SYNBIOTICS CORP
Form DEF 14A
September 27, 2005
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

**SCHEDULE 14A**

**Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934**

Filed by the Registrant x

Filed by a Party other than the Registrant ¨

Check the appropriate box:

¨ Preliminary Proxy Statement
¨ **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
x Definitive Proxy Statement
¨ Definitive Additional Materials
¨ Soliciting Material Pursuant to §240.14a-12

# SYNBIOTICS CORPORATION

**(Name of Registrant as Specified In Its Charter)**

**(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)**

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x No fee required.
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1) Title of each class of securities to which transaction applies:

2) Aggregate number of securities to which transaction applies:

3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11:

4) Proposed maximum aggregate value of transaction:

5) Total fee paid:

¨ Fee paid previously with preliminary materials.

¨ Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

1) Amount Previously Paid:

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# SYNBIOTICS CORPORATION

## PROXY STATEMENT

## WRITTEN CONSENT SOLICITATION OF SHAREHOLDERS

**September 30, 2005**

## INTRODUCTION

These proxy materials and the enclosed consent are being mailed in connection with the solicitation of written consents by the board of directors of Synbiotics Corporation, a California corporation (the Company ). The mailing address of our principal executive offices is 11011 Via Frontera, San Diego, California 92127.

Shareholders are being asked to consider and vote upon two proposals to amend our Articles of Incorporation, as amended. The first is to effect a reverse split of our outstanding common stock pursuant to which each 2,000 outstanding shares of common stock will be combined into one whole share and, in lieu of us issuing any fractional shares resulting from the combination, we will pay $0.13 cash for each pre-reverse split share traceable to a fractional share (the Reverse Split ). The second proposal is to effect a 2,000-for-1 forward split of the resulting whole shares of common stock (the Forward Split ), contingent upon, and effective after completion of, the Reverse Split.

If the Reverse Split and the Forward Split (together, the Split Transaction ) are approved as described below, holders of less than 2,000 shares of common stock immediately before the Reverse Split no longer will be shareholders of the Company, and will be entitled only to receive payment of $0.13 per share of common stock held immediately before the Reverse Split ( Pre-Split Shares ). Shareholders holding 2,000 or more Pre-Split Shares will remain shareholders of the Company, but any fractional shares indicated for them in the Reverse Split will also be cashed out. As a result of the reverse split and a contemplated private financing, we expect that the continuing shareholders percentage interest in the Company will remain approximately the same as before the Split Transaction, except for an increase in the percentage ownership of Redwood Holdings, LLC and its affiliates. We intend to terminate our registration and further reporting obligations under the Securities Exchange Act of 1934, as amended (the 1934 Act ), as soon as possible following the Split Transaction.

Our board of directors has considered, and recommends that our shareholders approve, the Split Transaction and the related transactions. None of the directors recommending the Split Transaction are independent, as we currently do not have any independent directors. The fairness of the

Split Transaction to our unaffiliated shareholders has not been opined upon by any financial advisor or other third party. Because our controlling shareholder Redwood West Coast, LLC and its affiliates control a significant amount of our voting capital stock and will continue to be shareholders of the Company following the Split Transaction, their interests in the transaction will be different from the interests of our unaffiliated shareholders in the Split Transaction. Following the Split Transaction, Redwood West Coast, LLC and its affiliates will not only maintain control of the Company, but will have a controlling interest in a privately held company that is no longer subject to the federal periodic reporting and other requirements applicable to publicly held companies. Two of our directors, Thomas A. Donelan and Christopher P. Hendy, are affiliates of Redwood Holdings, LLC, which is affiliated with Redwood West Coast, LLC. In order to finance the Split Transaction, Redwood Holdings, LLC will purchase

shares of Series C preferred stock to be newly issued by the Company, thereby increasing its percentage

ownership of the Company following the Split Transaction. Our other director, Paul R. Hays, currently is and will remain our President and Chief Executive Officer following the Split Transaction.

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Our board of directors has fixed July 29, 2005, as the record date for determining the shareholders entitled to give consents. At the close of business on the record date, we had 33,822,033 shares of common stock outstanding and entitled to vote, and 1,531 shares of Series C preferred stock outstanding and entitled to vote.

Any shareholder executing a consent has the power to revoke it at any time before October 28, 2005 (or if earlier, the date on which at least the minimum number of shares have consented in order to approve the Split Transaction) by delivering written notice of such revocation to our Secretary at our offices.

We will pay the expenses of soliciting consents, including the charges and expenses of brokerage firms and others for forwarding solicitation material to beneficial owners of shares. In addition to the use of the mails, some of our directors, officers and regular employees, without extra compensation, may solicit consents by telephone, fax, e-mail and in person.

These proxy materials will be first mailed to shareholders of record beginning on approximately September 30, 2005.

Consents are to be submitted by no later than October 28, 2005 to our consent tabulator, Mellon Investor Services LLC, at Mellon Investor Services, Proxy Processing, PO Box 3510, S. Hackensack, New Jersey 07606-9210.

Our Annual Report on Form 10-K for the year ended December 31, 2004 is included as Exhibit A to this proxy statement, our Quarterly Report on Form 10-Q for the quarter ended June 30, 2005 is included as Exhibit B to this proxy statement, and our Current Report on Form 8-K filed on August 31, 2005 is included as Exhibit F to this proxy statement. The exhibits to the Form 10-K, Form 10-Q and Form 8-K are not included, but they can be viewed on EDGAR at www.sec.gov or, if you request us in writing, we will send copies of them to you free of charge.

Approval of each of the proposals described in this proxy statement requires the affirmative vote of the holders of the majority of the outstanding shares of common stock (voting as a separate class), the affirmative vote of the holders of the majority of the outstanding shares of Series C preferred stock (voting as a separate class), and also the affirmative vote of the holders of the majority of the voting power of all stock entitled to vote. Abstentions (including failures to return consents) and broker nonvotes have the same effect as negative votes. In determining whether the holders of the majority of the voting power of all stock entitled to vote have approved, the shares of Series C preferred stock are entitled to 7,784.52 votes each.

Our board of directors, executive officers and other affiliates of our major shareholder Redwood West Coast, LLC, beneficially own approximately 49.7% of the outstanding shares of our common stock and 93.5% of the outstanding shares of our Series C preferred stock. If all such shares are voted for the Split Transaction, an additional affirmative vote of only 115,972 shares, or 0.3%, of the outstanding common stock will be required in order for the Split Transaction to be approved.

## SUMMARY TERM SHEET

This summary highlights the material information about the Split Transaction and the related transactions. You should read this entire proxy statement and its exhibits before deciding whether to sign and return your consent.

The following summary briefly describes the material terms of the Split Transaction. The proxy statement contains a more detailed description of such terms.

If the Split Transaction is completed, our board of directors has determined that in lieu of issuing any fractional shares resulting from the Reverse Split, we will make a cash payment of $0.13 per Pre-Split

Share traceable to a fractional share. Accordingly, if the Reverse Split is completed, shareholders with less than 2,000 Pre-Split Shares will have no further interest in the Company and will become entitled only to payment for their Pre-Split Shares. Also, even for holders of at least one whole share as of immediately after the Reverse Split, we will not issue any fractional shares in the Reverse Split, but instead will pay cash in lieu of fractional shares at the rate of $0.13 for each Pre-Split Share. We expect to pay approximately $137,000 in the aggregate, and no shareholder with a single account could receive more than $259.87 as a result of the payout for their Pre-Split Shares. After the Reverse Split is completed and we identify those shareholders entitled to payment for their Pre- Split Shares, we will effect the Forward Split such that each post-Reverse Split whole share of common stock will be converted into 2,000 shares of common stock after the Forward Split. Shareholders who hold a number of Pre-Split Shares that is exactly divisible by 2,000 will after the Split Transaction have the same number of shares of common stock as before the Split Transaction. Other shareholders, who held at least 2,000 Pre-Split Shares, will have after the Split Transaction slightly fewer shares of common stock than before the Split Transaction. For example, a holder of 20,500 Pre-Split Shares would, after the Split Transaction, have 20,000 shares of common stock and be entitled to $65.00 cash (see Special Factors Structure of the Split Transaction beginning on page 11).

The primary practical effect of the Split Transaction will be to reduce the number of shareholders of record to less than 300, thereby allowing us to elect to deregister our common stock and our poison pill preferred stock purchase rights under the 1934 Act and go private, which we would then promptly do (see Special Factors Effect of the Split Transaction on the Company beginning on page 12).

All of the members of our board of directors and our controlling shareholder, Redwood West Coast, LLC and its affiliates, Redwood Holdings, LLC, Remington Capital, LLC and Jerry L. Ruyan (collectively, the Affiliates ), believe that the Split Transaction is fair, both procedurally and substantively, to the Company and its unaffiliated shareholders, including both those who will be cashed out in the Split Transaction and those will remain shareholders of the Company. Our board of directors and each of the Affiliates have determined that the Split Transaction, including the payment of $0.13 in cash in lieu of any fractional shares resulting from the Reverse Split, is advisable and in the best interests of the Company and its unaffiliated shareholders. Our board of directors and each of the Affiliates believe that the Company s value will increase in the future and therefore did not consider a sale of the Company at this time, but recognize that not all shareholders may currently share this belief. Shareholders who do not share this belief may, to the extent they currently hold 2,000 or more shares of our common stock, sell shares in the open market prior to the Split Transaction so as to reduce their holdings below 2,000 shares and have their remaining interest in the Company cashed out at a premium over the current market value. Our board of directors recommends that you vote FOR both proposals in connection with the Split Transaction (see Special Factors Factors Considered by the Board of Directors and the Affiliates beginning on page 7, Proposal No. 1 Recommendation of the Board of Directors beginning on page 19 and Proposal No. 2 Recommendation of the Board of Directors beginning on page 19).

