SYNBIOTICS CORP
Form 10-Q
May 04, 2001

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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, 2001

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	95-3737816
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
11011 Via Frontera San Diego, California	92127
(Address of principal executive offices)	(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 [X] No [_]

As of May 4, 2001, 9,624,588 shares of Common Stock were outstanding.

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SYNBIOTICS CORPORATION

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

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

	Three Months Ended March 31,	
	2001	2000
Revenues:		
Net sales	$ 7,962,000	$ 9,172,000
License fees	61,000	61,000
Royalties	3,000	2,000

	8,026,000	9,235,000
Operating expenses:		
Cost of sales	3,208,000	4,979,000
Research and development	507,000	547,000
Selling and marketing	1,564,000	2,507,000
General and administrative	1,597,000	1,726,000
	6,876,000	9,759,000
Income (loss) from operations	1,150,000	(524,000)
Other income (expense):		
Interest, net	(294,000)	(332,000)
Income (loss) before income taxes	856,000	(856,000)
Provision for (benefit from) income taxes	27,000	(22,000)
Net income (loss)	829,000	(834,000)
Cumulative translation adjustment	(484,000)	(108,000)
Comprehensive income (loss)	$ 345,000	$ (942,000)
Basic and diluted net income (loss) per share	$ 0.08	$ (0.09)

See accompanying notes to condensed consolidated financial statements.

Item 1. Financial Statements (continued)

Synbiotics Corporation
Condensed Consolidated Balance Sheet

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Assets	
Current assets:	
Cash and equivalents	$ 1,
Accounts receivable	4,
Inventories	5,
Other current assets	

Total current assets	12,
Property and equipment, net	1,
Goodwill	12,
Deferred tax assets	
Deferred debt issuance costs	
Investment in W3 held for sale	
Other assets	3,
	$ 30,
Liabilities and Shareholders' Equity:	
Current liabilities:	
Accounts payable and accrued expenses	$ 7,
Current portion of long-term debt	8,
Deferred revenue	
Other current liabilities	1,
Total current liabilities	16,
Long-term debt	
Deferred revenue	
Other liabilities	1,
	2,
Mandatorily redeemable common stock	3,
Non-mandatorily redeemable common stock and other shareholders' equity:	
Common stock, no par value, 24,800,000 share authorized, 9,003,000 and 8,752,000 shares issued and outstanding at March 31, 2001 and December 31, 2000	40,
Common stock warrants	1,
Accumulated other comprehensive loss	(1,
Accumulated deficit	(31,
Total non-mandatorily redeemable common stock and other shareholders' equity	8,
	$ 30,

See accompanying notes to condensed consolidated financial statements.

Item 1. Financial Statements (continued)

Synbiotics Corporation
Condensed Consolidated Statement of Cash Flows (unaudited)

Cash flows from operating activities:
Net income (loss)
Adjustments to reconcile net income (loss) to net cash provided by (used for) operating activitie
Depreciation and amortization
Changes in assets and liabilities:
Accounts receivable
Inventories
Deferred taxes
Other assets
Accounts payable and accrued expenses
Deferred revenue
Other liabilities

Net cash provided by (used for) operating activities

Cash flows from investing activities:
Acquisition of property and equipment
Proceeds from sale of investment in W3 held for sale
Proceeds from sale of securities available for sale

Net cash (used for) provided by investing activities

Cash flows from financing activities:
Payments of long-term debt
Proceeds from issuance of common stock, net

Net cash used for financing activities

Net increase in cash and equivalents

Effect of exchange rates on cash

Cash and equivalents - beginning of period

Cash and equivalents - end of period

See accompanying notes to condensed consolidated financial statements.

