

SYNBIOTICS CORP
Form 10-Q
May 28, 2004
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U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2004

OR

.. **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 0-11303

SYNBIOTICS CORPORATION

(Exact name of registrant as specified in its charter)

California
(State or other jurisdiction of
incorporation or organization)

95-3737816
(I.R.S. Employer
Identification No.)

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11011 Via Frontera

San Diego, California
(Address of principal executive offices)

92127
(Zip Code)

Registrant's telephone number, including area code: (858) 451-3771

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

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

As of May 28, 2004, 20,378,479 shares of common stock were outstanding.

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****Synbiotics Corporation****Condensed Consolidated Balance Sheet**

	March 31, 2004 <u>(unaudited)</u>	December 31, 2003 <u>(audited)</u>
Assets		
Current assets:		
Cash and equivalents	\$ 1,022,000	\$ 1,045,000
Accounts receivable	2,997,000	2,686,000
Inventories	5,418,000	5,266,000
Other current assets	1,027,000	878,000
	<u>10,464,000</u>	<u>9,875,000</u>
Property and equipment, net	1,121,000	1,232,000
Goodwill	1,397,000	1,397,000
Intangibles, net	2,162,000	2,358,000
Other assets	416,000	479,000
	<u>\$ 15,560,000</u>	<u>\$ 15,341,000</u>
Liabilities and Shareholders Equity:		
Current liabilities:		
Accounts payable and accrued expenses	\$ 4,902,000	\$ 4,005,000
Current portion of long-term debt	4,668,000	4,804,000
	<u>9,570,000</u>	<u>8,809,000</u>
Other liabilities	2,175,000	2,134,000
	<u>2,175,000</u>	<u>2,134,000</u>
Shareholders' equity:		
Series C preferred stock, \$1,000 liquidation preference per share (aggregating \$2,800,000 at March 31, 2004 and December 31, 2003), 4,000 shares authorized, 2,800 shares issued and outstanding at March 31, 2004 and December 31, 2003	2,604,000	2,604,000
Common stock, no par value, 70,000,000 shares authorized, 20,379,000 and 20,025,000 shares issued and outstanding at March 31, 2004 and December 31, 2003	46,473,000	46,316,000
Common stock warrants	1,035,000	1,035,000
Accumulated other comprehensive loss	(498,000)	(411,000)
Accumulated deficit	(45,799,000)	(45,146,000)

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Total shareholders' equity	<u>3,815,000</u>	<u>4,398,000</u>
	<u>\$ 15,560,000</u>	<u>\$ 15,341,000</u>

See accompanying notes to condensed consolidated financial statements.

Table of Contents**Synbiotics Corporation****Condensed Consolidated Statement of Operations and Comprehensive (Loss) Income (unaudited)**

	Three Months Ended	
	March 31,	
	2004	2003
Revenues:		
Net sales	\$ 5,131,000	\$ 6,148,000
Royalties	47,000	2,000
	<u>5,178,000</u>	<u>6,150,000</u>
Operating expenses:		
Cost of sales	2,448,000	2,963,000
Research and development	423,000	265,000
Selling and marketing	1,113,000	1,065,000
General and administrative	1,576,000	818,000
Patent litigation settlement		(515,000)
	<u>5,560,000</u>	<u>4,596,000</u>
(Loss) income from operations	(382,000)	1,554,000
Other income (expense):		
Interest, net	(110,000)	(135,000)
(Loss) income before income taxes	(492,000)	1,419,000
Provision for income taxes	3,000	21,000
Net (loss) income	(495,000)	1,398,000
Translation adjustment	(87,000)	198,000
Comprehensive (loss) income	<u>\$ (582,000)</u>	<u>\$ 1,596,000</u>
Basic net (loss) income per share	<u>\$ (0.03)</u>	<u>\$ 0.07</u>
Diluted net (loss) income per share	<u>\$ (0.03)</u>	<u>\$ 0.03</u>

See accompanying notes to condensed consolidated financial statements.

Table of Contents**Synbiotics Corporation****Condensed Consolidated Statement of Cash Flows (unaudited)**

	Three Months Ended	
	March 31,	
	2004	2003
Cash flows from operating activities:		
Net (loss) income	\$ (495,000)	\$ 1,398,000
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	294,000	333,000
Receivable from patent litigation settlement		(515,000)
Changes in assets and liabilities:		
Accounts receivable	(350,000)	(1,000,000)
Inventories	(179,000)	153,000
Other assets	(161,000)	58,000
Accounts payable and accrued expenses	969,000	505,000
Other liabilities	43,000	40,000
Net cash provided by operating activities	121,000	972,000
Cash flows from investing activities:		
Acquisition of property and equipment	(40,000)	(133,000)
Receipts from notes receivable	58,000	
Net cash provided by (used for) investing activities	18,000	(133,000)
Cash flows from financing activities:		
Payments of long-term debt	(137,000)	(381,000)
Net cash used for financing activities	(137,000)	(381,000)
Net increase in cash and equivalents	2,000	458,000
Effect of exchange rates on cash	(25,000)	18,000
Cash and equivalents beginning of period	1,045,000	869,000
Cash and equivalents end of period	\$ 1,022,000	\$ 1,345,000

See accompanying notes to condensed consolidated financial statements.

