CYANOTECH CORP
Form 10-Q
November 07, 2013
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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 September 30, 2013

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	(IRS Employer

of incorporation or organization)	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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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 November 6, 2013:

Title of Class	**Shares Outstanding**
Common stock - $0.02 par value	5,485,388

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CYANOTECH CORPORATION

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

CYANOTECH CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands except par value and number of shares)

(Unaudited)

	September 30, 2013	March 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$ 3,279	$ 4,364
Accounts receivable, net of allowance for doubtful accounts of $6 at September 30, 2013 and $6 at March 31, 2013	4,038	3,766
Inventories, net	4,480	3,688
Deferred tax assets	110	110
Prepaid expenses and other current assets	564	263
Total current assets	12,471	12,191
Equipment and leasehold improvements, net	10,930	8,835
Restricted cash	2,010	3,360
Deferred tax assets	3,094	3,429
Other assets	809	772
Total assets	$ 29,314	$ 28,587
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current maturities of long-term debt	$ 199	$ 128
Customer deposits	67	33
Accounts payable	2,124	1,852
Accrued expenses	753	872
Total current liabilities	3,143	2,885
Long-term debt, excluding current maturities	5,354	5,454
Deferred rent	19	21
Total liabilities	8,516	8,360
Commitments and contingencies		
Stockholders equity:		
Common stock of $0.02 par value, shares authorized 50,000,000; 5,485,388 shares issued and outstanding at September 30, 2013 and 5,463,938 shares at March 31, 2013	110	109
Additional paid-in capital	29,511	29,077

Accumulated deficit		(8,823)		(8,959)
Total stockholders equity		20,798		20,227
Total liabilities and stockholders equity	$	29, 314	$	28,587

See accompanying Notes to Condensed Consolidated Financial Statements.

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CYANOTECH CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands, except per share amounts)

(Unaudited)

	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012	Six Months Ended September 30, 2013	Six Months Ended September 30, 2012
NET SALES	$ 7,299	$ 6,936	$ 14,208	$ 13,442
COST OF SALES	4,306	4,124	8,363	8,056
Gross profit	2,993	2,812	5,845	5,386
OPERATING EXPENSES:				
General and administrative	1,261	1,285	2,816	2,433
Sales and marketing	1,180	880	2,184	1,718
Research and development	171	80	286	131
Loss on disposal of equipment and leasehold improvements	21	13	26	35
Total operating expenses	2,633	2,258	5,312	4,317
Income from operations	360	554	533	1,069
OTHER EXPENSE:				
Loss on extinguishment of debt		(51)		(51)
Interest expense, net	(25)	(17)	(62)	(29)
Total other expense, net	(25)	(68)	(62)	(80)
Income before provision for income taxes	335	486	471	989
PROVISION FOR INCOME TAXES	(229)	(10)	(335)	(20)
NET INCOME	$ 106	$ 476	$ 136	$ 969
NET INCOME PER SHARE:				
Basic	$ 0.02	$ 0.09	$ 0.02	$ 0.18
Diluted	$ 0.02	$ 0.08	$ 0.02	$ 0.17
SHARES USED IN CALCULATION OF NET INCOME PER SHARE:				
Basic	5,475	5,450	5,470	5,445
Diluted	5,699	5,635	5,655	5,758

See accompanying Notes to Condensed Consolidated Financial Statements.

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CYANOTECH CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	Six Months Ended September 30, 2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 136	$ 969
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss on extinguishment of debt		51
Loss on disposal of equipment and leasehold improvements	26	35
Depreciation and amortization	488	399
Amortization of debt issue costs and other assets	22	74
Share based compensation expense	405	372
Reduction of allowance for doubtful accounts		(10)
Reduction of inventory reserve	(3)	
Deferred income tax provision	335	
Net (increase) decrease in assets:		
Accounts receivable	(272)	(1,435)
Inventories	(789)	191
Prepaid expenses and other assets	(360)	(64)
Net increase (decrease) in liabilities:		
Customer deposits	34	(6)
Accounts payable	272	450
Accrued expenses	(119)	(381)
Deferred rent	(2)	3
Net cash provided by operating activities	173	648
CASH FLOWS FROM INVESTING ACTIVITIES:		
Decrease (increase) in restricted cash	1,350	(2,250)
Investment in equipment and leasehold improvements	(2,610)	(1,304)
Net cash used in investing activities	(1,260)	(3,554)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from long term debt, net of costs		2,281
Principal payments on long-term debt	(29)	(596)
Payments for debt issuance costs		(259)
Proceeds from stock options exercised	31	22
Net cash provided by financing activities	2	1,448
Net decrease in cash and cash equivalents	(1,085)	(1,458)
Cash and cash equivalents at beginning of period	4,364	5,061
Cash and cash equivalents at end of period	$ 3,279	$ 3,603
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		

