CYANOTECH CORP
Form 10-Q
February 13, 2019

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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, 2018

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
	Emerging growth company

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

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

As of February 12, 2019, the number of shares outstanding of the registrant's sole class of common stock, par value $0.02 per share, was 5,836,110.

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Report and other presentations made by Cyanotech Corporation ("CYAN") and its subsidiary contain "forward-looking statements," which include statements that are predictive in nature, depend upon or refer to future events or conditions, and usually include words such as "expects," "anticipates," "intends," "plan," "believes," "predicts", "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 Federal Securities Laws, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Our forward-looking statements in this Report include, but are not limited to:

Statements relating to our business strategy;

Statements relating to our business objectives; and

Expectations concerning future operations, profitability, liquidity and financial resources.

These forward-looking statements are subject to risk, uncertainties and assumptions about us and our operations that are subject to change based on various important factors, some of which are beyond our control, including those factors described in Item 2 of Part I of this quarterly report and in Item 1A of Part I of the Company's annual report on Form 10-K filed on June 15, 2018. Additionally, the following factors, among others, could cause our financial performance to differ significantly from the goals, plans, objectives, intentions and expectations expressed in our forward-looking statements:

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

Access to available and reasonable financing on a timely basis;

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

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

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

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CYANOTECH CORPORATION

FORM 10-Q

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CYANOTECH CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)

(Unaudited)

	December 31, 2018	**March 31, 2018**
ASSETS		
Current assets:		
Cash	$ *1,573*	$ *1,329*
Accounts receivable, net of allowance for doubtful accounts of $27 at December 31, 2018 and $27 at March 31, 2018	*1,883*	*2,664*
Inventories, net	*10,112*	*9,034*
Prepaid expenses and other current assets	*641*	*590*
Total current assets	*14,209*	*13,617*
Equipment and leasehold improvements, net	*15,183*	*15,734*
Restricted cash	—	*65*
Other assets	*291*	*291*
Total assets	$ *29,683*	$ *29,707*
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Accounts payable	$ *4,055*	$ *3,527*
Accrued expenses	*1,073*	*892*
Short-term contract obligation	*332*	—
Line of credit	*1,750*	*500*
Current maturities of long-term debt	*663*	*655*
Customer deposits	*172*	*133*
Total current liabilities	*8,045*	*5,707*
Long-term debt, less current maturities	*5,328*	*5,790*
Other long-term liabilities	*57*	*103*

Total liabilities	13,430	11,600
Commitments and contingencies		
Stockholders’ equity:		
Preferred stock of $0.01 par value, authorized 10,000,000 shares; no shares issued and outstanding	—	—
Common stock of $0.02 par value, shares authorized 50,000,000; 5,836,110 shares issued and outstanding at December 31, 2018 and 5,772,032 shares at March 31, 2018	117	115
Additional paid-in capital	32,318	32,051
Accumulated deficit	(16,182)	(14,059)
Total stockholders’ equity	16,253	18,107
Total liabilities and stockholders’ equity	$ 29,683	$ 29,707

See accompanying Notes to Condensed Consolidated Financial Statements.

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CYANOTECH CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2018	2017	2018	2017
NET SALES	$10,044	$9,150	$24,143	$26,014
COST OF SALES	5,928	4,910	15,906	14,551
Gross profit	4,116	4,240	8,237	11,463
OPERATING EXPENSES:				
General and administrative	1,337	1,368	4,190	4,132
Sales and marketing	2,068	1,620	5,088	4,549
Research and development	216	142	635	433
Total operating expenses	3,621	3, 130	9,913	9,114
Income (loss) from operations	495	1,110	(1,676)	2,349
Interest expense, net	(134)	(130)	(414)	(371)
Income(loss) before income taxes	361	980	(2,090)	1,978
INCOME TAX EXPENSE (BENEFIT)	73	(127)	33	(105)
NET INCOME (LOSS)	$288	$1,107	$(2,123)	$2,083
NET INCOME (LOSS) PER SHARE:				
Basic	$0.05	$0.19	$(0.37)	$0.36
Diluted	$0.05	$0.19	$(0.37)	$0.36
SHARES USED IN CALCULATION OF NET INCOME (LOSS) PER SHARE:				
Basic	5,836	5,749	5,809	5,714
Diluted	5,862	5,831	5,809	5,774

See accompanying Notes to Condensed Consolidated Financial Statements.