Our board of directors did not retain any advisors to render an opinion as to the fairness, from a financial point of view, to our shareholders of the consideration to be received by them in connection with the transaction. Our board of directors and each of the Affiliates based their determination of the fairness of the cash-out price on a comparison of the cash-out price against the market price for our common stock. The cash-out price of $0.13 per share represents a 30% premium over $0.10, the average closing price for our common stock for the 30 trading days ending on April 18, 2005, the day before the announcement of the Split Transaction. Our board of directors and each of the Affiliates believes that the cash-out price adequately reflects their consideration of the relative costs and benefits of being cashed out versus remaining a shareholder of the Company, and did not perform any quantitative analysis other than a comparison of the cash-out price against market price in reaching its decision to set the cash-out price at $0.13 (see Special Factors Factors Considered by the Board of

Directors and the Affiliates beginning on page 7 and No Opinion of Financial Advisor beginning on page 14).

Each of the proposals requires the affirmative vote of a majority of the outstanding common stock, the affirmative vote of a majority of the outstanding preferred stock and also the affirmative vote of the holders of the majority of the voting power of all stock entitled to vote. Even if both proposals are approved, the board of directors may, in its discretion, abandon the Split Transaction (see Proposal No. 1 Vote Required beginning on page 19, Proposal No. 2 Vote Required beginning on page 19 and Special Factors Factors Considered by the Board of Directors and the Affiliates beginning on page 7).

All of our directors and the Affiliates have interests in the Split Transaction that may potentially be different from the interests of our unaffiliated shareholders. The Affiliates own 48.5% of our outstanding common stock, and, along with our directors and officers, control 49.7% of our outstanding common stock. The Affiliates also own 86.9% of our outstanding preferred stock, and, along with our directors and officers, control 93.5% of our outstanding preferred stock. Following the completion of the Split Transaction, each of our remaining shareholders, including affiliates and members of management owning common shares, will own a slightly increased or slightly decreased (depending upon the size of the indicated fraction of a share post-Reverse Split) percentage of the outstanding common stock and a slightly decreased percentage of the fully-diluted common stock (except that Redwood Holdings, LLC, which will be buying new shares of Series C preferred stock from us to finance the cash payments to the holders of post-Reverse Split fractional shares, will have an increase in its percentage of fully-diluted common stock). Our directors and the Affiliates will not only maintain their controlling interest in the Company after the Split Transaction, but will have control over a privately held company that is not subject to the federal periodic reporting and other requirements applicable to public companies. We do not anticipate any changes in the Company s board of directors or management following the Split Transaction (see Security Ownership of Certain Beneficial Owners and Management beginning on page 23, Other Issues Related to the Split Transaction Conduct of the Company s Business After the Split Transaction beginning on page 20 and Other Issues Related to the Split Transaction Source of Funds and Financial Effect of the Split Transaction beginning on page 19).

Under California law, our shareholders are not entitled to dissenter s or appraisal rights with respect to the Split Transaction (see Other Issues Related to the Split Transaction Dissenters Rights beginning on page 22).

Under state escheat laws, any payment for fractional interests not claimed by the shareholder entitled to such payment may be claimed by various states (see Other Issues Related to the Split Transaction Escheat Laws beginning on page 21).

Any receipt of cash in the Split Transaction by shareholders holding Pre-Split Shares will be a taxable transaction in the same way as if they sold their shares in the market for $0.13 per share (see Special Factors Material Federal Income Tax Consequences beginning on page 14).

If the Split Transaction is approved by our shareholders, each shareholder holding fewer than 2,000 Pre-Split Shares or holding a number of Pre-Split Shares not exactly divisible by 2,000 will receive a letter from our exchange agent following the effective date of the Split Transaction. This letter will indicate the procedures to be followed for surrendering your stock certificates (see Other Issues Related to the Split Transaction Exchange of Stock Certificates beginning on page 21). All other shareholders will continue to hold their current share certificates.

There are risks associated with the Split Transaction, including risks associated with remaining a shareholder following the Split Transaction, such as the lack of liquidity for shares of a privately held company, the loss of the informational benefits of the 1934 Act and the operation risks of maintaining an investment in the Company; as well as risks associated with being cashed out in the Split Transaction, such as loss of the opportunity to participate in the Company s future growth and the

possibility that the fair value of the shares may exceed the cash-out price (see Risk Factors beginning on page 15).

## SPECIAL FACTORS

### *Background*

In the fourth quarter of 2004, our board of directors began to evaluate the costs and expenses to the Company associated with maintaining compliance with public reporting obligations and corporate governance standards in light of the new requirements imposed on public companies under the Sarbanes-Oxley Act of 2002. The board noted that, in addition to incurring substantial financial costs, management s time and attention would be diverted from the other operations of the Company during 2005 and 2006 in order to bring the Company into compliance with the internal control requirements under Section 404 of the Sarbanes-Oxley Act, which would first become applicable to the Company for fiscal 2006.

On January 7, 2005, our board of directors discussed whether, in light of the costs and related burdens of being a public company in the current market, remaining a public company was in the best interests of the Company and its shareholders. As a result, on April 5, 2005, our board of directors adopted a resolution to solicit shareholder approval, via written consent, of the Split Transaction. On April 19, 2005, our board of directors adopted resolutions to: 1) authorize amendments to our Articles of Incorporation to effect the Split Transaction; and 2) authorize a Series C purchase agreement whereby, to finance the cash-out of any fractional shares resulting from the Reverse Split, Redwood Holdings, LLC, upon approval of the Split Transaction by the shareholders, will purchase 180 shares of Series C preferred stock for $180,000 in cash.

To the extent that two of our directors, Thomas A. Donelan and Christopher P. Hendy, are affiliated with and were designated as representatives of Redwood West Coast, LLC on the board, Redwood West Coast, LLC and the other Affiliates participated in the board s decision to authorize the Split Transaction, as well as the financing of the Split Transaction by Redwood Holdings, LLC.

We have approximately 568 shareholders of record. Many of our shareholders hold a small number of shares.

As of July 29, 2005, approximately 508 shareholders of record of our common stock owned fewer than 2,000 shares. At that time, these shareholders represented approximately 89.4% of the total number of shareholders of record of our common stock, but these accounts represented approximately only 0.3% of the total number of outstanding shares of our common stock. Also at that time, shareholders not of record but beneficially owning fewer than 2,000 shares represented 1,393, or approximately 74.5%, of our 1,871 street name shareholders, but these accounts represented approximately only 1.9% of the total number of outstanding shares of common stock.

### *Effect of the Split Transaction on the Affiliates*

The Affiliates, and our executive officers and directors, will participate in the Split Transaction to the same extent as our unaffiliated shareholders. All of the Affiliates currently own sufficient shares of common stock (over 2,000 each) or Series C preferred stock so that they will continue to be shareholders after the effectiveness of the Split Transaction. Accordingly, the ownership of the Company following the Split Transaction will be concentrated in our directors and the Affiliates while the Company will no longer be subject to the current federal public reporting scheme and other federal securities laws that apply to public companies. As with all other remaining shareholders, the percentage

ownership by the Affiliates of the total outstanding common shares after the Split Transaction may increase slightly or decrease slightly, depending on the size of the indicated fractional share. In addition, Redwood Holdings, LLC will purchase 180 shares of Series C preferred stock for $180,000

cash in order to finance the Split Transaction. This will increase the Affiliates percentage ownership of our common stock, on a beneficial ownership basis, by about 2 percentage points each (from 58.8% to 60.5%).

The Split Transaction will have no effect on the rights or preferences of the outstanding Series C preferred stock, nor on any of our stock options or warrants outstanding.

***Purpose of the Split Transaction***

The purpose behind the Split Transaction is to reduce our number of shareholders of record to below 300. This, in turn, will enable us under the applicable legal standards to elect to deregister our securities under the 1934 Act, thereby going private. We would deregister as soon as possible, in order to (i) eliminate the costs associated with preparing and filing documents under the 1934 Act with the U.S. Securities and Exchange Commission ( SEC ), (ii) eliminate or reduce the costs and other burdens associated with being a 1934 Act registrant, including the costs of complying with Section 404 of the Sarbanes-Oxley Act of 2002 as to internal control over financial reporting, (iii) avoid the requirement of regular mandatory disclosure of our financial information and management analyses, to the public but also to our competitors and commercial counterparties, even when such disclosure would be adverse to a Company objective, (iv) reduce the costs of administering shareholder accounts and responding to shareholder requests, (v) provide liquidity to shareholders holding less than 2,000 Pre-Split Shares of common stock, and (vi) provide greater flexibility in the management and governance of the Company.

***Reasons for the Split Transaction***

We expect to benefit from substantial cost savings as a result of the Split Transaction and going private, primarily from avoiding various 1934 Act compliance costs but also simply from reducing the number of shareholder accounts.