Cash paid during the period for:				
Interest	$	151	$	84
Income taxes	$	113	$	44

See accompanying Notes to Condensed Consolidated Financial Statements.

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CYANOTECH CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

As of September 30, 2013

(Unaudited)

1. BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information pursuant to the instructions to Form 10-Q and Regulation S-X of the Securities and Exchange Commission (SEC). These interim condensed consolidated financial statements are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring adjustments and accruals) necessary to present fairly the Condensed Consolidated Balance Sheets, Condensed Consolidated Statements of Operations, and Condensed Consolidated Statements of Cash Flows for the periods presented in accordance with GAAP. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. The Condensed Consolidated Balance Sheet as of March 31, 2013 was derived from the audited financial statements. These condensed consolidated financial statements and notes should be read in conjunction with the Company s consolidated financial statements for the year ended March 31, 2013, contained in the Company s annual report on Form 10-K as filed with the SEC on June 24, 2013.

The accompanying consolidated condensed financial statements include the accounts of Cyanotech Corporation and its wholly owned subsidiary, Nutrex Hawaii, Inc. (Nutrex Hawaii or Nutrex , collectively the Company). All significant intercompany balances and transactions have been eliminated in consolidation.

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 as of the date of the financial statements and the reported amounts of revenues and expenses during the periods 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.

Recent Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update No. 2013-11 on the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss or tax credit carryforward, exists. Under the guidance, an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. The updated guidance is effective for fiscal years and interim periods within those years, beginning after December 15, 2013. The adoption of this guidance is not expected to have a material effect on the Company s Consolidated Financial Statements.

2. **INVENTORIES**

Inventories are stated at the lower of cost or market. Cost is determined by the first-in, first-out method. Inventories consist of the following:

	September 30, 2013	March 31, 2013
	(in thousands)	
Raw materials	$ 784	$ 932
Work in process	330	330
Finished goods(1)	3,085	2,164
Supplies	281	262
	$ 4,480	$ 3,688

(1) Net of reserve for obsolescence of $6,000 and $9,000 at September 30, 2013 and March 31, 2013, respectively.

The Company recognizes abnormal production costs, including fixed cost variances from normal production capacity, as an expense in the period incurred. There were no abnormal production costs charged to cost of sales for the three and six months ended September 30, 2013. Approximately $481,000 and $714,000 of abnormal production costs were charged to cost of sales for the three and six months ended September 30, 2012.

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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	3 to 7 years
Leasehold improvements	10 to 25 years

Equipment and leasehold improvements consist of the following:

	September 30, 2013		March 31, 2013	
	(in thousands)			
Equipment	$	7,782	$	7,455
Leasehold improvements		8,751		8,313
Furniture and fixtures		217		208
		16,750		15,976
Less accumulated depreciation and amortization		(10,853)		(10,496)
Construction-in-progress		5,033		3,355
Equipment and leasehold improvements, net	$	10,930	$	8,835

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. Recoverability of these assets is measured by a comparison of the carrying amount to forecasted undiscounted future cash flows expected to be generated by the asset. If the carrying amount exceeds its estimated future cash flows, then an impairment charge is recognized to the extent that the carrying amount exceeds the asset s fair value. Management has determined no asset impairment existed as of September 30, 2013. The Company recognized a loss on disposal of assets in the amount of $21,000 and $26,000 for the three and six months ended September 30, 2013, respectively. The Company recognized a loss on disposal of assets in the amount of $13,000 and $35,000 for the three and six months ended September 30, 2012, respectively.

