CYANOTECH CORP
Form 10-K
June 24, 2013
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# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D. C. 20549**

# FORM 10-K

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the Fiscal Year Ended March 31, 2013**

**Commission File Number 0-14602**

# CYANOTECH CORPORATION

(Exact name of registrant as specified in its charter)

| **Nevada** | **91-1206026** |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I. R. S. Employer Identification No.) |
| **73-4460 Queen Kaahumanu Highway, Suite 102, Kailua-Kona, Hawaii** | **96740** |
| (Address of principal executive offices) | (Zip Code) |

Registrant s telephone number, including area code: **(808) 326-1353**

| Securities registered pursuant to Section 12(b) of the Act: | Name of each exchange on which registered: |
|---|---|
| **None** | **NASDAQ Capital Market** |

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

**Common Stock, $0.02 par value**
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. o Yes x No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. o Yes x No

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

Indicate by checkmark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§229.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). x Yes o No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

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

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

The aggregate market value of the Registrant s Common Stock held by non-affiliates of the Registrant on September 30, 2012 was approximately $29,559,905 based on the closing sale price of the Common Stock on the NASDAQ Capital Market on that date.

Number of shares outstanding of Registrant s Common Stock at June 19, 2013 was 5,463,938.

**DOCUMENTS INCORPORATED BY REFERENCE**

**Portions of the Registrant s Definitive Proxy Statement for its 2013 Annual Meeting of Stockholders, to be filed with the Securities and Exchange Commission on or prior to July 30, 2013 and to be used in connection with the Annual Meeting of Stockholders expected to be held on August 29, 2013, are incorporated by reference in Part III of this Form 10-K.**

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**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 perfo 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. 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:

- Environmental restrictions, soil and water conditions, levels of sunlight and seasonal weather patterns, particularly heavy rain, wind and other hazards;

- Consumer perception of our products due to adverse scientific research or findings, publicity regarding nutritional supplements, litigation, regulatory investigations or other events, conditions and circumstances involving the Company which receive national media coverage;

- The effects of competition, including tactics and locations of competitors and operating and market competition;

- Demand for our products, the quantities and qualities thereof available for sale and levels of customer satisfaction, including significant unforeseen fluctuations in global demand for products similar to our products;

- Our dependence on the experience, continuity and competence of our executive officers and other key employees;

- The added risks associated with the current local, national and world economic crises, including but not limited to, the volatility of crude oil prices, inflation and currency fluctuations;

- Changes in domestic and/or foreign laws, regulations or standards, affecting nutraceutical products or our methods of operation;

- Access to available and reasonable financing on a timely basis;

- Changes in laws, corporate governance requirements and tax rates, regulations, accounting standards and the application to us or the nutritional products industry of new decisions by courts, regulators or other government authorities;

- The risk associated with the geographic concentration of our business;

- Acts of war, terrorist incidents or natural disasters; and

- Other risks or uncertainties described elsewhere in this Report and in other periodic reports previously and subsequently filed by us with the Securities and Exchange Commission.

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**PART I**

**Item 1. Business**

Unless otherwise indicated, all references in this report to the Company , we , us , our , and Cyanotech refer to Cyanotech Corporation and its wholly owned subsidiary, Nutrex Hawaii, Inc. ( Nutrex Hawaii or Nutrex ), a Hawaii corporation.

**General**

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 ISO 9001:2008 compliant and GMP (Good Manufacturing Practices) certified by the Natural Products Association , 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:

- 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; and

- Hawaiian *BioAstin*® natural astaxanthin - a powerful dietary antioxidant shown to support and maintain the body s natural inflammatory response, to enhance skin, and to support eye and joint health. It has expanding applications as a human nutraceutical and functional food ingredient

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 nutritional products derived from microalgae.

Our production of these products at the 90-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, free of pesticides and herbicides. 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.

**Our Business**

We operate entirely in one operating segment, the cultivation and production of microalgae into high-value, high-quality natural health and nutrition products. We cultivate, on a large-scale basis, two microalgal species from which our two major product lines, spirulina products and natural astaxanthin products, are derived. We record revenue and cost of sales information by product category, but do not record operating expenses by such product category.

The following table sets forth, for the three years ended March 31, 2013, the net sales contributed by each of our product lines (in thousands):

| | Net Sales | | |
|---|---|---|---|
| | **2013** | **2012** | **2011** |
| Spirulina products: | | | |
| *Spirulina Pacifica*® | $ 8,863 | $ 8,701 | $ 8,387 |
| Natural astaxanthin products: | | | |
| *BioAstin*® | 18,713 | 15,912 | 8,434 |
| Other | 5 | 18 | 6 |
| Total | $ 27,581 | $ 24,631 | $ 16,827 |

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***Spirulina Products***

We have been producing a strain of spirulina microalgae marketed as Hawaiian *Spirulina Pacifica*® since 1984. *Spirulina Pacifica*® represents 32%, 35% and 50% of net sales for the years ended March 31, 2013, 2012 and 2011, respectively. *Spirulina Pacifica*® provides a vegetable-based, highly absorbable source of protein, natural beta-carotene, mixed carotenoids, B vitamins, gamma linolenic acid, essential amino acids and other phytonutrients.

*Spirulina Pacifica*® is produced in two forms: powder and tablets. Powder is used as an ingredient in nutritional supplements and health beverages; tablets are consumed as a daily dietary supplement. Both forms are sold as raw material ingredients in bulk quantities, as packaged consumer products under the Nutrex Hawaii label and as private label consumer packaged products.

*Spirulina Pacifica*® is GRAS (generally recognized as safe) for addition to a variety of foods as determined by the United States Food and Drug Administration. Our all natural *Spirulina Pacifica*® is cultivated without the use of herbicides or pesticides, is not genetically modified (non GMO) and is certified Kosher by Organized Kashrus Laboratories of Brooklyn, New York and certified Halal by the Islamic Food and Nutrition Council of America.

Our *Spirulina Pacifica*® is cultivated in a combination of fresh water and a metered amount of nutrient-rich deep ocean water (containing essential trace elements), drawn from a depth of 2,000 feet below sea level. This water mixture is supplemented with other major required nutrients. With the exception of deep ocean water, the raw materials and nutrients required in our spirulina production are available from multiple sources; however, there can be no assurance that the pricing from a new source will be comparable to current pricing. In the case of deep ocean water, although abundantly available at this location, the facility to pump and deliver the water to our location is owned by the State of Hawaii. The facility is constructed of two separately located pump stations providing redundancy should one station fail. The State of Hawaii sets the price for deep ocean water annually based on its cost to deliver the water. If the pricing for a critical raw material or nutrient significantly increases, this could have a material adverse effect on our business, financial condition and results of operations. The ability of our suppliers to meet performance and quality specifications and delivery schedules is also important to operations.

Continuing the production process, the spirulina crop in each pond is circulated by paddlewheels to keep an even blend of nutrients in suspension and a uniform exposure of the algae to sunlight. Our ponds are engineered to maintain the right media depth for sunlight to permeate each crop completely, facilitating rapid growth. The design of our cultivation ponds promotes efficient growing conditions, allowing the *Spirulina Pacifica*® algae to reproduce rapidly. Each pond can be harvested, on average, in six days. As sunlight is a major component of cultivation, production can be impacted by seasonal changes during the winter months, with shortened daylight hours, increased cloud cover and potential inclement weather.

Once ready for harvest, a majority of the spirulina algae are pumped from a pond to our processing building where the crop is separated from the culture media. The culture remaining in the ponds serves as an inoculum for the next growth cycle. Harvested spirulina is washed with fresh water and filtered before moving to the drying stage. Culture media separated from spirulina algae during processing are conserved and recycled. Our *Integrated Culture Biology Management* ( ICBM ) technology for microalgae cultivation has proven to be a reliable and stable operating environment, allowing us to grow and harvest spirulina without significant contamination by unwanted microorganisms and without associated loss of productivity.

*Spirulina Pacifica*® powder is dried via our low-oxygen *Ocean-Chill Drying* process, thereby preserving high levels of antioxidant carotenoids and other nutrients sensitive to heat and oxygen. The rapid drying process results in a dark green powder. Spirulina powder is difficult to form into tablets. Most tablet manufacturers either add high amounts (from 10% to 30%) of inert substances to glue the tablet together or use a heat granulation process that destroys nutrients. In contrast, our *Spirulina Pacifica*® tablets contain a maximum of 2% of such substances and are produced in cold press compression tablet-making machines.

