

CYANOTECH CORP  
Form 10-Q/A  
November 13, 2014

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q/A**

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

**For Quarterly Period Ended September 30, 2014**

**Or**

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

**For the Transition Period From                      to**

**Commission File Number 0-14602**

**CYANOTECH CORPORATION**

(Exact name of registrant as specified in its charter)

**NEVADA**

(State or other jurisdiction of incorporation or organization)

**91-1206026**

(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 No

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

Number of common shares outstanding as of November 12, 2014:

<b>Title of Class</b>	<b>Shares Outstanding</b>
Common stock - \$0.02 par value	5,516,999

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CYANOTECH CORPORATION

FORM 10-Q/A

**EXPLANATORY NOTE**

This Amendment No. 1 on Form 10-Q/A (this “Amendment”) amends the Registrant’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2014, which the Registrant previously filed with the Securities and Exchange Commission (the “SEC”) on November 12, 2014 (the “Original Filing”). The Registrant is filing this Amendment to disclose material new information pertaining to the status of litigation reported in PART I. FINANCIAL INFORMATION, Item 1. Financial Statements, Note 7 to Condensed Consolidated Financial Statements, and in PART II. OTHER INFORMATION, Item 1. Legal Proceedings, which developed after the Original Filing was transmitted to the SEC’s Edgar database on November 10, 2014 and accepted for filing. A Joint Notice of Settlement was filed electronically with a federal court on November 11, 2014. Due to the Veterans’ Day Holiday, the Original Filing was not effectively filed with the SEC until November 12, 2014. As required by Rule 12b-15 under the Securities Act of 1934, new certifications by our principal executive officer and principal financial officer are filed as exhibits to this Amendment and apply to this filing and the Original Filing, as amended. Except as set forth below, the Original Filing has not been amended, updated or otherwise modified.

**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)

	<b>September 30, 2014</b>	<b>March 31, 2014</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 2,858	\$4,312
Accounts receivable, net of allowance for doubtful accounts of \$6 at September 30, 2014 and \$6 at March 31, 2014	4,185	3,347
Inventories, net	5,312	4,876
Deferred tax assets	216	216
Prepaid expenses and other current assets	452	339
Total current assets	13,023	13,090
Equipment and leasehold improvements, net	13,232	11,826
Restricted cash	1,091	1,368
Deferred tax assets	3,550	3,124
Other assets	872	902
Total assets	\$ 31,768	\$30,310
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Current maturities of long-term debt	\$ 210	\$204
Customer deposits	34	30
Accounts payable	4,244	3,184
Accrued expenses	1,032	774
Total current liabilities	5,520	4,192
Long-term debt, excluding current maturities	5,155	5,263
Deferred rent	8	8
Total liabilities	10,683	9,463

Commitments and contingencies

Stockholders' equity:

Common stock of \$0.02 par value, shares authorized 50,000,000; 5,516,999 shares issued and outstanding at September 30, 2014 and 5,488,038 shares at March 31, 2014	110	110
Additional paid-in capital	30,354	29,891
Accumulated deficit	(9,379 )	(9,154 )
Total stockholders' equity	21,085	20,847
Total liabilities and stockholders' equity	\$ 31,768	\$30,310

See accompanying Notes to Condensed Consolidated Financial Statements.

## CYANOTECH CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands, except per share amounts)

(Unaudited)