The Company has capitalized $55,000 and $98,000 of interest for the three and six months ended September 30, 2013, respectively. No interest was capitalized for the three and six month period ended September 30, 2012.

4. ACCRUED EXPENSES

Accrued expenses consist of the following:

	September 30, 2013		March 31, 2013	
	(in thousands)			
Wages, commissions	$	598	$	623
Customer rebates		67		109
Rent		50		21
Other expenses		38		119
	$	753	$	872

5. LONG-TERM DEBT

Long-term debt consists of the following:

	September 30, 2013		March 31, 2013	
	(in thousands)			
Term loans	$	5,553	$	5,582
Less current maturities		(199)		(128)
Long-term debt, excluding current maturities	$	5,354	$	5,454

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Term Loan Agreements

The Company executed a loan agreement with a lender providing for $5,500,000 in aggregate credit facilities (the Loan), secured by substantially all the Company s assets, pursuant to a Term Loan Agreement dated August 14, 2012 (the Loan Agreement). The Loan Agreement is evidenced by promissory notes in the amounts of $2,250,000 and $3,250,000, the repayment of which is partially guaranteed under the provisions of a United States Department of Agriculture (USDA) Rural Development Guarantee program (the Guarantees). The proceeds of the Loan will be used to acquire new processing equipment and leasehold improvements at its Kona, Hawaii facility.

The provisions of the Loan require the payment of interest only for the first 12 months of the term; thereafter, and until its maturity on August 14, 2032, the obligation fully amortizes over nineteen (19) years. Interest on the Loan accrues on the outstanding principal balance at an annual variable rate equal to the published Wall Street Journal prime rate (3.25% at September 30, 2013) plus 1.0% and is adjustable on the first day of each calendar quarter and fixed for that quarter. At no time shall the annual interest rate be less than 5.50%. The Loan has a prepayment penalty of 5% for any prepayment made prior to the first anniversary of the date of the Loan Agreement, which penalty is reduced by 1% each year thereafter until the fifth anniversary of such date, after which there is no prepayment penalty. The balance under this Loan was $5,486,000 at September 30, 2013. Proceeds from the Loan are classified as restricted cash until drawn upon to acquire new processing equipment and leasehold improvements.

The Loan includes a one-time origination and guaranty fees totaling $214,500 and an annual renewal fee payable in the amount of 0.25% of the USDA guaranteed portion of the outstanding principal balance as of December 31 of each year, beginning December 31, 2012. The USDA has guaranteed 80% of all amounts owing under the Loan. The Company is subject to financial covenants and customary affirmative and negative covenants. The Company was in compliance with these financial covenants at September 30, 2013.

The Company has three equipment loans with John Deere credit providing for $103,000 in equipment financing; these loans are payable in 48 equal monthly principal payments. At September 30, 2013 and March 31, 2013 the total outstanding combined balance was approximately $55,000 and $66,000, respectively. The equipment loans have maturity dates of May 2015 as to $18,000, November 2015 as to $16,000 and June 2016 as to $21,000. The loans are at a 0% rate of interest and are net of unamortized discount of $1,000 and $2,000 at September 30, 2013 and March 31, 2013, respectively

In September 2011, the Company executed a Term Loan Agreement with Nissan Motor Acceptance Corporation providing for $23,000 in equipment financing, secured by the equipment. The Term Loan has a maturity date of September 13, 2016 and is payable in 60 equal monthly principal payments. The interest rate under this Term Loan is 0%. Imputed interest at a rate of 2% (cash discount offered by seller) has been recorded and is being amortized as interest over the term of the loan. The balance outstanding under the Term Loan was $13,000 and $15,000 at September 30, 2013 and March 31, 2013, respectively, less the unamortized discount of $400 and $600 at September 30, 2013 and March 31, 2013, respectively.

Future principal payments under the term loan agreements as of September 30, 2013 are as follows:

Payments Due	**(in thousands)**

Next 12 Months	$	199
Year 2		206
Year 3		201
Year 4		200
Year 5		211
Thereafter		4,536
Total principal payments	$	5,553

6. LEASES

The Company leases facilities, equipment and land under operating leases expiring through 2035. The land lease provides for contingent rentals in excess of minimum rental commitments based on a percentage of the Company s sales. Management has accrued for the estimated contingent rent as of September 30, 2013.