The new legal requirements imposed on public companies under Section 404 of the Sarbanes-Oxley Act, including requirements relating to our system of internal controls, add to the administrative burden and costs of being a public company. Our management does not believe that we can prudently pay the expense of complying with these legal requirements. The expenses associated with implementing the additional processes and procedures necessary for compliance with Section 404, which was originally to take effect for our fiscal year 2005 but has now been delayed by the SEC until our fiscal year 2006, and the required attestation of those controls have been estimated to be equal to the entire $95,000 cost of the fiscal 2004 year-end audit. Moreover, compliance with Section 404 would inevitably result in a diversion of management time and attention from other duties. Accordingly, we are undertaking to effect the Split Transaction at this time so that we may go private and avoid becoming subject to the additional requirements of Section 404 before they become applicable to us. We believe that this will spare us from significant expenses that we would otherwise incur in 2005 and 2006 to comply with these requirements.

In addition to the account administration cost reductions which would result directly from the Split Transaction, if we go private we believe we would save approximately $60,000 per year in other costs associated with public filings, including legal and accounting fees associated with filing directly attributable to the public filings.

We would also expect reductions in other administrative costs associated with being a public company, including directors and officers insurance, EDGAR preparation and filing costs and investor relations expenses, of at least $42,000.

The cost of administering each record or beneficial shareholder s account is the same regardless of the number of shares held in that account. Therefore, our costs to maintain such small accounts are disproportionately high when compared to the total number of shares involved. In 2005, assuming that the Split

Transaction does not occur, we expect to incur costs of approximately $20.00 per record shareholder for transfer agent and other administrative fees, as well as printing and postage costs associated with the delivery of proxy materials and the annual report required to be distributed to shareholders under the 1934 Act. In addition, in 2005, assuming that the Split Transaction does not occur, we expect to incur costs of approximately $25.00 for each shareholder holding shares in street name through a nominee (i.e., a bank or broker). These fees are in connection with the administrative fees, as well as printing and postage costs associated with the delivery of proxy materials and the annual report. We expect these costs to increase over time in the absence of the Split Transaction.

We expect that we will reduce the total cost of administering record shareholder accounts by at least $10,000 per year if we complete the Split Transaction. Furthermore, we expect that we will reduce the total cost of administering street name shareholder accounts by at least $35,000 per year if we complete the Split Transaction, for a total administrative cost savings of $45,000 per year. In light of these disproportionate costs, the board of directors believes that it is in the best interests of the Company and our shareholders as a whole to eliminate the administrative burden and costs associated with such small accounts and such public filings.

We are aware that these estimates of the costs of being a 1934 Act public company are lower than those presented by many other public companies and experts. If we have underestimated these costs, our savings from the Split Transaction and from going private would be even greater.

In addition, although 1934 Act disclosure requirements currently ensure that we provide information about us that the investing public finds useful, the same information is often useful to our competitors and to parties negotiating contracts with us. Going private would enable us to shut off a flow of information that our business adversaries can use against us.

Moreover, the Split Transaction will provide shareholders with fewer than 2,000 Pre-Split Shares with an efficient way to cash out their investment in the Company because we will pay all transaction costs such as brokerage fees in connection with the Split Transaction. Otherwise, shareholders with small holdings would likely incur brokerage fees that are disproportionately high relative to the market value, based on the $0.07 closing price as of April 18, 2005, of their shares if they wanted to sell their stock. The Split Transaction will eliminate these problems for most shareholders with small holdings.

***Factors Considered by the Board of Directors and the Affiliates***

Our board of directors, in the course of reaching its decision to recommend to the shareholders the approval of the Split Transaction, and each of the Affiliates considered the following factors favoring the Split Transaction:

- anticipated reductions in the expenses of compliance with the reporting, proxy statement disclosure and internal controls compliance requirements of U.S. securities laws and the associated drain on management time and attention;

- anticipated reductions in operating expenses associated with administering a large number of shareholder accounts;

- the value being paid to cash-out any fractional shares resulting from the Reverse Spit is higher than the market value, based on the $0.07 closing price, and higher than the $0.08 per share book value, of the common stock on April 18, 2005, which is prior to announcement of the Split Transaction, and also higher than the $0.10 average closing price for the 30 trading days ending on

April 18, 2005;

the value being paid to cash-out any fractional shares resulting from the Reverse Split is higher than the $0.12846 per share, on a converted basis, we received for the sale of our Series C preferred stock, which is convertible into unregistered shares of our common stock, in September 2004 in conjunction with our debt restructuring;

the ability of smaller shareholders to receive cash for their shares without being burdened by disproportionately high service fees or brokerage commissions; and

the ability of shareholders wishing to remain shareholders to purchase sufficient shares in advance of the Effective Date to cause them to own more than 2,000 Pre-Split Shares.

The board of directors and each of the Affiliates also considered the following potential adverse factors of the Split Transaction:

following the Split Transaction, the shareholders of less than 2,000 Pre-Split Shares before the Reverse Split will cease to hold any equity interest in the Company and will lose their ability to participate in the future growth of the Company, if any, or benefit from increases, if any, in the value of the Company. This factor is somewhat mitigated by the fact that these shareholders may purchase shares of our common stock before the Effective Date to get over the 2,000 share threshold and avoid being cashed out;

following the Split Transaction, other shareholders whose fractional shares are cashed out in the Reverse Split will, to that extent, lose their ability to benefit from any future increases in shareholder value;

the market for Company stock will become extremely illiquid or even non-existent after the Split Transaction; and

the payment for fractional shares, which cannot exceed $259.87 for any single account, is a taxable transaction for shareholders. This factor is somewhat mitigated by the fact that for many cashed-out shareholders the transaction will result in recognition of a capital loss.

The board of directors and each of the Affiliates considered the following alternative transactions to accomplish the reduction in the number of shareholders to fewer than 300 holders of record and then go private, but ultimately determined the Split Transaction was the preferred method:

(a) A cash tender offer The board of directors and each of the Affiliates believed a cash tender offer would not result in shares being tendered by a sufficient number of record shareholders so as to accomplish the going private objective. It was thought unlikely that many holders of small numbers of shares would make the effort to tender their shares of common stock and the cost of mounting and completing the tender offer could be significant in relation to the value of the shares of common stock sought to be purchased. Additionally, there is the risk that holders of greater than 2,000 shares would tender their shares, thereby causing us to expend significant amounts of cash but not reducing the number of shareholders to less than 300; and

(b) A purchase of shares in the open market The trading market for the common stock is not particularly active; therefore, it would be highly unlikely that shares of common stock could be acquired by us from a sufficient number of record holders to accomplish the board of directors objectives. This is especially so because there is no reason to believe that many record holders of fewer than 2,000 shares would be looking to sell their shares in response to open-market bids. Moreover, such a program could be construed as an issuer self-tender offer, resulting in regulatory compliance costs.

Our board of directors and each of the Affiliates are not aware of any firm offers made by any non-affiliate of the Company for the merger or consolidation of the Company with or into another company, the sale or transfer of all or a substantial portion of the Company s assets or the acquisition of a controlling interest in the company against which the cash-out price can be compared. In addition, our board of directors and each of the Affiliates did not consider a sale of the Company, to non-affiliates or otherwise, as an alternative to the Split Transaction because they believe that a sale of the Company at this time would result in a lower consideration per share to our shareholders than the cash-out price of $0.13 per share. Our board of directors and each of the Affiliates also believe that the value of the Company will increase, and that, accordingly, a sale of the Company in the future will result in a higher price paid to shareholders than would a sale of the Company at this time. Our

board of directors and each of the Affiliates recognize, however, that certain shareholders may not share the belief that the value of the Company will increase in the future, or they may not wish to hold their investment in the Company for as long as it will take for the value of the Company to see a sufficient increase. Such shareholders may, to the extent they currently hold 2,000 or more shares of our common stock, sell shares in the open market prior to the Split Transaction so as to reduce their holdings below 2,000 shares and have their remaining interest in the Company cashed out at a premium over the current market value, without having to wait for a liquidity event in the form of a sale of the Company.

Our board of directors and each of the Affiliates did not consider whether the $0.13 cash-out price is higher than the going-concern value or liquidation value, because any amounts received upon a liquidation of the Company would be paid first to our secured creditors, then to our unsecured creditors, then to holders of our preferred stock and then to the holders of our common stock; the board of directors and each of the Affiliates believe that if the Company were to be liquidated at this time, the proceeds would be insufficient to satisfy all of our obligations to secured creditors and unsecured creditors and the holders of our preferred stock.

We did not retain any outside party to provide a report and opinion relating to the fairness of the consideration to be paid to unaffiliated shareholders holding fewer than 2,000 Pre-Split Shares and other fractional shares resulting from the Reverse Split in any one account and the fairness of the Split Transaction to the Company and its remaining shareholders. We chose not to retain an outside party to make such determinations as to the fairness of the Split Transaction because we did not feel that it would be an effective use of our resources to incur the expenses of a financial advisor. Based on a recent analysis of the distribution of our shareholders, the Split Transaction would result in the cash-out of about 1,057,000 Pre-Split Shares of common stock at $0.13 per share, for a total cash-out amount of approximately $137,000. However, because holders can continue to buy and sell shares through the effective date of the Split Transaction, this figure might change. No single account can receive more than $259.87 in payment for its Pre-Split Shares of common stock because the maximum number of shares that can be cashed out of any single account is 1,999. No independent committee of the board of directors has reviewed or approved the fairness of the Split Transaction. No unaffiliated representative acting solely on behalf of the unaffiliated shareholders for the purpose of negotiating the terms of the Split Transaction or preparing a report concerning the fairness of the Split Transaction was retained by us or by our unaffiliated directors (indeed, we do not even have any unaffiliated directors). In spite of the absence of a fairness opinion from a third party and an unaffiliated representative acting solely on behalf of the unaffiliated shareholders, we believe that the Split Transaction is fair to all unaffiliated shareholders for the reasons set forth in the remaining portion of this section.