Item 1. Financial Statements (continued)

SYNBIOTICS CORPORATION
Notes to Condensed Consolidated Financial Statements (unaudited)

Note 1 - Interim Financial Statements:

The accompanying condensed consolidated balance sheet as of March 31, 2001 and the condensed consolidated statements of operations and comprehensive income (loss) and of cash flows for the three months ended March 31, 2001 and 2000 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. 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, 2000. 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 - Inventories:

Inventories consist of the following:

	March 31, 2001	December 31, 2000
	(unaudited)	(audited)
Inventories:		
Raw materials	$2,635,000	$2,293,000
Work in process	332,000	409,000
Finished goods	2,783,000	2,571,000
	$5,750,000	$5,273,000

Note 3 - Income (Loss) per Share:

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

	Three Months Ended Mar	
	2001	
Basic and diluted net income (loss) used:		
Income (loss) from continuing operations	$829,000	$(834
Less accretion of mandatorily redeemable common stock	(34,000)	(32
Net income (loss) used in computing basic and diluted net income		

(loss) per share	$795,000	$(866

Item 1. Financial Statements (continued)

SYNBIOTICS CORPORATION
Notes to Condensed Consolidated Financial Statements (unaudited)

	Three Months Ende
	2001
Shares used:	
Weighted average common shares outstanding used in computing basic income (loss) per share	9,499,000
Weighted average options and warrants to purchase common stock as determined by the treasury method	237,000
Shares used in computing diluted income (loss) per share	9,736,000

Weighted average options and warrants to purchase common stock as determined by the application of the treasury method and weighted average shares of common stock issuable upon assumed conversion of debt totalling 1,337,000 shares have been excluded from the shares used in computing diluted net (loss) per share for the three months ended March 31, 2000 as their effect is anti-dilutive. In addition, warrants to purchase 250,000 shares of common stock at $2.00 per share and 265,000 shares of common stock at $4.54 per share have been excluded from the shares used in computing diluted net income (loss) per share for the three months ended March 31, 2001 and 2000, respectively, as their exercise price is higher than the weighted average market price for those periods. In addition, the effect of the warrants to purchase 265,000 shares of common stock at $4.54 per share was anti-dilutive for the three months ended March 31, 2000.

Note 4 - Segment Information and Significant Customers:

The Company has determined that it has only one reportable segment based on the fact that all of its products are animal health products. Although the Company sells diagnostic, vaccine and instrument products, it does not base its business decision making on a product category basis.

The following are revenues for the Company's diagnostic, vaccine and instrument products:

	Three Months Ended March 31,	
	2001	2000
	(unaudited)	(unaudited)
Diagnostics	$7,286,000	$6,554,000

Vaccines	242,000	2,039,000
Instruments	434,000	579,000
Other revenues	64,000	63,000
	$8,026,000	$9,235,000

The following are revenues and long-lived assets information by geographic area:

	Three Months Ended March 31,	
	2001	2000
	(unaudited)	(unaudited)
Revenues:		
United States	$ 5,549,000	$ 6,510,000
France	691,000	1,292,000
Other foreign countries	1,786,000	1,433,000
	$ 8,026,000	$ 9,235,000

	March 31, 2001	December 31, 2000
	(unaudited)	(audited)
Long-lived assets:		
United States	$13,130,000	$12,921,000
France	4,846,000	5,337,000
	$17,976,000	$18,258,000

There were no sales to any one customer that totalled 10% or more of total revenues during the three months ended March 31, 2001. The Company had sales to one customer totalling $1,053,000 during the three months ended March 31, 2000.

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

The information contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Quarterly Report on Form 10-Q contains both historical financial information and forward-looking statements. Forward-looking statements are characterized by words such as "intend", "plan", "believe", "will", "would", etc. Historical financial information may not be indicative of future financial performance. In fact, future financial performance may be materially different than the historical financial information presented herein. Moreover, the forward-looking statements about future business or future results of operations are subject to significant uncertainties and risks, including those detailed under the caption "Future Operating Results", which could cause actual future results to differ

materially from what is suggested by the forward-looking information.

Results of Operations

Our net sales for the first quarter of 2001 decreased by $1,210,000 or 13% from the first quarter of 2000. The decrease reflects a decrease in our sales of vaccine products of $1,797,000, an increase in our diagnostic product sales of $732,000 and a decrease in our instrument product sales of $145,000. The decrease in our vaccine sales is due solely to Intervet's inability to supply us with FeLV vaccine. Our increase in diagnostic sales is primarily due to sales of our poultry diagnostic products which we acquired from KPL in April 2000. Our instrument product sales decreased primarily due to our decision in the fourth quarter of 2000 to scale back our instrument manufacturing operations.

