

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

- Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For Quarterly Period Ended December 31, 2021
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)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, \$0.02 par value per share	CYAN	NASDAQ

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 every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer
Non-accelerated filer

Accelerated filer
Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of February 4, 2022, the number of shares outstanding of the registrant's common stock was 6,194,166.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Report and other presentations made by Cyanotech Corporation (“CYAN”) and its subsidiary contain “forward-looking statements,” which include statements that are predictive in nature, depend upon or refer to future events or conditions, and usually include words such as “expects,” “anticipates,” “intends,” “plan,” “believes,” “predicts,” “estimates” or similar expressions. In addition, any statement concerning future financial performance, ongoing business strategies or prospects and possible future actions are also forward-looking statements. Forward-looking statements are based upon current expectations and projections about future events and are subject to risks, uncertainties and the accuracy of assumptions concerning CYAN and its subsidiary (collectively, the “Company”), the performance of the industry in which CYAN does business, and economic and market factors, among other things. **These forward-looking statements are not guarantees of future performance. You should not place undue reliance on forward-looking statements.**

Forward-looking statements speak only as of the date of the Report, presentation or filing in which they are made. Except to the extent required by the Federal Securities Laws, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Our forward-looking statements in this Report include, but are not limited to:

- Statements relating to our business strategy;
- Statements relating to our business objectives; and
- Expectations concerning future operations, profitability, liquidity and financial resources.

These forward-looking statements are subject to risk, uncertainties and assumptions about us and our operations that are subject to change based on various important factors, some of which are beyond our control, including those factors described in Item 2 of Part I of this quarterly report and in Item 1A of Part I of the Company’s Annual Report on Form 10-K filed on June 22, 2021. Additionally, the following factors, among others, could cause our financial performance to differ significantly from the goals, plans, objectives, intentions and expectations expressed in our forward-looking statements:

- The added risks associated with or attributed to the current local, national and world economic conditions, including but not limited to, the volatility of crude oil prices, inflation and currency fluctuations;
- Access to available and reasonable financing on a timely basis;
- The Company’s inability to generate enough revenues to meet its obligations or repay maturing indebtedness;
- Failure of capital projects to operate as expected or meet expected results;

It is not possible to predict or identify all potential risks and uncertainties and the above referenced factors and list do not comprise a complete list of all potential risks and uncertainties. Should one or more of these risks or uncertainties materialize, or should any of our assumptions prove incorrect, actual results may vary in material respects from those projected in any forward-looking statement contained in this report. All forward-looking statements speak only as of the date of this report and are expressly qualified in their entirety by the cautionary statements included in or incorporated by reference into this report. Except as is required by law, the Company expressly disclaims any obligation to publicly release any revisions to forward-looking statements to reflect events after the date of this report. Throughout this report, Cyanotech Corporation, together with its subsidiary, are referred to as “the Company.”

CYANOTECH CORPORATION
FORM 10-Q
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PART I. FINANCIAL INFORMATION**Item 1. Financial Statements**

CYANOTECH CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)
(Unaudited)

	December 31, 2021	March 31, 2021
ASSETS		
Current assets:		
Cash	\$ 2,298	\$ 3,767
Accounts receivable, net of allowance for doubtful accounts of \$156 as of December 31, 2021 and \$32 as of March 31, 2021	4,526	2,436
Inventories	8,724	8,415
Prepaid expenses and other current assets	293	488
Total current assets	15,841	15,106
Equipment and leasehold improvements, net	11,936	12,136
Operating lease right-of-use assets, net	3,412	3,517
Other assets	112	120
Total assets	\$ 31,301	\$ 30,879
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 2,275	\$ 2,287
Accrued expenses	1,291	844
Customer deposits	83	124
Operating lease obligations, current portion	382	343
Line of credit	—	1,000
Current maturities of long-term debt	626	1,210
Total current liabilities	4,657	5,808
Long-term debt, less current maturities	4,400	4,823
Long-term operating lease obligations	3,027	3,175
Other long-term liabilities	20	32
Total liabilities	12,104	13,838
Commitments and contingencies		
Stockholders' equity:		
Preferred stock of \$0.01 par value, authorized 10,000,000 shares; no shares issued and outstanding	—	—
Common stock of \$0.02 par value, authorized 50,000,000 shares; issued and outstanding 6,194,166 shares at December 31, 2021 and 6,116,073 shares at March 31, 2021	124	122
Additional paid-in capital	33,544	33,267
Accumulated deficit	(14,471)	(16,348)
Total stockholders' equity	19,197	17,041
Total liabilities and stockholders' equity	\$ 31,301	\$ 30,879

See accompanying notes to condensed consolidated financial statements

CYANOTECH CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 (In thousands, except per share amounts)
 (Unaudited)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2021	2020	2021	2020
Net sales	\$ 9,459	\$ 6,985	\$ 27,842	\$ 22,907
Cost of sales	6,221	4,914	17,170	14,560
Gross profit	<u>3,238</u>	<u>2,071</u>	<u>10,672</u>	<u>8,347</u>
Operating expenses:				
General and administrative	1,403	1,001	4,171	3,801
Sales and marketing	1,127	1,300	3,808	3,918
Research and development	200	211	483	519
Total operating expenses	<u>2,730</u>	<u>2,512</u>	<u>8,462</u>	<u>8,238</u>
Income (loss) from operations	508	(441)	2,210	109
Interest expense, net	(116)	(123)	(312)	(374)
Gain on extinguishment of debt	—	1,389	—	1,389
Income before income taxes	392	825	1,898	1,124
Income tax expense (benefit)	6	(2)	21	3
Net income	<u>\$ 386</u>	<u>\$ 827</u>	<u>\$ 1,877</u>	<u>\$ 1,121</u>
Net income per share:				
Basic	<u>\$ 0.06</u>	<u>\$ 0.14</u>	<u>\$ 0.31</u>	<u>\$ 0.18</u>
Diluted	<u>\$ 0.06</u>	<u>\$ 0.13</u>	<u>\$ 0.30</u>	<u>\$ 0.18</u>
Shares used in calculation of net income per share:				
Basic	<u>6,183</u>	<u>6,097</u>	<u>6,144</u>	<u>6,060</u>
Diluted	<u>6,371</u>	<u>6,222</u>	<u>6,219</u>	<u>6,169</u>

See accompanying notes to condensed consolidated financial statements

CYANOTECH CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited)

Three months ended December 31, 2021 and 2020

	<u>Common Stock Shares</u>	<u>Common Stock Amount</u>	<u>Additional Paid-in Capital</u>	<u>Accumulated Deficit</u>	<u>Total Stockholders' Equity</u>
(in thousands, except per share data)					
Balances at September 30, 2021	6,138,728	\$ 123	\$ 33,347	\$ (14,857)	\$ 18,613
Issuances of common stock for Director Stock Grants	55,438	1	157	—	158
Share-based compensation expense	—	—	40	—	40
Net income	—	—	—	386	386
Balances at December 31, 2021	<u>6,194,166</u>	<u>\$ 124</u>	<u>\$ 33,544</u>	<u>\$ (14,471)</u>	<u>\$ 19,197</u>
Balances at September 30, 2020	6,097,073	\$ 122	\$ 33,164	\$ (16,974)	\$ 16,312
Share-based compensation expense	—	—	18	—	18
Net income	—	—	—	827	827
Balances at December 31, 2020	<u>6,097,073</u>	<u>\$ 122</u>	<u>\$ 33,182</u>	<u>\$ (16,147)</u>	<u>\$ 17,157</u>

Nine months ended December 31, 2021 and 2020

	<u>Common Stock Shares</u>	<u>Common Stock Amount</u>	<u>Additional Paid-in Capital</u>	<u>Accumulated Deficit</u>	<u>Total Stockholders' Equity</u>
(in thousands, except per share data)					
Balances at March 31, 2021	6,116,073	\$ 122	\$ 33,267	\$ (16,348)	\$ 17,041
Issuances of common stock for Director Stock Grants	55,438	1	157	—	158
Issuance of vested shares of restricted stock	34,751	1	(40)	—	(39)
Shares withheld for tax payments	(12,096)	—	—	—	—
Share-based compensation expense	—	—	160	—	160
Net income	—	—	—	1,877	1,877
Balances at December 31, 2021	<u>6,194,166</u>	<u>\$ 124</u>	<u>\$ 33,544</u>	<u>\$ (14,471)</u>	<u>\$ 19,197</u>
Balances at March 31, 2020	6,011,885	\$ 120	\$ 32,994	\$ (17,268)	\$ 15,846
Issuances of common stock for Director Stock Grants	66,385	1	157	—	158
Issuance of common stock in connection with severance of former executive	11,400	—	—	—	—
Shares withheld from former executive for tax payments	(3,635)	—	—	—	—
Issuance of vested shares of restricted stock	17,469	1	(7)	—	(6)
Shares withheld for tax payments	(6,431)	—	—	—	—
Share-based compensation expense	—	—	38	—	38
Net income	—	—	—	1,121	1,121
Balances at December 31, 2020	<u>6,097,073</u>	<u>\$ 122</u>	<u>\$ 33,182</u>	<u>\$ (16,147)</u>	<u>\$ 17,157</u>

See accompanying notes to condensed consolidated financial statements

CYANOTECH CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (Dollars in thousands)
 (Unaudited)