	<b>Three Months Ended September 30, 2014</b>		<b>Six Months Ended September 30, 2014</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
NET SALES	\$8,684	\$7,299	\$16,126	\$14,208
COST OF SALES	4,408	4,306	8,882	8,363
Gross profit	4,276	2,993	7,244	5,845
<b>OPERATING EXPENSES:</b>				
General and administrative	2,170	1,261	4,917	2,816
Sales and marketing	1,462	1,180	2,696	2,184
Research and development	105	171	221	286
Loss on disposal of equipment and leasehold improvements	3	21	13	26
Total operating expenses	3,740	2,633	7,847	5,312
Income (loss) from operations	536	360	(603 )	533
Interest expense, net	(23 )	(25 )	(48 )	(62 )
Income (loss) before income tax	513	335	(651 )	471
INCOME TAX EXPENSE (BENEFIT)	325	229	(426 )	335
NET INCOME (LOSS)	\$188	\$106	\$(225 )	\$136
<b>NET INCOME (LOSS) PER SHARE:</b>				
Basic	\$0.03	\$0.02	\$(0.04 )	\$0.02
Diluted	\$0.03	\$0.02	\$(0.04 )	\$0.02
<b>SHARES USED IN CALCULATION OF NET INCOME (LOSS) PER SHARE:</b>				
Basic	5,493	5,475	5,491	5,470
Diluted	5,668	5,699	5,491	5,655

See accompanying Notes to Condensed Consolidated Financial Statements.





## CYANOTECH CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	<b>Six Months Ended September 30, 2014    2013</b>	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net (loss) income	\$(225 )	\$136
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Loss on disposal of equipment and leasehold improvements	13	26
Depreciation and amortization	582	488
Amortization of debt issue costs and other assets	24	22
Share based compensation expense	431	405
Reduction of inventory reserve	(1 )	(3 )
Deferred income tax (benefit) provision	(426 )	335
Net (increase) decrease in assets:		
Accounts receivable	(838 )	(272 )
Inventories	(435 )	(789 )
Prepaid expenses and other assets	(107 )	(360 )
Net increase (decrease) in liabilities:		
Customer deposits	4	34
Accounts payable	1,060	272
Accrued expenses	258	(119 )
Deferred rent	—	(2 )
Net cash provided by operating activities	340	173
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from restricted cash	277	1,350
Investment in equipment and leasehold improvements	(2,001)	(2,610)
Net cash used in investing activities	(1,724)	(1,260)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Principal payments on long-term debt	(102 )	(29 )
Proceeds from stock options exercised	32	31
Net cash (used in) provided by financing activities	(70 )	2
Net decrease in cash and cash equivalents	(1,454)	(1,085)
Cash and cash equivalents at beginning of period	4,312	4,364

Cash and cash equivalents at end of period	\$2,858	\$3,279
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SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

Cash paid during the period for:

Interest	\$149	\$151
Income taxes	\$—	\$113

See accompanying Notes to Condensed Consolidated Financial Statements.

CYANOTECH CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2014

(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 results of operations for the interim periods are not necessarily indicative of the results to be expected for the full fiscal year. The Condensed Consolidated Balance Sheet as of March 31, 2014 was derived from the audited financial statements. These condensed consolidated financial statements and notes should be read in conjunction with the Company’s audited consolidated financial statements for the year ended March 31, 2014, contained in the Company’s annual report on Form 10-K as filed with the SEC on June 27, 2014.

The accompanying condensed consolidated 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 any 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 May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers", which will supersede most existing U.S. GAAP revenue recognition guidance. This new standard requires an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. In addition, ASU 2014-09 contains expanded disclosure requirements relating to the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. ASU 2014-09 is effective for fiscal periods beginning after December 15, 2016 and permits the use of either the full retrospective or cumulative effect transition method. Early adoption is not permitted. We have not yet selected a transition method and are evaluating the impact that this new standard will have on our 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:

	<b>September</b>	<b>March</b>
	<b>30,</b>	<b>31,</b>
	<b>2014</b>	<b>2014</b>
	<b>(in thousands)</b>	
Raw materials	\$1,066	\$1,235
Work in process	1,619	1,407
Finished goods(1)	2,316	1,953
Supplies	311	281
	<b>\$5,312</b>	<b>\$4,876</b>

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(1) Net of reserve for obsolescence of \$5,000 and \$6,000 at September 30, 2014 and March 31, 2014, 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 months ended September 30, 2014 and \$81,000 of abnormal production costs charged to cost of sales for the six months ended September 30, 2014. There were no abnormal production costs charged to cost of sales for the three and six months ended September 30, 2013.