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CYANOTECH CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	Nine Months Ended December 31,	
	2018	**2017**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	$ *(2,123*)	$ *2,083*
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Depreciation and amortization	*1,421*	*1,403*
Share-based compensation expense	*282*	*369*
Amortization of debt issue costs and other assets	*57*	*52*
Net (increase) decrease in assets:		
Accounts receivable	*781*	*(791*)
Inventories	*(1,078*)	*(1,730*)
Prepaid expenses and other assets	*(84*)	*(86*)
Net increase (decrease) in liabilities:		
Accounts payable	*528*	*(76*)
Accrued expenses	*181*	*332*
Customer deposits	*39*	*(80*)
Other long-term liabilities	*(46*)	*(8*)
Net cash (used in) provided by operating activities	*(42*)	*1,468*
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment in equipment and leasehold improvements	*(375*)	*(667*)
Investment in Cellana asset purchase	*(100*)	—
Investment in restricted cash	—	*(65*)
Net cash used in investing activities	*(475*)	*(732*)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net draws (payments) on line of credit	*1,250*	*(111*)
Payments on short term contract obligation	*(63*)	—
Payments on capitalized leases	*(49*)	*(67*)
Principal payments on long-term debt	*(429*)	*(394*)
Proceeds from long-term debt, net of costs	—	*166*
Withholding on restricted stock unit vesting	*(32*)	—
Proceeds from stock options exercised	*19*	*26*
Net cash provided by (used in) financing activities	*696*	*(380*)

Net increase in cash	*179*	*356*
Cash and restricted cash at beginning of period	*1,394*	*1,407*
Cash at end of period	$*1,573*	$*1,763*
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$*358*	$*313*
Income taxes	$*17*	$—
Purchase of Cellana assets	$*495,000*	$—
Less: Issuance of short-term obligation	*395,000*	—
Cash paid to acquire Cellana assets	$*100,000*	$—

See accompanying Notes to Condensed Consolidated Financial Statements.

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CYANOTECH CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018

(Unaudited)

1. ORGANIZATION AND BASIS OF PRESENTATION

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

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

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information pursuant to the instructions to Form *10*-Q and Regulation S-*X* of the Securities and Exchange Commission (SEC). These interim condensed consolidated financial statements are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring adjustments and accruals) necessary to present fairly the Condensed Consolidated Balance Sheets, Condensed Consolidated Statements of Operations, 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, 2018* 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, 2018,* contained in the Company's annual report on Form *10*-K as filed with the SEC on *June 15, 2018.*

2. SIGNIFICANT ACCOUNTING POLICIES

Consolidation

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

Use of Estimates

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

Cash and Restricted Cash

The Company considers only its monetary liquid assets with original maturities of *three* months or less as cash and cash equivalents. Proceeds from equipment loans are classified as restricted cash until drawn upon.

The following table provides a reconciliation of cash and restricted cash reported within the Company's consolidated balance sheets to the total amount presented in the consolidated statement of cash flows:

	December 31, 2018	**March 31, 2018**
	(in thousands)	
Cash	$ *1,329*	$ *1,407*
Restricted Cash	*65*	—
Cash and restricted cash at beginning of period	$ *1,394*	$ *1,407*
Cash	$ *1,573*	$ *1,329*
Restricted Cash	—	*65*

Cash and restricted cash at end of period	$*1,573*	$*1,394*

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Concentration of Accounts Receivable and Revenues

At *December 31, 2018, 67%* of the Company's accounts receivable was comprised of *two* customer balances of *43%* and *24%,* respectively. At *March 31, 2018, 76%* of the Company's accounts receivable was comprised of *three* customer balances of *45%, 16%* and *15%,* respectively. Two customers accounted for *66%* of total net sales for the *three* months ended *December 31, 2018,* comprised of *35%* and *31%,* respectively. Two customers accounted for *50%* of total net sales for the *three* months ended *December 31, 2017,* comprised of *26%* and *24%,* respectively. Two customers accounted for *62%* of total net sales for the *nine* months ended *December 31, 2018,* comprised of *35%* and *27%,* respectively. Two customers accounted for *47%* of total net sales for the *nine* months ended *December 31, 2017,* comprised of *30%* and *17%,* respectively.

Revenue Recognition

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

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

Customer contract liabilities consist of customer deposits received in advance of fulfilling an order and are shown separately on the consolidated balance sheets. During the *three*-month periods ended *December 31, 2018* and *December 31, 2017,* the Company recognized *$0* and *$20,000,* respectively, of revenue from deposits that were included in contract liabilities as of *March 31, 2018* and *March 31, 2017,* respectively. During the *nine*-month periods ended *December 31, 2018* and *December 31, 2017,* the Company recognized *$114,000* and *$91,000,* respectively, of revenue from deposits that were included in contract liabilities as of *March 31, 2018* and *March 31, 2017,* respectively. The Company’s contracts have a duration of *one* year or less and therefore, the Company has elected the practical expedient of *not* disclosing revenues allocated to partially unsatisfied performance obligations.