	Nine Months Ended December 31,	
	2021	2020
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 1,877	\$ 1,121
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,202	1,340
Gain from extinguishment of debt – PPP loan	—	(1,389)
Amortization of debt issue costs and other assets	45	73
Amortization of operating leases right-of-use assets	232	236
Share-based compensation expense	318	196
Provision for doubtful accounts	124	31
Net (increase) decrease in assets:		
Accounts receivable	(2,214)	441
Inventories	(309)	64
Prepaid expenses and other assets	180	78
Net increase (decrease) in liabilities:		
Accounts payable	(269)	(665)
Accrued expenses	447	(140)
Customer deposits	(41)	(211)
Operating lease obligations	(236)	(236)
Deferred rent and other liabilities	(12)	(20)
Net cash provided by operating activities	1,344	919
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment in equipment and leasehold improvements	(745)	(583)
Net cash used in investing activities	(745)	(583)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on short-term contract obligation	—	(38)
Net payments on line of credit	(1,000)	(250)
Net payments on debt – related party	(500)	—
Proceeds from long-term debt – PPP loan	—	1,381
Principal payments on long-term debt	(529)	(498)
Payments on finance leases	—	(20)
Taxes paid related to net share settlement of restricted stock units	(39)	(6)
Net cash (used in) provided by financing activities	(2,068)	569
Net (decrease) increase in cash	(1,469)	905
Cash at beginning of period	3,767	2,417
Cash at end of period	<u>\$ 2,298</u>	<u>\$ 3,322</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	\$ 268	\$ 344
Income taxes	<u>\$ 2</u>	<u>\$ 14</u>

See accompanying notes to condensed consolidated financial statements

CYANOTECH CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2021
(Unaudited)

1. ORGANIZATION AND BASIS OF PRESENTATION

Cyanotech Corporation (the “Company”), located in Kailua-Kona, Hawaii, was incorporated in the state of Nevada on March 3, 1983 and is listed on the NASDAQ Capital Market under the symbol “CYAN”. The Company is engaged in the production of natural products derived from microalgae for the nutritional supplements market.

The Company is an agricultural company that produces high value natural products derived from microalgae grown in complex and intricate open-pond agricultural systems on the Kona coast of Hawaii. The Company's products include Hawaiian Spirulina Pacifica, a superfood with numerous benefits, including boosting the immune system and overall cellular health; and Hawaiian BioAstin, a powerful antioxidant shown to support and maintain the body's natural inflammatory response.

The accompanying unaudited 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, Condensed Consolidated Statements of Stockholders’ Equity 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, 2021 was derived from the audited consolidated 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, 2021, contained in the Company's annual report on Form 10-K as filed with the SEC on June 22, 2021.

Liquidity and Capital Resources

As of December 31, 2021, the Company had cash of \$2,298,000 and working capital of \$11,186,000 compared to \$3,767,000 and \$9,298,000, respectively, as of March 31, 2021. The Company has a Revolving Credit Agreement (“Credit Agreement”) with First Foundation Bank (“Bank”) that allows the Company to borrow up to \$2,000,000 on a revolving basis. At December 31, 2021 and March 31, 2021, the Company had outstanding borrowings of \$0 and \$1,000,000, respectively, on the line of credit. The line of credit is subject to renewal on August 30, 2022 and the Company intends to renew or replace it with another line of credit on or before the expiration date.

As of December 31, 2021, the Company had \$4,111,000 in long-term debt (“Term Loans”) payable to the Bank that require the payment of principal and interest monthly through August 2032. Pursuant to the Term Loans and the Credit Agreement, the Company is subject to annual financial covenants, customary affirmative and negative covenants and certain subjective acceleration clauses. As of March 31, 2021, the Company was in compliance with all required annual financial covenants under the Term Loans and the Credit Agreement.

In response to the coronavirus (“COVID-19”) pandemic and the uncertainty surrounding the pandemic, in May 2020, the Company obtained a Paycheck Protection Program (“PPP”) loan in the amount of \$1,381,000, under the Coronavirus Aid, Relief, and Economics Security Act (“CARES Act”). The proceeds were used for certain payroll costs in accordance with the PPP and the PPP Flexibility Act of 2020 (“PPP Flexibility Act”). In December 2020, the Company received notice of forgiveness of the PPP loan in whole, including all accrued interest to date. (see Note 6). In April 2019, the Company obtained a loan in the amount of \$1,500,000 from a related party. The proceeds were used to pay down accounts payable and for general operating capital purposes. On April 12, 2021, the Company amended this loan (see Notes 6 and 13).

Funds generated by operating activities and available cash are expected to continue to be the Company's most significant sources of liquidity for working capital requirements, debt service and funding of maintenance levels of capital expenditures.

Based upon the Company's operating plan and related cash flow and financial projections, cash flows expected to be generated by operating activities and available financing are expected to be sufficient to fund its operations through at least December 31, 2022, and the Company's debt service coverage ratio and current ratio covenants are expected to be in compliance with the annual Term Loans and Credit Agreement covenant requirements as of March 31, 2022, the next measurement date. However, no assurances can be provided that the Company will achieve its operating plan and cash flow projections for the next fiscal years or its projected consolidated financial position as of March 31, 2022. Such estimates are subject to change based on future results and such change could cause future results to vary significantly from expected results.

2. SIGNIFICANT ACCOUNTING POLICIES

Consolidation

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 intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

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.

Cash

Cash consists of cash on hand and cash in bank deposits.

Concentration Risk

A significant portion of revenue and accounts receivable are derived from a few major customers. For the three months ended December 31, 2021, two customers individually accounted for 22% and 21% of the Company's total net sales, and for the three months ended December 31, 2020, two customers individually accounted for 18% and 19% of the Company's total net sales. For the nine months ended December 31, 2021, two customers individually accounted for 21% and 18% of the Company's total net sales, and for the nine months ended December 31, 2020, two customers individually accounted for 17% each of the Company's total net sales. Two customers accounted for 67% of the Company's accounts receivable balance as of December 31, 2021, and three customers accounted for 57% of the Company's accounts receivable balance as of March 31, 2021.

Revenue Recognition

The Company records revenue based on the five-step model which includes: (1) identifying the contract with the customer; (2) identifying the performance obligations in the contract; (3) determining the transaction price; (4) allocating the transaction price to the performance obligations; and (5) recognizing revenue when the performance obligations are satisfied. Substantially all of the Company's revenue is generated by fulfilling orders for the purchase of our microalgal nutritional supplements to retailers, wholesalers, or direct to consumers via online channels, with each order considered to be a distinct performance obligation. These orders may be formal purchase orders, verbal phone orders, e-mail orders or orders received online. Shipping and handling activities for which the Company is responsible under the terms and conditions of the order are not accounted for as performance obligations but as fulfillment costs. These activities are required to fulfill the Company's promise to transfer the goods and are expensed when revenue is recognized.

Revenue is measured as the net amount of consideration expected to be received in exchange for fulfilling a performance obligation. The Company has elected to exclude sales, use and similar taxes from the measurement of the transaction price. The amount of consideration expected to be received and revenue recognized includes estimates of variable consideration, which includes costs for trade promotion programs, coupons, returns and early payment discounts. Such estimates are calculated using historical averages adjusted for any expected changes due to current business conditions and experience. The Company reviews and updates these estimates at the end of each reporting period and the impact of any adjustments are recognized in the period the adjustments are identified. In assessing whether collection of consideration from a customer is probable, the Company considers the customer's ability and intent to pay that amount of consideration when it is due. Payment of invoices is due as specified in the underlying customer agreement, typically 30 days from the invoice date, which occurs on the date of transfer of control of the products to the customer. Revenue is recognized at the point in time that control of the ordered products is transferred to the customer. Generally, this occurs when the product is delivered, or in some cases, picked up from one of the Company's distribution centers by the customer. Revenue from extraction services is recognized when control is transferred upon completion of the extraction process.

Customer contract liabilities consist of customer deposits received in advance of fulfilling an order and are shown separately on the consolidated balance sheets. During the three months ended December 31, 2021 and 2020, the Company recognized \$6,000 and \$0, respectively, of revenue from deposits that were included in contract liabilities as of March 31, 2021 and 2020, respectively. During the nine months ended December 31, 2021 and 2020, the Company recognized \$55,000 and \$251,000, respectively, of revenue from deposits that were included in contract liabilities as of March 31, 2021 and 2020, respectively. The Company's contracts have a duration of one year or less and therefore, the Company has elected the practical expedient of not disclosing revenues allocated to partially unsatisfied performance obligations.

Disaggregation of Revenue

The following table represents revenue disaggregated by major product line and extraction services for the:

	Three Months Ended December 31, 2021	Three Months Ended December 31, 2020
(\$ in thousands)		
Packaged sales		
Astaxanthin packaged	\$ 3,563	\$ 3,388
Spirulina packaged	1,612	1,659
Total packaged sales	5,175	5,047
Bulk sales		
Astaxanthin bulk	1,128	291
Spirulina bulk	2,990	1,413
Total bulk sales	4,118	1,704
Contract extraction revenue	166	234
Total net sales	<u>\$ 9,459</u>	<u>\$ 6,985</u>
(\$ in thousands)		
Packaged sales		
Astaxanthin packaged	\$ 11,618	\$ 10,767
Spirulina packaged	6,150	5,626
Total packaged sales	17,768	16,393
Bulk sales		
Astaxanthin bulk	2,041	1,173
Spirulina bulk	7,558	4,628
Total bulk sales	9,599	5,801
Contract extraction revenue	475	713
Total net sales	<u>\$ 27,842</u>	<u>\$ 22,907</u>

Recently Adopted Accounting Pronouncements

In December 2019, the FASB issued ASU 2019-12, “*Simplifying the Accounting for Income Taxes*” (“ASU 2019-12”), which as part of its Simplification Initiative to reduce the cost and complexity in accounting for income taxes, removes certain exceptions related to the approach for intra-period tax allocation, the methodology for calculating income taxes in an interim period and the recognition of deferred tax liabilities for outside basis differences. ASU 2019-12 also amends other aspects of the guidance to help simplify and promote consistent application of GAAP. The guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020, with early adoption permitted. The Company adopted ASU 2019-12 as of April 1, 2021 with no impact on its consolidated financial statements and related disclosures.