### 3. EQUIPMENT AND LEASEHOLD IMPROVEMENTS, NET

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 (in years)	3 to 10
Furniture and fixtures (in years)	3 to 7
Leasehold improvements (in years)	10 to 25

Equipment and leasehold improvements consist of the following:

	<b>September 30,</b>	<b>March 31,</b>
	<b>2014</b>	<b>2014</b>
	<b>(in thousands)</b>	
Equipment	\$9,234	\$8,840
Leasehold improvements	9,912	9,756
Furniture and fixtures	298	291
	19,444	18,887
Less accumulated depreciation and amortization	(11,915)	(11,393)
Construction-in-progress	5,703	4,332
Equipment and leasehold improvements, net	\$13,232	\$11,826

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, 2014. The Company recognized a loss on disposal of assets in the amount of \$3,000 and \$13,000 for the three and six months ended September 30, 2014, respectively. 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 has capitalized \$57,000 and \$112,000 of interest for the three and six months ended September 30, 2014, respectively. \$55,000 and \$98,000 of interest was capitalized for the three and six month period ended September 30, 2013.

#### 4. ACCRUED EXPENSES

Accrued expenses consist of the following:

	<b>September 30,</b>	<b>March 31,</b>
	<b>2014</b>	<b>2014</b>
	<b>(in thousands)</b>	
Wages and profit sharing	\$ 704	\$ 582
Customer rebates	102	55
Other expenses	226	137
	\$ 1,032	\$ 774

#### 5. LONG-TERM DEBT

Long-term debt consists of the following:

	<b>September 30,</b>	<b>March 31,</b>
	<b>2014</b>	<b>2014</b>
	<b>(in thousands)</b>	
Term loans	\$ 5,365	\$ 5,467
Less current maturities	(210 )	(204 )
Long-term debt, excluding current maturities	\$ 5,155	\$ 5,263

### *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, 2014) 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 \$5,328,000 at September 30, 2014. 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 fee 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, 2014.

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, 2014 and March 31, 2014, the total outstanding combined balance was approximately \$29,000 and \$42,000, respectively. The equipment loans mature at various dates between May 2015 and June 2016. The loans are at a 0% rate of interest and are net of unamortized discount of \$1,000 and \$1,000 at September 30, 2014 and March 31, 2014, 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 \$9,000 and \$12,000 at

September 30, 2014 and March 31, 2014, respectively, less the unamortized discount of \$200 and \$300 at September 30, 2014 and March 31, 2014, respectively.

Future principal payments under the term loan and capital lease agreements as of September 30, 2014 are as follows:

<b>Payments Due</b>	<b>(in thousands)</b>
Next 12 Months	\$ 210
Year 2	205
Year 3	205
Year 4	216
Year 5	228
Thereafter	4,301
Total principal payments	\$ 5,365



**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, 2014.

Future minimum lease payments under all non-cancelable operating leases at September 30, 2014 are as follows:

<b>Payments Due</b>	<b>(in thousands)</b>
Next 12 Months	\$ 496
Year 2	408
Year 3	406
Year 4	401
Year 5	404
Thereafter	4,924
Total minimum lease payments	\$ 7,039

**7. COMMITMENTS AND CONTINGENCIES**

On September 12, 2012, the Company entered into an agreement with ThyssenKrupp Industrial Solutions (USA), Inc. ("TKIS"), formerly Uhde Corporation of America, 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, TKIS will build, ship and provide assistance in installing the Equipment. The Equipment, which was originally scheduled for delivery approximately 14 months from the date of the agreement, is now scheduled for a delivery in the third quarter of this fiscal year. The Company will pay TKIS an aggregate of \$3,222,000 for the equipment and services, of which \$645,000 remains unpaid as of September 30, 2014. Progress payments through September 30, 2014 of \$2,577,000 have been classified in construction in progress in 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.