Each production lot of *Spirulina Pacifica*® is sampled and subjected to thorough quality control analyses including testing for moisture, carotenoids, minerals, color and taste, among others. Further, each lot of our *Spirulina Pacifica*® undergoes a prescribed set of microbiological food product tests, including total aerobic bacteria, coliform bacteria and E. coli. The *Spirulina Pacifica*® powder and tablets are packaged to extend shelf life and ensure product freshness. Our packaged consumer products are bottled and labeled by third party contractors in California. These contractors are subject to regular government inspections and hold Drug Manufacturing Licenses & Processed Food Registrations with the State of California Department of Health. Such packaging services are readily available from multiple sources.

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The majority of our bulk spirulina sales are to health food manufacturers and formulators with their own spirulina product lines, many of whom identify and promote Cyanotech s Hawaiian *Spirulina Pacifica*® in their products. Such customers purchase bulk powder or bulk tablets and package these products under their brand label for sale to the health and natural food markets. Some of the brands produced by these customers are marketed and sold domestically in direct competition with the packaged consumer products sold through our Nutrex Hawaii subsidiary. Nutrex Hawaii packaged consumer products are sold direct to consumers and through an established health food distribution network in the domestic market. In selected foreign markets, we have exclusive sales distributors for both our bulk and packaged consumer products.

Our *Spirulina Pacifica*® products compete with a variety of vitamins, dietary supplements, other algal products and similar nutritional products available to consumers. The nutritional products category is highly competitive and includes international, national, regional and local producers and distributors, many of whom have greater resources than Cyanotech and many of whom offer a greater variety of products. Our direct competition in the spirulina market is currently from Dainippon Ink and Chemical Company s Earthrise facility in California, Parry Nutraceuticals, a division of Murugappa Group of India and several farms in China. Other competitors include numerous smaller farms in China, India, Thailand, Taiwan, Cuba, South Africa and South America. We have experienced increased price competition due to the large number of spirulina suppliers as well as customers who generally treat these products as commodities with price being the major determining factor driving their purchasing decision. As one of the largest producers of spirulina, our challenge is to increase our market share among customers who seek the high-quality products we produce while concurrently adjusting our product mix to meet our revenue and profitability targets.

***Natural Astaxanthin Products***

We commenced commercial production of natural astaxanthin in 1997 and in 1999 introduced *BioAstin*®, our natural astaxanthin product for the human health and nutrition market. *BioAstin*® represents 68%, 65% and 50% of net sales for the years ended March 31, 2013, 2012 and 2011, respectively. Astaxanthin s antioxidant properties are believed to surpass many of the antioxidant properties of vitamin C, vitamin E, beta-carotene and other carotenoids. Independent scientific studies indicate that in certain models, natural astaxanthin has up to 550 times the antioxidant activity of vitamin E and 10 times the antioxidant activity of beta-carotene. In addition, a growing body of scientific literature suggests that natural astaxanthin has beneficial properties as an anti-inflammatory, with additional benefits for joint, skin and eye health.

*BioAstin*® is produced in three forms: a liquid lipid extract, gelcaps and microencapsulated beadlets with all three forms sold in bulk quantities. *BioAstin*® gelcaps are also sold in packaged consumer form under the Nutrex Hawaii label as well as private label consumer packaged product. Over time, we have shifted our focus and resources on producing and marketing natural astaxanthin for the higher value human nutrition market.

*BioAstin*® is GRAS (generally recognized as safe) as determined by the United States Food and Drug Administration. Our all natural *BioAstin*® is cultivated without the use of herbicides or pesticides and is not genetically modified (non GMO). In fiscal 2012 we applied for a new dietary ingredient (NDI), with the United States Food and Drug Administration, providing for a daily dosage of 12mg of astaxanthin which was reviewed without comment.

We produce natural astaxanthin from *Haematococcus pluvialis* microalgae grown in fresh water supplemented with nutrients. As these algae are extremely susceptible to contamination by unwanted algae, protozoa and amoebae, we developed a proprietary system known as the *PhytoDome Closed Culture System* or *PhytoDome CCS* to overcome this problem. Using these large-scale photobioreactors, we have generally been able to grow consistently large volumes of contaminant-free *Haematococcus* culture, although quarterly production levels are subject to seasonality. Raw materials and nutrients for our natural astaxanthin production share the same sourcing constraints and pricing risks as those existing in our spirulina production. Fresh water is critical to the production of our natural astaxanthin and is supplied by the County of Hawaii. While we have

not experienced any constraint on fresh water availability to date, availability could be impacted by a significant population growth in the region as well as throughput constraints on the water delivery infrastructure. We have met with officials of the County of Hawaii to assess the fresh water situation and evaluate the probability of future risks. We recycle fresh water in our production process where possible and continue to explore further recycling opportunities. However, there is no guarantee that these efforts will result in significant changes to our fresh water utilization.

For the final stage of cultivation, the *Haematococcus* algae is transferred to open ponds where an environmental stress is applied causing the algae to form spores which accumulate high levels of astaxanthin. Once ready for harvest, the media containing these spores is transported through underground pipes to our astaxanthin processing building where the culture media and algal spores are separated. Fresh water recovered from this stage of processing may be recycled for further use in cultivation. Unlike spirulina, astaxanthin is produced in a batch-mode and each cultivation pond must be completely drained and thoroughly cleaned between cycles. Pond cultivation can be negatively impacted seasonally with shortened daylight hours and potential inclement weather and increased cloud cover in winter months.

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The harvested algal spores are dried to flakes or a fine powder. During processing, the spores are cracked in a proprietary system to assure high bioavailability of astaxanthin. Each production lot of astaxanthin is sampled and tested for astaxanthin concentration. Finally, the bulk powder is vacuum-packed. Natural astaxanthin for human consumption is processed further utilizing a high-pressure extraction process. The resulting product is a lipid extract insoluble in water used in the production of gelcaps. This product can also be micro-encapsulated into beadlets which our customers use in other formulations.

All natural astaxanthin products undergo a prescribed set of microbiological food product tests to ensure safety and quality. We use third party contract manufacturers for the extraction services, the production of gelcaps and the production of beadlets. All third party contract manufacturers are audit inspected by our Quality Control Department and are required to comply with the Food and Drug Administration (FDA) Good Manufacturing Practices (GMP) regulations. The majority of these contract manufacturers hold independent third party GMP certifications. Although these services are available only from a limited number of sources, we believe we have the ability to use other parties if any of the current contract manufacturers become unavailable; however, there is no assurance that the pricing from a new contract manufacturer will be comparable to current negotiated pricing. In addition, a new contract manufacturer would have to pass our qualification process ensuring quality standards can be met or exceeded. Significant price increases for any of these services could have a material adverse effect on our business, financial condition and results of operations.

*BioAstin*® is sold in liquid lipid form as a raw ingredient to dietary supplement manufacturers, health food formulators and cosmetic manufacturers, and *BioAstin*® gelcaps and beadlets are sold in bulk quantities to distributors. *BioAstin*® gelcaps are also sold as a packaged consumer product through Nutrex Hawaii directly to natural product distributors, retailers and consumers. In 2007, we also introduced a line of *BioAstin*® based nutritional supplements, *MDFormulas*. *MDFormulas* combined the health benefits of *BioAstin*® with other proven nutrients with benefits for targeted applications such as skin, heart and joint health.

*BioAstin*® and *MDFormulas* compete directly with similar products marketed by other manufacturers including Fuji Chemical of Japan, Algatechnologies of Israel, and Valensa (formally U.S. Nutraceuticals, LLC) in the United States. In the general category of nutritional supplements, *BioAstin*® also competes with a variety of vitamins, dietary supplements and other antioxidant products available to consumers. The nutritional products market is highly competitive and includes international, national, regional and local producers and distributors, many of whom have greater resources than we have, and many of whom offer a greater variety of products.

The potential benefits of astaxanthin to human health are continuing to emerge. As one of the most potent and bioactive biological antioxidants found in nature, the number of potential roles of natural astaxanthin for human health is growing. Much research has been published in recent years on the beneficial roles of antioxidants in our health, in the aging process and on specific health conditions. The full efficacy of *BioAstin*® as a human nutraceutical supplement requires further significant clinical study. We have spent limited amounts on clinical trials over the past few fiscal years. Independent antioxidant research and prior clinical trials show promising human applications. We hold three United States patents relating to the usage of *BioAstin*® in the treatment of Carpal Tunnel Syndrome, the treatment of canker/cold sores and for its use as a topical and oral sunscreen.

**Major Customers**

We have no customers with sales at or above 10% of our total net sales for the years presented.