In November 2018, the FASB issued ASU 2018-18 – *Collaborative Arrangements* (“ASU 2018-18”), which clarifies that certain transactions between collaborative arrangement participants should be accounted for as revenue when the collaborative arrangement participant is a customer in the context of a unit of account and precludes recognizing as revenue consideration received from a collaborative arrangement participant if the participant is not a customer. This ASU requires retrospective adoption to the date the Company adopted ASC 606, April 1, 2018, by recognizing a cumulative-effect adjustment to the opening balance of retained earnings of the earliest annual period presented. The Company adopted ASU 2018-18 as of April 1, 2020 with no impact on its financial statements.

In August 2018, the FASB issued ASU 2018-15, “Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract” (“ASU No. 2018-15”), which aligns the capitalization requirements for implementation costs incurred in a hosting arrangement that is a service contract with the existing capitalization requirements for implementation costs incurred to develop or obtain internal-use software (*Subtopic 350-40*). The Company adopted ASU No. 2018-15 as of April 1, 2020 with no impact on its financial statements.

In August 2018, the FASB issued ASU 2018-13, “Fair Value Measurement - Disclosure Framework (*Topic 820*)” (“ASU No. 2018-13”). The updated guidance improves the disclosure requirements on fair value measurements. The Company adopted this standard as of April 1, 2020, with no impact to its disclosures.

3. INVENTORIES

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

	December 31, 2021	March 31, 2021
	(in thousands)	
Raw materials	\$ 1,399	\$ 547
Work in process	3,273	3,206
Finished goods	3,743	4,423
Supplies	309	239
Inventories	<u>\$ 8,724</u>	<u>\$ 8,415</u>

The Company recognizes abnormal production costs, including fixed cost variances from normal production capacity, fixed production overhead costs, idle facilities, freight handling costs and spoilage, as an expense in the period incurred, without adjusting overhead absorption rates. Normal production capacity is defined as the production expected to be achieved over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The Company had no abnormal production costs for the three or nine months ended December 31, 2021 or 2020.

Beginning in fiscal 2021, cultivation of astaxanthin was completed in the first six months of the fiscal year during the most productive months of the year due to the best growing conditions, compared to year-round production in the prior fiscal years. The same approach is being followed in fiscal year 2022. The Company calculates total production costs for the year based on normal capacity of production expected to be achieved in a year under normal circumstances. These costs are then allocated into inventory based on the period of production, not including abnormal production costs. Allocating fixed and overhead costs requires management’s judgement to determine when production is outside of the normal range of expected variation in production.

Other non-inventoriable fixed costs of \$76,000 and \$79,000 were expensed to cost of sales for the three months ended December 31, 2021 and 2020, respectively. Other non-inventoriable fixed costs of \$113,000 and \$124,000 were expensed to cost of sales for the nine months ended December 31, 2021 and 2020, respectively.

4. EQUIPMENT AND LEASEHOLD IMPROVEMENTS

Equipment and leasehold improvements consist of the following as of:

	December 31, 2021	March 31, 2021
	(in thousands)	
Equipment	\$ 20,128	\$ 19,056
Leasehold improvements	14,751	14,703
Furniture and fixtures	376	372
	<u>35,255</u>	<u>34,131</u>
Less accumulated depreciation and amortization	(23,942)	(22,740)
Construction-in-progress	623	745
Equipment and leasehold improvements, net	<u>\$ 11,936</u>	<u>\$ 12,136</u>

Management has determined no asset impairment existed as of December 31, 2021 and March 31, 2021, respectively. Depreciation and amortization expense were approximately \$404,000 and \$423,000 for the three months ended December 31, 2021 and 2020, respectively. Depreciation and amortization expense were approximately \$1,202,000 and \$1,340,000 for the nine months ended December 31, 2021 and 2020, respectively.

5. SHORT-TERM CONTRACT OBLIGATION

On November 30, 2018, the Company completed the purchase of a six-acre production and research facility from Cellana LLC (“Cellana”) under a purchase agreement that was signed August 31, 2018. In accordance with the terms of the third amendment to the asset purchase agreement, the Company acquired the asset for \$495,000 with a cash down payment of \$100,000 leaving a short-term obligation of \$395,000 on the asset purchase.

The short-term obligation was comprised of two separate loans in the principal amount of \$180,000 and \$215,000. The first loan of \$180,000 bore an interest rate of 6.25% and was payable in four monthly installments of principal and interest. The loan commenced on December 1, 2018 and matured on July 15, 2019. There were no principal amounts outstanding at December 31, 2021 or March 31, 2021.

The second loan had a principal amount of \$215,000 and was a non-interest bearing loan that was payable in twelve monthly installments. The loan commenced on December 1, 2018 and matured on October 15, 2019. This contract contained a hold back of \$38,000 pending resolution of certain closing items by the seller, which have been resolved in fiscal year 2021, with no principal amounts outstanding at December 31, 2021 or March 31, 2021.

6. LINE OF CREDIT AND LONG-TERM DEBT

Total debt consists of the following as of:

	December 31, 2021	March 31, 2021
	(in thousands)	
Line of credit	\$ —	\$ 1,000
Long-term debt	4,145	4,673
Debt - related party	1,000	1,500
Less current maturities	(626)	(2,210)
Long-term debt, excluding current maturities	4,519	4,963
Less unamortized debt issuance costs	(119)	(140)
Total long-term debt, net of current maturities and unamortized debt issuance costs	\$ 4,400	\$ 4,823

Line of Credit and Term Loans

On August 30, 2016, the Credit Agreement, which the Company entered into with the Bank on June 3, 2016, became effective after the Company and the Bank received the necessary approvals from the State of Hawaii to secure the lien on the Company’s leasehold property in Kona, Hawaii. The Credit Agreement allows the Company to borrow up to \$2,000,000 on a revolving basis. Borrowings under the Credit Agreement bear interest at the Wall Street Journal prime rate (3.25% at both December 31, 2021 and March 31, 2021) plus 2%, floating, provided that at no time shall the annual interest rate be less than 5.25%.

At December 31, 2021, there was no outstanding balance under the Credit Agreement and at March 31, 2021, the outstanding balance was \$1,000,000, and was included in current liabilities on the Condensed Consolidated Balance Sheets. The line of credit, which is subject to annual renewal, was renewed on August 30, 2021 and will be subject to renewal upon expiration on August 30, 2022.

The Credit Agreement grants the Bank the following security interests in the Company’s property: (a) a lien on the Company’s leasehold interest in its Kona facility; (b) an assignment of the Company’s interest in leases and rents on its Kona facility; and (c) a security interest in all fixtures, furnishings and equipment related to or used by the Company at the Kona facility. Each security interest is further subject to the terms of the Credit Agreement.

In 2015, the Company executed a loan agreement with a lender providing for \$2,500,000 in aggregate credit facilities (the “2015 Loan”) secured by substantially all the Company’s assets, pursuant to a Term Loan Agreement dated July 30, 2015 (the “2015 Loan Agreement”). The 2015 Loan is evidenced by a promissory note in the amount of \$2,500,000, the repayment of which is partially guaranteed under the provisions of the United States Department of Agriculture (“USDA”) Rural Development Guarantee program. The proceeds of the 2015 Loan were used to pay off a \$500,000 short term note payable that matured on September 18, 2015, and to acquire new processing equipment and leasehold improvements at the Company’s Kona, Hawaii facility.

The provisions of the 2015 Loan require the payment of principal and interest until its maturity on September 1, 2022, the obligation fully amortizes over seven (7) years. Interest on the 2015 Loan accrues on the outstanding principal balance at an annual variable rate equal to the published Wall Street Journal prime rate (3.25% at both December 31, 2021 and March 31, 2021, respectively) plus 2.0% and is adjustable on the first day of each calendar quarter and fixed for that quarter, provided that at no time shall the annual interest rate be less than 6.0%. The 2015 Loan has a prepayment penalty of 5.0% for any prepayment made prior to the first anniversary of the date of the 2015 Loan Agreement, which penalty is reduced by 1.0% each year thereafter until the fifth anniversary of such date, after which there is no prepayment penalty. The balance under the 2015 Loan was \$324,000 and \$635,000 at December 31, 2021 and March 31, 2021, respectively, and was included in long-term debt in the debt table above.

In 2012, the Company executed a loan agreement with a lender providing for \$5,500,000 in aggregate credit facilities (the “2012 Loan”) secured by substantially all the Company’s assets, including a mortgage on the Company’s interest in its lease at the National Energy Laboratory of Hawaii Authority, pursuant to a Term Loan Agreement dated August 14, 2012 (the “2012 Loan Agreement”). The 2012 Loan 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 USDA Rural Development Guarantee. The proceeds of the 2012 Loan were used to acquire processing equipment and leasehold improvements at its Kona, Hawaii facility.

The provisions of the 2012 Loan required 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 2012 Loan accrues on the outstanding principal balance at an annual variable rate equal to the published Wall Street Journal prime rate (3.25% at December 31, 2021 and March 31, 2021) plus 1.0% and is adjustable on the first day of each calendar quarter and fixed for that quarter, provided that at no time shall the annual interest rate be less than 5.5%. The balance under the 2012 Loan was \$3,787,000 and \$3,978,000 at December 31, 2021 and March 31, 2021, respectively, and was included in long-term debt in the debt table above.

The 2015 Loan includes a one-time origination and guaranty fee totaling \$113,900 and an annual renewal fee payable in the amount of 0.5% of the USDA guaranteed portion of the outstanding principal balance as of December 31 of each year, beginning December 31, 2015. The USDA has guaranteed 80% of all amounts owing under the 2015 Loan. The 2012 Loan included 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 2012 Loan. The balance in unamortized debt issuance costs was \$119,000 and \$140,000 at December 31, 2021 and March 31, 2021, respectively.