The determination by our board of directors and the Affiliates that the Split Transaction is fair to all unaffiliated shareholders was based on a comparison of the cash-out price to the market price for our common stock. The cash-out price of $0.13, determined by our board of directors, reflects a 30% premium over the $0.10 average closing price for the 30 trading days ending on the day before the announcement of the Split Transaction. In arriving at its decision to set the cash-out price at $0.13 per share, our board of directors first determined that the cash-out price should be set at a premium over market price in order to compensate cashed-out shareholders for the loss of their equity interest in the Company. Each of the Affiliates agreed with this determination. In addition, our board of directors and each of the Affiliates believed that it would be necessary to pay a premium over market price in order to induce a sufficient number of shareholders to reduce their holdings below 2,000 shares (or to maintain holdings of less than 2,000 shares, to the extent they currently hold fewer than 2,000 shares) so as to become cashed out in the Split Transaction and allow us to achieve our objective of going private.

The amount of the premium (30% over the average closing price for the 30 trading days prior to the date of announcement of the Split Transaction) was based on the board s general impression of premiums currently being paid to shareholders in the context of mergers, acquisitions, tender offers and similar transactions that the board has learned of through news and industry publications. The board did not consider any specific transactions or any specific premiums paid in any such transactions in establishing the premium to be used in the determination of the cash-out price in the Split Transaction, nor did the board quantify or analyze how the cash-out price in the Split Transaction compared to the consideration or premiums paid in any other

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transaction. Neither the board nor any of the Affiliates performed any quantitative analysis regarding the Split Transaction (or any transactions completed by third parties), other than a comparison of the cash-out price against market price, to determine the fairness of the cash-out price in the Split Transaction. Although the board and each of the Affiliates believes that the value of the Company will increase in the future, they did not take their own beliefs or the future prospects of the Company into account in determining the fairness of the cash-out price. The board and the Affiliates relied on a comparison of the cash-out price to the market price for our common stock because they believe that the market price provides a more relevant metric for investors to evaluate the Company s value and prospects than their own beliefs.

Our board of directors and each of the Affiliates believes that the cash-out price adequately takes into account their consideration of the positive aspects of being cashed out (the benefits to smaller shareholders of receiving cash for their shares without having to pay brokerage commissions or service fees) versus the negative aspects of being cashed out (the loss of the opportunity to participate in any future growth of the Company), as more fully described in this proxy statement, and is therefore fair both to unaffiliated shareholders who will be cashed out and to those who will remain shareholders of the Company after the Split Transaction.

The board of directors and each of the Affiliates believe that the Split Transaction is procedurally and substantively fair to all unaffiliated shareholders both those whose interest in the Company will be wholly cashed-out and those who will continue to hold shares of the Company after the Split Transaction. Present shareholders (including those whose shares are expected to be cashed out) generally will have an opportunity both to evaluate all of the information contained herein and to compare the potential value of an investment in the Company with that of other available investments. The board of directors and each of the Affiliates believe that the Split Transaction is procedurally fair to our unaffiliated shareholders because the Reverse Split is being effected in accordance with all requirements under California law and hence will require the affirmative vote of the holders of a majority of each class of the Company s outstanding capital stock. In addition, between the date hereof and the Effective Date all shareholders of the Company will have an opportunity to buy or sell in the public market a number of Pre-Split Shares so that holders who would otherwise be cashed out in whole or in part can continue to be shareholders, and continuing holders can also divide or otherwise adjust their existing holdings as to become cashed-out shareholders as to some or all of their Pre-Split Shares. None of our directors or affiliates is expected to act so as to become a wholly cashed-out shareholder. Our board of directors and each of the Affiliates believe that the Split Transaction is substantively fair to continuing shareholders as well as cashed-out shareholders because the cash-out price of $0.13 per share represents a premium over the current market price of the Company s common stock and takes into account the relative advantages, disadvantages, risks and prospects to each group, which are described above and elsewhere in this proxy statement, including the section entitled Risk Factors. We believe that, in making their decision to determine the $0.13 cash-out price, our directors were conscious of the importance of the issues (including those that adversely affect continuing shareholders as well as those that affect cashed-out shareholders) and acted in accordance with their fiduciary duties to us and our shareholders.

Finally, based on a comparison of (i) the estimated aggregate cash-out price of $137,000 at $0.13 per share, plus professional fees and other expenses associated with the Split Transaction of approximately $43,000 against (ii) the cost savings of $242,000 that we believe we would achieve each year if we are able to go private, our board of directors and each of the Affiliates believe that the per share cash-out price of $0.13 is fair to both the unaffiliated shareholders who will be cashed out and the unaffiliated shareholders who will remain shareholders of the Company.

No provision has been made to grant unaffiliated shareholders access to our corporate files or to obtain counsel or appraisal services at our expense.

The board of directors retains the right to reject (and not implement) the Split Transaction (even after approval thereof) if it determines subsequently that the Split Transaction is not then in the best interests of the Company and its shareholders. If the Split Transaction is not approved, or, if approved, is not implemented, the proposed deregistration of our common stock will not be implemented. There are no current circumstances that would cause the board of directors to exercise its right not to implement the Split Transaction. Factors that could

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cause the board of directors to decide not to implement the Split Transaction in the future include, without limitation, if the market price of the Company s common stock increases beyond the cash-out price of $0.13, or if the Company receives an offer to acquire the Company for a consideration that would result in the payment of an amount greater than $0.13 per share to the Company s shareholders.

***Structure of the Split Transaction***

The Split Transaction includes the Reverse Split (with a cash payment in lieu of fractional shares) and the Forward Split of the common stock. If the Split Transaction is approved by shareholders, the Reverse Split is expected to occur on a Saturday, following advance notice by press release. Upon consummation of the Reverse Split, each shareholder of record or beneficial shareholder on that Saturday will receive one share of common stock for each whole block of 2,000 Pre-Split Shares held in his or her account at that time. If a shareholder of record holds 2,000 or more Pre-Split Shares in his or her account, any fractional share in such account after the Reverse Split will be cashed out (and to that extent he or she is referred to here as a Partially Cashed-Out Shareholder ). Any shareholder of record who holds fewer than 2,000 Pre-Split Shares in his or her account at the time of the Reverse Split (a Cashed-Out Shareholder ) will receive only a cash payment instead of fractional shares and will no longer be a shareholder of the Company after the Split Transaction. Immediately following the Reverse Split and the payment to the Partially Cashed-Out Shareholders and the Cashed-Out Shareholders, all shareholders who are not Cashed-Out Shareholders will receive in the Forward Split effective on the Sunday after the Reverse Split, 2,000 shares of common stock for every one whole share of common stock they held following the Reverse Split.

We intend for the Split Transaction to treat shareholders holding common stock in street name through a nominee (such as a bank or broker) in the same manner as shareholders whose shares are held of record in their own names, and nominees will be instructed to effect the Split Transaction for their beneficial holders. Accordingly, we also refer to those street name holders who receive a cash payment instead of fractional shares as Partially Cashed-Out Shareholders or Cashed-Out Shareholders , as the case may be. However, nominees may have different procedures and shareholders holding shares in street name should contact their nominees.

In general, the Split Transaction can be illustrated by the following examples:

| HYPOTHETICAL SCENARIO | RESULT |
|---|---|
| Mr. Smith is a shareholder who holds 1,000 shares of common stock in his account before the Split Transaction. | Instead of receiving a fractional share of common stock immediately after the Reverse Split, Mr. Smith s shares will be converted into the right to receive cash. Mr. Smith would receive $130.00 ($0.13 x 1,000 shares). Note: If Mr. Smith wants to continue his investment in the Company, before the Effective Date, he can buy at least 1,000 more shares. Mr. Smith would have to act far enough in advance of the Split Transaction so that the purchase is completed and the additional shares are credited in his account by the Effective Date. |

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| HYPOTHETICAL SCENARIO | RESULT |
|---|---|
| Ms. Jones has two separate accounts. As of the Effective Date, she holds 1,000 shares of common stock in one account and 1,500 shares of common stock in the other. | Ms. Jones will receive cash payments equal to the cash-out price of her common stock in each account instead of receiving fractional shares. Ms. Jones would receive two checks totaling $325.00 (1,000 shares x $0.13 = $130.00; 1,500 shares x $0.13 = $195.00) Note: If Ms. Jones wants to continue her investment in the Company, she can consolidate or transfer her two accounts before the Effective Date into an account with at least 2,000 Pre-Split Shares. Alternatively, she can buy at least 1,000 more shares for the first account and 500 more shares for the second account, and hold them in her respective accounts. She would have to act far enough in advance of the Split Transaction so that the consolidation or the purchase is completed by the Effective Date. |
| Mr. Walker holds 10,000 shares of common stock as of the Effective Date. | After the Split Transaction, Mr. Walker will continue to hold 10,000 shares of common stock. |
| Mr. Wu holds 20,500 shares of common stock as of the Effective Date. | In the Reverse Split, Mr. Wu s stock is combined into 10 whole shares plus an entitlement to $65.00 cash (500 x $0.13 = $65.00). In the Forward Split, the 10 whole shares will be divided into 20,000 shares of common stock. |
| Ms. Harris holds 1,000 shares of common stock in street name in a brokerage account as of the Effective Date. | We intend for the Split Transaction to treat shareholders holding shares of common stock in street name through a nominee (such as a bank or broker) in the same manner as shareholders whose shares are registered in their names. Nominees will be instructed to effect the Split Transaction for their beneficial holders. If this occurs, Ms. Harris will receive, through her broker, a check for $130.00 (1,000 shares x $0.13). However, nominees may have a different procedure and shareholders holding shares of common stock in street name should contact their nominees. |