Disaggregation of Revenue

The following table represents revenue disaggregated by product in the *three* and *nine* months ended *December 31, 2018* and *December 31, 2017 (*in thousands):

	Three months ended December 31, 2018			Nine months ended December 31, 2018		
	Astaxanthin	Spirulina	Total	Astaxanthin	Spirulina	Total
Packaged products	$*6,012*	$ *3,212*	$*9,224*	$*15,388*	$ *6,208*	$*21,596*
Bulk products	*287*	*533*	*820*	*884*	*1,663*	*2,547*
Total	$*6,299*	$ *3,745*	$*10,044*	$*16,272*	$ *7,871*	$*24,143*

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	Three months ended December 31, 2017			Nine months ended December 31, 2017		
	Astaxanthin	Spirulina	Total	Astaxanthin	Spirulina	Total
Packaged products	$*5,746*	$ *2,268*	$*8,014*	$*15,649*	$ *6,560*	$*22,209*
Bulk products	*317*	*819*	*1,136*	*748*	*3,057*	*3,805*
Total	$*6,063*	$ *3,087*	$*9,150*	$*16,397*	$ *9,617*	$*26,014*

Reclassification

Certain amounts previously reported in the fiscal *2018* consolidated financial statements have been reclassified to conform with the fiscal *2019* financial presentation. These reclassifications have *no* impact on net income.

Recently Adopted Accounting Pronouncements

In *May 2017,* the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") *2017-09, Compensation-Stock Compensation (Topic 718) Scope of Modification Accounting* ("ASU *No. 2017-09"*). ASU *No. 2017-09* will clarify and reduce both (i) diversity in practice and (ii) cost and complexity when applying the guidance in Topic *718,* to a change to the terms and conditions of a share-based payment award. This guidance became effective for fiscal years beginning after *December 15, 2017* and interim periods within those fiscal years. The amendments in ASU *No. 2017-09* are applied prospectively to awards modified on or after the adoption date. The Company adopted this standard as of *April 1, 2018* with *no* impact on its consolidated financial statements.

In *November 2016,* the FASB issued ASU *2016-18,* "*Statement of Cash Flows (Topic 230): Restricted Cash"* ("ASU *No. 2016-18"*). This update addresses the fact that diversity exists in the classification and presentation of changes in restricted cash on the statement of cash flows under Topic *230, Statement of Cash Flows*. ASU *No. 2016-18* became effective for public companies for the fiscal years beginning after *December 15, 2017,* and interim periods within those fiscal years. The Company adopted this standard as of *April 1, 2018* by using the retrospective method, which required reclassification of restricted cash in the accompanying consolidated statement of cash flows as of the beginning of the period for the *nine* months ended *December 31, 2018.*

In *August 2016,* FASB issued ASU *2016-15,* "*Statement of Cash Flows (Topic 230)*: *Classification of Certain Cash Receipts and Cash Payments"* ("ASU *No. 2016-15"*). ASU *No. 2016-15* clarifies and provides specific guidance on *eight* cash flow classification issues that are *not* currently addressed by current GAAP and thereby reduces the current diversity in practice. ASU *No. 2016-15* is effective for public business entities for annual periods, including interim periods within those annual periods, beginning after *December 15, 2017.* The Company adopted this standard as of *April 1, 2018* with *no* impact on its consolidated financial statements and related disclosures.

In *May 2014,* the FASB issued their converged standard on revenue recognition, Accounting Standards Update *No. 2014-09,* "*Revenue from Contracts with Customers (Topic 606)"* ("ASU *No. 2014-09"*), updated in *December 2016* with the release of ASU *2016-20.* This standard outlines a single comprehensive model for companies to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that an entity recognizes revenue to depict the transfer of promised goods and services in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods and services. In addition, the new standard requires that reporting companies disclose the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. In *August 2015,* the FASB issued ASU *No 2015-14* "*Revenue from Contracts with Customers (Topic 606*): *Deferral of the Effective Date,*" which deferred the effective date of ASU *No. 2014-09* to annual reporting periods beginning after *December 15, 2017.*

The new revenue standard is required to be applied either retrospectively to each prior reporting period presented or prospectively with the cumulative effect of initially applying the standard recognized at the date of the initial application, supplemented with certain disclosures related to the effect of adoption on previously reported amounts, if any (the modified retrospective method). The Company adopted the standard on *April 1, 2018* for contracts that were *not* completed before the adoption date, using the modified retrospective method. The Company has evaluated the effect of the standard and concluded it is *not* material to the timing or amount of revenues or expenses recognized in the Company's historical consolidated financial statements. As a result, the Company has concluded that the application of the standard does *not* have a material effect that requires a retrospective adjustment to any previously reported amounts in the Company's historical consolidated financial statements for reporting disclosure purposes.

Recently Issued Accounting Pronouncements

In *November 2018,* the FASB issued ASU *2018-18 – Collaborative Arrangements*, which clarifies that certain transactions between collaborative arrangement participants should be accounted for as revenue when the collaborative arrangement participant is a customer in the context of a unit of account and precludes recognizing as revenue consideration received from a collaborative arrangement participant if the participant is *not* a customer. This ASU will be effective for us in the *first* quarter of fiscal *2021* with early adoption permitted. This ASU requires retrospective adoption to the date we adopted ASC *606, April 1, 2018,* by recognizing a cumulative-effect adjustment to the opening balance of retained earnings of the earliest annual period presented. The Company is currently evaluating the impact of the adoption of this standard on its financial statements.