Loan Covenants

The Company’s Credit Agreement, 2015 Loan and 2012 Loan are subject to annual debt service and other financial covenants, including covenants which require the Company to meet key financial ratios and customary affirmative and negative covenants. As of March 31, 2021, the Company was in compliance with all required annual financial covenants. The next remeasurement date will be March 31, 2022.

Long-term Debt – PPP

In May 2020, the Company obtained a PPP loan in the amount of \$1,381,000 with an original maturity date of May 2022. In December 2020, the Company received notice of forgiveness of the PPP loan in whole, including all accrued unpaid interest. For the three and nine months ended December 31, 2020, the Company recorded the forgiveness of \$1,381,000 of principal and \$8,000 of accrued interest for a total of \$1,389,000, which was included in gain on extinguishment of debt on the Condensed Consolidated Statements of Operations. The Company used the proceeds of the PPP loan for certain payroll costs in accordance with the PPP.

Debt – Related Party

In April 2019, the Company obtained a loan in the amount of \$1,500,000 and the interest was payable quarterly. The loan was originally due in April 2021. In April 2021, the Company amended the loan, which extended the expiration to April 2024, converted \$500,000 into revolving loans, adjusted the interest rate to reflect a floor of 5%, and granted a security interest in substantially all of the Company’s personal property assets, subject to limited exceptions. Concurrently, with the amendment and conversion of the original loan, the Company repaid in cash the principal amount of \$500,000 plus accrued interest to date of \$1,900 (see Note 13). At December 31, 2021, the balance under this loan was \$1,000,000 and was included in long-term debt, and at March 31, 2021, the balance under this loan was \$1,500,000, of which \$500,000 was included in current maturities of long-term debt and \$1,000,000 was included in long-term debt, in the debt table above. Interest is payable quarterly.

Equipment Finance Agreement

In October 2017, the Company entered into an Equipment Finance Agreement (the “Equipment Agreement”) with a lender, which provides up to \$175,000 of financing for equipment. The interest rate on this loan is 4.75%. The provisions of the Equipment Agreement require the payment of principal and interest until its maturity on October 31, 2022. The balance under this loan was \$34,000 and \$60,000 at December 31, 2021 and March 31, 2021, respectively, and was included in long-term debt in the debt table above.

Future principal payments under the loans and finance lease obligations at December 31, 2021 are as follows:

Payments Due	(in thousands)
Remainder of 2022	\$ 243
2023	477
2024	1,289
2025	306
2026	322
Thereafter	2,508
Total principal payments	\$ 5,145

7. OPERATING LEASES

The Company leases facilities, equipment and land under non-cancelable operating leases expiring through 2037. One of its facility leases contains price escalations and a renewal option for five years. Right-of-use assets represent the right to use an underlying asset for the lease term and lease liabilities represent the obligation to make lease payments arising from the lease. Right-of-use assets and liabilities were recognized at April 1, 2019 based on the present value of lease payments over the lease term, using the Bank's incremental borrowing rate based on the information available at recognition, and the Company has elected to exclude non-lease components. In the second quarter of fiscal 2021, the Company commenced a solar lease for one of its buildings which was added to the right-of-use assets and liabilities. At December 31, 2021, the weighted average remaining lease terms was 13.0 years, the weighted average discount rate was 7.4%, and for both nine months ended December 31, 2021 and 2020, the operating lease costs were \$445,000.

Supplemental balance sheet information related to leases consist of the following as of:

Operating leases	Balance Sheet Classification	December 31, 2021	March 31, 2021
		(in thousands)	
Right-of-use assets	Operating lease right-of-use assets	\$ 4,255	\$ 4,128
Accumulated lease amortization	Operating lease right-of-use assets	(843)	(611)
Total right-of-use assets		\$ 3,412	\$ 3,517
Current lease liabilities	Operating lease obligations	\$ 382	\$ 343
Non-current lease liabilities	Long-term operating lease obligations	3,027	3,175
Total lease liabilities		\$ 3,409	\$ 3,518

Maturities of lease liabilities at December 31, 2021 are as follows:

Payments	(in thousands)
Remainder of 2022	\$ 464
2023	396
2024	396
2025	374
2026	362
Thereafter	3,299
Total undiscounted lease payments	5,291
Less: present value discount	(1,882)
Total lease liability balance	\$ 3,409

8. ACCRUED EXPENSES

Accrued expenses consist of the following as of:

	December 31, 2021	March 31, 2021
	(in thousands)	
Wages, commissions, bonus and profit sharing	\$ 521	\$ 211
Vacation	399	408
Rent, interest and legal	184	86
Other accrued expenses	187	139
Total accrued expenses	\$ 1,291	\$ 844

9. COMMITMENTS AND CONTINGENCIES

From time to time, the Company may be involved in litigation and investigations relating to claims and matters arising out of its operations in the normal course of business. There were no significant legal matters outstanding at December 31, 2021.

10. SHARE-BASED COMPENSATION

The Company has share-based compensation plans, which are more fully described in Note 10, Share-Based Compensation, to the Consolidated Financial Statements included in the Company’s annual report on Form 10-K for the fiscal year ended March 31, 2021 as filed with the SEC on June 22, 2021.

As of December 31, 2021, the Company had two equity-based compensation plans: the 2016 Equity Incentive Plan (the “2016 Plan”) and the 2014 Independent Director Stock Option and Restricted Stock Grant Plan (the “2014 Directors Plan”). The Company has also issued stock options, which remain outstanding as of December 31, 2021, under two equity-based compensation plans which have expired according to their terms: the 2005 Stock Option Plan (the “2005 Plan”) and the 2004 Independent Director Stock Option and Stock Grant Plan (the “2004 Directors Plan”). These plans allowed the Company to award stock options and shares of restricted common stock to eligible employees, certain outside consultants and independent directors. No additional awards will be issued under the 2005 Plan or the 2004 Directors Plan.

At the 2021 Annual Meeting of Stockholders, the stockholders of the Company approved an amendment to the 2014 Directors Plan to increase the number of shares of common stock available for issuance under the plan by 300,000 shares. These shares are reflected in the table below.

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

	As of December 31, 2021		
	Authorized	Available	Outstanding
2016 Plan	1,300,000	993,121	214,174
2014 Directors Plan	650,000	287,695	12,000
2005 Plan	—	—	51,500
2004 Directors Plan	—	—	6,000
Total	1,950,000	1,280,816	283,674

Stock Options

All stock option grants made under the 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 2016 Plan, 2005 Plan and 2014 Directors Plan were determined by the Board of Directors or the Compensation Committee of the Board of Directors in accordance with the provisions of the respective plans. The terms of each option grant include vesting, exercise, and other conditions 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 all Plans was \$17,000 and \$10,000 for the three months ended December 31, 2021 and 2020, respectively. Compensation expense recognized for options issued under all Plans was \$47,000 and \$19,000 for the nine months ended December 31, 2021 and 2020, respectively.

A summary of option activity under the Company's stock plans for the nine months ended December 31, 2021 is presented below:

Option Activity	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at March 31, 2021	374,300	\$ 3.64	3.0	\$ 129,700
Granted	50,000	\$ 2.96		
Forfeited	(3,000)	\$ 4.95		
Expired	(166,800)	\$ 3.84		
Outstanding at December 31, 2021	<u>254,500</u>	\$ 3.36	6.7	\$ 135,600
Exercisable at December 31, 2021	<u>112,833</u>	\$ 4.37	4.1	\$ 39,183

The aggregate intrinsic value 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 \$3.24 and \$3.30 at December 31, 2021 and March 31, 2021, respectively.

A summary of the Company's non-vested options for the nine months ended December 31, 2021 is presented below:

Nonvested Options	Shares	Weighted Average Grant-Date Fair Value
Nonvested at March 31, 2021	125,000	\$ 1.19
Granted	50,000	1.60
Vested	(33,333)	1.20
Nonvested at December 31, 2021	<u>141,667</u>	<u>\$ 1.33</u>

The weighted average grant-date fair value of stock options granted during the nine months ended December 31, 2021 was \$79,000. As of December 31, 2021, total unrecognized stock-based compensation expense related to all unvested stock options was \$155,000, which is expected to be expensed over a weighted average period of 2.4 years.

Restricted Stock

Grants of fully vested restricted stock issued to Non-Employee Directors during the nine months ended December 31, 2021 and 2020 were 55,438 and 66,385 shares, respectively. Compensation expense recognized for these grants issued under the 2014 Directors Plan was \$158,000 and \$0 for the three months ended December 31, 2021 and 2020, respectively, and \$158,000 for both nine months ended December 31, 2021 and 2020.

Restricted Stock Units ("RSUs")

RSUs are service-based awards granted to eligible employees under the 2016 Plan. Compensation expense recognized for RSUs issued under the 2016 Plan was \$23,000 and \$8,000 for the three months ended December 31, 2021 and 2020, respectively. Compensation expense recognized for RSUs issued under the 2016 Plan was \$113,000 and \$20,000 for the nine months ended December 31, 2021 and 2020, respectively.

The following table summarizes information related to awarded RSUs for the nine months ended December 31, 2021:

Nonvested Restricted Stock Units	Shares	Weighted Average Grant Price
Nonvested restricted stock units at March 31, 2021	28,188	\$ 2.38
Granted	38,672	2.91
Vested	(34,751)	2.84
Forfeited	(2,935)	2.61
Nonvested restricted stock units at December 31, 2021	29,174	\$ 2.52

As of December 31, 2021, total unrecognized stock-based compensation expense related to unvested restricted stock units was \$35,000, which is expected to be expensed over a weighted average period of 1.1 years.

11. INCOME TAXES

On December 22, 2017 H.R. 1, originally known as the Tax Cuts and Jobs Act, (the “Tax Act”) was enacted. Among the significant changes to the U.S. Internal Revenue Code, the Tax Act lowers the U.S. federal corporate income tax rate (“Federal Tax Rate”) from 34% to 21% effective January 1, 2018. The 21% Federal Tax Rate applies to fiscal years ending March 31, 2019 and each year thereafter.

