CYANOTECH CORP
Form 10-Q
February 12, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For Quarterly Period Ended December 31, 2008

Or

o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Transition Period From to

Commission File Number 0-14602

CYANOTECH CORPORATION

(Exact name of registrant as specified in its charter)

NEVADA	**91-1206026**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)

73-4460 Queen Kaahumanu Hwy. #102, Kailua-Kona, HI 96740

(Address of principal executive offices)

(808) 326-1353

(Registrant s telephone number)

Not Applicable

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

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

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

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

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

Number of common shares outstanding as of February 12, 2009:

Title of Class	**Shares Outstanding**
Common stock - $0.02 par value	5,245,770

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CYANOTECH CORPORATION

FORM 10-Q

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Part 1. FINANCIAL INFORMATION

Item 1. Financial Statements (unaudited)

CYANOTECH CORPORATION

CONSOLIDATED CONDENSED BALANCE SHEETS

(Dollars in thousands except par value and share amounts)

(unaudited)

	December 31, 2008	March 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 276	$ 1,090
Accounts receivable, net of allowance for doubtful accounts of $15 at December 31, 2008 and $23 at March 31, 2008	2,346	1,934
Inventories	3,100	1,601
Prepaid expenses and other assets	229	263
Total current assets	5,951	4,888
Equipment and leasehold improvements, net	4,276	4,269
Other assets	487	623
Total assets	$ 10,714	$ 9,780
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,213	$ 805
Accrued expenses	361	320
Customer deposits		104
Current maturities of long-term debt	605	567
Total current liabilities	2,179	1,796
Long-term debt, less current maturities	1,045	1,505
Other liabilities		100
Total liabilities	3,224	3,401
Commitments and contingencies (Note 5)		
Stockholders equity:		
Common stock of $0.02 par value, shares authorized 7,500,000; 5,245,770 and 5,242,270 shares issued and outstanding at December 31, 2008 and March 31, 2008, respectively	105	105
Additional paid-in capital	27,500	27,337
Accumulated deficit	(20,115)	(21,063)
Total stockholders equity	7,490	6,379

Total liabilities and stockholders equity	$	10,714	$	9,780

See accompanying Notes to Consolidated Condensed Financial Statements.

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CYANOTECH CORPORATION

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

AND COMPREHENSIVE INCOME (LOSS)

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended December 31, 2008	Three Months Ended December 31, 2007	Nine Months Ended December 31, 2008	Nine Months Ended December 31, 2007
NET SALES	$ 3,553	$ 2,763	$ 10,528	$ 7,950
COST OF PRODUCT SALES	1,987	2,410	6,280	6,083
Gross profit	1,566	353	4,248	1,867
OPERATING EXPENSES:				
Research and development	65	22	155	105
Sales and marketing	298	391	820	1,096
General and administrative	647	501	2,220	1,882
Total operating expenses	1,010	914	3,195	3,083
Income (loss) from operations	556	(561)	1,053	(1,216)
OTHER INCOME (EXPENSE):				
Interest income	2	3	7	20
Interest expense	(41)	(36)	(130)	(115)
Other income, net			10	1
Total other expense, net	(39)	(33)	(113)	(94)
Income (loss) before income tax (benefit) expense	517	(594)	940	(1,310)
INCOME TAX (BENEFIT) EXPENSE	3		(8)	10
NET INCOME (LOSS)	$ 514	$ (594)	$ 948	$ (1,320)
NET INCOME (LOSS) PER SHARE:				
Basic	$ 0.10	$ (0.11)	$ 0.18	$ (0.25)
Diluted	$ 0.10	$ (0.11)	$ 0.18	$ (0.25)
SHARES USED IN CALCULATION OF NET INCOME (LOSS) PER SHARE:				
Basic	5,246	5,242	5,243	5,242
Diluted	5,246	5,242	5,246	5,242
COMPREHENSIVE INCOME (LOSS):				
Net income (loss)	$ 514	$ (594)	$ 948	$ (1,320)
Other comprehensive loss				(4)
	$ 514	$ (594)	$ 948	$ (1,324)

See accompanying Notes to Consolidated Condensed Financial Statements.