Our cost of sales as a percentage of our net sales was 40% during the first quarter of 2001 compared to 54% during the first quarter of 2000 (i.e., our gross margin increased to 60% from 46%). The higher gross margin is a direct result of three factors:

- the decreased vaccine sales which have historically had low-margins;
- sales of the newly acquired poultry diagnostic products which have significantly higher margins; and
- an offset due to the fact that a significant portion of our manufacturing costs are fixed costs.

Among our major products, our DiroCHEK(R) canine heartworm diagnostic products and the ProChem(R) consumables are manufactured at our facilities, whereas our WITNESS(R), VetRED(R), all vaccines and the SCA 2000(TM) are manufactured by third parties. In addition to affecting our gross margins, outsourcing of manufacturing renders us relatively more dependent on the third-party manufacturers, which risk is currently being realized with Intervet's inability to satisfactorily supply us with FeLV vaccine.

We are currently in the process of transferring the manufacturing of our poultry diagnostic products to our manufacturing facilities in San Diego, and we expect the transfer to be completed by the end of the third quarter of 2001. We believe that our gross margins on these products will improve as we will have more products to absorb our fixed manufacturing costs.

Our research and development expenses during the first quarter of 2001 decreased by $40,000 or 7% from the first quarter of 2000. The decrease is due primarily to the decrease in our instrument research and development effort in conjunction with the scaling back of our instrument manufacturing operations. Our research and development expenses as a percentage of our net sales were 6% during the first quarters of 2001 and 2000.

Our selling and marketing expenses during the first quarter of 2001 decreased by $943,000 or 38% from the first quarter of 2000. The decrease is due primarily to the disposition of W3COMMERCE during the fourth quarter of 2000, the termination of our direct-to-veterinarian telemarketing group during the third quarter of 2000 and a concerted effort to reduce our print media advertising. Our selling and marketing expenses as a percentage of our net sales were 20% and 27% during the first quarter of 2001 and 2000, respectively.

Our general and administrative expenses during the first quarter of 2001 decreased by $129,000 or 7% from the first quarter of 2000. The decrease is due primarily to a decrease in legal expenses related to a decrease in the level of activity of our patent litigation with Heska. Our general and administrative expenses as a percentage of our net sales were 20% and 19% during the first quarter of 2001 and 2000, respectively.

Our net interest expense decreased $38,000 or 11% from the first quarter of 2000 due to a decrease in the prime rate during the first quarter of 2001.

Our effect tax rate was 3% for the first quarter of 2001 and 2000. As of December 31, 2000, we had established a deferred tax asset valuation allowance for all of our U.S. deferred tax assets. During the first quarter of 2001, we realized certain U.S deferred tax assets (primarily net operating loss carryforwards) and we released a corresponding portion of our deferred tax valuation allowance, resulting in no deferred tax expense. In addition, due to our utilization of net operating loss carryforwards, our current tax expense represents alternative minimum taxes.

Financial Condition and Liquidity

We believe that our present capital resources, which included negative working capital of $4,248,000 at March 31, 2001 are insufficient to meet our working capital needs and service our debt for the next twelve months. Additionally, pursuant to our debt agreement with Imperial Bank, we are required to maintain certain financial ratios and levels of tangible net worth and we are also restricted in our ability to make capital expenditures or investments without Imperial Bank's consent. As of March 31, 2001, we had outstanding principal balances on our Imperial Bank debt of $8,132,000. As of March 31, 2001, we were not in compliance with some of our financial covenants, and we had not obtained a waiver from Imperial Bank.

We will need to raise additional capital. We are currently exploring our options which include the sale of our animal health business, a merger or acquisition, debt restructuring, and the sale of additional equity. In addition, we are taking steps to eliminate cash drains; for example, in the fourth quarter of 2000 we divested W3COMMERCE and scaled back our instrument manufacturing operations, and we terminated our direct selling initiative in the third quarter of 2000.