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In *August 2018,* the FASB issued ASU *2018-15,* "*Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract"* ("ASU *No. 2018-15"*), which aligns the capitalization requirements for implementation costs incurred in a hosting arrangement that is a service contract with the existing capitalization requirements for implementation costs incurred to develop or obtain internal-use software *(Subtopic 350-40).* ASU *2018-15* becomes effective for the Company in the *first* quarter of fiscal *2021* and *may* be adopted either retrospectively or prospectively. Early adoption is permitted. The Company is currently evaluating the impact of the adoption of this standard on its financial statements.

In *August 2018,* the FASB issued ASU *2018-13,* "*Fair Value Measurement - Disclosure Framework (Topic 820)"* ("ASU *No. 2018-13"*).The updated guidance improves the disclosure requirements on fair value measurements. The updated guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after *December 15, 2019.* Early adoption is permitted for any removed or modified disclosures. The Company is currently assessing the timing and impact of adopting the updated provisions.

In *June 2018,* the FASB issued ASU *2018-07,* "*Compensation - Stock Compensation (Topic 718)"* ("ASU *No. 2018-07"*): Improvements to Nonemployee Share-Based Payment Accounting. ASU *No. 2018-07* expands the scope of Topic *718* to include share-based payment transactions for acquiring goods and services from non-employees, and as a result, the accounting for share-based payments to non-employees will be substantially aligned. ASU *No. 2018-07* is effective for fiscal years beginning after *December 15, 2018,* including interim periods within that fiscal year. Early adoption is permitted but *no* earlier than an entity's adoption date of Topic *606.* The Company is currently evaluating the impact this new guidance will have on its financial statements and related disclosures.

In *February 2016,* the FASB issued ASU *2016-02,* "*Leases (Topic 842)"* (*"*ASU *No. 2016-02"*). The principle objective of ASU *No. 2016-02* is to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet. ASU *No. 2016-02* continues to retain a distinction between finance and operating leases but requires lessees to recognize a right-of-use asset representing its right to use the underlying asset for the lease term and a corresponding lease liability on the balance sheet for all leases with terms greater than *twelve* months. ASU *No. 2016-02* is effective for fiscal years and interim periods beginning after *December 15, 2018.* Early adoption of ASU *No. 2016-02* is permitted. Entities were required to apply the amendments at the beginning of the earliest period presented using a modified retrospective approach. This guidance is applicable to the Company's fiscal year beginning *April 1, 2019.* In *July 2018,* the FASB issued ASU *2018-10* "*Codification Improvements to Topic 842, Leases*" ("ASU *No. 2018-02"*). ASU *No. 2018-02* affects narrow aspects of the guidance issued in the amendments in ASU *No. 2016-02* including those regarding residual value guarantees, rate implicit in the lease, lessee reassessment of lease classification, lessor reassessment of lease term and purchase option, variable lease payments that depend on an index or a rate, investment tax credits, lease term and purchase option, transition guidance for amounts previously recognized in business combinations, certain transition adjustments, transition guidance for leases previously classified as capital leases under Topic *840,* transition guidance for modifications to leases previously classified as direct financing or sales-type leases under Topic *840,* transition guidance for sale and leaseback transactions, impairment of net investment in the lease, unguaranteed residual asset, effect of initial direct costs on rate implicit in the lease, and failed sale and leaseback transactions. In *July 2018,* the FASB issued ASU *No. 2018-11,* "*Leases (Topic 842): Targeted Improvements*," which provides entities with an additional (and optional) transition method to adopt the new leases standard. Under this method, an entity initially applies the new leases

standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Consequently, the prior comparative period's financials will remain the same as those previously presented. Entities that elect this optional transition method must provide the disclosures that were previously required. The Company expects it will elect this optional transition method. The Company has selected resources to track and record leases and is starting the assessment and valuation process by evaluating the population of leases under the revised definition of what qualifies as a leased asset, and expects to have the assessment completed by *March 2019.* The Company is the lessee under various agreements for facilities and equipment that are currently accounted for as operating and capital leases. The Company expects this guidance will have a material impact on its consolidated balance sheets due to the recognition of lease rights and obligations as assets and liabilities, respectively. The Company does *not* expect this guidance to have a material effect on its consolidated results of operations and cash flows.

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3. INVENTORIES

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

	December 31, 2018	March 31, 2018
	(in thousands)	
Raw materials	$*460*	$*410*
Work in process	*4,649*	*2,602*
Finished goods	*4,828*	*5,878*
Supplies	*175*	*144*
Inventories, net	$*10,112*	$*9,034*

The Company recognizes abnormal production costs, including fixed cost variances from normal production capacity, as an expense in the period incurred. Abnormal costs related to spirulina production of *$0* and *$250,000* were charged to cost of sales for the *three* and *nine* months ended *December 31, 2018,* respectively. There were *no* abnormal production costs for the *three* and *nine* months ended *December 31, 2017.* Non-inventoriable fixed costs related to production of *$35,000* (astaxanthin) and *$176,000* (*$35,000* astaxanthin and *$141,000* spirulina) were charged to cost of sales for the *three* and *nine* months ended *December 31, 2018,* respectively. Non-inventoriable fixed costs related to spirulina production of *$4,000* and *$88,000* were charged to cost of sales for the *three* and *nine* months ended *December 31, 2017,* respectively.

