lender in connection with this Amendment.

(b) Lender Expenses . Borrower shall have paid to Lender all of Lender’s legal fees and expenses incurred in connection with the preparation, negotiation and closing of this Amendment.

4. Effect of Amendment . Except for the amendments set forth in this Amendment, the Loan Agreement and all other Loan Documents shall remain unchanged and in full force and effect. Nothing in this Amendment is intended, or shall be construed, to constitute a novation or an accord and satisfaction of any of Borrower’s obligations under or in connection with the Loan Agreement or any other Loan Document.

5. Miscellaneous.

(a) Entire Agreement. This Amendment, together with the Loan Agreement and other Loan Documents constitutes the entire agreement and understanding among the parties relating to the subject matter hereof, and supersedes all prior proposals, negotiations, agreements and understandings relating to such subject matter. In entering into this Amendment, Borrower acknowledges that it is relying on no statement, representation, warranty, covenant or agreement of any kind made by the Lender or any employee or agent of Lender , except for the agreements of Lender set forth herein.

(b) Binding Effect. This Amendment shall be binding upon and shall inure to the benefit of the parties hereto and their respective successors and assigns, provided that no party other than Lender may assign any of its rights or obligations hereunder without the prior written consent of Lender .

(c) Governing Law. THIS AMENDMENT SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE INTERNAL LAWS OF THE STATE OF MICHIGAN APPLICABLE TO CONTRACTS MADE AND PERFORMED IN SUCH STATE.

(d) Counterparts, Facsimile or Electronic Signatures. This Amendment may be executed in multiple counterparts, each of which shall be deemed to be an original and all of which when taken together shall constitute one and the same instrument. A facsimile or PDF signature shall be effective as an original signature.

[Signatures on following page]

IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be executed and delivered as of the date first hereinabove set forth.

BORROWER:

PEN BRANDS LLC,
an Ohio limited liability company

By : /s/ Anne Marie Thomas
Anne Marie Thomas
Title: President

LENDER:

MCC-ABL DIVISION OF MBANK,
a Michigan banking corporation

By: /s/ Edward P. Lewan
Edward P. Lewan
Title: President

ACKNOWLEDGEMENT OF GUARANTOR

Scott E. Rickert, guarantor under that certain Validity Guaranty dated April 4, 2014 in favor of Lender (the “Validity Guaranty”), and PEN, Inc., a Delaware corporation, a guarantor under that certain Corporate Guaranty dated May 1, 2015 (the “Corporate Guaranty”), each acknowledge the above Amendment and agrees that their respective Guaranty shall continue in full force and effect.

GUARANTOR:

/s/ Scott E. Rickert
Scott E. Rickert, an individual

PEN, INC.
a Delaware corporation

By: /s/ Scott E. Rickert
Scott E. Rickert
Title: Chief Executive Officer

Certificate of Principal Executive Officer
Pursuant to Rule 13a-14(a)/15d-14(a)

I, Scott Rickert, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarterly period ended September 30, 2017 of PEN Inc. (the “registrant”);

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present, in all material respects, the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.

4. The registrant’s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in the Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting) as defined in the Exchange Act Rules 13a - 15(f) and 15d - 15(f) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors:

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: November 14, 2017

/s/ Scott Rickert

Scott E. Rickert

President and Chief Executive Officer

Certificate of Principal Financial Officer
Pursuant to Rule 13a-14(a)/15d-14(a)

I, Jaqueline M. Soptick, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarterly period ended September 30, 2017 of PEN Inc. (the “registrant”);

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present, in all material respects, the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.

4. The registrant’s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in the Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting) as defined in the Exchange Act Rules 13a - 15(f) and 15d - 15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors:

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: November 14, 2017

/s/ Jacqueline M. Soptick

Jacqueline M. Soptick
Chief Accounting Officer

Section 1350 Certification of Principal Executive Officer

In connection with the quarterly report of PEN Inc. (the "Company") on Form 10-Q for the quarterly period ended September 30, 2017, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Scott Rickert, President and Chief Executive Officer of the Company, and I, Jacqueline M. Soptick, Chief Accounting Officer, certify to the best of our knowledge:

1. The Report fully complies with the requirements of Section 13 (a) or 15 (d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 14, 2017

/s/ Scott Rickert

Scott Rickert
President and Chief Executive Officer

Date: November 14, 2017

/s/ Jacqueline M. Soptick

Jacqueline M. Soptick
Chief Accounting Officer