The Company utilizes its estimated annual effective tax rate to determine its provision or benefit for income taxes for interim periods. The income tax provision or benefit is computed by multiplying the estimated annual effective tax rate by the year-to-date pre-tax book income (loss). The Company recorded an income tax expense of \$6,000 and an income tax benefit of \$2,000 for the three months ended December 31, 2021 and 2020, respectively. The Company recorded an income tax expense of \$21,000 and \$3,000 for the nine months ended December 31, 2021 and 2020, respectively. The Company’s effective tax rate was 1.5% and 0.2% for the three months ended December 31, 2021 and 2020, respectively. The Company’s effective tax rate was 1.1% and 0.3% for the nine months ended December 31, 2021 and 2020, respectively. The effective tax rates for all periods differ from the statutory rate of 21% as a result of state taxes (net of federal benefit) and the net change in valuation allowance against the net deferred tax asset the Company believes is not more likely than not to be realized. The Company continues to carry a full valuation allowance on its net deferred tax assets.

The Company is subject to taxation in the United States and seven 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 December 31, 2021 and 2020, 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 2017.

In response to the COVID-19 pandemic, the CARES Act was signed into law in March 2020. The CARES Act lifts certain deduction limitations originally imposed by the Tax Act. Corporate taxpayers may carryback net operating losses originating during 2018 through 2020 for up to five years, which was not previously allowed under the Tax Act. The CARES Act also eliminates the 80% of taxable income limitations by allowing corporate entities to fully utilize net operating loss carryforwards to offset taxable income in 2018, 2019 and 2020. The CARES Act allows taxpayers with alternative minimum tax credits to claim a refund in 2020 for the entire amount of the credits instead of recovering the credits through refunds over a period of years, as originally enacted by the Tax Act.

In addition, the CARES Act increases the limitation applied to the deductibility of business interest from 30% of adjusted taxable income to 50% of adjusted taxable income for the 2019 and 2020 tax years, raises the corporate charitable deduction limit to 25% of taxable income, and makes qualified improvement property generally eligible for 15-year cost-recovery and 100% bonus depreciation. The enactment of the CARES Act did not result in any material adjustments to the Company's income tax provision for the three and nine months ended December 31, 2021 or 2020.

On December 27, 2020, the Consolidated Appropriations Act, 2021 ("CAA") was enacted. The CAA includes the COVID related Tax Relief Act of 2020 ("COVID TRA"). Section 276 of the COVID TRA includes provisions that overturn IRS Notice 2020-32 and Rev. Rul. 2020-27, allowing full deductibility of expenses incurred to receive full forgiveness of its PPP loan. The Company received full forgiveness of its PPP loan during the third quarter of fiscal 2021. For income tax purposes, the forgiveness has been excluded from income and the applicable expenses incurred during the prior fiscal year have been deducted.

12. 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 income per share computations for the three and nine months ended December 31, 2021 and 2020 are as follows:

	Three Months Ended December 31, 2021		
	Net Income (Numerator)	Shares (Denominator)	Per Share Amount
	(in thousands)		
Basic income per share	\$ 386	6,183	\$ 0.06
Effective dilutive securities – common stock options and restricted stock units	—	188	—
Diluted income per share	<u>\$ 386</u>	<u>6,371</u>	<u>\$ 0.06</u>

	Three Months Ended December 31, 2020		
	Net Income (Numerator)	Shares (Denominator)	Per Share Amount
	(in thousands)		
Basic income per share	\$ 827	6,097	\$ 0.14
Effective dilutive securities – common stock options and restricted stock units	—	125	—
Diluted income per share	<u>\$ 827</u>	<u>6,222</u>	<u>\$ 0.13</u>

	Nine Months Ended December 31, 2021		
	Net Income (Numerator)	Shares (Denominator)	Per Share Amount
	(in thousands)		
Basic income per share	\$ 1,877	6,144	\$ 0.31
Effective dilutive securities – common stock options and restricted stock units	—	75	—
Diluted income per share	<u>\$ 1,877</u>	<u>6,219</u>	<u>\$ 0.30</u>

	Nine Months Ended December 31, 2020		
	Net Income (Numerator)	Shares (Denominator)	Per Share Amount
	(in thousands)		
Basic income per share	\$ 1,121	6,060	\$ 0.18
Effective dilutive securities – common stock options and restricted stock units	—	109	—
Diluted income per share	<u>\$ 1,121</u>	<u>6,169</u>	<u>\$ 0.18</u>

Restricted stock units become dilutive within the period granted and remain dilutive until the units vest and are issued as common stock.

13. RELATED PARTY TRANSACTIONS

In April 2019, the Company obtained an unsecured subordinated loan from Skywords Family Foundation, Inc. (“Skywords”) in the principal amount of \$1,500,000 pursuant to a Promissory Note (“the Skywords Note”) executed by the Company in favor of Skywords. Skywords is controlled by the Company’s Chairman of the Board of Directors and largest stockholder. The Skywords Note bore interest at a rate of 1% plus the prime rate (as published by the Wall Street Journal), which was recalculated and payable on a quarterly basis. The principal amount and any accrued and unpaid interest was due and payable on April 12, 2021. The proceeds of the Skywords Note were used to pay down accounts payable and for general operating capital purposes.

On April 12, 2021, the Company entered into an Amended and Restated Promissory Note (the “Skywords Amended Note”) with Skywords. The Company and Skywords agreed to amend, restate, replace and otherwise modify without novation, the Skywords Note in order to convert \$500,000 of the outstanding principal amount into revolving loans that may be prepaid and reborrowed from time to time in principal amounts not to exceed \$500,000, extend the maturity date by three years, adjust the interest rate to reflect a floor of 5% and secure Skywords’ interest by granting a security interest in substantially all of the Company’s personal property assets, subject to limited exceptions (the “Collateral”). On April 12, 2021, concurrently with the conversion, the Company repaid in cash to Skywords, the principal amount of \$500,000 plus accrued interest to date of \$1,900. The Skywords Amended Note bears interest at a rate of 1% plus the prime rate (as published by the Wall Street Journal), which will be recalculated and payable on a quarterly basis, provided that at no time shall the annual interest rate be less than 5%. The principal amount and any accrued and unpaid interest will be due and payable on April 12, 2024, unless accelerated in an event of default. The Company may prepay the Skywords Amended Note at any time without penalty.

On April 12, 2021, in connection with the grant of a security interest in the Collateral, the Company also entered into an Intercreditor and Subordination Agreement with the Bank and Skywords. The Company is indebted to the Bank pursuant to two Term Loans and a Credit Agreement, each of which granted the Bank a security interest in substantially all of the Company’s personal property assets. The Bank’s security interest in the Company’s personal property assets ranks senior to Skywords’ security interest in the Collateral, and the Intercreditor and Subordination Agreement generally governs the relationship between the Bank and Skywords as secured lenders to the Company and includes customary terms.

At December 31, 2021 and March 31, 2021, the Skywords Note principal balance was \$1,000,000 and \$1,500,000, respectively. The loan balance at December 31, 2021 was included in long-term debt and at March 31, 2021, \$500,000 was included in current maturities of long-term debt and \$1,000,000 was included in long-term debt on the Condensed Consolidated Balance Sheets.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Overview:

We are a world leader in the production of high value natural products derived from microalgae. Incorporated in 1983, we are guided by the principle of providing beneficial, quality microalgal products for health and human nutrition in a sustainable, reliable and environmentally sensitive operation. We are Good Manufacturing Practices (“GMP”) certified by the Merieux NutriSciences, reinforcing our commitment to quality in our products, quality in our relationships (with our customers, suppliers, employees and the communities we live in), and quality of the environment in which we work. Our products include:

- *BioAstin® Hawaiian Astaxanthin®* - a powerful dietary antioxidant shown to support and maintain the body’s natural inflammatory response, to enhance skin, and to support eye, joint and immune health. It has expanding applications as a human dietary supplement and dietary ingredient; and
- *Hawaiian Spirulina Pacifica®* - a nutrient-rich dietary supplement used for extra energy, a strengthened immune system, cardiovascular benefits and as a source of antioxidant carotenoids

Microalgae are a diverse group of microscopic plants that have a wide range of physiological and biochemical characteristics and contain, among other things, high levels of natural protein, amino acids, vitamins, pigments and enzymes. Microalgae have the following properties that make commercial production attractive: (1) microalgae grow much faster than land grown plants, often up to 100 times faster; (2) microalgae have uniform cell structures with no bark, stems, branches or leaves, permitting easier extraction of products and higher utilization of the microalgae cells; and (3) the cellular uniformity of microalgae makes it practical to control the growing environment in order to optimize a particular cell characteristic. Efficient and effective cultivation of microalgae requires consistent light, warm temperatures, low rainfall and proper chemical balance in a very nutrient-rich environment, free of environmental contaminants and unwanted organisms. This is a challenge that has motivated us to design, develop and implement proprietary production and harvesting technologies, systems and processes in order to commercially produce human dietary supplement products derived from microalgae.

Our production of these products at the 96-acre facility on the Kona Coast of the island of Hawaii provides several benefits. We selected the Keahole Point location in order to take advantage of relatively consistent warm temperatures, sunshine and low levels of rainfall needed for optimal cultivation of microalgae. This location also offers us access to cold deep ocean water, drawn from an offshore depth of 2,000 feet, which we use in our *Ocean-Chill Drying* system to eliminate the oxidative damage caused by standard drying techniques and as a source of trace nutrients for microalgal cultures. The area is also designated a Biosecure Zone, with tight control of organisms allowed into the area and free of genetically modified organisms (“GMO”). We believe that our technology, systems, processes and favorable growing location generally permit year-round harvest of our microalgal products in a cost-effective manner.