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CYANOTECH CORPORATION

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	Nine Months Ended December 31, 2008		Nine Months Ended December 31, 2007	
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net income (loss)	$	948	$	(1,320)
Adjustments to reconcile net income (loss) to net cash used in operating activities:				
Depreciation		324		380
Amortization of debt issue costs and other assets		41		27
Share-based compensation expense		156		
Net (increase) decrease in:				
Accounts receivable		(404)		295
Refundable income taxes				8
Inventories		(1,499)		(257)
Prepaid expenses and other assets		129		(304)
Net increase (decrease) in:				
Accounts payable		408		551
Accrued expenses		41		50
Customer deposits		(205)		289
Net cash used in operating activities		(61)		(281)
CASH FLOWS FROM INVESTING ACTIVITIES:				
Investment in equipment and leasehold improvements		(331)		(80)
Cash used in investing activities		(331)		(80)
CASH FLOWS FROM FINANCING ACTIVITIES:				
Principal payments on long-term debt		(422)		(293)
Cash used in financing activities		(422)		(293)
Net decrease in cash and cash equivalents		(814)		(654)
Cash and cash equivalents at beginning of period		1,090		1,444
Cash and cash equivalents at end of period	$	276	$	790
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:				
Cash paid during the period for:				
Interest	$	110	$	94
Income taxes	$		$	10

See accompanying Notes to Consolidated Condensed Financial Statements.

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CYANOTECH CORPORATION
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

As of December 31, 2008
(Unaudited)

1. BASIS OF PRESENTATION

The accompanying consolidated condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles (GAAP) for complete financial statements. These consolidated condensed financial statements and notes should be read in conjunction with the Company s consolidated financial statements contained in the Company s annual report on Form 10-K for the year ended March 31, 2008 filed on June 26, 2008.

The accompanying consolidated condensed financial statements include the accounts of Cyanotech Corporation and its wholly-owned subsidiaries, Nutrex Hawaii, Inc. (Nutrex Hawaii or Nutrex) and Cyanotech Japan YK (Cyanotech Japan or CJYK). All significant intercompar balances and transactions have been eliminated in consolidation. On August 31, 2007, the Company discontinued the activity of its wholly owned Japanese subsidiary CJYK. All aquaculture feed business in Japan was absorbed by the Company s U.S. operations. CJYK remained a registered Japanese corporation until November 30, 2007, at which time it was dissolved. All CJYK assets and liabilities were absorbed into the Company as of September 1, 2007. The Company made this decision due to declining sales of approximately 40% in each of the two fiscal years 2007 and 2006. CJYK sales for the quarter ended December 31, 2007, were approximately $45,000. Dissolution of this subsidiary has not had a significant impact on the consolidated financial statements.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities at the balance sheet date and the reported amounts of revenues and expenses during the period reported. Management reviews these estimates and assumptions periodically and reflects the effect of revisions in the period that they are determined to be necessary. Actual results could differ from those estimates and assumptions.

2. INVENTORIES

Inventories are stated at the lower of cost (which approximates first-in, first-out) or market. Market is defined as sales price less cost to dispose and a normal profit margin. Inventories consist of the following:

	December 31, 2008	March 31, 2008
	(in thousands)	
Raw materials	$ 448	$ 321
Work in process	357	214
Finished goods	2,104	888
Supplies	191	178

	$	3,100	$	1,601

In accordance with Statement of Financial Accounting Standards (SFAS) No. 151, fixed production related costs of approximately $18,000 and $121,000 were not inventoried for the quarter ended December 31, 2008 and 2007, respectively, and $40,000 and $178,000 for the nine months ended December 31, 2008 and 2007, respectively, due to below normal production capacity.

3. EQUIPMENT AND LEASEHOLD IMPROVEMENTS

Equipment and leasehold improvements are stated at cost. Depreciation and amortization are provided using the straight-line method over the estimated useful lives for equipment and furniture and fixtures, or the shorter of the land lease term or estimated useful lives for leasehold improvements as follows:

Equipment	3 to 10 years
Furniture and fixtures	7 years
Leasehold improvements	10 to 20 years

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Equipment and leasehold improvements consist of the following:

	December 31, 2008		March 31, 2008	
	(in thousands)			
Equipment	$	6,431	$	6,335
Leasehold improvements		7,432		7,348
Furniture and fixtures		115		94
		13,978		13,777
Less accumulated depreciation and amortization		(9,924)		(9,600)
Construction-in-progress		222		92
Equipment and leasehold improvements, net	$	4,276	$	4,269

Management reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. Upon such an occurrence, recoverability of these assets is determined by comparing the forecasted undiscounted net cash flows from the related assets, to its carrying amount. If the carrying value exceeds the related cash flows, then the carrying value of the long-lived assets are compared to the asset s fair value using discounted cash flow. Management has determined no asset impairment occurred during the three or nine months ended December 31, 2008.