***Effect of the Split Transaction on the Company***

Our Articles of Incorporation, as amended, currently authorize the issuance of 70,000,000 shares of common stock and 25,000,000 shares of preferred stock, for an aggregate of 95,000,000 shares. As of the record date, 33,822,033 shares of common stock were outstanding, and 1,531 shares of Series C preferred stock were outstanding. Based upon our best estimates, if the Split Transaction had been consummated as of the record date, the number of outstanding shares of common stock would have been reduced by the Split Transaction from

33,822,033 to approximately 32,765,472. This would have reduced the number of holders of record of common

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stock from approximately 568 to approximately 60 or by approximately 508 shareholders of record and would also have reduced our number of street-name shareholders from approximately 1,871 to approximately 478 or by approximately 1,393 street-name shareholders. There would be no change in the number of shares of, or holders of, Series C preferred stock as a result of the Split Transaction, except that Redwood Holdings, LLC would buy an additional 180 shares of Series C preferred stock for $180,000 in order to satisfy Comerica Bank s requirement that the cash-out payments in lieu of fractional shares be financed by the simultaneous sale of other equity securities (see Other Issues Related to the Split Transaction Source of Funds and Financial Effect of the Split Transaction ).

Our common stock and our preferred stock rights are currently registered under Section 12(g) of the 1934 Act and, as a result, we are subject to the periodic reporting and other requirements of the 1934 Act. As a result of the Split Transaction, we will have less than 300 holders of record of our publicly-traded common stock and the requirement that the Company maintain its registration under the 1934 Act will become terminable; we could, and would, elect to become a private company. As a result of the Company s deregistration, our shares of common stock will no longer have an effective trading market, and as a practical matter will no longer be publicly traded or quoted on the over-the-counter market. In addition, following the Split Transaction we and our insiders will no longer be required to file periodic and other reports with the SEC, and we will formally terminate our reporting obligations under the 1934 Act. In connection with the proposed Split Transaction, we have filed a Rule 13e-3 Transaction Statement on Schedule 13E-3 (the Schedule 13E-3 ) with the SEC.

The Split Transaction constitutes a part of a going private transaction under the U.S. securities laws.

Based on the aggregate number of shares owned by holders of less than 2,000 Pre-Split Shares as of the record date, and the estimated number of other fractional shares that would result from the Reverse Split, we estimate that payments of cash in lieu of the issuance of fractional shares will total approximately $137,000 in the aggregate. No shareholder with a single account can receive more than $259.87.

The common stock will continue to have no par value and the number of authorized common shares will remain the same following consummation of the Split Transaction.

***Accounting Treatment of the Split Transaction***

We plan to account for the cash-out of fractional share interests as stock repurchases, which will have the effect of reducing the carrying amount of our common stock. There will be no other material accounting effects on the Company associated with the Split Transaction.

The following table sets forth the effect of the Split Transaction on the Affiliates interest in the net book value and net loss of the Company as of and for the year ended December 31, 2004:

| | Change in Interest in | |
|---|---|---|
| **Affiliate** | **Net Book Value** | **Net Loss** |
| Thomas A. Donelan | $ 0.0% | $ 0.0% |
| Christopher P. Hendy | $ 0.0% | $ 0.0% |

| | | | | |
|---|---|---|---|---|
| Jerry L. Ruyan | $ (2,000) | 0.0% | $ | 0.0% |
| Redwood Holdings, LLC | $ 102,000 | 2.4% | $ (15,000) | 2.4% |
| Redwood West Coast, LLC | $ (15,000) | -0.4% | $ 3,000 | -0.4% |
| Remington Capital, LLC | $ | 0.0% | $ 1,000 | 0.0% |
| Total Affiliates | $ 85,000 | 1.9% | $ (11,000) | 1.9% |

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***Material Federal Income Tax Consequences***

The Split Transaction will not have any material federal income tax consequences on the Company, as we believe that the Split Transaction will be treated as a tax-free recapitalization.

The following is a discussion of the material anticipated federal income tax consequences of the Split Transaction to shareholders of the Company. It should be noted that this discussion is based upon the federal income tax laws currently in effect and as currently interpreted. This discussion does not take into account possible changes in such laws or interpretations, including any amendments to applicable statutes, regulations and proposed regulations, or changes in judicial or administrative rulings, some of which may have retroactive effect. This discussion is provided for general information only, and does not purport to address all aspects of the range of possible federal income tax consequences of the reverse stock split and is not intended as tax advice to any person. In particular, and without limiting the foregoing, this discussion does not account for or consider the federal income tax consequences to shareholders of the Company in light of their individual investment circumstances or to holders subject to special treatment under the Federal income tax laws (for example, life insurance companies, regulated investment companies, and foreign taxpayers). This discussion does not discuss any consequence of the Split Transaction under any state, local or foreign tax laws.

No ruling from the Internal Revenue Service will be obtained regarding the federal income tax consequences to the shareholders of the Company in connection with the Split Transaction. The Company has not received an opinion of counsel regarding the federal income tax consequences to the Company and its shareholders in connection with the Split Transaction. However, each shareholder is encouraged to consult his or her tax adviser regarding the specific tax consequences of the Split Transaction to such shareholder, including the application and effect of federal, state, local and foreign taxes, and any other tax laws.

The board of directors believes that the Split Transaction will be a tax-free recapitalization to the Company and its continuing shareholders and a taxable transaction to Cashed-Out Shareholders and, to the extent their fractional shares are cashed out, to Partially Cashed-Out Shareholders, all as further detailed below. If the Reverse Split qualifies as a recapitalization described in Section 368(a)(1)(E) of the Internal Revenue Code of 1986, as amended (the Code ), (i) no gain or loss will be recognized by a shareholder of common stock who is neither a Cashed-Out Shareholder nor a Partially Cashed-Out Shareholder, (ii) any Cashed-Out Shareholder of Partially Cashed-Out Shareholder who receives cash proceeds, which cannot exceed $259.87 for any single shareholder account, from the sale of fractional shares of common stock will recognize a gain or loss equal to the difference, if any, between such proceeds and the basis of its common stock allocated to its fractional share interests, and such gain or loss, if any, will generally constitute capital gain or loss if its fractional share interests are held as capital assets at the time of their sale, (iii) the tax basis of the new common stock received by holders of common stock will be the same as the tax basis of the common stock exchanged therefore, minus (in the case of Partially Cashed-Out Shareholders) the basis allocated to the cashed-out fractional share interest, and (iv) the holding period of the new common stock in the hands of holders of new common stock will include the holding period of their common stock exchanged therefor, provided that such common stock was held as a capital asset immediately before the exchange.

Certain Cashed-Out Shareholders and Partially Cashed-Out Shareholders may be subject to information reporting with respect to the cash received in exchange for their fractional shares of common stock. If you are subject to information reporting and do not provide appropriate information when requested, you may also be subject to backup withholding at a rate of 28%. Any amount withheld from you under such rules is not an additional tax and may be refunded or credited against your federal income tax liability, provided that the required information is properly furnished in a timely manner to the IRS.

***No Opinion of Financial Advisor***

Our board of directors did not retain any advisor to deliver a fairness opinion in connection with the Split Transaction.

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**Risk Factors**

You should consider the following risks prior to casting your vote on the two proposals described in this proxy statement.

***Risks Associated with the Split Transaction***

NONE OF THE BOARD MEMBERS WHO ARE RECOMMENDING THE SPLIT TRANSACTION IS INDEPENDENT, AND THE FAIRNESS OF THE SPLIT TRANSACTION TO UNAFFILIATED SHAREHOLDERS HAS NOT BEEN ANALYZED OR OPINED UPON BY ANY INDEPENDENT THIRD PARTY OR FINANCIAL ADVISOR.

None of our board members are independent; two of our directors are affiliated with our controlling shareholder, and our remaining director is the President and Chief Executive Officer of the Company. Accordingly, the fairness of the Split Transaction to our unaffiliated shareholders, including those whose minority interest in the Company will be cashed out, has not been considered, and shareholder approval of the Split Transaction is not being recommended, by any independent board members or any independent committee of the board. In addition, our board of directors did not retain any independent third party or financial advisor to deliver a fairness opinion in connection with the Split Transaction or to analyze the fairness of the $0.13 per share consideration to our unaffiliated shareholders.

THE DETERMINATION BY OUR BOARD OF DIRECTORS REGARDING THE FAIRNESS OF THE SPLIT TRANSACTION TO UNAFFILIATED SHAREHOLDERS REFLECTS THE BOARD S ANALYSIS OF THE RELATIVE ADVANTAGES AND DISADVANTAGES OF REMAINING A SHAREHOLDER, AND WAS BASED ON A COMPARISON OF THE CASH-OUT PRICE TO THE MARKET PRICE FOR OUR COMMON STOCK.