We have previously disclosed the negative effect of the legal costs of one pending patent lawsuit against the Company and a related administrative proceeding initiated by the Company to challenge the validity of the patent which is the subject of the lawsuit.<sup>1</sup> Our legal costs grew significantly in the first quarter of this fiscal year due to costs related to development of reports by our medical and economic experts, the extension of discovery and deposition deadlines, and costs related to preparation for the oral hearing with the Patent Trial and Appeal Board (“PTAB”) on our *Inter Partes* Review (see *Risk Factors*, pages 14-15, and discussion of increase in *Operating Expenses*, page 16-17).

Patent litigation and *Inter Partes* Review matters :

On June 29, 2012, U.S.Nutraceuticals LLC, d/b/a Valensa International [“**Valensa**”] and The Board of Trustees of the University of Illinois [the “**Patent Owner**”] filed a lawsuit against Cyanotech Corporation and Nutrex Hawaii, Inc. in the U.S. District Court for the Middle District of Florida, Ocala Division (the “**Litigation**”) primarily alleging infringement of U.S. patent no. 5,527,533<sup>2</sup> (the “**’533 Patent**” or “**Patent**”).

In an effort by the Company to accelerate a determination of the invalidity of the ‘533 Patent, the Company petitioned the **PTAB** of the U. S. Patent and Trademark Office on June 28 and 29, 2013 to conduct an administrative review of the validity of the ‘533 Patent, as challenged in our Petition; PTAB instituted an *Inter Partes* Review of 18 of the 27 Claims within the ‘533 Patent on December 19, 2013 (“**IPR**”). The Patent Owner is the respondent in the IPR.

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<sup>1</sup>Form 10-K, Item 3 – Legal Proceedings, dated March 31, 2014 (filed June 27, 2014), Form 8-K, Item 8.01 – Other Events, dated June 30, 2013 (filed August 26, 2013); and Forms 10-Q for the quarter ended September 30, 2013 (see Item 2 – Management’s Discussion and Analysis, *Operating Expenses*, page 16); and Form 10-Q/A (filed February 14, 2014) for the quarter ended December 31, 2013 (see Item 2 – Management’s Discussion and Analysis, *Operating Expenses*, page 16).

<sup>2</sup> The “533 Patent was granted on June 16, 1996; it expired on October 27, 2014.

(a) *Factual Basis* : (i) The product involved in the Litigation and the *Inter Partes* Review is a natural health supplement called astaxanthin (“**Astaxanthin**”) which the Company grows and harvests, and in different forms markets, and sells to wholesalers, retailers and consumers. Valensa is Patent Owner’s licensee of certain rights under the ‘533 Patent and was one of the Company’s domestic wholesale customers for several years until the expiration of its supply contract with us and after it was given a 12-month notice in December 2011 that our Company would no longer sell bulk product to Valensa and to other domestic bulk customers. Valensa manufactures, markets and sells products containing Astaxanthin to wholesalers and retailers.

(ii) All Claims within the ‘533 Patent are “method of treating” claims. The ‘533 Patent is generally described in the “Field of Invention” section as a method for retarding and ameliorating certain specified diseases, injuries or damage (“condition”) by administering a therapeutically-effective amount of Astaxanthin to an individual suffering from the condition. The ‘533 Patent includes 27 Claims pertaining to: retinal damage; retinal injury; neuronal damage to a retina; age-related macular degeneration; ischemic or intraocular pressure-related disease of a retina; inflammatory disease of a retina; a free radical-induced injury to the central nervous system or comprised of a traumatic or an ischemic injury; a degenerative disease; or a degenerative central nervous system disease of a brain or spinal cord. Patent Owner and Valensa assert that all 27 Claims under the ‘533 Patent are valid. The Company asserts that all 27 Claims are invalid and therefore the entire ‘533 Patent is invalid.

(iii) Patent Owner and Valensa allege in the Litigation, but the Company denies, that the scope of the ‘533 Patent method claims extends to, and its 27 Claims apply to, our manufacturing, marketing and sales of Astaxanthin as a nutritional supplement. Patent Owner and Valensa allege, but the Company denies, that the Claims of the ‘533 Patent broadly cover “eye health,” although those particular words do not appear in the ‘533 Patent. The Company alleges that whether one or all Claims within the ‘533 Patent are determined to be valid, no Claim was infringed by any of our manufacturing, marketing or sales of Astaxanthin products and we have not induced anyone to infringe the Patent.