We restructured a $1,000,000 payment due to KPL in conjunction with our April 2000 acquisition of their poultry diagnostic product line by agreeing to $200,000 in April 2001 and to make eight monthly payments of $100,000 beginning in May 2001.

Additionally, the 621,000 shares of our common stock which we issued to Merial in conjunction with the 1997 acquisition of SBIO-E are subject to a put provision. The put option gives Merial the right, beginning on July 9, 2001, to sell all or any portion of its shares to us at a price of $5 per share, for a total of $3,105,000. We would not be required to pay this money as long as we have senior debt outstanding.

Our operations are seasonal due to the success of our canine heartworm diagnostic products. Our sales and profits tend to be concentrated in the first half of the year, as our distributors prepare for the heartworm season by purchasing diagnostic products for resale to veterinarians. The operations of SBIO-E have reduced our seasonality as sales of their large animal diagnostic products tend to occur evenly throughout the year. We believe that increased sales of our SCA 2000 instruments and supplies and our newly acquired poultry diagnostic products would also reduce our seasonality.

Future Operating Results

Our future operating results are subject to a number of factors, including:

We will need additional capital in the near future

We will need to raise additional capital. We are currently exploring our options which include the sale of our animal health business, a merger or acquisition, debt restructuring, and the sale of additional equity.

As of March 31, 2001, we were not in compliance with covenants on $8,132,000 of indebtedness to Imperial Bank (see below). If Imperial Bank declares the loans to be in default, we will be unable to repay the loans. Also, we do not have the resources to repay the loans on their March 29, 2002 maturity date.

We owed $1,000,000 to Kirkegaard & Perry Laboratories, Inc. ("KPL"), in conjunction with our April 2000 acquisition of their poultry diagnostic product line. We have restructured the payment schedule. Under the new schedule we paid $200,000 in April 2001, and we will make eight monthly payments of $100,000 beginning in May 2001.

Additionally, the 621,000 shares of our common stock which we issued to Merial in conjunction with the 1997 acquisition of Synbiotics Europe ("SBIO-E") are subject to a put provision. The put option gives Merial the right, beginning on July 9, 2001, to sell all or any portion of its shares to us at a price of $5 per share, for a total of $3,105,000. We would not be required to pay this money as long as we have senior debt outstanding.

In addition, we believe that we would need additional funds to finance us later in the fiscal year, during our traditional slow season and during the time for building inventory in anticipation of next year's heartworm diagnostics selling season.

We may also need to raise additional funds if our estimates of revenues, working capital and/or capital expenditure requirements change or prove inaccurate or in order for us to respond to unforeseen technological or marketing hurdles or to take advantage of unanticipated opportunities. Further, our future capital requirements will depend on many factors beyond our control or ability to accurately estimate, including continued scientific progress in our product and development programs, the cost of manufacturing scale-up, the costs involved in preparing, filing, prosecuting, maintaining and enforcing patent claims, the cost involved in patent infringement litigation, competing technological and market developments, and the cost of establishing effective sales and marketing arrangements. Such funds may not be available at the time or times needed, or available on terms acceptable to us.

Our independent auditors' report, related to our financial statements as of and for the year ended December 31, 2000, has indicated that they have substantial doubt about our ability to continue as a going concern.

We are not in compliance with our bank loan covenants

As of March 31, 2001, we were not in compliance with some of the financial covenants in our agreement with Imperial Bank, and we have not obtained waivers from the bank. We cannot assure you that we will be in compliance with the covenants in the future. Failure to be in compliance with the covenants places us in technical default of the debt agreement, and Imperial could demand repayment of the loans. We do not have and would not have the funds to repay the loans on short notice.

We may sell our primary business

We have announced that we have engaged investment bankers to consider means of

enhancing shareholder value, including the possible sale of our animal health business. There can be no assurance that our animal health business can be sold for a favorable price, and we have not decided what we would do with the proceeds of any sale. Also, the uncertainties caused by this process may undermine our relationships with our customers, employees and suppliers.