**Research and Development**

Our expertise for many years has been in the development of efficient, stable and cost-effective production systems for microalgal products. We have learned production levels from our systems may not be sustainable across periods of days, weeks, or even months. Accordingly, we typically investigate each specific microalgae identified in the scientific literature for potentially marketable products and for solutions to production stability and efficiency challenges, and then strive to develop the technology to grow such microalgae on a commercial scale or to incorporate procedures or technology to improve production stability and efficiency. Successful microalgal product developments and technical solutions are highly uncertain and dependent on numerous factors, many beyond our control. Products and solutions or improvements that appear promising in early phases of development may be found to be ineffective, may be uneconomical because of manufacturing costs or other factors, may be precluded from commercialization due to the proprietary rights of other companies, or may fail to receive necessary regulatory approvals. We had research and development expenditures of $258,000, $320,000 and $282,000 in fiscal years 2013, 2012 and 2011, respectively. No investment was made in scientific clinical trials during fiscal 2013 and 2012. We invested $66,000 in scientific clinical trials during fiscal 2011.

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**Patents, Trademarks and Licenses**

We have been granted four United States patents: one on aspects of our production methods and three relating to usage of our *BioAstin*® products.

Our production method patent is directed to microalgae production technology, and will expire in April 2016. Our patents relating to usage of our *BioAstin*® products are three utility patents on the use of astaxanthin, which will expire in December 2019, February 2020 and April 2020.

Although we view our proprietary rights as important, we currently believe that a loss of patent rights is not likely to have a material adverse effect on our present business as a whole. Instead, our commercial results mainly depend upon our trade secrets, know-how, other non-patent proprietary rights, customer relationships, our climate and our location. As a result, we feel that our competitors in the U.S. would not be able to implement competing technology covered by our patents now, after their expirations or otherwise, without our same combination of non-patented attributes.

We have registered trademarks in the U.S. and in some foreign markets, such as the European Union. Our operations are not dependent upon any single trademark, although some trademarks are identified with a number of our products and are important in the sale and marketing of such products.

**Regulations**

Several governmental agencies regulate various aspects of our business and our products in the United States, including the Food and Drug Administration, the Federal Trade Commission, the Consumer Product Safety Commission, the State of Hawaii Department of Health, the Department of Agriculture, the Environmental Protection Agency, the United States Postal Service, state attorney general offices and various agencies of the states and localities in which our products are sold. We believe we are in compliance the all material government regulations which apply to our products and operations. However, we are not able to predict the nature of any future laws, regulations, interpretations or applications, nor can we predict what effect future changes would have on our business.

Our international customers are subject to similar governmental agency regulations in their various geographic regions. Compliance by our customers with such local regulations is beyond our control and we cannot predict their ability to maintain such compliance. However, we strive to assist our customers in meeting local regulations pertaining to the use and sale of our products whenever possible.

**Environmental Matters**

In 2002, we were issued under the Endangered Species Act ( ESA ) an Incidental Take Permit ( ITP ) by the United States Department of Interior Fish and Wildlife Service ( FWS ). The ESA defines incidental take as incidental to, and not for the purpose of, the carrying out of an otherwise lawful activity. This permit authorizes incidental take of the endangered Hawaiian stilt (*Himantopus mexicanus knudseni)* that is anticipated to occur as a result of ongoing operations and maintenance at our Kona facility. As a mandatory component for the issuance of such permit, we submitted and maintain a Habitat Conservation Plan ( HCP ) to ensure that the effects of the permitted action on listed species are adequately minimized and mitigated.

The HCP called for the creation of a nesting and breeding ground for the Hawaiian stilt to offset any take activity. We have complied with these requirements since 2002. The breeding program was so successful that the increase in the Hawaiian stilt population in the area became a potential hazard for the adjacent State airport facility. We disassembled the stilt habitat and are mitigating take by using standard non-lethal hazing devices to discourage nesting and breeding.

A requirement of the ITP is to provide insurance coverage for funding the project for the term of the ITP. Our insurance broker was unable to locate an underwriter who would provide such a bond. As permitted by law, the FWS waived this requirement recognizing that this HCP did not involve a significant capital expenditure. However, under Hawaii state law, no waiver provision is available. A new ITP was issued by the FWS on September 29, 2006 and by the State of Hawaii Division of Forestry and Wildlife (DOFAW) on October 13, 2006, both which expire on March 17, 2016. In October 2005, we submitted a new ten-year HCP to the FWS and the DOFAW.

**Employees**

As of March 31, 2013, we employed 88 people on a full-time basis and one person on a part-time basis. Of the total, 40 are involved in harvesting, production and quality, with the remainder in maintenance, shipping, sales, administration and support. Management believes that its relations with employees are good. Attracting permanent entry level and skilled employees can be difficult due to the limited local population. None of our employees are subject to collective bargaining agreements.

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**Internet Information**

Our Internet address is *www.cyanotech.com*. There we make available, free of charge, copies of Cyanotech documents, news releases and financial statements issued in the last 12 months. Included are copies of the Board of Directors Code of Conduct, the Company s Code of Conduct and Ethics, the Nominating and Corporate Governance Committee Charter, the Compensation Committee Charter and the Charter and Powers of the Audit Committee. The information found on our web site, unless otherwise indicated, is not part of this or any other report we file or furnish to the Securities and Exchange Commission. *Spirulina Pacifica*® and *BioAstin*® are sold directly online through our wholly owned subsidiary website, *www.nutrex-hawaii.com*, as well as through resellers in over 40 countries worldwide. Corporate data and product information are also available at *www.cyanotech.com*.

**Item 1A. Risk Factors**

You should carefully consider the risks described below which we believe are significant but not the only ones we face. Any of the following risks could have a material adverse effect on our business, financial condition and operating results. You should also refer to the other information contained in this report, including our financial statements and the related notes.

**Our production of algae involves an agricultural process, subject to such risks as weather, disease and contamination.**

The production of our algae products involves complex agricultural systems with inherent risks including weather, disease, and contamination. These risks are unpredictable and also include such elements as the control and balance of necessary nutrients and other factors. The efficient and effective cultivation of microalgae requires consistent light, warm temperatures, low rainfall and proper chemical balance in a very nutrient-rich environment. If the chemical composition of a pond changes from its required balance, unusually high levels of contamination due to the growth of unwanted organisms or other biological problems may occur and would result in a loss of harvestable output. These often arise without warning and sometimes there are few or no clear indicators as to appropriate remediation or corrective measures. 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, environmental factors cannot be controlled in an open air environment, therefore, we cannot, and do not attempt to, provide any form of assurance with regard to our systems, processes, location, or cost-effectiveness.

**There is risk in operating entirely in one business segment such as the cultivation and production of microalgae at a single production facility.**

Single location agricultural and production facilities do not provide the protections and assurances afforded by operations in two or more widely separated locations. Our single location in Hawaii is susceptible to catastrophic natural disasters such as earthquakes, tsunamis, hurricanes and volcanic eruptions. In the event of a natural disaster or localized extended outages of critical utilities or transportation systems, we could experience a significant business interruption. In addition, Hawaii from time to time has experienced shortages of water, electric power and fuels. Future shortages could disrupt our operations and could result in additional expense. Also, a single agricultural facility provides limited biologic diversity protection against invasive, mutant, or harmful organisms.

**Our facilities in Hawaii are located adjacent to a major airport, and an aircraft disaster could disrupt our operations.**

Our production facility and corporate headquarters in Hawaii are located adjacent to the Keahole International airport. In the event of an aircraft disaster, we could experience a significant business interruption, including loss of water, electrical and communication services as well as inability to access our facilities.

**Unfavorable publicity or consumer perception of our products and any similar products distributed by other companies could have a material adverse effect on our business.**

The nutritional supplements market is highly dependent upon consumer perception regarding the safety, efficacy and quality of nutritional supplements. Consumer perception of our products can be significantly influenced by scientific research and findings, as well as by national media attention and other publicity regarding the consumption of nutritional supplements. There can be no assurance that future research or publicity will be favorable to the nutritional supplements market or any product in particular, or consistent with earlier publicity. Our dependence on consumer perception means that any adverse reports, findings or publicity, whether or not accurate or with merit, could have a material adverse effect on the demand for our products and on our results of operations, cash flow and financial condition.

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**The nutritional products industry is extremely competitive. Many of our significant competitors have greater financial and other resources than we do, and one or more of these competitors could use their greater resources to gain market share at our expense.**

The nutritional products market includes international, national, regional and local producers and distributors, many of whom have substantially greater production, financial, research and development, personnel and marketing resources than we do, and many of whom offer a greater variety of products. As a result, each of these companies could compete more aggressively and sustain that competition over a longer period of time than we could. Our lack of resources relative to our significant competitors may cause us to fail to anticipate or respond adequately to development of new products and changing consumer demands and preferences, or may cause us to experience significant delays in obtaining or introducing new or enhanced products. These failures or delays could reduce our competitiveness and cause a decline in our market share and sales. Increased competition in our industry could result in price reductions, reduced gross profit margin or loss of market share, any of which could have a material effect on our business, results of operations and financial condition.