Our board of directors based its decision to set the cash-out price in the Split Transaction at $0.13 per share on a comparison of the cash-out price to the market price for our common stock. In arriving at its decision to set the cash-out price at $0.13 per share, our board of directors took into account the positive aspects of being cashed out (the benefits to smaller shareholders of receiving cash for their shares without having to pay brokerage commissions or service fees) as well as the negative aspects of being cashed out (the loss of the opportunity to participate in any future growth of the Company), as more fully described in this proxy statement. Our board of directors believes that the cash-out price of $0.13 adequately reflects the board s consideration of the relative costs and benefits of being cashed out versus remaining a shareholder of the Company. Our board of directors did not perform any quantitative analysis other than the comparison of the cash-out price against market price in light of the board s general impression of premiums currently being paid to shareholders in the context of mergers, acquisitions, tender offers and similar transactions in reaching its decision to set the cash-out price at $0.13. The board did not consider any specific transactions or any specific premiums paid in any such transactions in establishing the premium to be used in the determination of the cash-out price in the Split Transaction, nor did the board quantify or analyze how the cash-out price in the Split Transaction compared to the consideration or premiums paid in any other transaction.

***Risks Associated with Remaining A Shareholder***

WE WOULD NO LONGER BE A PUBLIC COMPANY. THE LACK OF LIQUIDITY FOR SHARES OF OUR COMMON STOCK FOLLOWING THE EFFECTIVE DATE MAY ADVERSELY AFFECT THE VALUE OF YOUR SHARES.

Following the Split Transaction, we would have less than 300 shareholders of record. As a result, we would become entitled under applicable law to, and in fact we promptly would, deregister our shares of common stock under the 1934 Act. Once we deregister our shares of common stock, we will not file any more current, quarterly

or annual reports with the SEC. As a result, there will be no effective trading market for our shares and shareholders desiring to sell their shares would probably have a difficult time finding a buyer for these shares. This lack of liquidity would probably adversely affect your ability to sell your shares and the price which a buyer is willing to pay for the shares.

YOU WOULD LOSE THE BENEFITS OF THE 1934 ACT.

As mentioned, we would no longer be disclosing the kind of information now disclosed in our current, quarterly and annual reports, nor would we be disclosing the kind of information now disclosed in our proxy statements for annual and special shareholder meetings and written consent solicitations. In addition, our officers, directors and significant shareholders would no longer need to file statements of their securities transactions and ownership under Sections 16 or 13(d) of the 1934 Act. It will be much more difficult for you to monitor the status of your investment. In addition, we will not be required to comply with Sarbanes-Oxley Act Section 404 s requirements regarding internal control over financial reporting.

WE DO NOT INTEND TO PAY DIVIDENDS OR MAKE OTHER DISTRIBUTIONS TO OUR COMMON SHAREHOLDERS IN THE FORESEEABLE FUTURE.

We have never paid dividends on our common stock and we do not intend to do so in the foreseeable future. Accordingly, because continuing shareholders will not receive any dividends with respect to their shares of common stock and because the shares of our common stock will no longer be tradable on the open market following the Split Transaction, continuing shareholders will have limited opportunities to receive any cash returns on their investment.

WE DO NOT HAVE ANY PLANS TO SELL THE COMPANY OR OTHERWISE ENTER INTO A TRANSACTION THAT WOULD PROVIDE LIQUIDITY FOR YOUR SHARES.

We do not have any present intention or plans to sell the Company or enter into any other transaction that would provide shareholders with a liquidity event for their shares, which means your shares could remain illiquid for an indefinite period.

SHAREHOLDERS WILL CONTINUE TO BE SUBJECT TO THE OPERATIONAL AND OTHER RISKS FACING US, WHICH RISKS, IF REALIZED, COULD RESULT IN A SUBSTANTIAL REDUCTION IN THE VALUE OF THEIR SHARES OF COMMON STOCK.

Following the Split Transaction, we will continue to face the same risks we have faced in the past, including without limitation the risks associated with a short-term obligation that we could not afford to pay in accordance with its terms; namely, an unsecured contractual obligation of $1,500,000 due in July 2006, originally in favor of Barnes-Jewish Hospital ( BJH ) and now held by Remington Capital, LLC, an affiliate of Redwood. These and other risks related to our need for additional capital are described in the risk factor beginning We have a short-term obligation that we cannot afford to pay under the caption Risk Factors in our Form 10-K, as amended, attached to this proxy statement as Exhibit A, and in our Form 10-Q, attached to this proxy statement as Exhibit B, as well as the other risks described in the Form 10-K and the Form 10-Q. On August 30, 2005, we restructured our overall short-term obligation to BJH, as more fully discussed in our Form 8-K which is attached to this proxy statement as Exhibit F. Although the restructuring eliminated any payment default on the $1,000,000 unsecured contractual obligation which had been due in July 2005 and any accrual of interest at the rate of 10.5% on the entire $2,500,000 obligation to BJH that would have resulted from a default, and effectively extended the payment terms on the $500,000 principal outstanding under the new promissory

note issued to BJH and the new promissory note issued to Remington Capital, LLC in the amount of $350,000, we continue to be responsible to ultimately repay such principal (plus interest now accruing). There has been no modification of the terms of the $1,500,000 contractual obligation sold by BJH to Remington Capital, LLC in connection with the restructuring. There is no guarantee that we will be able to adequately address these risks and the others described in the risk factor referred to above, and the value of your shares may never reach $0.13 or more per share.

***Risks Associated with Not Being A Shareholder***

SHAREHOLDERS WHO ARE CASHED OUT WILL FORFEIT THE OPPORTUNITY TO PARTICIPATE IN ANY FUTURE GROWTH IN THE VALUE OF THEIR SHARES.

Shareholders who are completely cashed out in the Split Transaction will no longer be shareholders in the Company (unless they subsequently acquire shares from other shareholders following the Effective Date) and will no longer participate in any growth in the value of our common stock that may occur in the future. Continuing shareholders will, to the extent their interest is partially cashed out in lieu of fractional shares, similarly lose the right to participate in any future growth in the value of the cashed-out shares. It is possible that the value of our shares could exceed $0.13 in the future.

THE CURRENT FAIR VALUE OF YOUR SHARES MAY BE MORE THAN $0.13.

The $0.13 cash out price was determined by calculating the average closing price of our common stock over the 30-day period prior to the announcement of the Split Transaction and adding a premium of 30%, which may not in fact indicate the true current value of your shares. We did not use a financial advisor or obtain any fairness opinion regarding the $0.13 price. Due to the nature of the Split Transaction, California statutes do not give you any dissenters   rights or appraisal rights, even if you believe the true value of your Pre-Split Shares was more than $0.13 per share.

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**PROPOSAL NO. 1**

**AMENDMENT OF ARTICLES OF INCORPORATION TO EFFECT A REVERSE STOCK SPLIT**

The board of directors has authorized, and recommends for your approval, a Split Transaction comprising two separate transactions pursuant to which:

- a reverse stock split (the Reverse Split ) pursuant to which each block of 2,000 shares of common stock registered in the name of a shareholder or held in a shareholder s street-name stock brokerage account at the effective time of the Reverse Split will be converted into one share of common stock;
  - shareholders holding fewer than 2,000 shares of common stock, of record or in a street-name stock brokerage account, will cease to be shareholders and instead will receive a cash payment of $0.13 per share for each Pre-Split Share;
  - shareholders holding more than 2,000 shares of common stock, of record or in a street-name stock brokerage account, will, to the extent their number of shares is not exactly divisible by 2,000 and therefore the Reverse Split would result in a fractional share as well as one or more whole shares, receive instead of the fractional share a cash payment of $0.13 for each Pre-Split Share which became part of the fractional share;
- a forward stock split (the Forward Split ) pursuant to which each whole share of common stock outstanding following consummation of the Reverse Split and fractional share payment will be converted into 2,000 shares of common stock.

For example: if you hold 10,000 Pre-Split Shares at the effective time of the Split Transaction, your holdings will remain as 10,000 shares of common stock. If you hold 1,500 Pre-Split Shares at the effective time of the Split Transaction, you would cease to be a shareholder and instead we would pay you $195 cash. If you hold 20,500 Pre-Split Shares at the effective time of the Split Transaction, you would become a holder of 20,000 shares of common stock and we would pay you $65 in cash in lieu of the Reverse Split fractional share.

The Split Transaction would be formally effected by two successive amendments of our Articles of Incorporation. If approved by the shareholders, the Split Transaction will become effective on a weekend as may be determined by the board of directors (the Effective Date ). It is anticipated that upon such approval, we would issue a press release giving at least three business days advance notice of the Effective Date, and the Effective Date would occur that weekend. The Reverse Split would occur on the Saturday and the Forward Split would occur on the Sunday. The forms of proposed amendment to the Company s Articles of Incorporation, as amended, necessary to effect the Split Transaction are attached to this proxy statement as Exhibit D.

Any holder of less than 2,000 Pre-Split Shares who desires to retain an equity interest in the Company after the Effective Date may do so by purchasing, in the public market, before the Effective Date, a sufficient number of shares of common stock such that the shareholder holds 2,000 or more Pre-Split Shares. Similarly, holders of more than 2,000 Pre-Split Shares may purchase, in the public market, before the Effective Date, a sufficient number of shares of common stock to top off one s holding so that it becomes exactly divisible by 2,000 so the Reverse Split would not result in an indicated fractional share; that way, none of one s interest in the Company would be cashed out. There can be no assurance that shares will be available for purchase on the public market at an attractive price.

The first proposal is to approve an amendment to the Company s Articles of Incorporation to effect the Reverse Split portion of the Split Transaction.