Results of Operations

The following tables present selected consolidated financial data for each of the periods indicated (\$ in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2021	2020	2021	2020
Net sales	\$ 9,459	\$ 6,985	\$ 27,842	\$ 22,907
Net sales increase	35.4%		21.5%	
Gross profit	\$ 3,238	\$ 2,071	\$ 10,672	\$ 8,347
Gross profit as % of net sales	34.2%	29.6%	38.3%	36.4%
Operating expenses	\$ 2,730	\$ 2,512	\$ 8,462	\$ 8,238
Operating expenses as % of net sales	28.9%	36.0%	30.4%	36.0%
Operating income (loss)	\$ 508	\$ (441)	\$ 2,210	\$ 109
Operating income (loss) as % of net sales	5.4%	(6.3)%	7.9%	0.5%
Income tax expense (benefit)	\$ 6	\$ (2)	\$ 21	\$ 3
Net income	\$ 386	\$ 827	\$ 1,877	\$ 1,121

Comparison of the Three Months Ended December 31, 2021 and 2020
Net Sales (in thousands)

	Three Months Ended December 31,		\$ Change	% Change
	2021	2020		
Packaged sales				
Astaxanthin	\$ 3,563	\$ 3,388	\$ 175	5.2%
Spirulina	1,612	1,659	(47)	(2.8)%
Total Packaged sales	\$ 5,175	\$ 5,047	\$ 128	2.5%
Bulk sales				
Astaxanthin	\$ 1,128	\$ 291	\$ 837	287.6%
Spirulina	2,990	1,413	1,577	111.6%
Total Bulk sales	\$ 4,118	\$ 1,704	\$ 2,414	141.7%
Contract extraction revenue	\$ 166	\$ 234	\$ (68)	(29.1)%
Total sales				
Astaxanthin	\$ 4,691	\$ 3,679	\$ 1,012	27.5%
Spirulina	4,602	3,072	1,530	49.8%
Contract extraction revenue	166	234	(68)	(29.1)%
Total sales	\$ 9,459	\$ 6,985	\$ 2,474	35.4%

Net Sales The net sales increase of 35.4% for the current quarter compared to the same period last year was primarily driven by an increase in spirulina and astaxanthin bulk sales, offset by a decrease in spirulina packaged sales and contract extraction sales. The increase in both spirulina and astaxanthin bulk sales in the current quarter was primarily due to increased sales to a few of our major customers due to their high demand combined with higher production volumes of spirulina.

Gross Profit Gross profit as a percent of net sales increased by 4.6 percentage points compared to the same period last year, which was the result of lower costs of both spirulina and astaxanthin due to higher production volumes.

Operating Expenses Operating expenses increased by \$0.2 million, or 8.7%, for the current year third quarter compared to the prior year same quarter, primarily due to bonus and profit sharing and Board of Directors annual stock grants in the current year third quarter, offset by lower advertising fees in the current year third quarter.

Income Taxes We recorded a state income tax expense of \$6,000 for the third quarter of this fiscal year compared to an income tax benefit of \$2,000 for the same period last year. We continue to carry a full valuation allowance on our net deferred tax assets.

Comparison of the Nine Months Ended December 31, 2021 and 2020
Net Sales (in thousands)

	Nine Months Ended December 31,		\$ Change	% Change
	2021	2020		
Packaged sales				
Astaxanthin	\$ 11,618	\$ 10,767	\$ 851	7.9%
Spirulina	6,150	5,626	524	9.3%
Total Packaged sales	\$ 17,768	\$ 16,393	\$ 1,375	8.4%
Bulk sales				
Astaxanthin	\$ 2,041	\$ 1,173	\$ 868	74.0%
Spirulina	7,558	4,628	2,930	63.3%
Total Bulk sales	\$ 9,599	\$ 5,801	\$ 3,798	65.5%
Contract extraction revenue	\$ 475	\$ 713	\$ (238)	(33.4)%
Total sales				
Astaxanthin	\$ 13,659	\$ 11,940	\$ 1,719	14.4%
Spirulina	13,708	10,254	3,454	33.7%
Contract extraction revenue	475	713	(238)	(33.4)%
Total sales	\$ 27,842	\$ 22,907	\$ 4,935	21.5%

Net Sales The net sales increase of 21.5% for the first nine months of fiscal 2022 compared to the same period last year was primarily driven by an increase in spirulina and astaxanthin bulk sales and packaged sales for both products, offset by a decrease in contract extraction sales. The increase in astaxanthin and spirulina packaged sales in the period was primarily due to an increase in sales to one of our major customers driven by consumer demand as COVID-19 restrictions have been relaxed, and as we transition from selling direct to a large customer to utilizing an integrated third-party logistics and marketing provider with a data science driven platform. The increase in bulk astaxanthin sales is primarily due to strong demand for a few significant customers. The increase in bulk sales of spirulina is due to high demand, with key customers in particular, combined with higher production volumes of spirulina.

Gross Profit Gross profit as a percent of net sales increased by 1.9 percentage points compared to the same period last year, which was the result of lower costs of both spirulina and astaxanthin due to higher production volumes.

Operating Expenses Operating expenses increased by \$0.2 million, or 2.7%, for the first nine months of fiscal 2022 compared to the prior year same quarter, primarily due to bonus and profit sharing in the current year, offset by lower advertising expenses.

Income Taxes We recorded a state income tax expense of \$21,000 for the third quarter of this fiscal year compared to an income tax expense of \$3,000 for the same period last year. We continue to carry a full valuation allowance on our net deferred tax assets.

Liquidity and Capital Resources

As of December 31, 2021, we had cash of \$2.3 million and working capital of \$11.2 million compared to \$3.8 million and \$9.3 million, respectively, at March 31, 2021. We have a Credit Agreement with the Bank that allows us to borrow up to \$2.0 million on a revolving basis. At December 31, 2021, we had no outstanding borrowings and at March 31, 2021, we had outstanding borrowings of \$1.0 million, on the line of credit. The line of credit is subject to renewal on August 30, 2022, and we intend to renew or replace it with another line of credit on or before the expiration date.

As of December 31, 2021, we had \$4.1 million in Term Loans payable to the Bank that require the payment of principal and interest monthly through August 2032. Pursuant to the Term Loans and the Credit Agreement, we are subject to annual financial covenants, customary affirmative and negative covenants and certain subjective acceleration clauses. As of March 31, 2021, we were in compliance with all required annual financial covenants under the Term Loans and the Credit Agreement.

In response to the COVID-19 pandemic and the uncertainty surrounding the pandemic, in May 2020, we obtained a PPP loan in the amount of \$1.4 million under the CARES Act. The proceeds were used for certain payroll costs in accordance with the PPP and the PPP Flexibility Act. In December 2020, we received notice of forgiveness of the PPP loan in whole, including all accrued interest to date (see Note 6 in the notes to condensed consolidated financial statements). In April 2019, we obtained a loan in the amount of \$1.5 million from a related party. The proceeds were used to pay down accounts payable and for general operating capital purposes. On April 12, 2021, we amended this loan (see Notes 6 and 13 in the notes to condensed consolidated financial statements).

Funds generated by operating activities and available cash are expected to continue to be our most significant sources of liquidity for working capital requirements, debt service and funding of maintenance levels of capital expenditures.

Based upon our operating plan and related cash flow and financial projections, cash flows expected to be generated by operating activities and available financing are expected to be sufficient to fund our operations through at least December 31, 2022, and our debt service coverage ratio and current ratio covenants are expected to be in compliance with the annual Term Loans and Credit Agreement covenant requirements as of March 31, 2022, the next measurement date. However, no assurances can be provided that we will achieve our operating plan and cash flow projections for the next fiscal years or our projected consolidated financial position as of March 31, 2022. Such estimates are subject to change based on future results and such change could cause future results to vary significantly from expected results.

Cash Flows The following table summarizes our cash flows for the periods indicated (\$ in thousands):

	Nine Months Ended December 31,	
	2021	2020
Total cash provided by (used in):		
Operating activities	\$ 1,344	\$ 1,141
Investing activities	(745)	(295)
Financing activities	(2,068)	990
(Decrease) increase in cash	\$ (1,469)	\$ 1,836

Cash used in operating activities for the nine months ended December 31, 2021 was the result of an increase of \$2.2 million in accounts receivable balances, offset by \$1.9 million net income and non-cash charges of \$1.9 million.

Cash used in investing activities for the nine months ended December 31, 2021 primarily includes costs for acquiring equipment and leasehold improvements at our Kona facility.

Cash used in financing activities for the nine months ended December 31, 2021 consists primarily of principal payments of our related party loan of \$0.5 million, payments on the line of credit of \$1.0 million and debt service payments of \$0.5 million.

Sources and Uses of Capital

As of December 31, 2021, our working capital was \$11.2 million, an increase of \$1.9 million compared to March 31, 2021. There was an increase in accounts receivable balances, primarily due to timing of shipments and increased sales, and an increase in inventories in the first half of fiscal 2022, as we continued cultivation of astaxanthin and higher inventories at our third-party processors. Cultivation improvements that we have made, allow us to produce all of the required demand for astaxanthin during the most favorable growing season. These increases were offset by the payments of \$0.5 million on the related party loan, \$1.0 million on the line of credit and \$0.5 million of debt service.

Our results of operations and financial condition can be affected by numerous factors, many of which are beyond our control and could cause future results of operations to fluctuate materially as it has in the past. Future operating results may fluctuate as a result of changes in sales volumes to our largest customers, weather patterns, increased competition, increased materials, nutrient and energy costs, government regulations and other factors beyond our control.

A significant portion of our expense levels are relatively fixed, so the timing of increases in expenses is based in large part on forecasts of future sales. If net sales are below expectations in any given period, the adverse impact on results of operations may be magnified by our inability to adjust spending quickly enough to compensate for the sales shortfall. We may also choose to reduce prices or increase spending in response to market conditions, which may have a material adverse effect on financial condition and results of operations.