**We depend heavily on the unique abilities and knowledge of our officers and key personnel. Our Chief Executive Officer and our Chief Scientific Officer have knowledge and experience critical to our ongoing operations of the Company. We also depend on the unique knowledge of our Chief Financial Officer and Vice President of Finance and Administration, Vice President of Operations, Vice President of Sales and Marketing, and Vice President of Quality & Regulatory Affairs. We are a small company and the loss of any such personnel or the delay in the replacement of one could significantly delay the achievement of our business objectives and could adversely affect our ability to do business or could hinder our ability to provide needed management.**

The Chief Scientific Officer and founder of our company is our primary scientific resource, continuing to improve production and cultivation technology and to investigate new microalgal products. Our Chief Financial Officer has a unique understanding of our financial systems and needs. Our Vice President Operations has years of experience with the mechanical operation of the production facility and continues to improve our production process. Our Vice President Sales and Marketing has developed valuable personal relationships with domestic and foreign customers. Our Vice President of Quality and Regulatory Affairs has experience and knowledge of federal and state regulations governing our production processes and product representation essential to continuing compliance. Attracting permanent skilled employees in Hawaii can be difficult due to limited local qualified applicants.

**Our operations are vulnerable because we have limited personnel and redundancy and backup systems in our data management function.**

Our internal order, inventory and product data management system is an electronic system through which orders are placed for our products and through which we manage product pricing, shipment, returns and other matters. This system s continued and uninterrupted performance is critical to our day-to-day business operations. Despite our precautions, unanticipated interruptions in our computer and telecommunications systems have, in the past, caused problems or stoppages in this electronic system. These interruptions, and resulting problems, could occur again in the future. We also have limited personnel available to process purchase orders and to manage product pricing and other matters in any manner other than through this electronic system. Any significant interruption or delay in the operation of this electronic management system could cause a decline in our sales and profitability.

**A significant or prolonged economic downturn could have a material adverse effect on our results of operations.**

Our results of operations are affected by the business activity of our customers who in turn are affected by the level of economic activity in the industries and markets that they serve. A decline in the level of business activity of our clients or the economy as a whole could have a material adverse effect on our revenues and profit margin.

The global cost of oil derived energy impacts us in several ways, and it may hinder our efforts to achieve profitability. Oil prices primarily impact us through the costs of electricity, transportation, materials and supplies which are tied to the cost of oil either directly or indirectly. The return of a high cost of oil on a global basis may signal a prolonged economic downturn resulting in a material adverse effect on our business.

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**Our quarterly operating results may vary from quarter to quarter, which may result in increased volatility of our share price.**

We have experienced, and may in the future continue to experience, fluctuations in our quarterly operating results. These fluctuations could reduce the market price of our common stock. Factors that may cause our quarterly operating results to vary include, but are not limited to:

- weather-related cultivation difficulties;
- fluctuations in customer demand;
- business decisions of our customers regarding orders for our products;
- changes in energy costs;
- changes in raw material costs;
- production problems which we cannot solve technically or economically;
- contamination of our cultivation and production facilities;
- effects of weather on our ability to meet customer demand;
- timing of promotional activities;
- the introduction of new products by us or our competitors;

- changes in our pricing policies or those of our competitors;

- changes in seasonal and other trends in our customers buying patterns;

- changes in government regulation, both domestic and foreign;

- fluctuation in foreign currency exchange rates;

- global economic and political conditions and related risks, including acts of terrorism; and

- other factors beyond our control.

A significant portion of our expense levels are relatively fixed. If net sales are below expectations in any given period, the adverse impact on results of operations may be magnified by our inability to reduce expenses quickly enough to compensate for the sales shortfall.

**Our global operations expose us to complex management, foreign currency, legal, tax and economic risks, which we may not be able to address quickly and adequately.**

Our products are marketed in a number of countries around the world. For the year ended March 31, 2013, approximately 37% of our net sales were from sales to foreign customers. As a result, we are subject to a number of risks which include, but are not limited to:

- the burden of complying with a wide variety of national and local laws;

- potentially longer payment cycles for foreign sales;

- restrictions (government and otherwise) on the movement of cash;

- the absence in some jurisdictions of effective laws protecting our intellectual and proprietary property rights, or of enforcement of such laws where they do exist;

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- changes in government regulations, both domestic and foreign;

- global economic and political conditions and related risks, including acts of terrorism; and

- fluctuations in foreign currency exchange rates.

**If we are unable to protect our intellectual property rights or if we infringe upon the intellectual property rights of others our business may be harmed.**

We currently have four United States patents in force: one on aspects of our production methods and three for use of our *BioAstin*® products. We regard our proprietary technology, trade secrets, trademarks and similar intellectual property as important and we rely on a combination of trade secret, contract, patent, copyright and trademark law to establish and protect our rights in our products and technology. However, there can be no assurance that we will be able to protect our technology adequately or that competitors will not be able to develop similar technology independently. In addition, the laws of certain foreign countries may not protect our intellectual property rights to the same extent as the laws of the United States. Litigation in the United States or abroad may be necessary to enforce our patent or other intellectual property rights, to protect our trade secrets, to determine the validity and scope of the proprietary rights of others or to defend against claims of infringement. Such litigation, even if successful, could result in substantial costs and diversion of resources and could have a material adverse effect on our business, results of operations and financial condition. Additionally, if any such claims are asserted against us, we may seek to obtain a license under the third party s intellectual property rights. There can be no assurance, however, that a license would be available on terms acceptable or favorable to us, if at all.

**Our insurance liability coverage is limited and may not be adequate to cover potential losses.**

In the ordinary course of business, we purchase insurance coverage (e.g., property and liability coverage) to protect us against loss of or damage to our properties and claims made by third parties and employees for property damage or personal injuries. However, the protection provided by such insurance is limited in significant respects and, in some instances, we have no coverage and certain of our insurance policies have substantial deductibles or has limits on the maximum amounts that may be recovered. For example, if a tsunami, earthquake or other catastrophic natural disaster should occur, we may not be able to recover all facility restoration costs and revenues lost from business interruption. In addition, we maintain product liability insurance in limited amounts for all of our products involving human consumption; however, broader product liability coverage is prohibitively expensive. Insurers have also introduced new exclusions or limitations of coverage for claims related to certain perils including, but not limited to, mold and terrorism. If a series of losses occurred, such as from a series of lawsuits in the ordinary course of business each of which were subject to the deductible amount, or if the maximum limit of the available insurance were substantially exceeded, we could incur losses in amounts that would have a material adverse effect on our results of operations and financial condition.

**Our ability to develop and market new products or modify existing products and production methods may be adversely affected if we lose the services of or cannot replace certain employees knowledgeable in advanced scientific and other fields.**

Our products are derived from and depend on proprietary and non-proprietary processes and methods founded on advanced scientific knowledge, skills, and expertise. If the services of employees knowledgeable in these fields are lost and cannot be replaced in a reasonable time frame at reasonable costs, our ability to develop and market new products or modify existing products and production methods would be adversely impacted. At the same time, regulatory compliance surrounding our products and financial matters generally requires a basic knowledge and level of expertise related to production, quality assurance, and financial control. If we lose the services or cannot reasonably replace employees who have the necessary knowledge and expertise our ability to remain in regulatory compliance could be adversely affected.

**We may need to raise additional capital in the future which may not be available.**

We believe our cash and cash equivalents to be provided from operations will be sufficient to meet our working capital and operating requirements for at least the next 12 months, but we may need to raise additional funds and we may not be able to secure funding on acceptable terms, if at all. If we raise additional funds through the issuance of equity or convertible debt securities, the percentage ownership of our then current stockholders may be reduced. If we raise additional funds through the issuance of convertible debt securities, or through additional debt or similar instruments, such securities, debt, or similar instruments could have rights senior to those of our common stockholders and such instruments could contain provisions restricting our operations. If adequate funds are not available to satisfy either short-term or long-term capital requirements, we may be required to limit operations with adverse results.

