CYANOTECH CORP
Form 10-Q
February 11, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For Quarterly Period Ended December 31, 2015

Or

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

For the Transition Period From to

Commission File Number 0-14602

CYANOTECH CORPORATION

(Exact name of registrant as specified in its charter)

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

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

(Address of principal executive offices)

(808) 326-1353

(Registrant's telephone number)

Not Applicable

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

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

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

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

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

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

Number of common shares outstanding as of February 11, 2016:

Title of Class	**Shares Outstanding**
Common stock - $0.02 par value	5,597,797

1

CYANOTECH CORPORATION

FORM 10-Q

INDEX

PART I. FINANCIAL INFORMATION

PART II. OTHER INFORMATION

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

CYANOTECH CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

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

(Unaudited)

	December 31, 2015	**March 31, 2015**
ASSETS		
Current assets:		
Cash and cash equivalents	$1,995	$2,226
Accounts receivable, net of allowance for doubtful accounts of $49 at December 31, 2015 and $6 at March 31, 2015	3,058	3,162
Inventories, net	7,352	5,678
Deferred tax assets	315	315
Prepaid expenses and other current assets	619	413
Total current assets	13,339	11,794
Equipment and leasehold improvements, net	17,904	14,754
Restricted cash	—	486
Deferred tax assets	2,867	3,035
Other assets	794	846
Total assets	$34,904	$30,915
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current maturities of long-term debt	$562	$234
Customer deposits	130	31
Accounts payable	3,910	2,926
Accrued expenses	1,321	1,124
Total current liabilities	5,923	4,315
Long-term debt, excluding current maturities	7,193	5,109
Deferred rent	10	8
Total liabilities	13,126	9,432

Commitments and contingencies		
Stockholders’ equity:		
Common stock of $0.02 par value, shares authorized 50,000,000; 5,597,797 shares issued and outstanding at December 31, 2015 and 5,564,799 shares at March 31, 2015	112	111
Additional paid-in capital	31,481	30,846
Accumulated deficit	(9,815)	(9,474)
Total stockholders’ equity	21,778	21,483
Total liabilities and stockholders’ equity	$34,904	$30,915

See accompanying Notes to Condensed Consolidated Financial Statements.

CYANOTECH CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands, except per share amounts)

(Unaudited)

	Three Months Ended December 31, 2015	Three Months Ended December 31, 2014	Nine Months Ended December 31, 2015	Nine Months Ended December 31, 2014
NET SALES	$7,534	$9,691	$23,644	$25,261
COST OF SALES	4,450	4,893	14,536	13,469
Gross profit	3,084	4,798	9,108	11,792
OPERATING EXPENSES:				
General and administrative	1,331	1,829	4,027	6,746
Sales and marketing	1,325	1,473	4,673	4,169
Research and development	132	155	475	376
(Gain) loss on disposal of equipment and leasehold improvements	—	113	(29)	126
Total operating expenses	2,788	3,570	9,146	11,417
Income (loss) from operations	296	1,228	(38)	375
Interest expense, net	(89)	(23)	(164)	(71)
Income (loss) before income tax	207	1,205	(202)	304
INCOME TAX EXPENSE	457	742	139	157
NET INCOME (LOSS)	$(250)	$463	$(341)	$147
NET INCOME (LOSS) PER SHARE:				
Basic	$(0.04)	$0.08	$(0.06)	$0.03
Diluted	$(0.04)	$0.08	$(0.06)	$0.03
SHARES USED IN CALCULATION OF NET INCOME (LOSS) PER SHARE:				
Basic	5,594	5,533	5,576	5,505
Diluted	5,594	5,779	5,576	5,704

See accompanying Notes to Condensed Consolidated Financial Statements.

CYANOTECH CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	Nine Months Ended December 31, 2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	$(341)	$147
Adjustments to reconcile net loss to net cash provided by operating activities:		
(Gain) loss on disposal of equipment and leasehold improvements	(29)	126
Depreciation and amortization	1,057	925
Amortization of debt issue costs and other assets	41	35
Share based compensation expense	569	584
Provision for doubtful accounts	43	—
Deferred income tax benefit	168	157
Net (increase) decrease in assets:		
Accounts receivable	61	(766)
Inventories	(1,645)	(1,542)
Prepaid expenses	(206)	(5)
Other assets	104	—
Net increase (decrease) in liabilities:		
Customer deposits	99	16
Accounts payable	984	641
Accrued expenses	198	269
Deferred rent	2	(1)
Net cash provided by operating activities	1,105	586
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from restricted cash	486	807
Investment in equipment and leasehold improvements	(4,033)	(3,184)
Net cash used in investing activities	(3,547)	(2,377)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from short term notes payable	500	—
Payment of short term notes payable	(500)	—
Proceeds from long-term debt, net of costs	2,407	—
Capitalized leases	(32)	—
Principal payments on long-term debt	(230)	(153)
Proceeds from stock options exercised	66	173

Net cash provided by financing activities	2,211	20
Net decrease in cash and cash equivalents	(231)	(1,771)
Cash and cash equivalents at beginning of period	2,226	4,312
Cash and cash equivalents at end of period	$1,995	$2,541
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$290	$221
Income taxes	$21	$—

See accompanying Notes to Condensed Consolidated Financial Statements.