Based upon our current operating plan, analysis of our consolidated financial position and projected future results of operations, we believe that our operating cash flows, cash balances and working capital will be sufficient to finance current operating requirements, debt service requirements, and routine planned capital expenditures, for the next twelve (12) months.

Outlook

This outlook section contains a number of forward-looking statements, all of which are based on current expectations. Actual results may differ materially.

Our strategic direction has been to position as a world leader in the production and marketing of high-value natural products from microalgae. We are vertically aligned, producing raw materials in the form of microalgae processed at our 96-acre facility in Hawaii, and integrating those raw materials into finished products. In fiscal 2022, our primary focus is stabilizing our production volume, rationalizing market channel participation, and leveraging our centers of core competence. We will continue to place emphasis on our Nutrex Hawaiian consumer products while exploring further opportunities for bulk sales orders for Spirulina and Astaxanthin, both domestically and internationally. Extraction services to third party customers utilizing our 1,000 bar super critical CO₂ extractor process are expected to generate additional income throughout the year. We will leverage our experience and reputation for quality, nutritional products which promote health and well-being. The foundation of our nutritional products is naturally cultivated *Hawaiian Spirulina Pacifica*® in powder and tablet form; and *BioAstin*® *Hawaiian Astaxanthin*® antioxidant in extract and softgel form. Information about our Company and our products can be viewed at www.cyanotech.com and www.nutrex-hawaii.com. Consumer products can also be purchased online at www.nutrex-hawaii.com.

Gross profit margin percentages going forward can be impacted by lower production volumes along with pressure on input costs as well as greater competition in the market place. This could cause margins to decline in future periods. We will continue to focus on higher margin consumer products that promote health and well-being and strive for continuous improvements in processes and production methods to stabilize costs and production levels for the future. However, significant sales variability between periods may occur based on historical results.

Producing the highest quality microalgae is a complex biological process which requires balancing numerous factors including microalgal strain variation, temperature, acidity, nutrient and other environmental considerations, some of which are not within our control. An imbalance or unexpected event can occur resulting in production levels below normal capacity. The allocation of fixed production overheads (such as depreciation, rent and general insurance) to inventories is determined based on normal production capacity. When our production volumes are below normal capacity limits, certain fixed production overhead costs cannot be inventoried and are recorded immediately in cost of sales. In addition, when production costs exceed historical averages, we evaluate whether such costs are one-time-period charges or an ongoing component of inventory cost.

To manage our cash resources effectively, we will balance production with sales demand, minimizing the cost associated with inventory levels when appropriate and manage our expenses judiciously. We could experience unplanned cash outflows and may need to utilize other cash resources to meet working capital needs. A prolonged downturn in sales could impair our ability to generate sufficient cash for operations and hamper our ability to attract additional capital investment which could become necessary to maintain optimal production levels and efficiencies.

Our future results of operations and the other forward-looking statements contained in this Outlook, in particular the statements regarding revenues, gross margin and capital spending, involve a number of risks and uncertainties. In addition to the factors discussed above, any of the following could cause actual results to differ materially: business conditions and growth in the natural products industry and in the general economy; changes in customer order patterns; changes in demand for natural products in general; changes in weather conditions; changes in health and growing conditions of our astaxanthin and spirulina products; competitive factors, such as increased production capacity from competing spirulina and astaxanthin producers and the resulting impact, if any, on world market prices for these products; government actions and increased regulations both domestic and foreign; shortage of manufacturing capacity; and other factors beyond our control. Risk factors are discussed in detail in Part II, Item 1A of this quarterly report and in Part I, Item 1A of our Form 10-K report for the year ended March 31, 2021.

We believe that our technology, systems, processes and favorable growing location generally permit year-round harvest of our microalgal products in a cost-effective manner. However, previously experienced imbalances in the highly complex biological production systems, together with volatile energy costs and rapidly changing world markets, suggest a need for continuing caution with respect to variables beyond our reasonable control. Therefore, we cannot, and do not attempt to, provide any definitive assurance with regard to our technology, systems, processes, location, or cost-effectiveness.

Off-Balance Sheet Arrangements

As of December 31, 2021, we had no off-balance sheet arrangements or obligations.

Impact of Inflation

Inflationary factors such as increases in the costs of materials and labor directly affect our operations. Most of our leases provide for cost-of-living adjustments and require us to pay for insurance and maintenance expenses, all of which are subject to inflation. Additionally, our future lease cost for new facilities may include potentially escalating costs of real estate and construction. There is no assurance that we will be able to pass on increased costs to our customers.

Depreciation expense is based on the historical cost of fixed assets and is therefore potentially less than it would be if it were based on current replacement cost. While property and equipment acquired in prior years will ultimately have to be replaced at higher prices, it is expected that replacement will be a gradual process over many years.

Critical Accounting Policies and Estimates

Our critical accounting policies and estimates are disclosed in the “Management’s Discussion and Analysis of Financial Condition and Results of Operations” section of our Annual Report on Form 10-K for the fiscal year ended March 31, 2021 filed with the SEC on June 22, 2021. In the nine months ended December 31, 2021, there were no changes to the application of critical accounting policies previously disclosed in our most recent Annual Report on Form 10-K.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our chief executive officer (“CEO”) and chief financial officer (“CFO”), we have evaluated the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15(d)-15(e) of the Exchange Act as of the end of the period covered by this Report. Based on that evaluation, our CEO and CFO have concluded that our disclosure controls and procedures are effective to provide reasonable assurance that information we are required to disclose in reports we file or submit under the Exchange Act is (1) recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms and (2) accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosures.

Management’s Report on Internal Control over Financial Reporting

The Company’s management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act). The Company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our management evaluated the effectiveness of our internal control over financial reporting as of December 31, 2021. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in “Internal Control - Integrated Framework” (2013 Framework). Based on our assessment, using those criteria, management concluded that our internal control over financial reporting was effective as of December 31, 2021.

Changes to Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the nine months ended December 31, 2021 that has materially affected, or was reasonably likely to materially affect, our internal control over financial reporting.

Limitations on the Effectiveness of Controls

Our management, including our CEO and CFO, do not expect that our disclosure controls and procedures or our internal controls over financial reporting will prevent all errors and all fraud. A control system no matter how well designed and implemented, can provide only reasonable, not absolute, assurance that the control system’s objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs.

The inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. Controls can also be circumvented by the individual acts of some persons, or by collusion of two or more people. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

This Form 10-Q should be read in conjunction with Item 9A “Controls and Procedures” of the Company’s Form 10-K for the fiscal year ended March 31, 2021, filed June 22, 2021.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, the Company may be involved in litigation and investigations relating to claims and matters arising out of its operations in the normal course of business. There were no significant legal matters outstanding at December 31, 2021.

Item 1A. Risk Factors

For a discussion of the risk factors relating to our business, please refer to Part I, Item 1A of our Form 10-K for the year ended March 31, 2021, which is incorporated by reference herein.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults upon Senior Securities

None.

Item 5. Other Information

None.

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Item 6. Exhibits

- 31.1* [Certifications of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 signed as of February 10, 2022.](#)
- 31.2* [Certifications of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 signed as of February 10, 2022.](#)
- 32* [Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 signed as of February 10, 2022.](#)
- 99.1* [Press Release dated February 10, 2022.](#)
- 101 The following financial statements from Cyanotech Corporation's Quarterly Report on Form 10-Q for the quarter ended December 31, 2021, formatted in Inline 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.
- 104 Cover Page Interactive Data File (Formatted as Inline XBRL and contained in Exhibit 101)

*Included herewith. Other exhibits were filed as shown above.

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)

February 10, 2022
(Date)

By: _____
/s/ Gerald R. Cysewski, PH.D.
Gerald R. Cysewski, PH.D.
Chief Executive Officer; Vice Chairman of the Board

February 10, 2022
(Date)

By: _____
/s/ Felicia Ladin
Felicia Ladin
*Chief Financial Officer, Vice President — Finance & Administration, and Treasurer
(Principal Financial Officer)*

EXHIBIT INDEX

Exhibit Number	Description
31.1*	Certifications of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 signed as of February 10, 2022.
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104	Cover Page Interactive Data File (Formatted as Inline XBRL and contained in Exhibit 101)

*Included herewith. Other exhibits were filed as shown above.

**Certification Pursuant
To 18 U. S. C. Section 1350,
As Adopted Pursuant To
Section 302 of the Sarbanes-Oxley Act of 2002**

I, Gerald R. Cysewski, Chief Executive Officer certify that:

1. I have reviewed this quarterly report on Form 10-Q of Cyanotech Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15 (e) and 15d-15 (e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: February 10, 2022

/s/ Gerald R. Cysewski

Gerald R. Cysewski
Chief Executive Officer; Vice Chairman of the Board

**Certification Pursuant
To 18 U. S. C. Section 1350,
As Adopted Pursuant To
Section 302 of the Sarbanes-Oxley Act of 2002**

I, Felicia Ladin, Chief Financial Officer certify that:

1. I have reviewed this quarterly report on Form 10-Q of Cyanotech Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15 (e) and 15d-15 (e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: February 10, 2022

/s/ Felicia Ladin

Felicia Ladin
*Chief Financial Officer; Vice President—Finance &
Administration, and Treasurer
(Principal Financial Officer)*

**Certification of CEO and CFO
Pursuant to 18 U.S.C. Section 1350,
As Adopted Pursuant to Section 906
of the Sarbanes-Oxley Act of 2002**

In connection with the Quarterly Report of Cyanotech Corporation (the "Company") on Form 10-Q for the period ended December 31, 2021 (the "Report") as filed with the Securities and Exchange Commission on the date hereof, each of the undersigned certifies that:

- 1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act (15 U.S.C. 78m or 78o (d)); and
- 2) The information contained in the Report fairly presents, in all material aspects, the financial condition and results of operations of the Company.