**Vote Required**

Approval of this proposal requires the affirmative vote of the holders of the majority of the outstanding shares of common stock, the affirmative vote of the holders of the majority of the outstanding shares of Series C preferred stock, and also the affirmative vote of the holders of the majority of the voting power of all stock

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entitled to vote. Abstentions (including failures to return consents) and broker nonvotes have the same effect as a negative vote. Outstanding shares of common stock are entitled to one vote each and outstanding shares of Series C preferred stock are entitled to 7,784.52 votes each.

**Recommendation of the Board of Directors**

The board of directors has unanimously determined that the Split Transaction, including the Reverse Split, is both substantively and procedurally fair to, and in the best interest of, the Company and our shareholders and unanimously recommends a vote FOR the proposal to approve the Reverse Split as described in this proxy statement.

## PROPOSAL NO. 2

## AMENDMENT OF ARTICLES OF INCORPORATION TO EFFECT A FORWARD STOCK SPLIT FOLLOWING THE REVERSE SPLIT

As more fully described in Proposal No. 1, the board of directors has authorized and recommends for your approval a Split Transaction comprising the Reverse Split, followed by the Forward Split.

Proposal No. 2 is to approve an amendment to the Company s Articles of Incorporation to effect the Forward Split portion of the Split Transaction following the Reverse Split. The amendment of the Articles to effect the Forward Split is contingent upon shareholder approval of the Reverse Split and will be effected only after completion of the Reverse Split. See Proposal No. 1 for a description of the principal effects of the Split Transaction.

**Vote Required**

Approval of this proposal requires the affirmative vote of the holders of the majority of the outstanding shares of common stock, the affirmative vote of the holders of the majority of the outstanding shares of Series C preferred stock, and also the affirmative vote of the holders of the majority of the voting power of all stock entitled to vote. Abstentions (including failures to return consents) and broker nonvotes have the same effect as a negative vote. Outstanding shares of common stock are entitled to one vote each and outstanding shares of Series C preferred stock are entitled to 7,784.52 votes each.

**Recommendation of the Board of Directors**

The board of directors has unanimously determined that the Split Transaction, including the Forward Split, is both substantively and procedurally fair to, and in the best interest of, the Company and our shareholders and unanimously recommends a vote FOR the proposal to approve the Forward Split as described in this proxy statement.

**OTHER ISSUES RELATED TO THE SPLIT TRANSACTION**

***Source of Funds and Financial Effect of the Split Transaction***

The costs of the Split Transaction, which include the cash-out payments to be made to shareholders plus about $50,000 for professional fees and other expenses related to the transaction, are not expected to have any material adverse effect on the Company s capitalization, liquidity, results of operations or cash flow. Because the

actual number of Pre-Split Shares which will be cashed-out by the Company is unknown at this time, the total cash we would pay to holders is unknown, but is estimated to be about $137,000.

In order to finance the cash payment in lieu of fractional shares, we have entered into an agreement to sell 180 newly issued and unregistered shares of Series C preferred stock to Redwood Holdings, LLC for $180,000 cash. Redwood Holdings, LLC is an affiliate of our controlling shareholder Redwood West Coast, LLC and our directors Thomas A. Donelan and Christopher P. Hendy. Any such sale of Series C preferred stock is contingent upon the shareholder approval of the Split Transaction, and upon the subsequent approval by the board of directors to implement the Split Transaction. This equity investment to maintain our cash levels is required by our lender Comerica Bank as a condition to its waiver of our covenant not to repurchase common stock.

The cash-out payment in lieu of fractional shares could be characterized as a stock redemption violating California Corporations Code Section 500. That section prohibits the redemption of stock unless certain financial tests are met. Under Section 316 of the California Corporations Code, if a redemption is made in violation of Section 500, our directors could be jointly and severally liable to our creditors for the amount of the illegal distribution plus interest and various costs.

***Conduct of the Company s Business After the Split Transaction***

We expect our business and operations to continue as they are currently being conducted and, except as disclosed in this document, the Split Transaction is not anticipated to have any material effect upon the conduct of our business. If the Split Transaction is consummated, all persons owning fewer than 2,000 Pre-Split Shares of common stock will no longer have any equity interest in, and will not be shareholders of, the Company and, therefore, will not participate in our future potential or earnings and growth.

We have no current plans or proposals to effect any extraordinary corporate transaction such as a merger, reorganization or liquidation; to sell or transfer any material amount of our assets; to change our board of directors or management; to change materially our indebtedness or capitalization; or otherwise to effect any material change in our corporate structure of business.

Our internal corporate governance practices and our procedures for internal control will remain unchanged, although we generally will not be making any future changes in them as might be mandated for companies subject to the 1934 Act. We will continue to be subject to all provisions of California corporate law.

***Receiving Cash Payment In Lieu of Shares***

We will not issue any fractional shares in connection with the Split Transaction. Instead, we will pay $0.13 for each such Pre-Split Share to which a fractional share is traceable. We refer to this amount as the Cash-Out Price. If the shareholders approve the Split Transaction, and if the board of directors approves the implementation of the Split Transaction, we anticipate that we would issue a press release giving at least three business days advance notice of the Effective Date and the Effective Date would occur that weekend.

All amounts payable to shareholders will be subject to applicable state laws relating to abandoned property (see Escheat Laws below). No brokerage commissions will be payable by shareholders in connection with the Split Transaction. We will not pay interest on cash sums due any shareholder pursuant to the Split Transaction.

Assuming the Split Transaction occurs, as soon as practicable after the Effective Date we will mail a letter of transmittal to each Partially Cashed-Out Shareholder and each Cashed-Out Shareholder. The letter of transmittal will contain instructions for the surrender of the certificate or certificates to our exchange agent in exchange for the Cash-Out Price, and, in the case of the Partially Cashed-Out Shareholders, a new certificate for the post-Forward Split shares which were not cashed out. No cash payment will be made to any shareholder of record until the shareholder of record has surrendered the outstanding certificate(s), together with the letter of

transmittal, to our exchange agent. For Partially Cashed-Out Shareholders and Cashed-Out Shareholders whose shares are held in street name, you will not receive a transmittal letter; rather, your cash payment will be sent directly to your nominee. No dissenters or appraisal rights are available under the California Corporations Code, the Company s By-laws or Articles of Incorporation, as amended, to any shareholders (see Other Issues Related to the Split Transaction Dissenters Rights below).

***Exchange of Stock Certificates***

It is currently anticipated that Mellon Investor Services, LLC will serve as exchange agent to receive stock certificates of Synbiotics Corporation from, and to send cash payments to, our shareholders entitled to receive them. Promptly following the effective date of the Split Transaction, the exchange agent will send a letter of transmittal to each Cashed-Out Shareholder and each Partially Cashed-Out Shareholder, which will describe the procedures for surrendering stock certificate(s) in exchange for the cash consideration and, in the case of the Partially Cashed-Out Shareholders, a new share certificate for the post-Forward Split shares which were not cashed out. Upon receipt of the certificate(s) and properly completed letters of transmittal, the exchange agent will within approximately 20 business days make the appropriate cash payment and, where applicable, deliver the new stock certificate. No interest will accrue on the cash consideration.

*PLEASE DO NOT SEND IN ANY STOCK CERTIFICATES AT THIS TIME.*

***Effective Time***

If this proposal is approved by the shareholders and the board of directors decides to proceed with the Split Transaction, the effective time of the Split Transaction will occur on a weekend, after we have given advance notice by press release and after the Secretary of State of the State of California accepts for filing the amendments to the Articles of Incorporation, as amended.

***Regulatory Approvals***

We are not aware of any material governmental or regulatory approval required for completion of the transaction, other than compliance with the relevant federal securities laws and the corporate laws of California.

***Escheat Laws***

The unclaimed property and escheat laws of each state provide that under circumstances defined in that state s statutes, holders of unclaimed or abandoned property must surrender that property to the state. Persons whose shares are cashed out and whose addresses are unknown to us, or who do not return their stock certificates and request payment for their cashed-out shares, generally will have a period of years from the Effective Date in which to claim the cash payment payable to them. For example, with respect to shareholders whose last known addresses are in California, as shown by our records, the period is three years. Following the expiration of that three-year period, the Unclaimed Property Law of California would likely cause the cash payments to escheat to the State of California. For shareholders who reside in other states or whose last known addresses, as shown by our records, are in states other than California, such states may have abandoned property laws which call for such

state to obtain either (i) custodial possession of property that has been unclaimed until the owner reclaims it; or (ii) escheat of such property to the state. Under the laws of such other jurisdictions, the holding period or the time period which must elapse before the property is deemed to be abandoned may be shorter or longer than three years. If we do not have an address for the holder of record of the shares, then unclaimed cash-out payments would be turned over to our state of incorporation, the state of California, in accordance with its escheat laws.