CYANOTECH CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2015

(Unaudited)

1. BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information pursuant to the instructions to Form 10-Q and Regulation S-X of the Securities and Exchange Commission (SEC). These interim condensed consolidated financial statements are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring adjustments and accruals) necessary to present fairly the Condensed Consolidated Balance Sheets, Condensed Consolidated Statements of Operations, and Condensed Consolidated Statements of Cash Flows for the periods presented in accordance with GAAP. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full fiscal year. The Condensed Consolidated Balance Sheet as of March 31, 2015 was derived from the audited consolidated financial statements. These condensed consolidated financial statements and notes should be read in conjunction with the Company's audited consolidated financial statements for the year ended March 31, 2015, contained in the Company's annual report on Form 10-K as filed with the SEC on July 15, 2015, as amended by Amendment No. 1 to the Company's annual report on Form 10-K/A, filed August 27, 2015 (as amended, the "Company's 10-K").

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

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

Recent Accounting Pronouncements

In November 2015, the FASB issued Accounting Standards Update (ASU) No. 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes*. This guidance simplifies the presentation of deferred income taxes and requires that deferred tax assets and liabilities be classified as noncurrent in the classified statement of financial position. This guidance is effective for the Company as of March 31, 2018 and is not expected to have a material impact on the consolidated financial statements as the guidance only changes the classification of deferred income taxes.

In August 2015, the FASB issued ASU 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*, which defers the effective date of ASU 2014-09 by one year to December 15, 2017 for interim and annual reporting periods beginning after that date and permitted early adoption of the standard, but not before the original effective date. We are currently reviewing the revised guidance and assessing the potential impact on our consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-11, *Inventory: Simplifying the Measurement of Inventory*, that requires inventory not measured using either the last in, first out (LIFO) or the retail inventory method to be measured at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable cost of completion, disposal, and transportation. The new standard will be effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years, and will be applied prospectively. Early adoption is permitted. The Company is evaluating the impact that this standard will have on its consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, "*Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*," which requires debt issuance costs related to a recognized debt liability to be presented in the balance sheet as a direct deduction from the debt liability rather than as an asset. ASU 2015-03 is effective on for fiscal years beginning after December 15, 2015. Early adoption is permitted. Upon adoption, an entity must apply the new guidance retrospectively to all prior periods presented in the financial statements, and must provide certain disclosures about the change in accounting principle, including the nature of and reason for the change, the transition method, a description of the prior-period information that has been retrospectively adjusted and the effect of the change on the financial statement line items (that is, debt issuance cost asset and the debt liability). The implementation of this guidance is not expected to have a material impact on the Company's consolidated financial statements.

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update ("ASU") 2014-09, "*Revenue from Contracts with Customers*," related to revenue recognition. The underlying principle of the new standard is that a business or other organization will recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects what it expects in exchange for the goods or services. The standard also requires more detailed disclosures and provides additional guidance for transactions that were not addressed completely in prior accounting guidance. ASU 2014-09 provides alternative methods of initial adoption.

Other recently issued accounting pronouncements did not or are not believed by management to have a material impact on the Company's present or future financial statements.

2. INVENTORIES

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

	December 31, 2015	**March 31, 2015**
	(in thousands)	
Raw materials	$307	$931
Work in process	3,084	1,509
Finished goods(1)	3,766	2,895
Supplies	195	343
	$7,352	$5,678

(1) Net of reserve for obsolescence of $4,000 and $4,000 at December 31, 2015 and March 31, 2015, respectively.

The Company recognizes abnormal production costs, including fixed cost variances from normal production capacity, as an expense in the period incurred. $21,000 of non-inventoriable fixed costs were charged to cost of sales for the three months ended December 31, 2015. $395,000 of extraction operations start-up costs and $149,000 of non-inventoriable fixed costs were charged to cost of sales for the nine months ended December 31, 2015. There were $196,000 abnormal production costs charged to cost of sales for the three months ended December 31, 2014. For the nine months ended December 31, 2014, there were $277,000 of abnormal production costs charged to cost of sales.

3. EQUIPMENT AND LEASEHOLD IMPROVEMENTS, NET

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

	Years
Equipment	3 to 10
Furniture and fixtures	3 to 7
Leasehold improvements	10 to 25

7

Equipment and leasehold improvements consist of the following:

	December 31, 2015	March 31, 2015
	(in thousands)	
Equipment	$16,065	$9,782
Leasehold improvements	12,193	10,216
Furniture and fixtures	352	298
	28,610	20,296
Less accumulated depreciation and amortization	(13,606)	(12,549)
Construction-in-progress	2,900	7,007
Equipment and leasehold improvements, net	$17,904	$14,754

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. Recoverability of these assets is measured by a comparison of the carrying amount to forecasted undiscounted future cash flows expected to be generated by the asset. If the carrying amount exceeds its estimated future cash flows, then an impairment charge is recognized to the extent that the carrying amount exceeds the asset's fair value. Management has determined no asset impairment existed as of December 31, 2015. There was no gain or loss recognized for the three months ended December 31, 2015. The Company recognized a gain on disposal of assets in the amount of $29,000 for the nine months ended December 31, 2015, respectively. The Company recognized a loss on disposal of assets in the amount of $113,000 and $126,000 for the three and nine months ended December 31, 2014, respectively.