Date: February 10, 2022

/s/ Gerald R. Cysewski
Gerald R. Cysewski
Chief Executive Officer; Vice Chairman of the Board

Date: February 10, 2022

/s/ Felicia Ladin
Felicia Ladin
*Chief Financial Officer; Vice President—Finance &
Administration, and Treasurer
(Principal Financial Officer)*

**News Release**

Contact: Bruce Russell
(310) 346-6131
brussell@cyanotech.com

Cyanotech Reports Financial Results for the Third Quarter and First Nine Months of Fiscal 2022

KAILUA KONA, Hawaii (February 10, 2022) — Cyanotech Corporation (Nasdaq Capital Market: CYAN), a world leader in microalgae-based, high-value nutrition and health dietary supplement products, announced financial results for the third quarter and first nine months of fiscal year 2022, ended December 31, 2021.

Commenting on the third quarter fiscal 2022 results, Cyanotech's Chief Executive Officer, Gerald R. Cysewski, Ph.D., said: "In the third quarter, we were able to produce consistent results even as we contend with the same range of supply chain constraints facing most production and manufacturing businesses. Demand remains strong as we are benefitting from increased interest in naturally derived high value nutritional products for human health and well-being."

Third Quarter Fiscal 2022

Cyanotech reported net sales of \$9,459,000 for the third quarter of fiscal 2022 compared to \$6,985,000 for the third quarter of fiscal 2021, an increase of 35.4%. Gross profit was \$3,238,000, with gross profit margin of 34.2%, compared to gross profit of \$2,071,000, with gross profit margin of 29.6%. Operating income for the third quarter of fiscal 2022 was \$508,000 compared to operating loss of \$441,000 in the same period of the prior year. Net income for the current fiscal quarter was \$386,000, or \$0.06 per diluted share, compared to net income of \$827,000, or \$0.13 per diluted share, for the same period of the prior year. The prior year net income included the forgiveness of the loan under the Paycheck Protection Program in the amount of \$1,389,000.

First Nine Months Fiscal 2022

Cyanotech reported net sales of \$27,842,000 for the first nine months of fiscal 2022 compared to \$22,907,000 for the same period in fiscal 2021, an increase of 21.5%. Gross profit was \$10,672,000, with gross profit margin of 38.3%, compared to gross profit of \$8,347,000, with gross profit margin of 36.4%. Operating income for the first nine months of fiscal 2022 was \$2,210,000 compared to \$109,000 in the same period of the prior year. Net income for the first nine months of fiscal 2022 was \$1,877,000, or \$0.30 per diluted share, compared to net income of \$1,121,000, or \$0.18 per diluted share, for the same period of the prior year. The prior year net income included the forgiveness of the loan under the Paycheck Protection Program in the amount of \$1,389,000.

Trailing Twelve Months

For the trailing twelve months ended December 31, 2021, compared to the trailing twelve months ended December 31, 2020, net sales were \$37,280,000 compared to \$31,541,000. Gross profit was \$13,442,000, with gross profit margin of 36.1%, compared to \$11,431,000 and 36.2%. Net income was \$1,676,000, or \$0.27 per diluted share, compared to net income of \$1,242,000, or \$0.20 per diluted share. The prior trailing twelve months ended December 31, 2020 included the forgiveness of the loan under the Paycheck Protection Program in the amount of \$1,389,000.

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(808) 326-1353 fax (808) 329-3597 ~ www.cyanotech.com



Please review the Company's Form 10-Q for the period ended December 31, 2021 for more detailed information.

— Cyanotech will host a virtual broadcast at 8:00 PM EDT on Friday, February 11, 2022 to respond to questions about its operating results and other topics of interest. Interested parties are asked to submit questions to questions@cyanotech.com before 12 p.m. (noon) EDT on Friday, February 11, 2022. The Company will respond only to relevant questions relating to the Company's third quarter fiscal 2022 financial performance and will not be accepting any questions or comments during the broadcast.

To join the broadcast, please browse <http://cyanotech.com/meet> approximately five minutes prior to the start time.

About Cyanotech — Cyanotech Corporation, a world leader in microalgae technology for more than 30 years, produces *BioAstin*® *Hawaiian Astaxanthin*® and *Hawaiian Spirulina Pacifica*®. These all-natural, dietary ingredients and supplements leverage our experience and reputation for quality, building nutritional brands which promote health and well-being. The Company's mission is to fulfill the promise of whole health through Hawaiian microalgae. Cyanotech's *BioAstin*® offers superior antioxidant activity which supports skin, eye and joint health, as well as recovery from exercise*. Cyanotech's Spirulina products offer nutrition that supports cardiovascular health and immunity*. All Cyanotech products are produced from microalgae grown at our 96-acre facility in Kona, Hawaii using patented and proprietary technology and are Generally Recognized as Safe ("GRAS") for use in food products. Cyanotech sells its products direct to consumers at retail locations in the United States and online at www.nutrex-hawaii.com and also distributes to dietary supplement, nutraceutical and cosmeceutical manufacturers and marketers. The Company is regulated by the Food and Drug Administration. Visit www.cyanotech.com for more information.

*These statements have not been evaluated by the Food and Drug Administration. This product is not intended to diagnose, treat, cure or prevent any disease.
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"Safe Harbor" Statement under the U.S. Private Securities Litigation Reform Act of 1995 Besides statements of present fact and historical fact, this press release may contain forward-looking statements. Forward-looking statements relate to the future and are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict. Our actual results may differ materially from those contemplated by forward-looking statements. We caution against relying on forward-looking statements. Important factors that could change actual, future results include: changes in sales levels to our largest customers, weather patterns in Hawaii, production problems, risks associated with new products, foreign exchange fluctuations, and availability of financing, as well as national and global political, economic, business, competitive, market and regulatory conditions. Other factors are more fully detailed in the Company's annual Form 10-K filings with the Securities and Exchange Commission.

Financial Tables Follow: The following tables do not contain footnotes or other information contained in the Company's Form 10-Q for the third quarter fiscal 2022 ended December 31, 2021, which can be found on the Cyanotech website (www.cyanotech.com) under Investors>Investor Filings upon filing. As such, the following Financial Tables are provided only as a guide and other factors are more fully detailed in the Company's annual Form 10-K filings with the Securities and Exchange Commission.

73-4460 Queen Kaahumanu Highway, #102 ~ Kailua-Kona, Hawaii 96740
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CYANOTECH CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share amounts)
(Unaudited)

	<u>December 31,</u> <u>2021</u>	<u>March 31,</u> <u>2021</u>
ASSETS		
Current assets:		
Cash	\$ 2,298	\$ 3,767
Accounts receivable, net of allowance for doubtful accounts of \$156 as of December 31, 2021 and \$32 as of March 31, 2021	4,526	2,436
Inventories	8,724	8,415
Prepaid expenses and other current assets	293	488
Total current assets	<u>15,841</u>	<u>15,106</u>
Equipment and leasehold improvements, net	11,936	12,136
Operating lease right-of-use assets, net	3,412	3,517
Other assets	112	120
Total assets	<u>\$ 31,301</u>	<u>\$ 30,879</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 2,275	\$ 2,287
Accrued expenses	1,291	844
Customer deposits	83	124
Operating lease obligations, current portion	382	343
Line of credit	—	1,000
Current maturities of long-term debt	626	1,210
Total current liabilities	<u>4,657</u>	<u>5,808</u>
Long-term debt, less current maturities	4,400	4,823
Long-term operating lease obligations	3,027	3,175
Other long-term liabilities	20	32
Total liabilities	<u>12,104</u>	<u>13,838</u>
Commitments and contingencies		
Stockholders' equity:		
Preferred stock of \$0.01 par value, authorized 10,000,000 shares; no shares issued and outstanding	—	—
Common stock of \$0.02 par value, authorized 50,000,000 shares; issued and outstanding 6,194,166 shares at December 31, 2021 and 6,116,073 shares at March 31, 2021	124	122
Additional paid-in capital	33,544	33,267
Accumulated deficit	(14,471)	(16,348)
Total stockholders' equity	<u>19,197</u>	<u>17,041</u>
Total liabilities and stockholders' equity	<u>\$ 31,301</u>	<u>\$ 30,879</u>

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CYANOTECH CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2021	2020	2021	2020
Net sales	\$ 9,459	\$ 6,985	\$ 27,842	\$ 22,907
Cost of sales	6,221	4,914	17,170	14,560
Gross profit	<u>3,238</u>	<u>2,071</u>	<u>10,672</u>	<u>8,347</u>
Operating expenses:				
General and administrative	1,403	1,001	4,171	3,801
Sales and marketing	1,127	1,300	3,808	3,918
Research and development	200	211	483	519
Total operating expenses	<u>2,730</u>	<u>2,512</u>	<u>8,462</u>	<u>8,238</u>
Income (loss) from operations	508	(441)	2,210	109
Interest expense, net	(116)	(123)	(312)	(374)
Gain on extinguishment of debt	—	1,389	—	1,389
Income before income taxes	392	825	1,898	1,124
Income tax expense (benefit)	6	(2)	21	3
Net income	<u>\$ 386</u>	<u>\$ 827</u>	<u>\$ 1,877</u>	<u>\$ 1,121</u>
Net income per share:				
Basic	<u>\$ 0.06</u>	<u>\$ 0.14</u>	<u>\$ 0.31</u>	<u>\$ 0.18</u>
Diluted	<u>\$ 0.06</u>	<u>\$ 0.13</u>	<u>\$ 0.30</u>	<u>\$ 0.18</u>
Shares used in calculation of net income per share:				
Basic	<u>6,183</u>	<u>6,097</u>	<u>6,144</u>	<u>6,060</u>
Diluted	<u>6,371</u>	<u>6,222</u>	<u>6,219</u>	<u>6,169</u>

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