4. LONG-TERM DEBT

Long-term debt consists of the following:

	December 31, 2008		March 31, 2008	
	(in thousands)			
Term loans	$	1,650	$	2,072
Less current maturities		(605)		(567)
Long-term debt, excluding current maturities	$	1,045	$	1,505

Term Loan Agreements

In February 2008, the Company executed a Term Loan Agreement (Term Loan A) with a lender providing for $1.1 million in aggregate credit facilities, secured by the Company s assets. Term Loan A has a maturity date of March 1, 2015, and is payable in 84 monthly principal and interest payments. The interest rate under Term Loan A, in the absence of a default under the agreement, is the prime rate in effect as of the close of business on the first day of each calendar quarter, plus 1%. As of December 31, 2008, the prime rate was 3.25%. The Company is prohibited from declaring any common stock dividends without the lender s prior written consent. Borrowings outstanding under Term Loan A were $984,351 and $1,078,400 at December 31, 2008, and March 31, 2008, respectively.

In April 2000, the Company executed a Term Loan Agreement (Term Loan B) with the same lender providing for $3.5 million in aggregate credit facilities, secured by the Company s assets. Term Loan B has a maturity date of May 1, 2010, and is payable in 120 monthly principal and interest payments. The interest rate under Term Loan B, in the absence of a default under the agreement, is the prime rate in effect as of the close of business on the first day of each calendar quarter, plus 1%. As of December 31, 2008, the prime rate was 3.25%. The Company is prohibited from declaring any common stock dividends without the lender s prior written consent. A warrant to purchase 5,000 shares of the Company s common stock was issued in conjunction with Term Loan B. The warrant expires in April 2011 and has an exercise price of $10.20 per share. The warrant may only be exercised after the Company has repaid Term Loan B in full. Borrowings outstanding under Term Loan B were $665,177 and $993,376 at December 31, 2008, and March 31, 2008, respectively.

The Company is required to comply with certain financial and operating covenants in connection with its loan agreements. At December 31, 2008, the Company was in compliance with these covenants.

These term loans are additionally secured by a $250,000 restricted cash deposit which is included in Other Assets in the accompanying consolidated condensed balance sheets at December 31, 2008 and March 31, 2008.

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Future principal payments under the Term Loan Agreements are as follows:

Year Ending March 31		**(in thousands)**
2009 (3 Months)	$	148
2010		612
2011		229
2012		155
2013		161
Thereafter through 2015		345
Total principal payments	$	1,650

5. LEASES

The Company leases facilities, equipment and land under operating leases expiring between 2008 and 2025. The land lease provides for contingent rental in excess of minimum rental commitments based on a percentage of the Company s annual sales. Contingent rental paid for nine months ended December 31, 2008 and 2007, was $54,000 and $35,000, respectively.

Future minimum lease payments under all non-cancelable operation leases are as follows:

Year ending March 31		**(in thousands)**
2009 (3 Months)	$	46
2010		168
2011		161
2012		151
2013		148
Thereafter through 2025		1,887
Total minimum lease payments	$	2,561

6. SHARE-BASED COMPENSATION

The Company has adopted the provisions of SFAS No. 123(R), Share-Based Payment, for its share-based compensation plans. SFAS No. 123(R) requires an entity to measure the cost of employee services received in exchange for an award. If an award vests or becomes exercisable based on the achievement of a condition other than service, such as for meeting certain performance or market condition, the award is classified as a liability. Liability-classified awards are remeasured to fair value at each balance sheet date until the award is settled. The Company currently has no liability-classified awards. Equity-classified awards, including grants of employee stock options, are measured at the grant-date fair value of the award and are not subsequently remeasured unless an award is modified. The cost of equity-classified awards is recognized in the income statement over the period during which an employee is required to provide the service in exchange for the award. All of the Company s stock options are service-based awards, and because the Company s future employee incentive stock options are plain vanilla, as defined by the U. S. Securities and Exchange Commission in Staff Accounting Bulletin No. 107, they are reflected only in Equity and Compensation Expense accounts.

Stock Options

As of December 31, 2008, the Company had the following two shareholder approved stock plans under which shares were available for equity-based awards: The 2005 Stock Option Plan (the 2005 Plan) wherein 700,000 shares of common stock are reserved for issuance until the Plan terminates on August 21, 2015, which includes 500,000 additional shares of common stock pursuant to a vote of the Company s stockholders on September 9, 2008, and; The Independent Director Stock Option and Stock Grant Plan (the 2004 Directors Plan) wherein 75,000 shares of common stock are reserved for issuance until the Plan terminates in 2014.