The Company has capitalized $35,000 and $172,000 of interest for the three and nine months ended December 31, 2015, respectively. $58,000 and $170,000 of interest was capitalized for the three and nine month periods ended December 31, 2014.

4. ACCRUED EXPENSES

Accrued expenses consist of the following:

December 31, 2015	March 31, 2015
(in thousands)	

Wages, bonus and profit sharing	$793	$930
Use tax	140	—
Rent and utilities	103	90
Customer rebates	74	74
Interest	36	24
Other expenses	175	6
	$1,321	$1,124

5. LONG-TERM DEBT

Long-term debt consists of the following:

	December 31, 2015	**March 31, 2015**
	(in thousands)	
Term loans	$7,529	$5,259
Capital lease	226	84
Less current maturities	(562)	(234)
Long-term debt, excluding current maturities	$7,193	$5,109

Term Loan Agreements

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

The provisions of the 2015 Loan require the payment of principal and interest until its maturity on September 1, 2022, the obligation fully amortizes over seven (7) years. Interest on the 2015 Loan accrues on the outstanding principal balance at an annual variable rate equal to the published Wall Street Journal prime rate (3.50% at December 31, 2015) plus 2.0% and is adjustable on the first day of each calendar quarter and fixed for that quarter. At no time shall the annual interest rate be less than 6.00%. The 2015 Loan has a prepayment penalty of 5% for any prepayment made prior to the first anniversary of the date of the 2015 Loan Agreement, which penalty is reduced by 1% each year thereafter until the fifth anniversary of such date, after which there is no prepayment penalty. The balance under the 2015 Loan was $2,426,000 at December 31, 2015.

The 2015 Loan includes a one-time origination and guaranty fee totaling $113,900 and an annual renewal fee payable in the amount of 0.50% of the USDA guaranteed portion of the outstanding principal balance as of December 31 of each year, beginning December 31, 2015. The USDA has guaranteed 80% of all amounts owing under the 2015 Loan. The Company is subject to financial covenants and customary affirmative and negative covenants. The Company was in compliance with these financial covenants at December 31, 2015.

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

The provisions of the 2012 Loan require the payment of interest only for the first 12 months of the term; thereafter, and until its maturity on August 14, 2032, the obligation fully amortizes over nineteen (19) years. Interest on the 2012 Loan accrues on the outstanding principal balance at an annual variable rate equal to the published Wall Street Journal prime rate (3.50% at December 31, 2015) plus 1.0% and is adjustable on the first day of each calendar quarter and fixed for that quarter. At no time shall the annual interest rate be less than 5.50%. The 2012 Loan has a prepayment penalty of 5% for any prepayment made prior to the first anniversary of the date of the 2012 Loan Agreement, which penalty is reduced by 1% each year thereafter until the fifth anniversary of such date, after which there is no prepayment penalty. The balance under the 2012 Loan was $5,097,000 at December 31, 2015. Proceeds from the 2012 Loan were classified as restricted cash until they were drawn upon to acquire new processing equipment and leasehold improvements.

The 2012 Loan includes a one-time origination and guaranty fee totaling $214,500 and an annual renewal fee payable in the amount of 0.25% of the USDA guaranteed portion of the outstanding principal balance as of December 31 of each year, beginning December 31, 2012. The USDA has guaranteed 80% of all amounts owing under the 2012 Loan. The Company is subject to financial covenants and customary affirmative and negative covenants. The Company was in compliance with these financial covenants at December 31, 2015.

Capital Leases

In July 2015, the Company executed a capital lease agreement with Huntington Technology Finance providing for $174,000 in equipment, secured by the equipment financed. The capital lease matures in July 2020 and is payable in 60 equal monthly payments. The interest rate under this capital lease is 6.57%. The balance under this lease was $160,000 and $0 at December 31, 2015 and March 31, 2015, respectively.

In March 2015, the Company executed a capital lease agreement with Thermo Fisher Financial providing for $86,000 in equipment, secured by the equipment financed. The capital lease matures in March 2018 and is payable in 36 equal monthly payments. The interest rate under this capital lease is 6.5%. The balance under this lease was $66,000 and $84,000 at December 31, 2015 and March 31, 2015, respectively.

Future principal payments under the term loans and capital lease agreements as of December 31, 2015 are as follows:

Payments Due	**(in thousands)**
Next 12 Months	$ 562
Year 2	590
Year 3	601
Year 4	629
Year 5	649
Thereafter	4,724
Total principal payments	$ 7,755

6. OPERATING LEASES

The Company leases facilities, equipment and land under operating leases expiring through 2035. The land lease provides for contingent rentals in excess of minimum rental commitments based on a percentage of the Company's sales. Management has accrued for the estimated contingent rent as of December 31, 2015.