The market in which we operate is intensely competitive, even with regard to our key canine heartworm diagnostic products, and many of our competitors are larger and more established

The market for animal health care products is extremely competitive. Companies in the animal health care market compete to develop new products, to market and manufacture products efficiently, to implement effective research strategies, and to obtain regulatory approval. Our current competitors include significantly larger companies such as Pfizer Animal Health, Merial S.A.S. and IDEXX Laboratories. These companies are substantially larger and have greater financial, manufacturing, marketing, and research resources than we do. In addition, IDEXX Laboratories prohibits its distributors from selling competitors' products, including ours. Further, additional competition could come from new entrants to the animal health care market. We cannot assure you that we will be able to compete successfully in the future or that competition will not harm our business.

Our canine heartworm diagnostic products constitute 47% of our sales for the three months ended March 31, 2000. In addition to our historic competition with IDEXX Laboratories, the sales leader in this product category, our sales were substantially affected in 1999 and 2000 by a new heartworm product from Heska Corporation. We have filed a lawsuit against Heska, claiming that its heartworm product infringes our patent.

We have a history of losses and an accumulated deficit

We did not achieve profitability for the years ended December 31, 1998, 1999 and 2000, and we have had a history of losses. We have incurred a consolidated accumulated deficit of $31,322,000 at March 31, 2001. We may not achieve annual profitability again and if we are profitable in the future there can be no assurance that profitability can be sustained.

We rely on third party distributors for a substantial portion of our sales, but we recently have experienced difficulties with the distribution channel

We have historically depended upon distributors for a large portion of our sales, and our ability to establish and maintain an adequate independent sales and marketing capability in any or all of our targeted markets is unclear. Distributor agreements render our sales exposed to the efforts of third parties who are not employees of Synbiotics and over whom we have no control. Their failure to generate significant sales of our products could materially harm our business. Reduction by these distributors of the quantity of our products which they distribute would materially harm our business. In addition, IDEXX Laboratories' prohibition against its distributors carrying competitors' products, including ours, has made, and could continue to make, some distributors unavailable to us. We adopted a similar policy in the second quarter of 1999, which caused some of our distributors to abandon our product line. We have rescinded this policy, and all but one of our former distributors are again selling our products. We are also exposed to the risk that any sales by us directly to veterinarians could alienate our current distributors.

Our direct selling strategy has been scaled back

We are inexperienced in large-scale direct selling. Also, veterinarians have traditionally relied on distributors, and the number of veterinarians willing to purchase directly from manufacturers is apparently smaller than we once believed. At the end of the third quarter of 2000, we refocused our sales and marketing efforts towards traditional animal health distribution and, as a result, we significantly reduced the headcount of our telesales force. Our 1999 foray toward direct selling to veterinarians, and our subsequent scale-back of that effort, may have created confusion in the market. Some effects of that confusion may persist.

Our profitable vaccine sales in Europe are halted due to a supply problem and in any event may decline soon

Merial distributes our feline leukemia virus ("FeLV") vaccine, which we obtain from Intervet Inc. (formerly Bio-Trends International, Inc.) ("Intervet"), in Europe. Our gross profit in 2000, 1999 and 1998 on these sales of FeLV vaccine to Merial in Europe was $750,000, $570,000 and $520,000, respectively. Merial has exercised a contractual right which will enable it, in 2002, to introduce its own FeLV vaccine product in Europe. If Merial does so, our sales to Merial in Europe would probably decline sharply.

Intervet has been unable to supply us with FeLV vaccine which meets Merial's specifications for European sales since August 2000. As a result, we have been unable to fill Merial's orders for Europe totalling $1,600,000. This is costing us sales and profits, and Merial has sent us a notice of breach.