Under the 2005 Plan, eligible employees and certain independent consultants may be granted options to purchase shares of the Company s common stock. The shares issuable under the 2005 Plan will either be shares of the Company s authorized but previously unissued common stock or shares reacquired by the Company, including shares purchased on the open market. As of December 31, 2008, 205,782 options remain available for grant under the 2005 Plan. Concurrent with the 2005 Plan approval, the 1995 Stock Option Plan was terminated, except for the outstanding options issued thereunder.

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Under the 2004 Directors Plan, upon election to the Board of Directors, a newly elected non-employee director is granted a ten-year option to purchase 1,000 shares of the Company s common stock at fair market value on the date of grant. Options granted vest and become exercisable six months from the date of grant. In addition, on the date of each Annual Meeting of Stockholders, each non-employee director continuing in office is automatically issued 875 shares of common stock, non-transferable for nine months following the date of grant. Compensation expense recognized for shares issued under the 2004 Plan was $7,000 and $4,000 for the nine months ended December 31, 2008 and 2007, respectively. As of December 31, 2008, 70,250 options remain available for grant under the 2004 Plan. Concurrent with the 2004 Plan approval on August 16, 2004, the 1994 Non-Employee Director Stock Option and Stock Grant Plan was terminated except for the outstanding options issued thereunder.

The following table presents shares authorized, available for future grant and outstanding under each of the Company s plans:

		As of December 31, 2008	
	Authorized	**Available**	**Outstanding**
2005 Plan	700,000	205,782	494,218
2004 Plan	75,000	70,250	1,000
1995 Plan			21,553
1994 Plan			2,250
Total	775,000	276,032	519,021

All stock option grants made under the 2005 Plan and the 2004 Directors Plan were at exercise prices no less than the Company s closing stock price on the date of grant. Options under the 2005 Plan and 2004 Plan were determined by the Board of Directors or the Stock Option and Compensation Committee of the Board in accordance with the provisions of the respective plans. The terms of each option grant including vesting, exercising, and other conditions are set forth in a Stock Option Agreement evidencing each grant. No option can have a life in excess of ten (10) years. The Company records compensation expense for employee stock options based on the estimated fair value of the options on the date of grant using the Black-Scholes option-pricing model. The model requires various assumptions, including a risk-free interest rate, the expected term of the options, the expected stock price volatility over the expected term of the options, and the expected dividend yield. Compensation expense for employee stock options will be recognized ratably over the vesting term. Compensation expense recognized for options issued under the 2005 Plan was $91,000 and $156,000, respectively, for the three and nine months ended December 31, 2008 and is classified as General and Administrative expense in the consolidated condensed statement of operations. There was no compensation expense recognized under the 2005 Plan for the three and nine months ended December 31, 2007.

A summary of option activity under the Company s Stock Plans for the nine months ended December 31, 2008 is presented below:

Option Activity	**Shares**		**Weighted Average Exercise Price**	**Weighted Average Remaining Contractual Term**		**Aggregate Intrinsic Value**
Outstanding at March 31, 2008	111,447	$	3.15	4.9 years	$	(176,086)
Granted	443,168		1.84	9.7 years		(169,441)
Exercised		$				
Forfeited or expired	(35,594)	$	4.49			(107,731)
Outstanding at December 31, 2008	519,021	$	1.94	9.1years	$	(250,759)
Exercisable at December 31, 2008	29,803	$	3.97	1.1years	$	(74,871)

The aggregate intrinsic value in the tables above is before applicable income taxes and represents the amount optionees would have received if all options had been exercised on the last business day of the period indicated, based on the Company s closing stock price of $1.46 per share for such day.

A summary of the Company s non-vested options for the nine months ended December 31, 2008 is presented below:

Nonvested Options	**Shares**		**Weighted Average Grant-Date Fair Value**
Nonvested at March 31, 2008	47,529	$	1.61
Granted	443,168		1.84
Vested	(179)		4.40
Forfeited or expired	(1,300)		1.60
Nonvested at December 31, 2008	489,218	$	1.80

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The following table summarizes the weighted average characteristics of outstanding stock options as of December 31, 2008:

		Outstanding Options	Exercisable Options
Range of Exercise Prices	**Number of Shares**		