Future minimum lease payments under all non-cancelable operating leases at December 31, 2015 are as follows:

Payments Due	**(in thousands)**
Next 12 Months	$ 602
Year 2	605
Year 3	609
Year 4	618
Year 5	555
Thereafter	5,007
Total minimum lease payments	$ 7,996

7. SHARE-BASED COMPENSATION

The Company accounts for share-based payment arrangements using fair value. If an award vests or becomes exercisable based on the achievement of a condition other than service, such as for meeting certain performance or market conditions, the award is classified as a liability. Liability-classified awards are remeasured to fair value at each balance sheet date until the award is settled. The Company currently has no liability-classified awards. Equity-classified awards, including grants of employee stock options, are measured at the grant-date fair value of the award and are not subsequently remeasured unless an award is modified. The cost of equity-classified awards is recognized in the statement of operations over the period during which an employee is required to provide the service in exchange for the award, or the vesting period. All of the Company’s stock options are service-based awards, and because the Company’s stock options are “plain vanilla,” as defined by the U.S. Securities and Exchange Commission in Staff Accounting Bulletin No. 107, they are reflected only in equity and compensation expense accounts.

Stock Options

As of December 31, 2015, the Company had one effective equity-based compensation plan: the Independent Director Stock Option and Restricted Stock Grant Plan (the “2014 Directors Plan”). The Company has also issued stock options, which remain outstanding as of December 31, 2015, under two equity-based compensation plans which have expired according to their terms; the 2005 Stock Option Plan (the “2005 Plan”) and the 2004 Independent Director Stock Option and Stock Grant Plan (the “2004 Directors Plan”).

On August 28, 2014, the Company’s shareholders approved the 2014 Directors Plan. This plan authorizes the Board of Directors to provide additional incentive to the Company’s independent directors through equity based compensation in the form of stock options and restricted stock. Awards under the 2014 Directors Plan are limited to the authorized amount of 350,000 shares. As of December 31, 2015, there were 314,241 shares available for grant under the 2014 Directors Plan.

Since both the 2005 Plan and the 2004 Directors Plan have expired, no additional awards will be issued under those plans.

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

	As of December 31, 2015		
	Authorized	Available	Outstanding
2014 Plan	350,000	314,241	6,000
2005 Plan	—	—	1,396,916
2004 Directors Plan	—	—	12,000
Total	350,000	314,241	1,414,916

All stock option grants made under equity-based compensation plans were issued at exercise prices no less than the Company's closing stock price on the date of grant. Options under the 2005 Plan and 2014 Directors Plan were determined by the Board of Directors or the Stock Option and Compensation Committee of the Board in accordance with the provisions of the respective plans. The terms of each option grant include vesting, exercise, and other conditions are set forth in a Stock Option Agreement evidencing each grant. No option can have a life in excess of ten (10) years. The Company records compensation expense for employee stock options based on the estimated fair value of the options on the date of grant using the Black-Scholes option-pricing model. The model requires various assumptions, including a risk-free interest rate, the expected term of the options, the expected stock price volatility over the expected term of the options and the expected dividend yield. Compensation expense for employee stock options is recognized ratably over the vesting term. Compensation expense recognized for options issued under the 2005 Plan was $164,000 and $488,000 for the three and nine months ended December 31, 2015, respectively. Compensation expense recognized for options issued under the 2005 Plan was $153,000 and $506,000 for the three and nine months ended December 31, 2014, respectively. Compensation expense recognized for restricted stock and options issued under the 2014 Directors Plan was $81,000 for the three and nine months ended December 31, 2015. Compensation expense recognized for restricted stock issued under the 2014 Directors Plan was $0 and $78,000 for the three and nine months ended December 31, 2014. All share-based compensation has been classified as general and administrative expense in the consolidated statements of operations.

A summary of option activity under the Company's stock plans for the nine months ended December 31, 2015 is presented below:

Option Activity	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
			(in Years)	
Outstanding at March 31, 2015	1,433,216	$ 4.08	6.4	$6,221,909
Granted	6,000	5.91	—	—

Exercised	(19,800)	3.31	—	55,249
Forfeited or expired	(4,500)	5.84	—	12,180
Outstanding at December 31, 2015	1,414,916	4.09	5.7	1,903,076
Exercisable at December 31, 2015	893,750	3.89	5.5	1,346,840

The aggregate intrinsic value in the table above is before applicable income taxes and represents the excess amount over the exercise price optionees would have received if all options had been exercised on the last business day of the period indicated, based on the Company’s closing stock price of $5.25 for such day.

A summary of the Company's non-vested options for the nine months ended December 31, 2015 is presented below:

Nonvested Options	**Shares**	**Weighted Average Grant-Date Fair Value**
Nonvested at March 31, 2015	614,416	$ 3.25
Granted	6,000	1.18
Vested	(96,250)	3.50
Forfeited or expired	(3,000)	4.04
Nonvested at December 31, 2015	521,166	3.18

The following table summarizes the weighted average characteristics of outstanding stock options as of December 31, 2015:

	Outstanding Options			**Exercisable Options**	
Range of Exercise Prices	**Number of Shares**	**Remaining Life (Years)**	**Weighted Average Price**	**Number of Shares**	**Weighted Average Price**
$1.60-3.70	380,020	4.7	$ 2.93	380,020	$ 2.93
$3.71-4.42	692,896	5.7	3.82	315,980	3.82
$4.43-5.40	117,500	7.1	5.00	69,500	5.07
$5.41-7.08	224,500	6.7	6.42	128,250	6.26
Total stock options	1,414,916	5.7	4.09	893,750	3.89

There were 6,000 stock options and 13,198 shares of restricted stock granted during the three and nine months ended December 31, 2015. There were no stock options or shares of restricted stock granted during the three months ended December 31, 2014. There were 45,000 stock options and 16,561 shares of restricted stock granted during the nine months ended December 31, 2014.