There is an epidemic of foot-and-mouth disease in the United Kingdom

Foot-and-mouth is a viral based disease that affects cloven-hoofed animals including cows, sheep and pigs. There is currently an epidemic of foot-and-mouth disease in the United Kingdom, with isolated outbreaks in France and the Netherlands. The virus is spread from animal to animal through direct contact, and can be carried through the air as well. There is no cure for this disease, and the only way to prevent the disease from spreading is to isolate and destroy the infected herds. We do not have a diagnostic test for foot-and-mouth disease, as the symptoms that the animal has the disease are readily evident. If the disease were to become significantly more wide spread, and the total number of animals and number of transactions in animals were to decrease, our sales of diagnostic products for bovine and swine diseases (primarily sold outside of the United States), which totalled $4,130,000 and $5,200,000 in 2000 and 1999, respectively, could be adversely affected. In addition, shipments of canine diagnostic products that are made in our French facility that are imported, or will be imported, into the United States (diagnostic tests for canine Leishmania, canine Ehrlichia and canine pregnancy) have been delayed, and may be delayed in the future, as they are subject to regulatory inspection and release at the port of entry.

There is no assurance that acquired businesses can be successfully combined

There can be no assurance that the anticipated benefits of the April 2000 acquisition of the poultry product line from KPL, or any other future acquisitions (collectively, the "Acquired Business") will be realized. Acquisitions of businesses involve numerous risks, including difficulties in the assimilation of the operations, technologies and products of the Acquired Business, introduction of different distribution channels, potentially dilutive issuances of equity and/or increases in leverage and risk resulting from issuances of debt securities, the need to establish internally operating functions which had been previously provided pre-acquisition by a corporate parent, accounting charges, operating companies in different geographic

locations with different cultures, the potential loss of key employees of the Acquired Business, the diversion of management's attention from other business concerns and the risks of entering markets in which we have no or limited direct prior experience. In addition, there can be no assurance that the acquisitions will not have a material adverse effect upon our business, results of operations, financial condition or cash flows, particularly in the quarters immediately following the consummation of the acquisition, due to operational disruptions, unexpected expenses and accounting charges which may be associated with the integration of the Acquired Business and us, as well as operating and development expenses inherent in the Acquired Business itself as opposed to integration of the Acquired Business. We did not achieve the hoped-for benefits from some of our past acquisitions, such as W3COMMERCE (2000) and Prisma (1998).

We depend on key executives and personnel

Our future success will depend, to a significant extent, on the ability of our management to operate effectively, both individually and as a group. Competition for qualified personnel in the animal health care products industry is intense, and we may not be successful in attracting and retaining such personnel. There are only a limited number of persons with the requisite skills to serve in those positions and it may become increasingly difficult to hire such persons. The loss of the services of any of our key personnel or the inability to attract or retain qualified personnel could harm our business.

We depend on third party manufacturers

We contract for the manufacture of some of our products, including our vaccines, our Witness(R) and VetRED(R) diagnostic products, our poultry diagnostic products and our SCA 2000(TM) blood coagulation timing instrument. We also expect that some of our anticipated new products will be manufactured by third parties. In addition, some of the products manufactured for us by third parties, including Witness(R) and VetRED(R), are licensed to us by their manufacturers. There are a number of risks associated with our dependence on third-party manufacturers including:

- reduced control over delivery schedules;
- quality assurance;
- manufacturing yields and costs;
- the potential lack of adequate capacity during periods of excess demand;
- limited warranties on products supplied to us; and
- increases in prices and the potential misappropriation of our intellectual property.

If our third party manufacturers fail to supply us with an adequate number of finished products, our business would be significantly harmed. We have no long-term contracts or arrangements with any of our vendors that guarantee product availability, the continuation of particular payment terms or the extension of credit limits.

In addition, sales of our FeLV vaccine to Merial and other distributors for resale in Europe will be at risk unless our manufacturer, Intervet Inc. (formerly Bio-Trends International, Inc.) obtains European Union regulatory approvals for its manufacturing facilities which make this product. Aside from this regulatory issue, Intervet has been unable to supply us with satisfactory FeLV vaccine for delivery to Merial in Europe, as noted above.

If we encounter delays or difficulties in our relationships with our manufacturers, the resulting problems could have a material adverse effect on us.

We rely on new and recent products

We rely to a significant extent on new and recently developed products, and expect that we will need to continue to introduce new products to be successful in the future. There can be no assurance that we will obtain and maintain market acceptance of our products. There can be no assurance that future products will meet applicable regulatory standards, be capable of being produced in commercial quantities at acceptable cost or be successfully commercialized.