(iv) Fact discovery concluded in July 2014. Expert discovery and advice of counsel discovery will conclude in November 2014. Based upon new evidence discovered in the course of the discovery process, the federal court granted leave to the Company to file both Third Amended Counterclaims (filed on September 16, 2014) and Fourth Amended Counterclaims (filed on October 6, 2014). Plaintiffs responded to the Fourth Amended Counterclaims on October 17, 2014. The patent in dispute expired October 27, 2014. Trial remains scheduled for the Court's docket on March 2, 2015.

(b) *Relief Sought by Patent Owner and Valensa* : (i) a declaration of patent infringement; (ii) a declaration that the patent infringement was intentional; (iii) a preliminary and a permanent injunction barring us and our employees and affiliates from infringing the ‘533 Patent; (iv) damages for infringement, plus interest and plus treble damages for willful infringement; (v) an award of attorneys’ fees and costs of suit, plus interest; and (vi) any further relief awarded by the Court.

(c) *Relief Sought by Company* : (i) a declaration of invalidity and unenforceability based on original patentability or on patent misuse; (ii) a declaration of non-infringement; (iii) a declaration of unfair competition under Hawaii law and under the Federal Lanham Act; (iv) a determination that this case is exceptional , thereby entitling the Company to recover its attorneys' fees; (v) an award of compensatory damages to Company; (vi) an award of statutory damages under Hawaii law; (vii) an order that Patent Owner and Valensa pay over all of their unlawful profits to Company; (viii) an order to Patent Owner and Valensa to destroy all materials (e.g., advertising materials) in the possession or control of either Patent Owner and Valensa which have been determined to be false; (ix) an injunction against Patent Owner and Valensa from continuing any methods of competition declared to be in violation of Hawaii law or the Lanham Act; and (x) any further relief awarded by the Court.

The Court records of the Litigation<sup>4</sup> and the filings in the *Inter Partes* Review<sup>5</sup> can be found as indicated in the respective footnotes. An oral hearing before PTAB was held on July 16, 2014. Absent good cause for an extension, PTAB must issue its ruling within one year after the IPR was instituted. A ruling is expected by December 19, 2014.

As of November 12, 2014, both matters remain pending. However, all parties to the litigation and the administrative proceeding agreed through their respective counsel on November 11, 2014, to confidential terms of settlement, subject only to reducing the comprehensive settlement to a formal written Settlement Agreement within two weeks. On November 12, 2014, litigation counsel filed a Joint Notice of Settlement with the U.S. District Court for the Middle District of Florida, Ocala Division, seeking an immediate stay of proceedings pending the filing of a joint motion for dismissal with prejudice which the parties anticipate filing on or before December 1, 2014.

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<sup>3</sup> The Patent expired October 27, 2014 and, accordingly, the claims for prospective injunctive relief are now moot.

<sup>4</sup> See: U.S. District Court for the Middle District of Florida, Case No. 5:12-cv-366, the public files for which are available at [www.pacer.gov](http://www.pacer.gov) by referencing the Middle District of Florida and the specific Case No. 5:12 CV 366, although access is subject to government charges for such access.

<sup>5</sup> See: the Patent Trial and Appeal Board of the U.S. Patent and Trademark Office, the public files for which are available at <https://ptabtrials.uspto.gov/> by entering "5527533" in the block for "Patent Number" and then clicking "Search."

## 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.

As of September 30, 2014, the Company had three equity-based compensation plans: the Independent Director Stock Option and Restricted Stock Grant Plan (the "2014 Directors Plan"); the 2005 Stock Option Plan (the "2005 Plan"); and the 2004 Independent Director Stock Option and Stock Grant Plan (the "2004 Directors Plan"). The Company's equity based compensation plans provide for the awarding of stock options and shares of restricted common stock for eligible employees, certain outside consultants and independent directors.