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**We have incurred significant losses in the past. If we incur significant losses in the future, we will experience negative cash flow which may hamper current operations and prevent us from sustaining or expanding our business.**

We have incurred net losses in two of the last seven fiscal years. As of March 31, 2013, we had an accumulated deficit of approximately $8,959,000. The Company had net income of $4,209,000, $3,632,000, $1,730,000, $1,391,000 and $1,142,000 for the fiscal years ended March 31, 2013, 2012, 2011, 2010 and 2009, respectively. However, in fiscal years ended March 31, 2008 and 2007, we incurred net losses in the amounts of $1,139,000 and $7,425,000, respectively. The 2007 loss included a non-cash impairment loss on equipment and leasehold improvements of $4,487,000. These account for approximately 96% of our accumulated deficit since our inception. Historically, we have relied upon cash from operations and financing activities to fund all of the cash requirements of our business. However, extended periods of net income do not assure positive cash flows. Future periods of net losses from operations could result in negative cash flow, and may hamper ongoing operations and prevent us from sustaining or expanding our business. We cannot assure you that we will sustain or increase profitability on a quarterly or annual basis in the future. If we do not achieve, sustain or increase profitability, our business will be adversely affected and our stock price may decline.

**Our stock price is volatile, which could result in substantial losses for investors purchasing shares of our common stock.**

Stock markets have experienced extreme volatility that has often been unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the trading price of our common stock. In addition, the average daily trading volume of the securities of small companies can be very low. Limited trading volume of our stock may contribute to its future volatility. Price declines in our common stock could result from general market and economic conditions and a variety of other factors, including any of the following:

- volatility resulting from minimal trading activity;
- changes in market valuations of similar companies;
- stock market price and volume fluctuations generally;
- economic conditions specific to the nutritional products industry;
- economic conditions tied to global resource markets, such as fuel costs;
- announcements by us or our competitors of new or enhanced products or of significant contracts, acquisitions, strategic relationships, joint ventures or capital commitments;

- fluctuations in our quarterly or annual operating results;

- changes in our pricing policies or the pricing policies of our competitors;

- changes in foreign currency exchange rates affecting our product costs, pricing or our customers markets;

- regulatory developments effecting our specific products or industry; and

- additions or departures of key personnel.

The price at which you purchase shares of our common stock may not be indicative of the price that will prevail later in the trading market. You may be unable to sell your shares of common stock at or above your purchase price, which may result in substantial losses to you. As of March 31, 2013, there were approximately 5.5 million shares of our common stock outstanding. We cannot predict the effect, if any, that future sales of shares of our common stock into the public market will have on the market price of our common stock. Sales of substantial amounts of common stock, including shares issued upon the exercise of stock options, or in anticipation of such sales, may materially and adversely affect prevailing market prices for our common stock.

**Recent European Union regulations include stringent requirements for health claims on food and supplement labels.**

The European Union has harmonized standards among Member States for health claims on food and supplement labels. The scientific assessment of health claims is performed by the European Food Safety Authority (EFSA), an advisory panel to the European Commission. The European Commission will consider the opinions of EFSA in determining whether to include a health claim on a Positive List of permissible claims. Once the list is published, only health claims for ingredients and products included on the list may be used in promotional materials for products marketed and sold in the European Union. This could severely decrease or limit the marketability for our products in this market area. We have implemented strategies that we believe will allow for continued and increasing sales of our products in the European Union. However there can be no guarantee that such strategies will be successful.

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**Item 2. Properties**

Our principal facility and corporate headquarters is located at the Natural Energy Laboratory of Hawaii Authority ( NELHA ) at Keahole Point in Kailua-Kona, Hawaii. It encompasses approximately 90 fully developed acres containing microalgal cultivation ponds, processing facilities, research and quality control laboratories, and sales and administrative offices. The property is leased from the State of Hawaii under a 40-year commercial lease expiring in 2035. We believe that there is sufficient available land at NELHA to meet anticipated needs if a revised NELHA lease can be negotiated with acceptable terms. Under the terms of the existing NELHA lease, we could be required to remove improvements at the end of the lease term. Based upon our analysis, we do not believe the projected cost for such removal to be reasonably estimable, or likely, given historical practices. However, conditions could change in the future. It is not possible to predict such changes or estimate any impact thereof. We also rent warehouse space near NELHA and in Ontario, California, and office space in Los Angeles, California.

**Item 3. Legal Proceedings**

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

**PART II**

**Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Our common stock is listed and traded on the NASDAQ Capital Market under the symbol CYAN . The closing price of our common stock was $5.23 as of June 19, 2013. The approximate number of holders of record of our common stock was 1,500. The high and low selling prices as reported by NASDAQ were as follows:

| Quarter Ended: | June 30 | September 30 | December 31 | March 31 |
|---|---|---|---|---|
| Fiscal 2013 | | | | |
| Common stock price per share: | | | | |
| High | $ 10.89 | $ 7.24 | $ 6.19 | $ 5.30 |
| Low | $ 6.57 | $ 5.44 | $ 4.60 | $ 4.28 |
| | | | | |
| Fiscal 2012 | | | | |
| Common stock price per share: | | | | |
| High | $ 3.69 | $ 4.38 | $ 9.09 | $ 11.35 |
| Low | $ 2.93 | $ 3.27 | $ 3.61 | $ 6.10 |

We are prohibited from declaring any common stock dividends without the prior written consent of a lender per the conditions of an existing term loan agreement with such lender. We have never declared or paid cash dividends on our common stock. We currently do not anticipate

paying any cash dividends on common stock.

The following table sets forth the Company s common shares authorized for issuance under equity compensation plans:

| | Common shares to be issued upon exercise of options outstanding | Weighted-average exercise price of outstanding options | Common shares available for future grant under equity compensation plans |
|---|---|---|---|
| Equity compensation, plans approved by security holders | 1,495,856 shares | $ 4.03 | 541,601 shares |

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**Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations**

Management s Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ) is intended to provide a reader of our financial statements with a narrative of our financial condition, results of operations, liquidity and certain other factors that may affect our future results from the perspective of management.

*Our MD&A should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere in this Form 10-K. A more comprehensive description of our products and markets for such products is provided in Part I. Item 1. Business.*

**Overview**

We are a world leader in the production of natural products derived from microalgae, with a core competency in cultivating and processing microalgae into high-value, high-quality natural products for the human nutrition market. We produce our algae in Hawaii and manufacture the finished products in Hawaii and California. Our products are marketed worldwide and are sold in bulk quantities to manufacturers, formulators and distributors in the health foods and nutritional supplements markets and as packaged consumer products to distributors, retailers and direct consumers. We generated 37%, 33% and 42% of our revenues outside of the United States during the years ended March 31, 2013, 2012 and 2011, respectively. Competing in a global marketplace, we are influenced by the general economic conditions of the countries in which our customers operate, including adherence to our customers local governmental regulations and requirements. Since all sales are made in U.S. currency, we have no material foreign exchange exposure.

Our production levels have a significant impact on our gross profit margin, as well as our ability to meet customer demand. Because our processes are agricultural, it is important to maintain production volumes in order to support the minimal resource levels required to sustain a large-scale open culture agricultural facility. Our production costs include customary variables such as availability and costs of personnel, raw materials, energy, water and freight. These variables fluctuate based on changes in the local, national and world economies. More complex variables include cultivation methods, feeding formulations and harvesting processes, all of which include efforts to anticipate the extent of weather and environmental events and make timely and sufficient adjustments. Although the variability of such costs cannot be fully anticipated, we have focused increased effort in this area in order to produce both spirulina and astaxanthin at levels sufficient to fully absorb production costs into inventory.

Fresh water is critical for our natural astaxanthin production and, while we have not experienced any constraint on fresh water availability, future availability could be negatively impacted by significant growth in the local population as well as by throughput constraints on the water delivery infrastructure owned by the County of Hawaii. Given the criticality of fresh water to our operations and the community, we recycle fresh water where possible and have developed additional water recycling systems in our efforts to utilize fresh water efficiently. Both fresh and sea water require electricity for pumping; and electricity, our single largest expenditure, depends on the cost of fuel which is, in turn, tied to the global price of crude oil.

In our discussion of operating results, we refer to abnormal costs. Complex biological processes in the cultivation and processing of our microalgae are influenced by factors beyond our control the weather, for example. As a result, we cannot assure that adequate production levels will be consistent period over period. To the extent that our production levels are not sufficient to absorb these costs on a period basis, we

recognize abnormal production costs, including fixed cost variances from normal production capacity, as an expense in the period incurred. Abnormal amounts of freight, handling costs and wasted material (spoilage) are recognized as current-period charges and fixed production overhead costs are allocated to inventory based on the normal capacity of production facilities. Normal 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.

To offset increased production costs, we seek ways to increase production efficiencies in volume yield, potency, and quality consistent with our commitment to produce high-value, high-quality products. However, these efforts cannot be guaranteed to achieve the desired results.