The range of fair value assumptions related to options granted during the period ended December 31, 2015 were as follows:

	2015
Exercise Price	$5.91
Volatility	50.42%

Risk Free Rate	0.22	%
Vesting Period (years)	3	
Forfeiture Rate	0	%
Expected Life (in years)	1.00	
Dividend Rate	0	%

As of December 31, 2015, total unrecognized stock-based compensation expense related to all unvested stock options was $1,105,000, which is expected to be expensed over a weighted average period of 2.1 years.

8. INCOME TAXES

We utilize our estimated annual effective tax rate to determine our provision (benefit) for income taxes for interim periods. The income tax provision (benefit) is computed by multiplying the estimated annual effective tax rate by the year to date pre-tax book income (loss). Our effective tax rate differs from the statutory rate of 34% as a result of non deductible stock option expense and the state taxes (net of federal benefit) and permanent differences. Our effective tax rate was 220.8% and (68.8%) for the three and nine months ended December 31, 2015, respectively, and 61.6% and 51.6% for the three and nine months ended December 31, 2014, respectively.

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

As of December 31, 2015, there was no liability for income tax associated with unrecognized tax benefits. The Company recognizes accrued interest related to unrecognized tax benefits as well as any related penalties in interest income or expense in its consolidated condensed statements of operations, which is consistent with the recognition of these items in prior reporting periods.

With few exceptions, the Company is no longer subject to U.S. federal, state, local, and non-U.S. income tax examination by tax authorities for tax years before 2010.

9. EARNINGS PER SHARE

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

Reconciliations between the numerator and the denominator of the basic and diluted earnings per share computations for the three months ended December 31, 2015 and 2014 are as follows:

	Three Months Ended December 31, 2015		
	Net Income (Numerator) (in thousands)	Shares (Denominator)	Per Share Amount
Basic loss per share	$(250)	5,594	$ (0.04)
Effect of dilutive securities—Common stock options	—	—	—
Diluted loss per share	$(250)	5,594	$ (0.04)

	Three Months Ended December 31, 2014		
	Net Income (Numerator) (in thousands)	Shares (Denominator)	Per Share Amount
Basic income per share	$463	5,533	$ 0.08
Effect of dilutive securities — Common stock options	—	246	—
Diluted income per share	$463	5,779	$ 0.08

Reconciliations between the numerator and the denominator of the basic and diluted earnings per share computations for the nine months ended December 30, 2015 and 2014 are as follows:

	Nine Months Ended December 31, 2015		
	Net Income (Numerator) (in thousands)	Shares (Denominator)	Per Share Amount
Basic loss per share	$(341)	5,576	$ (0.06)
Effect of dilutive securities—Common stock options	—	—	—
Diluted loss per share	$(341)	5,576	$ (0.06)

	Nine Months Ended December 31, 2014		
	Net Income (Numerator) (in thousands)	Shares (Denominator)	Per Share Amount
Basic income per share	$147	5,505	$ 0.03
Effect of dilutive securities — Common stock options	—	199	—
Diluted income per share	$147	5,704	$ 0.03

Basic and diluted earnings per share are the same in periods of a net loss, because common share equivalents are anti-dilutive when a net loss is recorded. Diluted earnings per share does not include the impact of common stock options totaling 112,500 and 636,416 for the three months ended December 31, 2015 and 2014, respectively, and 140,063 and 565,416 for the nine months ended December 31, 2015 and 2014, respectively, as the effect of their inclusion would be anti-dilutive.

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

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", "esti or similar expressions. In addition, any statement concerning future financial performance, ongoing business strategies or prospects and possible future actions are also forward-looking statements. Forward-looking statements are based upon current expectations and projections about future events and are subject to risks, uncertainties and the accuracy of assumptions concerning CYAN and its subsidiary (collectively, the "Company"), the performance of the industry in which CYAN does business, and economic and market factors, among other things. **These forward-looking statements are not guarantees of future performance. You should not place undue reliance on forward-looking statements.**

Forward-looking statements speak only as of the date of the Report, presentation or filing in which they are made. Except to the extent required by the Securities Exchange Act of 1934 (the "Exchange Act"), 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;

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 or attributed to the current local, national and world economic conditions, including but not limited to, the volatility of crude oil prices, inflation and currency fluctuations;

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;

The Company's inability to generate enough revenues to meet its obligations or repay maturing indebtedness;

Failure of capital projects to operate as expected or meet expected results;

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;

Legal costs associated with any legal proceedings, and the potential direct and indirect cost and other effects on our business or financial condition resulting from any legal proceedings;

The risk associated with the geographic concentration of our business;

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.