On August 28, 2014, the Company's shareholders approved the 2014 Directors Plan. This plan authorizes the Board of Directors to provide additional incentive to the Company's independent directors through equity based compensation in the form of stock options and restricted stock. Awards under the 2014 Directors Plan are limited to the authorized amount of 350,000 shares. As of September 30, 2014, there were 333,439 shares available for grant under the 2014 Directors Plan.

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, 2014, there were 395,148 options available for grant under the 2005 Plan.

The 2004 Directors Plan was terminated on August 28, 2014. As a result, no additional awards will be issued under this plan

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

	<b>As of September 30, 2014</b>		
	<b>Authorized</b>	<b>Available</b>	<b>Outstanding</b>
2014 Plan	350,000	333,439	16,561
2005 Plan	2,075,000	395,148	1,472,686
2004 Directors Plan	—	—	12,000
Total	2,425,000	728,587	1,501,247

All stock option grants made under equity-based compensation plans were issued at exercise prices no less than the Company's closing stock price on the date of grant. Options under the 2005 Plan and 2014 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. Compensation expense recognized for options issued under the 2005 Plan was \$160,000 and \$353,000 for the three and six months ended September 30, 2014, respectively. 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 restricted stock issued under the 2014 Directors Plan was \$78,000 for the three and six months ended September 30, 2014. Compensation expense recognized for restricted stock and options issued under the 2004 Directors Plan was \$51,000 for the three and six months ended September 30, 2013, 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, 2014 is presented below:

<b>Option Activity</b>	<b>Shares</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Term  (in Years)</b>	<b>Aggregate Intrinsic Value</b>
Outstanding at March 31, 2014	1,469,306	\$ 4.04	7.3	\$2,034,303
Granted	61,561	4.72	-	-
Exercised	(12,400 )	2.65	-	24,585
Forfeited or expired	(17,220 )	\$ 4.48	-	11,624
Outstanding at September 30, 2014	1,501,247	\$ 4.07	6.9	\$1,378,287
Exercisable at September 30, 2014	743,270	\$ 3.67	6.5	\$922,682

The aggregate intrinsic value as of September 30, 2014 in the table above is before applicable income taxes and represents the excess amount over the exercise price 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 \$4.71 for such day.

A summary of the Company's non-vested options for the six months ended September 30, 2014 is presented below:

<b>Nonvested Options</b>	<b>Shares</b>	<b>Weighted Average Grant-Date Fair Value</b>
Nonvested at March 31, 2014	851,066	\$ 3.22
Granted	45,000	2.73
Vested	(16,080 )	3.14
Forfeited or expired	(138,570)	3.09
Nonvested at September 30, 2014	741,416	\$ 3.22

The following table summarizes the weighted average characteristics of outstanding stock options as of September 30, 2014:

Range of Exercise Prices	Outstanding Options			Exercisable Options	
	Number of Shares	Remaining Life (Years)	Weighted Average Price	Number of Shares	Weighted Average Price
\$1.60 - 3.70	417,830	6.0	\$ 2.94	417,830	\$ 2.94
\$3.71 - 4.42	716,856	6.9	3.82	204,940	3.82
\$4.43 - 5.40	134,061	8.6	4.96	27,500	5.18
\$5.41 - 7.08	232,500	7.8	6.40	93,000	6.20
Total stock options	1,501,247	6.9	\$ 4.08	743,270	\$ 3.67

There were 45,000 stock options and 16,561 restricted shares granted during the three and six months ended September 30, 2014. There were 6,000 stock options and 9,000 restricted shares granted during the three and six months ended September 30, 2013. The value assumptions related to options granted during the six months ended September 30, 2014 were as follows:

	<b>2014</b>
Exercise Price:	\$4.72
Volatility:	63.98%
Risk Free Rate:	1.74%
Vesting Period (in years):	3
Forfeiture Rate:	4.51%
Expected Life (in years):	5.73
Dividend Rate:	0%

As of September 30, 2014, total unrecognized share-based compensation expense related to all unvested stock options was \$1,767,000 which is expected to be expensed over a weighted average period of 3.2 years.