We utilize several third-party contractors for the process of extraction for our natural astaxanthin product for the human nutrition market, and several third-party contractors are utilized for both encapsulation (for gelcaps) and micro-encapsulation (for beadlets). Although these services are available from a limited number of sources, we believe that we have the ability to use other parties if any of the current contractors become unavailable. If pricing for any of these services significantly increases, there could be a material adverse effect on our business, financial condition and results of operations. There have not been any significant changes in the cost of extraction or encapsulation services, although we continue to investigate cost effective alternatives to outsourcing. On September 12, 2012, we entered into an agreement with Uhde Corporation of America ( Uhde ) for the purchase of supercritical carbon dioxide extraction equipment to be used in the processing of its natural astaxanthin. The equipment is expected to be delivered by the end of fiscal year 2014.

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**Fiscal 2013 summary:**

- Net sales for the year were $27.6 million, an increase of $2.9 million or 12.0% over the prior year, driven primarily by an increase in sales of our consumer products and bulk astaxanthin products, offset by decreased sales of bulk spirulina products due to lower spirulina production in FY13.

- Net income was $4.2 million, an increase of $0.6 million or 16%, driven by the reversal of the remaining $1.9 million valuation allowance on our deferred tax asset as compared to the reversal of $0.8 million in the prior year. This was offset by a decrease in income from operations of $0.6 million as a result of high abnormal production costs associated with low spirulina production, as well as an increase in operating expenses. Earnings per diluted share were $0.74 for fiscal 2013 compared to $0.66 per diluted share for fiscal year 2012.

- Cash from operating activities was $1.9 million, a decrease of $3.2 million from the prior year that was driven by increased accounts receivable and a reduction in accrued expenses related to the payout of the management bonus that was accrued at the end of FY12. Cash and cash equivalents at March 31, 2013 were $4.4 million, down $0.7 million from a year ago. As a result, working capital increased 15% to $9.3 million at March 31, 2013 from $8.1 million a year ago.

**Results of Operations for the 2013, 2012 and 2011 Fiscal Years**

The following tables present selected consolidated financial data for each of the past three fiscal years ($ in thousands):

| **Consolidated Performance Summary** | **2013** | **2012** | **2011** |
|---|---|---|---|
| Net sales | $ 27,581 | $ 24,631 | $ 16,827 |
| Net sales increase | 12.0% | 46.4% | 6.9% |
| Gross profit | $ 10,958 | $ 9,774 | $ 6,341 |
| Gross profit as % of net sales | 39.7% | 39.7% | 37.7% |
| SG&A | $ 8,659 | $ 6,871 | $ 5,112 |
| SG&A as % of net sales | 31.4% | 27.9% | 30.4% |
| Operating income | $ 2,299 | $ 2,903 | $ 1,229 |
| Operating income as % of net sales | 8.3% | 11.8% | 7.3% |
| Income tax benefit (expense) | $ 2,021 | $ 779 | $ 567 |
| Net income | $ 4,209 | $ 3,632 | $ 1,730 |

| **Net sales by product** | **2013** | **2012** | **2011** |
|---|---|---|---|
| Spirulina | $ 8,863 | $ 8,701 | $ 8,387 |
| Net sales increase - Spirulina | 1.9% | 3.7% | 8.3% |
| Astaxanthin | $ 18,713 | $ 15,912 | $ 8,434 |
| Net sales increase - Astaxanthin | 17.6% | 88.7% | 5.7% |

**Fiscal 2013 results compared with Fiscal 2012**

***Net Sales*** The net sales growth of 12% in fiscal 2013 was driven largely by increased demand for *BioAstin*®, fueled by continued media attention on the health benefits of astaxanthin. Our astaxanthin sales increased 17.6% over the prior year. Our spirulina products also received the benefit of positive media on its health benefits and experienced 1.9% growth. Both products are sold in bulk form for use worldwide and in consumer packaged goods distributed primarily in the U.S. We cannot predict the impact of this publicity on future period sales. We will continue to focus on growing the market for our high quality, higher margin consumer products by emphasizing the higher nutritional content of our Hawaiian spirulina and the benefits of our natural astaxanthin over synthetics; however, increased competition may result in the decline of margins in the future

Competition for sales of spirulina remains intense due to the large number of suppliers. We expect competitive pricing pressure to continue in future periods and will continue to focus on the higher quality of Hawaiian spirulina in support of customers who demand higher quality raw materials for their formulations. Conversely, because of the limited number of suppliers and increasing demand for astaxanthin, the competitive forces are currently not quite as high. Because of this, we expect current producers to increase capacity to meet this increasing demand, placing further competitive pressures on us in the future.

***Gross Profit*** Our gross profit percent of net sales remained the same as in fiscal 2012. A 45% increase in sales of our higher margin consumer products was offset by a 6% decrease in bulk sales. This favorable mix impact was offset by abnormal production costs of $1.2 million that consist primarily of underabsorbed overhead costs due primarily to lower levels of spirulina production.

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In fiscal 2013, astaxanthin production levels increased by 6.7% over the prior year and spirulina production levels decreased by 13.1%. The increase in astaxanthin production levels was the result of capacity expansion and improvements to our production processes as well as generally favorable growing conditions through the third quarter of fiscal 2013. The decrease in spirulina production levels was driven by a morphological change in the size of the algae that inhibited successful harvests. We recently implemented process changes and ordered additional process equipment for culture media which should gradually increase production levels and help ensure more sustainable production over the long term.

Continued volatility in fuel costs in the future is likely. Therefore, we expect that electricity, water and shipping costs could be higher due to the impact of fuel cost increases for fiscal 2014. We continue to strive to increase production efficiencies in volume yield, potency and quality consistent with our commitment to produce high-value, high-quality products. However, these efforts cannot be guaranteed to achieve the desired results.

***Operating Expenses*** Operating expenses increased by $1,788,000, or 25%, in 2013 and increased as a percentage of net sales by 3.5%. General and Administrative expenses increased $666,000, or 17%, due to an increase in legal fees of $520,000, increases in costs associated with stock option grants to key employees of $233,000 and an increase in compensation costs related to salaries and benefits for new hires and transfers of $195,000, offset by a reduction in bonus expense of $376,000. Sales and Marketing expenses increased $1,195,000, or 48%, as a result of the expansion of our distribution of consumer products. Major components of these costs are a $811,000 increase in advertising and promotion a $195,000 increase in compensation costs related to salary adjustments, benefits and new hires. R&D expenses decreased $62,000, or 19%, due to a $32,000 reduction in bonus expense as well as reductions in general operating costs.

***Other Expense*** Other expense is comprised primarily of interest expense on term loans, amortization of debt issue costs and interest on other financing agreements, offset by deminimus interest earned and miscellaneous sales. The increase of $61,000 in 2013 is primarily due to the write off of unamortized debt issue costs related to early payoff of the previous Term Loan.

***Income Taxes*** For fiscal 2013 we recorded an income tax benefit of $2,021,000 compared with an income tax benefit of $779,000 for 2012. The 2013 and 2012 tax benefits are the result of a reduction in the deferred tax valuation allowance and recording of a net deferred tax asset. As a result, our effective tax rate was -92.4% and -27.3% for the fiscal years ended March 31, 2013 and 2012, respectively. As of March 31, 2013, there is no valuation allowance on our deferred tax asset, which now totals $3,539,000, compared to a $2,994,000 valuation allowance on gross deferred tax assets of $4,437,000 at the end of last year. At March 31, 2013 we had a Federal net operating loss carry forward of $9,976,000 and a state net operating loss of $6,070,000 for Hawaii.

**Fiscal 2012 results compared with Fiscal 2011**

***Net Sales*** The net sales growth of 46.4% in fiscal 2012 was driven largely by increased demand for *BioAstin*®, fueled by continued mainstream media attention on the health benefits of astaxanthin. Our astaxanthin sales increased 88.7% over the prior year. Our spirulina products also received the benefit of positive media on its health benefits and experienced 3.7% growth. Both products are sold in bulk form for use worldwide and in consumer packaged goods distributed primarily in the U.S. We cannot predict the impact of this publicity on future period sales. We will continue to focus on growing the market for our high quality, higher margin consumer products by emphasizing the higher nutritional content of our Hawaiian spirulina and the benefits of our natural astaxanthin over synthetics; however, increased competition may result in the decline of margins in the future.