There can be no assurance that new products can be manufactured at a cost or in quantities necessary to make them commercially viable. If we are unable to produce internally, or to contract for, a sufficient supply of our new products on acceptable terms, or if we should encounter delays or difficulties in our relationships with manufacturers, the introduction of new products would be delayed, which could have a material adverse effect on our business.

Our canine heartworm business is seasonal

Our operations are seasonal due to the timing of sales of our canine heartworm diagnostic products. Our sales and profits tend to be concentrated in the first half of the year as our distributors prepare for the heartworm season by purchasing diagnostic products for resale to veterinarians. Our European operations have reduced our seasonality as sales of their large animal diagnostic products tend to occur evenly throughout the year. We believe that increased sales of our SCA 2000 instrument products and our newly acquired poultry diagnostic products will also reduce our seasonality.

Any failure to adequately establish or protect our proprietary rights may adversely affect us

We rely on a combination of patent, copyright, and trademark laws, trade secrets, and confidentiality and other contractual provisions to protect our proprietary rights. These measures afford only limited protection. We currently have 11 issued U.S. patents and two pending patent applications. Our means of protecting our proprietary rights in the U.S. or abroad may not be adequate and competitors may independently develop similar technologies. Our future success will depend in part on our ability to protect our proprietary rights and the technologies used in our principal products. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or to obtain and use trade secrets or other information that we regard as proprietary. In addition, the laws of some foreign countries do not protect our proprietary rights as fully as do the laws of the United States. Issued patents may not preserve our proprietary position. Even if they do, competitors or others may develop technologies similar to or superior to our own. If we do not enforce and protect our intellectual property, our business will be harmed. From time to time, third parties, including our competitors, have asserted patent, copyright, and other intellectual property rights to technologies that are important to us. We expect that we will increasingly be subject to infringement claims as the number of products and competitors in the animal health care market increases.

The results of any litigated matter are inherently uncertain. In the event of an adverse result in any litigation with third parties that could arise in the future, we could be required to:

- pay substantial damages, including treble damages if we are held to have

willfully infringed;

- cease the manufacture, use and sale of infringing products;
- expend significant resources to develop non-infringing technology; or
- obtain licenses to the infringing technology.

Licenses may not be available from any third party that asserts intellectual property claims against us on commercially reasonable terms, or at all.

Also, litigation is costly regardless of its outcome and can require significant management attention. For example, in 1997, Barnes-Jewish Hospital (the "Hospital") filed an action against us claiming that our canine heartworm diagnostic products infringe

their patent. We settled this lawsuit, but there can be no assurance that we would be able to resolve similar incidents in the future. Our patent infringement litigation against Heska's use of heartworm diagnostic technology is also expensive.

Also, because our patents and patent applications cover novel diagnostic approaches,

- the patent coverage which we receive could be significantly narrower than the patent coverage we seek in our patent applications; and
- our patent positions involve complex legal and factual issues which can be hard for patent examiners or lawyers asserting patent coverage to successfully resolve .

Because of this, our patent position could be vulnerable and our business could be materially harmed.

The U.S. patent application system also exposes us to risks. In the United States, the first party to make a discovery is granted the right to patent it and patent applications are maintained in secrecy until the underlying patents issue. For these reasons, we can never know if we are the first to discover particular technologies. Therefore, we can never be certain that our technologies will be patented and we could become involved in lengthy, expensive, and distracting disputes concerning whether we were the first to make the disputed discovery. Any of these events would materially harm our business.

Our business is regulated by the United States and various foreign governments

Our business is subject to substantial regulation by the United States government, most notably the United States Department of Agriculture, and the French government. In addition, our operations may be subject to future legislation and/or rules issued by domestic or foreign governmental agencies with regulatory authority relating to our business. There can be no assurance that we will continue to be in compliance with any of these regulations.

For marketing outside the United States, we and our suppliers are subject to foreign regulatory requirements, which vary widely from country to country. There can be no assurance that we and our suppliers will meet and sustain compliance with any such requirements. In particular, our sales of FeLV vaccine to Merial or other distributors for resale in Europe will be at risk unless Intervet, our supplier, obtains European Union regulatory approvals for its manufacturing facilities which make this product.