## 9. INCOME TAXES

We utilize our estimated annual effective tax rate to determine our provision (benefit) for income taxes for interim periods. The income tax provision (benefit) is computed by taking the estimated annual effective tax rate and multiplying it by the year to date pre-tax book income (loss). We recorded income tax expense of \$325,000 and \$229,000 for the three months ended September 30, 2014 and 2013, respectively. Our effective tax rate was 63.4% and 68.4% for the quarters ended September 30, 2014 and 2013, respectively. We recorded an income tax expense (benefit) of (\$426,000) and income tax expense of \$335,000 for the six months ended September 30, 2014 and 2013, respectively. Our effective tax rate was 65.4% and 71.1% for the six months ended September 30, 2014 and 2013, respectively.



The effective tax rate for the three and six months ended September 30, 2014 differs from the statutory rate of 34% as a result of the state taxes (net of federal benefit) and permanent differences.

The Company is subject to taxation in the United States and two state jurisdictions. The preparation of tax returns requires management to interpret the applicable tax laws and regulations in effect in such jurisdictions, which could affect the amount of tax paid by the Company. Management, in consultation with its tax advisors, files its tax returns based on interpretations that are believed to be reasonable under the circumstances. The income tax returns, however, are subject to routine reviews by the various taxing authorities. As part of these reviews, a taxing authority may disagree with respect to the tax positions taken by management (“uncertain tax positions”) and therefore may require the Company to pay additional taxes. Management evaluates the requirement for additional tax accruals, including interest and penalties, which the Company could incur as a result of the ultimate resolution of its uncertain tax positions. Management reviews and updates the accrual for uncertain tax positions as more definitive information becomes available from taxing authorities, completion of tax audits, expiration of statute of limitations, or upon occurrence of other events.

As of September 30, 2014, there was no liability for income tax associated with unrecognized tax benefits. The Company recognizes accrued interest related to unrecognized tax benefits as well as any related penalties in interest income or expense in its consolidated condensed statements of operations, which is consistent with the recognition of these items in prior reporting periods.

With few exceptions, the Company is no longer subject to U.S. federal, state, local, and non-U.S. income tax examination by tax authorities for tax years before 2009.

## **10. EARNINGS PER SHARE**

Basic earnings per share is computed on the basis of the weighted average number of common shares outstanding. Diluted earnings per share is computed on the basis of the weighted average number of common shares outstanding plus the potentially dilutive effect of outstanding stock options using the “treasury stock” method.

Reconciliations between the numerator and the denominator of the basic and diluted earnings per share computations for the three months ended September 30, 2014 and 2013 are as follows:

	<b>Three Months Ended September 30, 2014</b>		
	<b>Net Income</b>	<b>Shares (Denominator)</b>	<b>Per Share Amount</b>
	<b>(in thousands)</b>		
Basic income per share	\$188	5,493	\$ 0.03
Effect of dilutive securities—Common stock options	—	175	—
Diluted income per share	\$188	5,668	\$ 0.03

	<b>Three Months Ended September 30, 2013</b>		
	<b>Net Income</b>	<b>Shares (Denominator)</b>	<b>Per Share Amount</b>
	<b>(in thousands)</b>		
Basic income per share	\$106	5,475	\$ 0.02
Effect of dilutive securities — Common stock options	—	224	—
Diluted income per share	\$106	5,699	\$ 0.02

Reconciliations between the numerator and the denominator of the basic and diluted earnings per share computations for the six months ended September 30, 2014 and 2013 are as follows:

	<b>Six Months Ended September 30, 2014</b>		
	<b>Net Income</b>	<b>Shares (Denominator)</b>	<b>Per Share Amount</b>
	<b>(in thousands)</b>		
Basic income per share	\$(225)	5,491	\$ (0.04 )
Effect of dilutive securities—Common stock options	—	—	—
Diluted income per share	\$(225)	5,491	\$ (0.04 )