4. EQUIPMENT AND LEASEHOLD IMPROVEMENTS

Equipment and leasehold improvements consist of the following:

	December 31, 2018	March 31, 2018
	(in thousands)	
Equipment	$*18,312*	$*17,935*

Leasehold improvements	*14,288*	*14,248*
Furniture and fixtures	*348*	*348*
	32,948	*32,531*
Less accumulated depreciation and amortization	*(18,767*)	*(17,346*)
Construction-in-progress	*1,002*	*549*
Equipment and leasehold improvements, net	$*15,183*	$*15,734*

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, 2018* and *March 31, 2018,* respectively.

5. SHORT TERM CONTRACT OBLIGATION

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

The short -term obligation is comprised of *two* separate loans in the principal amount of *$180,000* and *$215,000.* The *first* loan of *$180,000* bears an interest rate of *6.25%* and is payable in *four* monthly installments which includes principal and interest. The loan commenced on *December 1, 2018* and matures on *March 31, 2019.* The principal amount outstanding at *December 31, 2018* was *$137,000.*

The *second* loan in the amount of *$215,000* is a non-interest bearing loan that is payable in *twelve* monthly installments comprised of *two* monthly payments of *$10,000* and *ten* monthly payments of *$19,543.* The loan commenced on *December 1, 2018* and matures on *October 15, 2019.* This contract contains a hold back of *$38,000* pending resolution of certain closing items by the seller. The principal amount outstanding at *December 31, 2018* was *$195,000.*

6. LINE OF CREDIT

On *August 30, 2016,* the Revolving Credit Agreement (the "Credit Agreement"), which the Company and First Foundation Bank ("the Bank") entered into on *June 3, 2016,* became effective after the Company and the Bank received the necessary approvals from the State of Hawaii to secure the lien on the Company's leasehold property in Kona, Hawaii. The Credit Agreement allows the Company to borrow up to *$2,000,000* on a revolving basis. Borrowings

under the Credit Agreement bear interest at the Wall Street Journal prime rate (*5.50%* at *December 31, 2018*) plus *2%,* floating. The Credit Agreement includes various covenants as defined in the Credit Agreement. The Credit Agreement also contains standard acceleration provisions in the event of a default by the Company. As of *December 31, 2018,* the Company had borrowed *$1,750,000* and had *$250,000* available on the line. The line of credit is subject to annual renewal and was renewed on *August 30, 2018* and will be subject to renewal upon expiration on *August 30, 2019.* Pursuant to the *August 30, 2018* renewal, the current ratio covenant was changed from *2.10:1* to *1.50:1* and is applicable to both the Line of Credit and Long-Term Debt with the Bank.

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

7. ACCRUED EXPENSES

Accrued expenses consist of the following:

	December 31, 2018	March 31, 2018
	(in thousands)	
Wages, commissions, bonus and profit sharing	$ 799	$ 707
Other accrued expenses	274	185
Total accrued expenses	$ 1,073	$ 892

8. LONG-TERM DEBT

Long-term debt consists of the following:

	December 31, 2018	March 31, 2018
	(in thousands)	
Long-term debt	$ *6,101*	$ *6,530*
Capital lease obligations	*98*	*148*
Less current maturities	*(663*)	*(655*)
Long-term debt, excluding current maturities	*5,536*	*6,023*
Less unamortized debt issuance costs	*(208*)	*(233*)
Total long-term debt, net of current maturities and unamortized debt issuance costs	$ *5,328*	$ *5,790*

Term Loans

On *August 14, 2012,* the Company entered into a loan agreement (the *"August 2012* Loan Agreement") that provides a term loan in an aggregate principal amount of *$5,500,000* which is secured by substantially all the Company's assets, including a mortgage on the Company's interest in its lease at the National Energy Laboratory of Hawaii Authority. The *August 2012* Loan Agreement is partially guaranteed under the provisions of the U.S. Department of Agriculture ("USDA") Rural Development Guarantee program.

In accordance with terms of the *August 2012* Loan Agreement, monthly payments of principal and interest are required until the loan's maturity on *August 14, 2032.* Interest on the loan accrues on the outstanding principal balance at an annual variable rate equal to the published Wall Street Journal prime rate (*5.50%* at *December 31, 2018*) 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 balance under the *August 2012* Loan Agreement was *$4,492,000* and *$4,648,000* at *December 31, 2018* and *March 31, 2018,* respectively.

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

On *July 30, 2015,* the Company entered into a loan agreement (the *"2015* Loan Agreement") that provides a term loan in an aggregate principal amount of *$2,500,000* and is secured by all the Company's assets. The *2015* Loan Agreement is partially guaranteed under the provisions of the USDA Rural Development Guarantee program.