Competition for sales of spirulina remains intense due to the large number of suppliers. We expect competitive pricing pressure to continue in future periods and will continue to focus on the higher quality of Hawaiian spirulina in support of customers who demand higher quality raw materials for their formulations. Conversely, because of the limited number of suppliers and increasing demand for astaxanthin, the competitive forces are currently not quite as high. Because of this, we expect current producers to increase capacity to meet this increasing demand, placing further competitive pressures on us in the future.

***Gross Profit*** Our gross profit percent of net sales increased by 2% in fiscal 2012. An increase in sales of our higher margin consumer and bulk astaxanthin sales, and increased astaxanthin production accounted for the growth. This favorable mix impact was partially offset by abnormal production costs of $1.2 million in 2012 compared to $0.5 million in the prior year, mostly related to spirulina production.

In fiscal 2012, astaxanthin production levels increased by 69% over the prior year and spirulina production levels decreased by 12%. The increase in astaxanthin production levels was the result of improvements to our production processes as well as generally favorable growing conditions through the third quarter of fiscal 2012. These factors combined to increase output and reduce unit costs of astaxanthin. The decrease in spirulina production levels was driven by a morphological change in the size of the algae that inhibited successful harvests. We recently implemented process changes and ordered additional process equipment for culture media which should gradually increase production levels and help ensure more sustainable production over the long term.

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***Operating Expenses*** Operating expenses increased by $1,759,000, or 34%, in 2012 but decreased as a percentage of net sales by 2.5%. Included in this is an increase in General and Administrative expenses of $1,192,000, or 42%, due to increases in costs associated with stock option grants to key employees of $376,000, increased bonus costs of $338,000 as a result of the financial performance for the year, an increase in compensation costs related to salary adjustments and new hires of $194,000 and increased recruitment costs of $102,000. Sales and Marketing expenses increased $494,000, or 25%, consisting of increased commissions of $189,000 driven by sales growth, increased bonus costs of $125,000 as result of the financial performance for the year and increased advertising and promotion spending $76,000 to build our consumer business.

***Other Expense*** Other expense is comprised primarily of interest expense on term loans, amortization of debt issue costs and interest on other financing agreements, offset by deminimus interest earned and miscellaneous sales. The reduction of $16,000 in 2012 is primarily due to the reduction of the principal balance on our Term Loans.

***Income Taxes*** For fiscal 2012 we recorded an income tax benefit of $779,000 compared with an income tax benefit of $567,000 for 2011. The 2012 and 2011 tax benefits are the result of a reduction in the deferred tax valuation allowance and recording of a net deferred tax asset. As a result, our effective tax rate was -27.3% and -48.8% for the fiscal years ended March 31, 2012 and 2011, respectively. As of March 31, 2012, the remaining valuation allowance on our deferred tax asset was $3 million, compared to $5 million at March 31, 2011. At March 31, 2012 we had a Federal net operating loss carry forward of $12.3 million and state net operating losses of $7.6 million and $0.5 million for Hawaii and California, respectively.

**Liquidity and Capital Resources**

***Sources of Liquidity*** As of March 31, 2013, we had $9,306,000 in working capital, compared to $8,058,000 at March 31, 2012. Additionally, at March 31, 2013, we had $3,360,000 in restricted cash that will be used to acquire new processing equipment and leasehold improvements. Funds generated by operating activities and available cash and cash equivalents continue to be our most significant sources of liquidity for working capital requirements and for funding of investments in equipment, leasehold improvements and system upgrades. 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 and existing cash balances will be sufficient to finance current operating requirements and meet debt service and planned capital expenditures, for the next 12 months. We use estimates of future financial results including projected revenue, fund expenses, borrowings, and capital expenditures in reaching our conclusions. Such estimates are subject to change based on future results and such change could cause future results to vary significantly from expected results presented in this Form 10-K. Any significant investments in capital equipment related to capacity expansion may not be able to be funded from operating activities and available cash, and may require additional debt or equity funding.

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.

**Contractual Obligations**

The following table presents our contractual obligations at March 31, 2013 (in thousands):

| | Less Than 1 Year | 2-3 Years | 4-5 Years | After 5 Years | Total |
|---|---|---|---|---|---|
| Term Loans(1) | $ 128 | $ 407 | $ 405 | $ 4,642 | $ 5,582 |
| Interest payments(2) | 301 | 575 | 534 | 2,091 | 3,501 |
| Operating Leases(3) | 468 | 889 | 608 | 5,311 | 7,276 |
| Purchase obligations(4) | 1,737 | | | | 1,737 |
| Total | $ 2,634 | $ 1,871 | $ 1,547 | $ 12,044 | $ 18,096 |

Note: For additional information refer to Note 6, *Long-Term Debt* and Note 7, *Leases* in the Notes to Consolidated Financial Statements, included in Item 8, *Financial Statements and Supplementary Data,* of this Annual Report on Form 10-K.

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(1) Includes term loans with a current balance of $5,500,000, secured by substantially all of the assets of the Company. Also includes four equipment loans and an auto loan with a combined current balance of $82,000.

(2) Interest calculated from loan amortization using current rates.

(3) Operating lease obligations do not include percentage rent, property taxes and payments for common area maintenance.

(4) Purchase obligations include agreements to purchase goods or services that are enforceable, are legally binding and specify all significant terms, including fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. Purchase obligations do not include agreements that are cancelable without penalty.

***Cash Flows*** The following table summarizes our cash flows from operating, investing and financing activities for each of the past three fiscal years ($ in thousands):

| | 2013 | 2012 | 2011 |
|---|---|---|---|
| Total cash is provided by (used in): | | | |
| Operating activities | $ 1,897 | $ 5,082 | $ 1,747 |
| Investing activities | (7,254) | (2,029) | (264) |
| Financing activities | 4,660 | (54) | (238) |
| | | | |
| Increase (decrease) in cash and cash equivalents | $ (697) | $ 2,999 | $ 1,245 |

The decrease in cash provided by operating activities in fiscal 2013 compared to fiscal 2012 was driven largely by the increase in accounts receivable of $1,393,000 due to sales growth, compared to a reduction of $304,000 in fiscal 2012, and the payment of $613,000 in bonuses that were accrued as of the end of fiscal 2012. The increase in cash provided by operating activities in fiscal 2012 compared to fiscal 2011 was driven largely by the increase in sales and related profit. Increases in accounts payable, relating to increased activity with our third party processors and service providers, and accrued expenses, which included a bonus accrual of $613,000, contributed $1,201,000 million of this increase.

Cash used in investing activities increased in fiscal 2013 compared to fiscal 2012 due to the investment in equipment and leasehold improvements to increase astaxanthin production capacity as well as the construction of a new office facility at the Kona headquarters. Cash used in investing activities increased in fiscal 2012 compared to fiscal 2011 due to the investment in capital projects to increase astaxanthin production capacity and improve overall production efficiencies.

Cash provided by financing activities increased in fiscal 2013 due to the receipt of proceeds from new term loans. The decrease in fiscal 2012 compared to fiscal 2011 was also the result of a payment on a line of credit in fiscal 2011 that was not utilized in fiscal 2012.

**Effect of Recently Issued Accounting Standards and Estimates**

We do not believe that any recently issued, but not yet effective, accounting standards, if currently adopted, will have a material effect on our consolidated financial position, results of operations, or cash flows.

**Application of Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of financial statements in conformity with those accounting principles requires management to make judgments and estimates that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Management regularly re-evaluates its judgments and estimates which are based upon historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Management believes that of its significant accounting policies, policies that may involve a higher degree of judgment and complexity are inventory valuations, valuation of equipment and leasehold improvements and long-lived assets, and income taxes.

*Revenue* We recognize revenues as goods are shipped to customers and title is transferred. The criteria for recognition of revenue are when persuasive evidence that an arrangement exists and both title and risk of loss have passed to the customer, the price is fixed or determinable, and collectability is reasonably assured. Sales returns and allowances are estimated and recorded as a reduction to sales in the period in which sales are recorded. We record net shipping charges and sales tax in cost of goods sold.

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*Inventory* - We record inventories at the lower of cost or market. Cost is defined as the sum of the applicable expenditures and charges directly or indirectly incurred in bringing inventories to their existing condition and location. Cost for inventory purposes may be determined under any one of several assumptions as to the flow of cost factors, such as first-in, first-out; average cost; and last-in, first-out. Our inventories are stated using the first-in, first-out method. Inventory values are subject to many critical estimates, including production levels and capacity, changes in the prices paid for raw materials, supplies, and labor, changes in yield, potency, and quality of biomass, changes in processing or production methods, and changes in the carrying value of our inventories resulting from the prices our customers are willing to pay for our products. Such estimates are revised quarterly. Changes in management s estimates could result in increases or decreases in the recorded amounts of inventory and cost of sales.