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Future minimum lease payments under all non-cancelable operating leases at September 30, 2013 are as follows:

Payments Due		**(in thousands)**
Next 12 Months	$	481
Year 2		465
Year 3		362
Year 4		308
Year 5		299
Thereafter		5,161
Total minimum lease payments	$	7,076

7. COMMITMENTS AND CONTINGENCIES

On September 12, 2012, the Company entered into an agreement with Uhde Corporation of America (Uhde) for the purchase of supercritical carbon dioxide extraction equipment to be used in the processing of its natural astaxanthin (Equipment). Pursuant to the terms of the agreement, Uhde will build, ship and provide assistance in installing the Equipment, which is required to be delivered in approximately 14 months from the date of the agreement. The Company will pay Uhde an aggregate of $3,222,000 for the equipment and services, of which $645,000 remains unpaid as of September 30, 2013. Progress payments through September 30, 2013 of $2,577,000 have been classified as construction in progress on the consolidated balance sheet.

The Company is subject to legal proceedings and claims from time to time in the ordinary course of business. Although management cannot predict with certainty the ultimate resolution of legal proceedings and claims asserted against the Company, management does not believe that any currently pending legal proceeding to which the Company is a party is likely to have a material adverse effect on its business, results of operations, cash flows or financial condition.

8. SHARE-BASED COMPENSATION

The Company accounts for share-based payment arrangements using fair value. 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 conditions, 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 statement of operations over the period during which an employee is required to provide the service in exchange for the award, or the vesting period. All of the Company s stock options are service-based awards, and because the Company s 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 September 30, 2013, the Company had the following two shareholder approved plans under which shares were available for equity based awards: The 2005 Stock Option Plan (the 2005 Plan) wherein 2,075,000 shares of common stock are reserved for issuance until the Plan terminates on August 21, 2015, and; The Independent Director Stock Option and Stock Grant Plan (the 2004 Directors Plan) wherein 200,000 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 September 30, 2013, there were 419,328 options available for grant under the 2005 Plan.

Under the 2004 Directors Plan, upon election to the Board of Directors at an annual stockholders meeting, a newly elected non-employee director will be granted a ten-year option to purchase 6,000 shares of the Company s common stock. Options vest and become exercisable six months from the date of grant. In addition, on the date of each annual stockholders meeting, each non-employee director continuing in office is automatically issued 4,000 shares of the Company s common stock, and an additional 1,000 shares to the director serving as Chairman of the Board, non-transferable for six months following the date of grant. As of September 30, 2013, there were 115,123 shares available for grant under the 2004 Directors Plan.

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

	As of September 30, 2013		
	Authorized	Available	Outstanding
2005 Plan	2,075,000	419,328	1,463,556
2004 Directors Plan	200,000	115,123	18,000
Total	2,275,000	534,451	1,481,556

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 Directors 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 include vesting, exercise 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 is recognized ratably over the vesting term which ranges from 4 to 7 years. Compensation expense recognized for options issued under the 2005 Plan was $176,000 and $354,000 for the three and six months ended September 30, 2013, respectively. Compensation expense recognized for options issued under the 2005 Plan was $173,000 and $295,000 for the three and six months ended September 30, 2012, respectively. Compensation expense recognized for options issued under the 2004 Directors Plan was $51,000 for the three and six months ended September 30, 2013. Compensation expense recognized for options issued under the 2004 Directors Plan was $77,000 for the three and six months ended September 30, 2012, respectively. All share-based compensation has been classified as General and Administrative expense.

A summary of option activity under the Company s stock plans for the six months ended September 30, 2013 is presented below:

Option Activity	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at March 31, 2013	1,495,856	$ 4.03	8.3 years	$ 1,139,324
Granted	6,000	5.56		
Exercised	(12,450)	$ 2.40		42,390
Forfeited or expired	(7,850)	$ 4.48		12,765
Outstanding at September 30, 2013	1,481,556			