In accordance with terms in the *2015* Loan Agreement, payment of principal and interest are required until its maturity on *September 1, 2022.* Interest on the loan accrues on the outstanding principal balance at an annual variable rate equal to the published Wall Street Journal prime rate (*5.50%* at *December 31, 2018*) plus *2.0%* and is adjustable on the *first* day of each calendar quarter and fixed for that quarter.

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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.

At *no* time shall the annual interest rate be less than *6.00%.* The *2015* Loan Agreement has a prepayment penalty of *5%* for any prepayment made prior to the *first* anniversary of the date of the loan and each year thereafter the penalty is reduced by *1%* each year until the *fifth* anniversary of such date when there will *no* longer be a prepayment penalty. The balance under the *2015* Loan Agreement was *$1,475,000* and *$1,726,000* at *December 31, 2018* and *March 31, 2018,* respectively.

On *October 6, 2017,* the Company entered into an Equipment Finance Agreement (the “Equipment Agreement”), which provides up to *$175,000* of financing for equipment. The interest rate on this loan is *4.75%.* In accordance with terms in the Equipment Agreement, payment of principle and interest are required until its maturity on *October 31, 2022.* The balance under this loan was *$134,000* and *$156,000* at *December 31, 2018* and *March 31, 2018,* respectively.

Capital Leases

The Company has *three* capital leases providing for *$278,000* in equipment, secured by the equipment financed. The capital leases mature at various dates between *May 2019* and *March 2021* and are payable in *60* equal monthly payments, except for *one* which is payable in *36* equal monthly payments. The interest rates under these capital leases range from *4.18%* to *12.90%.* The aggregate balances under these leases were *$98,000* and *$148,000* at *December 31, 2018* and *March 31, 2018,* respectively.

9. CONTINGENCIES

From time to time, the Company *may* be involved in litigation and investigations relating to claims and matters arising out of its operations in the normal course of business. The Company believes that it currently is *not* a party to any legal proceedings or claims which, individually or in aggregate, would have a material effect on its consolidated financial position, results of operations or cash flows.

10. **SHARE-BASED COMPENSATION**

The Company has share-based compensation plans, which are more fully described in Note *9,* Share-Based Compensation, to the Consolidated Financial Statements included in the Company's annual report on Form *10*-K as filed with the SEC on *June 15, 2018.*

As of *December 31, 2018,* the Company had *two* equity-based compensation plans: the *2016* Equity Incentive Plan (the *"2016* Plan") and the *2014* Independent Director Stock Option and Restricted Stock Grant Plan (the *"2014* Directors Plan"). The Company has also issued stock options, which remain outstanding as of *December 31, 2018,* under *two* equity-based compensation plans which have expired according to their terms: the *2005* Stock Option Plan (the *"2005* Plan") and the *2004* Independent Director Stock Option and Stock Grant Plan (the *"2004* Directors Plan"). These plans allowed the Company to award stock options and shares of restricted common stock to eligible employees, certain outside consultants and independent directors. *No* additional awards will be issued under the *2005* Plan or the *2004* Directors Plan.

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

	As of December 31, 2018		
	Authorized	**Available**	**Outstanding**
2016 Plan	*1,300,000*	*1,113,022*	*170,975*
2014 Directors Plan	*350,000*	*184,400*	*12,000*
2005 Plan	—	—	*434,400*
2004 Directors Plan	—	—	*12,000*
Total	*1,650,000*	*1,297,422*	*629,375*

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Stock Options

All stock option grants made under the equity-based compensation plans were issued at exercise prices *no* less than the Company's closing stock price on the date of grant, determined by the Board of Directors or the Compensation Committee of the Board of Directors in accordance with the provisions of the respective plans. The terms of each option grant include vesting, exercise, and other conditions set forth in a Stock Option Agreement evidencing each grant. *No* option can have a life in excess of *ten* (*10*) years. The Company records compensation expense for employee stock options based on the estimated fair value of the options on the date of grant using the Black-Scholes option-pricing model. The model requires various assumptions, including a risk-free interest rate, the expected term of the options, the expected stock price volatility over the expected term of the options, and the expected dividend yield. Compensation expense for employee stock options is recognized ratably over the vesting term. Compensation expense recognized for options issued under all Plans was *$18,000* and *$54,000* for the *three* and *nine* months ended *December 31, 2018,* respectively. Compensation expense recognized for options issued under all Plans was *$13,000* and *$47,000* for the *three* and *nine* months ended *December 31, 2017,* respectively. All stock-based compensation has been classified as general and administrative expense in the condensed consolidated statement of operations.