Overview:

We are a world leader in the production of high value natural products derived from microalgae. Incorporated in 1983, we are guided by the principle of providing beneficial, quality microalgal products for health and human nutrition in a sustainable, reliable and environmentally sensitive operation. We are 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, co-workers and the communities we live in), and quality of the environment in which we work. Our products include:

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; and

Hawaiian *Spirulina Pacifica*® - a nutrient-rich dietary supplement used for extra energy, a strengthened immune system, cardiovascular benefits and as a source of antioxidant carotenoids

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

Results of Operations

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2015	2014	2015	2014
Net sales	$7,534	$9,691	$23,644	$25,261
Net sales decrease	(22.3)%		(6.4)%	
Gross profit	$3,084	$4,798	$9,108	$11,792
Gross profit as % of net sales	40.9 %	49.5 %	38.5 %	46.7 %
Operating expenses	$2,788	$3,570	$9,146	$11,417
Operating expenses as % of net sales	37.0 %	36.8 %	38.7 %	45.2 %
Operating income (loss)	$296	$1,228	$(38)	$375
Operating income (loss) as % of net sales	3.9 %	12.7 %	(0.2)%	1.5 %
Income tax expense	$457	$742	$139	$157
Net (loss) income	$(250)	$463	$(341)	$147
Net sales by product				
Packaged sales				
Astaxanthin packaged	$4,122	$5,445	$13,750	$13,375
Astaxanthin packaged sales (decrease) increase	(24.3)%		2.8 %	
Spirulina packaged	$2,125	$1,757	$5,450	$5,455
Spirulina packaged sales increase (decrease)	20.9 %		(0.0)%	
Total Packaged sales	$6,247	$7,202	$19,200	$18,830
Total Packaged sales (decrease) increase	(13.3)%		2.0 %	
Bulk sales				
Astaxanthin bulk	$259	$1,862	$1,010	$3,321
Astaxanthin bulk sales decrease	(86.1)%		(69.6)%	
Spirulina bulk	$1,028	$627	$3,434	$3,110
Spirulina bulk sales increase	64.0 %		10.4 %	
Total Bulk sales	$1,287	$2,489	$4,444	$6,431
Total Bulk sales (decrease)	(48.3)%		(30.9)%	

Comparison of the Three Months Ended December 31, 2015 and 2014

Net Sales The net sales decline of 22% for the quarter was driven by a 48% decrease in our bulk business and a 13% reduction in our packaged products. The decrease in packaged products included a 21% increase in sales of spirulina and a 24% decrease in sales of astaxanthin. 12% of the decrease in astaxanthin sales is due to a significant level of sales in transit from the second quarter of last year that were recognized as revenue in the third quarter. This did not occur in the current year, as shown in the Comparison of the Nine Months Ended December 31, 2015 and 2014. The remainder of the decrease is the result of our strategic initiatives to refocus our sales efforts on customer groups that offer higher margins. The 48% decrease in bulk sales included a 64% increase in spirulina sales and an 86% decrease in astaxanthin sales. The decrease in bulk astaxanthin sales is a result of lower inventory due to lower production in the first two quarters of fiscal 2016, coupled with higher demand for our packaged products. International sales represented 23% of net sales for the three months ended December 31, 2015 compared to 30% for the same period a year ago. Two customers accounted for 35% and 20% of total net sales for the three months ended December 31, 2015 and 2014, respectively.

Gross Profit Our gross profit percent of net sales decreased by 8.6 percentage points in the quarter. Gross profit was impacted by a 41% decrease in astaxanthin production in the second quarter of the current year when compared to the Company's strong production in the second quarter of last year, which resulted in a higher cost per kilo of astaxanthin sold in the third quarter of this year. Due to the fact that we grow our raw material, production is often impacted by seasonal weather patterns, and this was the case in the first two quarters of fiscal 2016, as production was impacted by lower sunlight and an unusual level of mid-day cloud cover in Kona, HI as a result of the El Nino conditions we are experiencing. There were $21,000 of non-inventoriable costs in the third quarter of fiscal 2016. There were $196,000 of non-inventoriable costs in the third quarter of fiscal 2015. The decline in gross profit was also due to changes in our customer mix, which resulted in higher overall sales allowances and reduced gross profit by $265,000 in the three months ended December 31, 2015 compared with the same period in 2014.

Operating Expenses Operating expenses decreased by $782,000 for the third quarter compared to the same period in the preceding year. Included in this is a decrease in general and administrative expenses of $498,000, or 27%, mainly from a $500,000decrease in legal costs due to matters that settled in the third quarter of the prior fiscal year. Sales and marketing expenses decreased $148,000, or 10%, mainly due to decreases in external commission and bank charges of $93,000 and $38,000 respectively.

Income Taxes We recorded income tax expense of $457,000 in the current quarter compared to income tax expense of $742,000 for the same period last year. Our effective tax rate was 220.8% for the current quarter and 61.6% for the same period last year. The effective tax rate in the current year differs from the statutory rate of 34% as a result of state taxes (net of federal benefit) and permanent differences, primarily employee stock option expenses that are not deductible for tax purposes.