	<b>Six Months Ended September 30, 2013</b>		
	<b>Net Income</b>	<b>Shares (Denominator)</b>	<b>Per Share Amount</b>
	<b>(in thousands)</b>		
Basic income per share	\$ 136	5,470	\$ 0.02
Effect of dilutive securities — Common stock options	—	185	—
Diluted income per share	\$ 136	5,655	\$ 0.02

Basic and diluted loss per share are the same in periods of a net loss, because common share equivalents are anti-dilutive when a net loss is recorded. Diluted earnings per share does not include the impact of common stock options totaling 632,642 and 672,568 for the three months ended September 30, 2014 and 2013, respectively, and 632,642 and 565,416 for the six months ended September 30, 2014 and 2013, respectively, as the effect of their inclusion would be anti-dilutive.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

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

We update previously reported litigation and an administrative proceeding regarding similar patent claim disputes on Form 10-K for the fiscal year ended March 31, 2014 which was filed on June 27, 2014. Both remain pending. However, all parties to the litigation and the administrative proceeding agreed through their respective counsel on November 11, 2014, to confidential terms of settlement, subject only to reducing the comprehensive settlement to a formal written Settlement Agreement within two weeks. On November 12, 2014, litigation counsel filed a Joint Notice of Settlement with the U.S. District Court for the Middle District of Florida, Ocala Division, seeking an immediate stay of proceedings pending the filing of a joint motion for dismissal with prejudice which the parties anticipate filing on or before December 1, 2014.

The administrative proceeding is an *Inter Partes Review* (“**IPR**”) filed by the Company against the patent owner before the Patent Trial and Appeal Board (“**PTAB**”). An oral hearing before PTAB was held on July 16, 2014. Absent good cause for an extension, PTAB must issue its ruling within one year after the IPR was instituted. A ruling is expected by December 19, 2014.

The litigation was instituted in federal court<sup>7</sup> in Florida by a patent licensee and the patent owner (“**Plaintiffs**”) against the Company over two years ago. Fact discovery concluded in July 2014. Expert discovery and advice of counsel discovery will conclude in November 2014. Based upon new evidence discovered in the course of the discovery process, the federal court granted leave to the Company to file both Third Amended Counterclaims (filed on September 16, 2014) and Fourth Amended Counterclaims (filed on October 6, 2014). Plaintiffs responded to the Fourth Amended Counterclaims on October 17, 2014. The patent in dispute expired October 27, 2014. Trial remains scheduled for the Court’s docket on March 2, 2015.

### Item 6. Exhibits

a) The following exhibits are furnished with this report:

- 10.1 2014 Independent Director Stock Option and Restricted Stock Grant Plan (Incorporated by reference to our Definitive Proxy Statement filed July 18, 2014, File No. 0-14602)
- 31.1 Certifications of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 signed as of November 12, 2014.
- 31.2 Certifications of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 signed as of November 12, 2014.
- 32 Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 signed as of November 12, 2014.

101 The following financial statements from Cyanotech Corporation's Quarterly Report on Form 10-Q for the quarter ended September 30, 2014, formatted in XBRL (eXtensible Business Reporting Language): (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Operations, (iii) the Condensed Consolidated Statements of Cash Flows, and (iv) Notes to Condensed Consolidated Financial Statements.

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<sup>6</sup> See: PTAB public files for this IPR at <http://ptabtrials.uspto.gov/> by entering "5527533" in the block for "Patent Number" and then clicking "Search."

<sup>7</sup> See: U.S. District Court for the Middle District of Florida, Case No. 5:12-cv-366, the public files for which are available at [www.pacer.gov](http://www.pacer.gov) by referencing the Middle District of Florida and the specific Case No. 5:12 CV 366; access is subject to government charges for access.

**SIGNATURES**

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

CYANOTECH CORPORATION  
(Registrant)

November 13, 2014 By: /s/ Brent D. Bailey  
(Date) Brent D. Bailey  
*President and Chief Executive Officer and Director*

November 13, 2014 By: /s/ Jole Deal  
(Date) Jole Deal  
*Vice President — Finance & Administration and CFO  
(Principal Financial and Accounting Officer)*

EXHIBIT INDEX

**Exhibit Number Description**

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