A summary of option activity under the Company's stock plans for the *nine* months ended *December 31, 2018* is presented below:

Option Activity	**Shares**	**Weighted Average Exercise Price**	**Weighted Average Remaining Contractual Term (in years)**	**Aggregate Intrinsic Value**
Outstanding at March 31, 2018	*589,400*	$ *4.06*	*4.9*	$ *675,300*
Granted	—	$ —		
Exercised	*(6,000*)	$ *2.85*		
Forfeited	*(5,000*)	$ *5.75*		
Outstanding at December 31, 2018	*578,400*	$ *4.06*	*4.2*	$ *43,804*
Exercisable at December 31, 2018	*483,400*	$ *4.15*	*3.3*	$ *43,804*

The aggregate intrinsic value in the table above is before applicable income taxes and represents the excess amount over the exercise price optionees would have received if all options had been exercised on the last business day of the period indicated, based on the Company's closing stock price of *$3.02* for such day.

A summary of the Company's non-vested options for the *nine* months ended *December 31, 2018* is presented below:

Nonvested Options	**Shares**	**Weighted Average Grant-Date Fair Value**
Nonvested at March 31, 2018	*120,000*	$ *1.81*
Granted	—	—
Vested	*(25,000*)	*1.71*
Forfeited	—	—
Nonvested at December 31, 2018	*95,000*	$ *1.83*

As of *December 31, 2018,* total unrecognized stock-based compensation expense related to all unvested stock options was *$127,000,* which is expected to be expensed over a weighted average period of *1.6* years.

Subsequent to *December 31, 2018, 50,000* stock options were granted from the *2016* Plan at an exercise price of *$3.00* per share.

Restricted Stock

There were *no* grants of fully vested restricted stock issued to Non-Employee Directors for the *three* months ended *December 31, 2018* and *December 31, 2017.* Grants of fully vested restricted stock issued to Non-Employee Directors was *47,223* shares and *57,501* shares for the *nine* months ended *December 31, 2018* and *December 31, 2017,* respectively. Compensation expense recognized for fully vested restricted stock was *$0* and *$170,000* for the *three* and *nine* months ended *December 31, 2018,* respectively. Compensation expense recognized for fully vested restricted stock was *$0* and *$276,000* for the *three* and *nine* months ended *December 31, 2017,* respectively.

Restricted Stock Units ("RSUs")

RSUs are service-based awards granted to eligible employees under the *2016* Plan. Compensation expense recognized for RSUs issued under the *2016* Plan was *$20,000* and *$58,000* for the *three* and *nine* months ended *December 31, 2018,* respectively. Compensation expense recognized for RSUs issued under the *2016* Plan was *$15,000* and *$48,000* for the *three* and *nine* months ended *December 31, 2017,* respectively.

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On *July 13, 2018, 22,449* RSUs were awarded to employees of the Company. This award is valued at *$4.0252* per share, the closing market price of the Company's common stock on the grant date, and vests over a period of *two* years.

The following table summarizes information related to awarded RSUs:

Nonvested Restricted Stock Units	**Shares**	**Weighted Average Grant Price**
Nonvested restricted stock units at March 31, 2018	*39,675*	$ *3.89*
Granted	*23,923*	*4.10*
Vested	*(7,670*)	*3.92*
Forfeited	*(4,953*)	*4.08*
Nonvested restricted stock units at December 31, 2018	*50,975*	$ *3.97*

As of *December 31, 2018,* total unrecognized stock-based compensation expense related to unvested restricted stock units was *$140,000,* which is expected to be expensed over a weighted average period of *1.8* years.

11. INCOME TAXES

On *December 22, 2017* H.R. *1,* originally known as the Tax Cuts and Jobs Act, (the "Tax Act") was enacted. Among the significant changes to the U.S. Internal Revenue Code, the Tax Act lowers the U.S. federal corporate income tax rate ("Federal Tax Rate") from *34%* to *21%* effective *January 1, 2018.* The Company will compute its income tax expense for the *March 31, 2019* fiscal year using a Federal Tax Rate of *21%.* The *21%* Federal Tax Rate will apply to fiscal years ending *March 31, 2019* and each year thereafter. The Company completed the accounting for the income tax effects of the Tax Act as of *March 31, 2018* and determined that the amount identified as provisional in the quarter ended *December 31, 2017* was a materially correct amount. As a result, *no* measurement period adjustments have been recorded.

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). We recorded an income tax expense of *$73,000* and (*$127,000*) for the *three* months ended *December 31, 2018* and *2017,* respectively. We recorded an income tax expense of *$33,000* and income tax benefit of (*$105,000*) for the *nine* months ended *December 31, 2018* and *2017,* respectively. Our effective tax rate was *20.2%* and (*1.6%*) for the *three* and *nine* months ended *December 31, 2018,* respectively, and (*13.0%*) and (*5.3%*) for the *three* and *nine* months ended *December 31, 2017,* respectively. The effective tax rate for the *three* and *nine*

months ended *December 31, 2018* differs from the statutory rate of *21%* as a result of state taxes (net of federal benefit) and the net change in valuation allowance against the net deferred tax asset the Company believes is *not* more likely than *not* to be realized.