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Notes to Condensed Consolidated Financial Statements (unaudited)

Note 1 - Interim Financial Statements:

The accompanying condensed consolidated balance sheet as of March 31, 2004 and the condensed consolidated statements of operations and comprehensive (loss) income and of cash flows for the three months ended March 31, 2004 and 2003 have been prepared by Synbiotics Corporation (the Company) and have not been audited. The condensed consolidated financial statements of the Company include the accounts of its wholly-owned subsidiary Synbiotics Europe SAS (SBIO-E). All significant intercompany transactions and accounts have been eliminated in consolidation. These financial statements, in the opinion of management, include all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation of the financial position, results of operations and cash flows for all periods presented. The financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K filed for the year ended December 31, 2003. Interim operating results are not necessarily indicative of operating results for the full year.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Note 2 Going Concern:

The accompanying consolidated condensed financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. Although the Company was profitable in 2003, during the first quarter of 2004 the Company incurred a net loss of \$495,000, and had an accumulated deficit of \$45,799,000 as of March 31, 2004.

As of March 31, 2004, the Company had an outstanding principal balance under its bank debt totaling \$4,668,000 (Note 5), all of which was due and payable in January 2004. The bank had informally reduced the monthly principal payments to \$30,000 for the payments due February 1, 2004, and March 1, 2004. On March 29, 2004, the Company entered into a forbearance agreement with the bank whereby the bank agreed not to exercise any of its rights under the credit agreement through May 5, 2004, and agreed to formally reduce the monthly principal payments to \$30,000 for the payments due April 1, 2004, and May 1, 2004; the forbearance agreement has now expired. The Company believes it will be able to restructure or refinance the bank debt. However, no assurance can be given that the Company will be successful in this effort to obtain an extension from the bank or to restructure or refinance the bank debt. The Company's resources do not enable it to repay the note in its entirety immediately.

These factors raise substantial doubt about the Company's ability to continue as a going concern for a reasonable period of time. The consolidated condensed financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

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Notes to Condensed Consolidated Financial Statements (unaudited)

Note 3 - Inventories:

Inventories consist of the following:

	March 31, 2004 <u>(unaudited)</u>	December 31, 2003 <u>(audited)</u>
Raw materials	\$ 2,996,000	\$ 2,532,000
Work in process	378,000	477,000
Finished goods	2,044,000	2,257,000
	<u>\$ 5,418,000</u>	<u>\$ 5,266,000</u>

Note 4 Goodwill and Other Intangible Assets:

The Company has allocated all of its goodwill to its only reporting unit, which is also its only reportable segment (Note 8). There were no changes in the carrying amount of goodwill from December 31, 2002 to March 31, 2004.

Other intangible assets were as follows:

	March 31, 2004		December 31, 2003	
	Gross Carrying Value	Accumulated Amortization	Gross Carrying Value	Accumulated Amortization
Patents	\$ 5,008,000	\$ 3,003,000	\$ 5,108,000	\$ 2,922,000
Licenses	618,000	461,000	618,000	446,000
	<u>\$ 5,626,000</u>	<u>\$ 3,464,000</u>	<u>\$ 5,726,000</u>	<u>\$ 3,368,000</u>

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The weighted-average amortization periods for patents and licenses are 9 years and 10 years, respectively, and the weighted-average amortization period for total intangible assets is 9 years. Annual pretax amortization for other intangibles over the next five years (including the remaining nine months of 2004) is estimated to be as follows:

2004	\$ 501,000
2005	638,000
2006	629,000
2007	369,000
2008	13,000
	<hr/>
	\$ 2,150,000
	<hr/>

Note 5 Note Payable:

As of March 31, 2004, the Company had an outstanding principal balance under its bank debt totaling \$4,668,000, all of which was due and payable in January 2004. The bank had informally reduced the monthly principal payments to \$30,000 for the payments due February 1, 2004, and March 1, 2004. On March 29, 2004, the Company entered into a forbearance agreement with the bank whereby the bank agreed not to exercise any of its rights under the credit agreement through May 5, 2004, and agreed to formally reduce the monthly principal payments to \$30,000 for the payments due April 1, 2004, and May 1, 2004; the forbearance agreement has now expired. The Company believes it will be able to restructure or refinance the bank debt. However, no assurance can be given that the Company will be successful in this effort to obtain an extension from the bank or to restructure or refinance the bank debt.

Table of Contents**SYNBIOTICS CORPORATION****Notes to Condensed Consolidated Financial Statements (unaudited)****Note 6 Preferred Stock Dividend:**

On March 11, 2004, the Company declared a dividend on the Series C preferred stock, in the form of common stock with a value totaling \$158,000, for dividends accrued and payable as of January 31, 2004. Redwood West Coast, LLC (Redwood), the holder of the Series C preferred stock, as permitted by the Certificate of Determination of the Series C preferred stock, had elected to receive a dividend in the form of shares of the Company's common stock in lieu of overdue cash dividends. As a result, the Company issued 354,000 shares of the Company's common stock to Redwood's distributees on March 11, 2004.

Note 7 (Loss) Income per Share:

The following is a reconciliation of net (loss) income and share amounts used in the computations of (loss) income per share:

	Three Months Ended	
	March 31,	
	2004	2003
	<u> </u>	<u> </u>
Basic net (loss) income used:		
Net (loss) income	\$ (495,000)	\$ 1,398,000
Less cumulative preferred stock dividends	(53,000)	(53,000)
	<u> </u>	<u> </u>
Net (loss) income used in computing basic net (loss) income per share	<u>\$ (548,000)</u>	<u>\$ 1,345,000</u>