Comparison of the Nine Months Ended December 30, 2015 and 2014

Net Sales The net sales decrease of 6% for the first nine months of this year was driven by a 2% increase in sales of our packaged products. Within this growth, sales of packaged spirulina were flat and sales of packaged astaxanthin increased 3%. This low growth rate is the result of our efforts to target new distributors and wholesalers to improve margins through more profitable channels. Sales of our bulk products decreased by 31%, comprised of a 10% decrease in sales of bulk spirulina and a 70% decrease in sales of bulk astaxanthin. The decrease in bulk astaxanthin sales is a result of the lower production, coupled with higher demand for our packaged products. International sales represented 26% of net sales for the nine months ended December 31, 2015 compared to 28% for the same period a year ago. Two customers accounted for 28% and 21% of total net sales for the nine months ended December 31, 2015 and 2014, respectively.

Gross Profit Our gross profit percent of net sales decreased by 8.2 percentage points in the first nine months of this year. Gross profit was also impacted by a 26% decrease in astaxanthin production when compared to the strong performance in the first nine months of last year, which resulted in a higher cost per kilo sold. Additionally, gross profit was unfavorably impacted by $544,000 in non-inventoriable costs, including $395,000 related to start-up costs on our new extraction facility. Due to the fact that we grow our raw material, production is often impacted by seasonal weather patterns. This was the case in the first three quarters of fiscal 2016, as production was impacted by lower sunlight and an unusual level of mid-day cloud cover in Kona, HI. Gross profit in the first nine months of fiscal 2015 included non-inventoriable costs of $277,000. The decline in gross profit was also due to changes in our customer mix, which resulted in higher overall sales allowances and reduced gross profit by $1,100,000 in the nine months ended December 31, 2015 compared with the same period in 2014.

Operating Expenses Operating expenses decreased by $2,271,000 for the nine months ended December 31, 2015, compared to the same period last year. Included in this is a decrease in general and administrative expenses of $2,720,000, or 40%, mainly due to a decrease in legal costs of $2,843,000 due to the settlement of matters in the third quarter of the prior fiscal year. Sales and marketing expenses increased $504,000, or 12%, due to an increase of $667,000 brand development costs and demonstration programs for our packaged products, offset by decreases in public relations consultants of $52,000, reduction in website expenses of $40,000 and a reduction of bank charges of $70,000.

Income Taxes We recorded income tax expense of $139,000 for the first nine months of this year compared to an income tax expense of $157,000 for the same period last year. Our effective tax rate was (68.8%) for the first nine months compared to 51.6% for the same period last year. The effective tax rate in the current year differs from the statutory rate of 34% as a result of state taxes (net of federal benefit) and permanent differences, primarily employee stock option expenses that are not deductible for tax purposes.

Liquidity and Capital Resources

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

	Nine months ended December 31,	
	2015	**2014**
Total cash (used in) provided by:		
Operating activities	$1,105	$586
Investing activities	(3,547)	(2,377)
Financing activities	2,211	20
Decrease in cash and cash equivalents	$(231)	$(1,771)

17

Cash provided by operating activities increased $519,000 compared to the same period last year due primarily to a decrease in accounts receivable in the first nine months of this year compared to an increase in the prior year.

Cash used in investing activities in the current period includes capital expenditures of $4,033,000 for leasehold improvements and equipment acquisitions at our Kona facility compared to $3,184,000 during the same period last year. In the current year, $486,000 was funded by restricted cash and $2,407,000 in proceeds from a new term loan, compared to our use of $807,000 of restricted cash last year.

Cash provided by financing activities in the period consists of proceeds from a new term loan of $2,407,000 million, net loan costs, along with stock options exercised and principal payments on debt in the normal course of business.

Sources and Uses of Capital

At December 31, 2015, our working capital was $7.4 million, a decrease of $0.1 million compared to March 31, 2015. The decrease is due to a lower cash balance as a result of investments in equipment and leasehold improvements. Cash and cash equivalents at December 31, 2015 totaled $1,995,000, a decrease of $231,000 compared to March 31, 2015.

On July 30, 2015, the Company executed the 2015 Loan Agreement with a lender providing for $2,500,000 in aggregate credit facilities secured by substantially all the Company's assets. The 2015 Loan is evidenced by a promissory note in the amount of $2,500,000 and partially guaranteed under the provisions of a USDA Rural Development Guarantee program. Proceeds of the 2015 Loan were used to pay off a $500,000 short term note payable that matured on September 18, 2015 and fund our capital projects related to increasing our astaxanthin production capacity.

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

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

Based upon our current operating plan, analysis of our consolidated financial position and projected future results of operations, we believe that our operating cash flows, cash balances, and working capital will be sufficient to finance current operating requirements, debt service requirements, and routine planned capital expenditures, for the next twelve (12) months. We expect liquidity in the remainder of fiscal 2016 to be generated from operating cash flows.

Outlook

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

Our strategic direction has been to position the Company as a world leader in the production and marketing of high-value natural products from microalgae. We are vertically aligned, producing raw materials in the form of microalgae processed at our 90-acre facility in Hawaii, and integrating those raw materials into finished products. In fiscal 2016, our primary focus is on building our consumer brands, increasing our astaxanthin production volume and improving the consistency of our production for both astaxanthin and spirulina. We will continue to put emphasis on our Nutrex Hawaii consumer products to introduce them to a broader consumer market, and leverage our experience and reputation for quality, building nutritional brands which promote health and well-being. The foundation of our nutritional products is naturally cultivated Hawaiian Spirulina Pacifica® in powder and tablet form; and BioAstin® Hawaiian Astaxanthin™ antioxidant in extract, softgel caplet and micro-encapsulated beadlet form. Information about our Company and our products can be viewed at www.cyanotech.com and www.nutrex-hawaii.com. Consumer products can also be purchased online at www.nutrex-hawaii.com.