The Company is subject to taxation in the United States and *six* 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, 2018,* 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 *2013.*

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_12._ EARNINGS (LOSS) PER SHARE

Basic earnings (loss) 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, 2018* and *2017* are as follows:

	Three Months Ended December 31, 2018		
	Net Loss (Numerator)	**Shares (Denominator)**	**Per Share Amount**
	(in thousands)		
Basic income per share	$*288*	*5,836*	$ *0.05*
Effect of dilutive securities — Common stock options	—	*26*	—
Diluted income per share	$*288*	*5,862*	$ *0.05*

	Three Months Ended December 31, 2017		
	Net Income (Numerator)	**Shares (Denominator)**	**Per Share Amount**
	(in thousands)		
Basic income per share	$*1,107*	*5,749*	$ *0.19*
Effect of dilutive securities — Common stock options	—	*82*	—
Diluted income per share	$*1,107*	*5,831*	$ *0.19*

Reconciliations between the numerator and the denominator of the basic and diluted (loss) earnings per share computations for the *nine* months ended *December 31, 2018* and *2017* are as follows:

Nine Months Ended December 31, 2018		
Net Loss (Numerator)	**Shares (Denominator)**	**Per Share Amount**

	(in thousands)		
Basic and diluted loss per share	$(2,123)	5,809	$ (0.37)

	Nine Months Ended December 31, 2017		
	Net Income (Numerator)	Shares (Denominator)	Per Share Amount
	(in thousands)		
Basic income per share	$2,083	5,714	$ 0.36
Effect of dilutive securities—Common stock options	—	60	—
Diluted income per share	$2,083	5,774	$ 0.36

Potentially dilutive securities include *75,000* outstanding options to purchase common stock for the *three* and *nine* months ended *December 31, 2018* and *20,991* restricted stock units for the *three* and *nine* months ended *December 31, 2018.* Diluted earnings per share does *not* include the impact of *75,000* options to purchase common stock for the *three* month period ended *December 31, 2018,* as the effect of their inclusion would be anti-dilutive. As a result of the net loss for the *nine* month period ended *December 31, 2018, no* potentially dilutive securities are included in the calculation of diluted loss per share because such effect would be anti-dilutive. Diluted earnings per share does *not* include the impact of *75,000* options to purchase common stock for the *three* and *nine* month period ended *December 31, 2017,* as the effect of their inclusion would be anti-dilutive. Restricted stock units become dilutive within the period granted and remain dilutive until the units vest and are issued as common stock.

13. RELATED PARTY TRANSACTIONS AND BALANCES

During the *nine* months ended *December 31, 2018,* the Company entered into a consulting agreement with an effective date of *May 5, 2018* with a vendor that employs *one* of our independent directors. The Company's independent director is *not* named in or involved in the performance of the consulting agreement. The contract amount of *$120,000* is reflected in general and administrative expense during the *nine* months ended *December 31, 2018* and *$120,000* in payments have been made against the contract during the *nine* months ended *December 31, 2018.*

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

Overview:

We are a world leader in the production of high value natural products derived from microalgae. Incorporated in 1983, we are guided by the principle of providing beneficial, quality microalgal products for health and human nutrition in a sustainable, reliable and environmentally sensitive operation. We are 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 *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 commercially produce human nutritional products derived from microalgae.

Our production of these products at the 96-acre facility on the Kona Coast of the island of Hawaii provides several benefits. We selected the Keahole Point location in order to take advantage of relatively consistent warm temperatures, sunshine and low levels of rainfall needed for optimal cultivation of microalgae. This location also offers us access to cold deep ocean water, drawn from an offshore depth of 2,000 feet, which we use in our *Ocean-Chill Drying* system to eliminate the oxidative damage caused by standard drying techniques and as a source of trace nutrients for microalgal cultures. The area is also designated a Biosecure Zone, with tight control of organisms allowed into the area and free of genetically modified organisms (GMO's). 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,**	
	2018	**2017**	**2018**	**2017**
Net sales	$10,044	$9,150	$24,143	$26,014
Net sales increase (decrease)	9.8 %		(7.2)%	
Gross profit	$4,116	$4,240	$8,237	$11,463
Gross profit as % of net sales	41.0 %	46.3 %	34.1 %	44.1 %
Operating expenses	$3,621	$3,130	$9,913	$9,114
Operating expenses as % of net sales	36.0 %	34.2 %	41.1 %	35.0 %
Operating income (loss)	$495	$1,110	$(1,676)	$2,349
Operating income (loss) as % of net sales	4.9 %	12.1 %	(6.9)%	9.0 %
Income tax expense (benefit)	$73	$(127)	$33	$(105)
Net income (loss)	$288	$1,107	$(2,123)	$2,083

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Comparison of the Three Months Ended December 31, 2018 and 2017

Net Sales *(in thousands)*

	Three Months Ended December 31, 2018	2017	$ Change	% Change
Packaged sales				
Astaxanthin	$6,012	$5,746	$266	4.6 %
Spirulina	3,212	2,268	944	41.6 %
Total Packaged sales	$9,224	$8,014	$1,210	15.0 %
Bulk sales				
Astaxanthin	$287	$317	$(30)	(9.5)%