To the extent that our production levels are not sufficient to absorb all production costs on a period basis, we recognize abnormal production costs, including fixed cost variances from normal production capacity, as an expense in the period incurred. Abnormal amounts of freight, handling costs and wasted material (spoilage) are recognized as current-period charges and fixed production overhead costs are allocated to inventory based on the normal capacity of production facilities. Normal 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. Changes in management s estimates could result in increases or decreases in the recorded amounts of inventory and cost of sales.

Management reviews inventory levels, inventory turnover, product age and product marketability quarterly to evaluate recoverability and determine if a reserve for inventory is deemed necessary. At March 31, 2013 an inventory reserve in the amount of $9,000 has been recognized, compared to $41,000 as of March 31, 2012.

*Equipment and leasehold improvements* - Equipment and leasehold improvements are reported at cost less accumulated depreciation and amortization. Self-constructed leasehold improvements include design, construction and supervision costs. These costs are recorded in construction in progress and are transferred to equipment and leasehold improvements when construction is completed and the facilities are placed in service. Long-lived assets, such as property, plant and equipment and purchased intangibles subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized to the extent that the carrying amount exceeds the asset s fair value. We have not recognized any impairment of long lived assets in 2013 or 2012.

*Income taxes* - Income taxes are accounted for under the asset and liability method. The asset and liability method requires the recognition of deferred tax assets and liabilities for the expected future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be recovered or settled. We record a valuation allowance to reduce our deferred tax assets to the amount that we believe is more likely than not to be realized. Judgment is required in assessing the need for the valuation allowance. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Based on our operating results for the past five years we believe that we will generate taxable income in future periods and therefore, conclude that it is more likely than not we will realize our deferred tax assets before they expire. Accordingly, we reduced our valuation allowance by $1,912,000 during 2013 and recognized an income tax benefit of $2,021,000 in the current year. We reduced our valuation allowance by $892,000 during fiscal 2012 and recognized an income tax benefit of $779,000 in that year. Our estimates of deferred tax assets to be realized may change in future periods, which could result in additional changes to our valuation allowance. Management has assessed the impact of uncertain tax positions to be immaterial. Should our operating performance not continue for a sustained period, we may need to re-establish some or all of the valuation allowance.

**Item 7A. Quantitative and Qualitative Disclosures about Market Risk**

We do not enter into any transactions using derivative financial instruments or derivative commodity instruments and believe that our exposure to market risk associated with other financial instruments is not material.

We have two term loans with interest rates that adjust quarterly based on the prime rate. As such, we are exposed to the interest rate risk whereby a 1% increase in the prime rate would lead to an increase of approximately $55,000 in interest expense for the year ending March 31, 2014 (based on March 31, 2013 amounts outstanding).

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**Item 8. Financial Statements and Supplementary Data**

**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders

Cyanotech Corporation

We have audited the accompanying consolidated balance sheets of Cyanotech Corporation (a Nevada corporation) and subsidiary (the Company ) as of March 31, 2013 and 2012, and the related consolidated statements of operations, stockholders equity and cash flows for each of the three years in the period ended March 31, 2013. Our audits of the basic consolidated financial statements included the financial statement schedule listed in the index appearing under Item 15(a)(2). These consolidated financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Cyanotech Corporation and subsidiary as of March 31, 2013 and 2012, and the results of their operations and their cash flows for each of the three years in the period ended March 31, 2013 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ Grant Thornton LLP

Irvine, California

June 24, 2013

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**CYANOTECH CORPORATION AND SUBSIDIARY**

**CONSOLIDATED BALANCE SHEETS**

**March 31,**

| | 2013 | 2012 |
|---|---|---|
| | (in thousands, except share data) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $ 4,364 | $ 5,061 |
| Accounts receivable, net of allowance for doubtful accounts of $6 in 2013 and $16 in 2012 | 3,766 | 2,373 |
| Inventories, net | 3,688 | 3,548 |
| Deferred tax assets | 110 | 137 |
| Prepaid expenses and other current assets | 263 | 300 |
| Total current assets | 12,191 | 11,419 |
| Equipment and leasehold improvements, net | 8,835 | 5,834 |
| Restricted cash | 3,360 | |
| Deferred tax assets | 3,429 | 1,307 |
| Other assets | 772 | 478 |
| Total assets | $ 28,587 | $ 19,038 |
| | | |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Current maturities of long-term debt | $ 128 | $ 234 |
| Customer deposits | 33 | 49 |
| Accounts payable | 1,852 | 1,726 |
| Accrued expenses | 872 | 1,352 |
| Total current liabilities | 2,885 | 3,361 |
| Long-term debt, less current maturities | 5,454 | 400 |
| Deferred rent | 21 | 12 |
| Total liabilities | 8,360 | 3,773 |
| Commitments and contingencies | | |
| Stockholders equity: | | |
| Common stock of $0.02 par value, authorized 50,000,000 shares; issued and outstanding 5,463,938 shares at 2013 and 5,440,968 shares at 2012 | 109 | 109 |
| Additional paid-in capital | 29,077 | 28,324 |
| Accumulated deficit | (8,959) | (13,168) |
| Total stockholders equity | 20,227 | 15,265 |
| Total liabilities and stockholders equity | $ 28,587 | $ 19,038 |

See accompanying notes to consolidated financial statements

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**CYANOTECH CORPORATION AND SUBSIDIARY**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

**Year ended March 31,**

| | 2013 | 2012 | 2011 |
|---|---|---|---|
| | (in thousands, except per share data) | | |
| Net sales | $ 27,581 | $ 24,631 | $ 16,827 |
| Cost of sales | 16,623 | 14,857 | 10,486 |
| Gross profit | 10,958 | 9,774 | 6,341 |
| Operating expenses: | | | |
| General and administrative | 4,680 | 4,014 | 2,822 |
| Sales and marketing | 3,675 | 2,480 | 1,986 |
| Research and development | 258 | 320 | 282 |
| Loss on disposal of equipment and leasehold improvements | 46 | 57 | 22 |
| Total operating expense | 8,659 | 6,871 | 5,112 |
| Income from operations | 2,299 | 2,903 | 1,229 |
| Other income (expense): | | | |
| Loss on extinguishment of debt | (51) | | |
| Interest expense, net | (60) | (55) | (70) |
| Other income, net | | 5 | 4 |
| Total other expense, net | (111) | (50) | (66) |
| Income before income tax benefit (expense) | 2,188 | 2,853 | 1,163 |
| Income tax benefit (expense) | 2,021 | 779 | 567 |
| Net income | $ 4,209 | $ 3,632 | $ 1,730 |
| Net income per share: | | | |
| Basic | $ 0.77 | $ 0.67 | $ 0.32 |
| Diluted | $ 0.74 | $ 0.66 | $ 0.32 |
| Shares used in calculation of net income per share: | | | |
| Basic | 5,455 | 5,414 | 5,353 |
| Diluted | 5,655 | 5,534 | 5,413 |

See accompanying notes to consolidated financial statements

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**CYANOTECH CORPORATION AND SUBSIDIARY**

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**

**Years ended March 31, 2013, 2012 and 2011**

| | Common Stock Shares | Common Stock Amount | Additional Paid-in Capital | Accumulated Deficit | Total Stockholders Equity |
|---|---|---|---|---|---|
| | | (in thousands, except per share data) | | | |
| Balances at March 31, 2010 | 5,252,572 | $ 105 | $ 27,545 | $ (18,530) | $ 9,120 |
| Issuances of common stock for Director Stock Grants | 10,000 | | 27 | | 27 |
| Issuance of common stock for exercise of stock options for cash | 132,596 | 3 | 184 | | 187 |
| Compensation expense related to stock options | | | 47 | | 47 |
| Net income | | | | 1,730 | 1,730 |
| Balances at March 31, 2011 | 5,395,168 | 108 | 27,803 | (16,800) | 11,111 |
| Issuances of common stock for Director Stock Grants | 8,000 | | 30 | | 30 |
| Issuance of common stock for exercise of stock options for cash | 37,800 | 1 | 68 | | 69 |
| Compensation expense related to stock options | | | 423 | | 423 |
| Net income | | | | 3,632 | 3,632 |
| Balances at March 31, 2012 | 5,440,968 | 109 | 28,324 | (13,168) | 15,265 |
| Issuances of common stock for Director Stock Grants | 13,000 | | 74 | | 74 |
| Issuance of common stock for exercise of stock options for cash | 9,970 | | 23 | | 23 |
| Compensation expense related to stock options | | | 656 | | 656 |
| Net income | | | | | |