We are focused on sustainability of production levels in order to promote growth in our astaxanthin and spirulina product lines. Our goal is to continue to improve and expand these lines to meet the demand of consumers. We will continue to promote the nutritional superiority of Hawaiian grown microalgae to maintain and expand market share. Significant sales variability between periods and even across several periods can be expected based on historical results.

Gross profit margin percentages going forward will be impacted by production volumes and continued pressure on input costs and greater competition in the market place. This could cause margins to decline in future periods. We will continue to focus on higher margin consumer products that promote health and well-being. We are dedicated to continuous improvements in process and production methods to stabilize and increase production levels for the future.

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

To manage our cash resources effectively, we will continue to balance production in light of sales demand, minimizing the cost associated with build-ups in inventory when appropriate. We could experience unplanned cash outflows and may need to utilize other cash resources to meet working capital needs. A prolonged downturn in sales could impair our ability to generate sufficient cash for operations and minimize our ability to attract additional capital investment which could become necessary in order to expand facilities, enter into new markets or maintain optimal production levels.

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

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

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Not applicable.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

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

Management's Report on Internal Control over Financial Reporting.

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act). The Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our management evaluated the effectiveness of our internal control over financial reporting as of December 31, 2015. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in "Internal Control - Integrated Framework" (2013 Framework)., Management's assessment identified a material weakness in internal control over financial reporting. Based on that assessment, management concluded that our internal control over financial reporting was not effective as of December 31, 2015.

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis. In its assessment of the effectiveness of internal control over financial reporting as of December 31, 2015, the Company determined the following control deficiency that constituted the material weakness:

During the year end closing procedures for fiscal year 2015, our external auditors identified invoices containing delivery terms of FOB Origin for which we had accepted customer purchase orders with vague terms or terms that indicated FOB Destination which were not delivered to the customer by March 31, 2015. We did not have controls in place to identify, clarify and resolve conflicts of terms between our customers' purchase orders and our invoices. This design deficiency in our internal control over financial reporting resulted in the recognition of revenue before transfer of title had occurred.

As a result of this finding, we have undertaken the following actions to address the material weakness:

Implemented additional training programs for the personnel responsible for reviewing customer purchase orders in order to clarify and confirm transfer of title and risk of loss when customer purchase orders terms are vague or missing, including appropriate review and approval procedures.

Implemented additional quarter end closing and review procedures to confirm delivery dates for all FOB Destination shipments.

Changes to Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarterly period ended December 31, 2015 that, except as noted above, has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Limitations on the Effectiveness of Controls.

Our management, including our Chief Executive Officer and Chief Financial Officer, do not expect that our disclosure controls and procedures or our internal controls over financial reporting will prevent all errors and all fraud. A control system no matter how well designed and implemented, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues within a company are detected. The inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistakes. Controls can also be circumvented by the individual acts of some persons, or by collusion of two or more people. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

This Form 10-Q should be read in conjunction with Item 9A "Controls and Procedures" of the Company's 10-K.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time the Company may become party to lawsuits and claims that arise in the ordinary course of business relating to employment, intellectual property, and other matters. There were no significant legal matters outstanding at December 31, 2015.

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

None.

Item 3. Defaults upon Senior Securities

None.

Item 5. Other Information

On February 11, 2016, the Company issued a press release announcing the Company’s financial condition and results of operations for the quarter ended December 31, 2015. A copy of the press release is furnished as Exhibit 99.1 to this Quarterly Report on Form 10-Q, and is incorporated herein by reference. The information contained in Exhibit 99.1 hereto shall not be deemed to be “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and shall not be incorporated by reference into any filings made by the Company under the Securities Act of 1933, as amended, or the Exchange Act, except as may be expressly set forth by specific reference in such filing.

Item 6. Exhibits

a) The following exhibits are furnished with this report:

31.1	Certifications of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 signed as of February 11, 2016.
31.2	Certifications of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 signed as of February 11, 2016.
32	Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 signed as of February 11, 2016.
99.1	Press Release dated February 11, 2016
101	The following financial statements from Cyanotech Corporation's Quarterly Report on Form 10-Q for the quarter ended December 31, 2015, formatted in XBRL (eXtensible Business Reporting Language): (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Operations, (iii) the Condensed Consolidated Statements of Cash Flows, and (iv) Notes to Condensed Consolidated Financial Statements.

SIGNATURES

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

	CYANOTECH CORPORATION (Registrant)
February 11, 2016 (Date)	By: /s/ Brent D. Bailey Brent D. Bailey *President and Chief Executive Officer and Director*
February 11, 2016 (Date)	By: /s/ Jole Deal Jole Deal *Vice President — Finance & Administration and CFO* *(Principal Financial and Accounting Officer)*

EXHIBIT INDEX

Exhibit Number	**Description**
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