We use hazardous materials

Our business requires that we store and use hazardous materials and chemicals, including radioactive compounds. Although we believe that our procedures for storing, handling, and disposing of these materials comply with the standards prescribed by local, state, and federal regulations, the risk of accidental contamination or injury from these materials cannot be completely eliminated. If any of these materials were mishandled, or if an accident with them occurred, the consequences could be extremely damaging and we could be held liable for them. Our liability for such an event would materially harm our business and could exceed all of our available resources for satisfying it.

Item 3 - Quantitative and Qualitative Disclosures About Market Risk

Our market risk consists primarily of the potential for changes in interest rates and foreign currency exchange rates.

Interest Rate Risk

The fair value of our debt at March 31, 2001 was approximately $8,132,000, which has a variable interest rate based on the prime rate.

A change in interest rates of five percentage points would have a material impact on our financial condition, results of operations and cash flows as it relates to our variable rate debt.

Foreign Currency Exchange Rate Risk

Our foreign currency exchange rate risk relates to the operations of SBIO-E as it transacts business in Euros, its local currency. However, this risk is limited to our intercompany receivable from SBIO-E and the conversion of its financial statements into the U.S. dollar for consolidation. There is no foreign currency exchange rate risk related to SBIO-E's transactions outside of the European Union as those transactions are denominated in Euros. Similarly, all of the foreign transactions of our U.S. operations are denominated in U.S. dollars. We do not hedge our cash flows on intercompany transactions, nor do we hold any other derivative securities or hedging instruments based on currency exchange rates. As a result, the effects of a 5% change in exchange rates would have a material impact on our financial condition, results of operations and cash flows, but only to the extent that it relates to the conversion of SBIO-E's financial statements, including its intercompany payable to us, into the U.S. dollar for consolidation.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

No material changes.

Item 2. Changes in Securities and Use of Proceeds

On January 1, 2001, in conjunction with the disposition of 84% of our investment in W3COMMERCE, and the elimination of a $2,813,000 convertible note payable which we had issued to the original owners of W3COMMERCE when we acquired it, we

issued 250,000 shares of our common stock to those original owners. This was a Section 3(a)(9) exchange with existing security holders, involving no underwriters. In this transaction, we also forgave $1,913,000 of intercompany loans which we had made to W3COMMERCE.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

On April 2, 2001, we announced that Kenneth M. Cohen had resigned as President, Chief Executive Officer and Director, and that Paul A. Rosinack had been named as President, Chief Executive Officer and a member of the Board of Directors. In addition, we announced that Rigdon Currie had replaced Donald E. Phillips as Chairman of the Board of Directors.

On April 11, 2001, we announced that on April 4, 2001 we received notification from Nasdaq that our common stock was subject to delisting from the Nasdaq National Market for failure to comply with Marketplace Rule 4450(a)(5), requiring maintenance of a minimum bid price of $1 per share. We also announced that we had filed a appeal with Nasdaq to rescind its decision to delist our common stock.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

10.34.1	Renewal and Amendment of Lease of Premises located at 16420 Via Esprillo, San Diego, California, dated as of November 1, 2000.
99.1	Press release dated April 2, 2001 entitled "Synbiotics Names New Management".
99.2	Press release dated April 11, 2001 entitled "Synbiotics Corporation Receives Nasdaq Notification - Company files Request for Hearing on Nasdaq Decision; Delisting Action Halted Pending Panel Decision on Appeal".

(b) Reports on Form 8-K

None.

SIGNATURES

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

SYNBIOTICS CORPORATION

Date: May 4, 2001 /s/ Michael K. Green

Michael K. Green
Senior Vice President and Chief Financial Officer
(signing both as a duly authorized officer and as principal financial officer)

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C.

EXHIBITS

TO

FORM 10-Q

UNDER

SECURITIES EXCHANGE ACT OF 1934

SYNBIOTICS CORPORATION

EXHIBIT INDEX

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