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***Dissenters Rights***

No dissenters or appraisal rights are available under the California Corporations Code to shareholders who may wish to dissent from the Split Transaction. There may exist other rights or actions under state law for shareholders who are aggrieved by reverse stock and/or forward stock splits generally, or by cash sales of convertible preferred stock to affiliates. Although the nature and extent of such rights or actions are uncertain and may vary depending upon facts or circumstances, shareholder challenges to corporate action in general are related to the fiduciary responsibilities of corporate officers and directors and to the fairness of corporate transactions. For example, shareholders could, if they deemed such to be applicable, take appropriate legal action against us and our board of directors, and claim that the transaction was unfair to the unaffiliated shareholders, and/or that there was no justifiable or reasonable business purpose for the Split Transaction. Shareholders holding less than 2,000 Pre-Split Shares who want to remain shareholders may purchase a sufficient number of additional shares on the open market in order to hold more than 2,000 Pre-Split Shares prior to the Effective Date of the Split Transaction. Those shareholders who do not desire to remain shareholders may sell a sufficient number of shares such that they hold fewer than 2,000 Pre-Split Shares before the Effective Date of the Split Transaction in order to be cashed out in the Split Transaction. In a similar way, larger shareholders can buy or sell shares before the Effective Date in order to generate a fractional share, which would be cashed out, or to avoid the generation of a fractional share and thus avoid being cashed out to any extent.

**MANAGEMENT AND AFFILIATES**

Information regarding our board of directors and executive officers is located at Item 10 Directors and Executive Officers of the Registrant of our Annual Report on Form 10-K, which is included as Exhibit A to this proxy statement. Each director and executive officer is a citizen of the United States, except for Serge Leterme who is a citizen of France.

Since 1998, Jerry L. Ruyan has been the managing member of Redwood Holdings, LLC, which he co-founded in 1998. Redwood Holdings, LLC, based in Cincinnati, Ohio, is a diversified venture capital company that invests in businesses that are in need of capital in order to sustain or accelerate growth through product development, market expansion or strategic acquisitions, and concentrates its efforts on growth businesses such as companies in manufacturing, service, distribution and technology markets.

Redwood West Coast, LLC, located in Cincinnati, Ohio, was formed in 2002 by Redwood Holdings, LLC for the sole purpose of investing in us. Likewise, Remington Capital, LLC, also located in Cincinnati, Ohio, was formed in 2004 by Redwood Holdings, LLC for the sole purpose of facilitating the restructuring our bank debt by acquiring a portion of our note payable to Comerica Bank.

The following table sets forth the ownership of the Redwood entities:

| | Entity | | |
|---|---|---|---|
| **Person** | **Redwood Holdings, LLC** | **Redwood West Coast, LLC** | **Remington Capital, LLC** |
| Thomas A. Donelan | 24.9% | 16.8% | |
| Christopher P. Hendy | 24.9% | 19.0% | |
| Jerry L. Ruyan | 49.8% | 54.0% | |

| | | | |
|---|---|---|---|
| Redwood Holdings, LLC | | 1.0% | 100.0% |
| Total ownership % | 99.6% | 90.8% | 100.0% |

No director or executive officer of the Company , nor any of Mr. Ruyan, Redwood Holdings, LLC, Redwood West Coast, LLC or Remington Capital, LLC has, during the past five years, been convicted in a criminal proceeding (excluding traffic violations or similar misdemeanors) or was a party to any judicial or

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administrative proceeding (except for matters that were dismissed without sanction or settlement) that resulted in a judgment, decree or final order enjoining the person from future violations of, or prohibiting activities subject to, federal or state securities laws, or a finding of violations of such laws.

**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The following table sets forth the beneficial ownership of each class of our voting stock as of July 29, 2005 of each of our directors, 5% shareholders, each person (the Named Executive Officers ) who

- was our chief executive officer in 2004;
- was serving as an executive officer on December 31, 2004 and was one of the four most highly compensated executive officers whose total 2004 salary and bonus exceeded $100,000; or
- but for the fact that he was not serving as an executive officer on December 31, 2004, would have been included under the preceding bullet point;

and of our directors and executive officers as a group. Except as noted, and except for the effect of applicable community-property laws, each person has sole investment and voting power over the shares shown. Percentages are calculated using the SEC s beneficial ownership rules and are based on 45,738,152 shares of our common stock assumed outstanding (33,822,033 shares actually outstanding and 11,916,119 assumed outstanding upon conversion of the Series C preferred stock) and 1,531 shares of our Series C preferred stock outstanding as of July 29, 2005. See the first footnote to this table for a statement of the ownership percentage of our common stock without this special assumption.

This table does not include the Split Transaction s effect of cashing out certain shares, nor does it include the anticipated purchase by Redwood Holdings, LLC of 180 shares of Series C preferred stock (which would confer beneficial ownership of 1,401,214 shares of underlying common stock). Such shares are not included either for Redwood Holdings, LLC or its affiliates Messrs. Donelan, Hendy and Ruyan (see footnotes 2, 3 and 6).

| Name and Address of Beneficial Owner | Amount and Nature of Beneficial Ownership | Percent of Class |
|---|---|---|
| *Common Stock:* | | |
| Keith A. Butler[(1)] | | |
| c/o Synbiotics Corporation | | |

| | | |
|---|---|---|
| 11011 Via Frontera<br>San Diego, CA 92127 | | |
| Thomas A. Donelan[1][2][4][6][7]<br>c/o Redwood Holdings, LLC<br>9468 Montgomery Road<br>Cincinnati, OH 45242 | 24,042,293 | 52.3% |
| Clifford Frank[1]<br>c/o Synbiotics Corporation<br>11011 Via Frontera<br>San Diego, CA 92127 | 366,105 | * |
| Paul R. Hays[1][3][5]<br>c/o Synbiotics Corporation<br>11011 Via Frontera<br>San Diego, CA 92127 | 1,753,701 | 3.8% |
| Christopher P. Hendy[1][2][4][6][7]<br>c/o Redwood Holdings, LLC<br>9468 Montgomery Road<br>Cincinnati, OH 45242 | 24,253,723 | 52.7% |

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| Name and Address of Beneficial Owner | Amount and Nature of Beneficial Ownership | Percent of Class |
|---|---|---|
| Serge Leterme, Ph.D.[1]<br>c/o Synbiotics Europe SAS<br>2 rue Alexander Fleming<br>69637 Lyon, Cedex 07, France | 636,938 | 1.4% |
| B. Kent Luther[1][3]<br>c/o Synbiotics Corporation<br>11011 Via Frontera<br>San Diego, CA 92127 | 31,250 | * |
| Redwood West Coast, LLC[1][6]<br>c/o Redwood Holdings, LLC<br>9468 Montgomery Road<br>Cincinnati, OH 45242 | 21,796,668 | 47.6% |
| Remington Capital, LLC[4]<br>c/o Redwood Holdings, LLC<br>9468 Montgomery Road<br>Cincinnati, OH 45242 | 250,000 | * |
| Jerry L. Ruyan[1][2][4][6][7]<br>c/o Redwood Holdings, LLC<br>9468 Montgomery Road<br>Cincinnati, OH 45242 | 25,553,918 | 55.8% |
| All executive officers and directors as a group (7 persons)[1][2][3][4][5][6][7] | 27,742,407 | 58.8% |
| *Series C Preferred Stock:* | | |
| Thomas A. Donelan[6][7]<br>c/o Redwood Holdings, LLC<br>9468 Montgomery Road | 1,331 | 86.9% |

| | | |
|---|---|---|
| Cincinnati, OH 45242 | | |
| Paul R. Hays[5]<br><br>c/o Synbiotics Corporation<br><br>11011 Via Frontera<br><br>San Diego, CA 92127 | 100 | 6.5% |
| Christopher P. Hendy[6][7]<br><br>c/o Redwood Holdings, LLC<br><br>9468 Montgomery Road<br><br>Cincinnati, OH 45242 | 1,331 | 86.9% |
| Redwood Holdings, LLC[7]<br><br>9468 Montgomery Road<br><br>Cincinnati, OH 45242 | 100 | 6.5% |
| Redwood West Coast, LLC[6]<br><br>9468 Montgomery Road<br><br>Cincinnati, OH 45242 | 1,231 | 80.4% |
| Jerry L. Ruyan[6][7]<br><br>c/o Redwood Holdings, LLC<br><br>9468 Montgomery Road<br><br>Cincinnati, OH 45242 | 1,331 | 86.9% |
| All executive officers and directors as a group (7 persons)[5][6][7] | 1,431 | 93.5% |

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* Less than one percent.

(1) Excluding the effect of the assumed conversion of the Series C preferred stock, the percentage ownership of the common stock would be as follows: Mr. Butler 0.0%; Mr. Donelan 40.2%; Mr. Frank 1.1%; Mr. Hays 5.0%; Mr. Hendy 40.8%; Dr. Leterme 1.9%; Mr. Luther 0.1%; Redwood West Coast, LLC 36.1%; Mr. Ruyan 44.9%; all executive officers and directors as a group (7 persons) 49.2%.

(2) Includes 766,483 shares of common stock held by Redwood Holdings, LLC which were acquired pursuant to elections of Redwood West Coast, LLC to receive shares of common stock in lieu of cash dividends on our Series C preferred stock held by Redwood West Coast, LLC, as permitted by the Certificate of Determination of our Series C preferred stock. As required by its Operating Agreement, Redwood West Coast, LLC directed that the shares of Common Stock be issued directly to its members. Redwood Holdings, LLC received 766,483 shares of our common stock in these distributions. Redwood Holdings, LLC is the owner of record of the 766,483 shares of our common stock. In addition, Redwood Holdings, LLC is the record owner of 100 shares of Series C preferred stock of Synbiotics Corporation. The shares are convertible at any time into such number of shares of common stock determined by dividing each share of Series C preferred stock, valued at $1,000, by the conversion price initially set at $0.12846. Mr. Donelan is a 24.9% beneficial owner , Mr. Hendy is a 24.9% beneficial owner and Mr. Ruyan is a 49.8% beneficial owner of Redwood Holdings, LLC, which has sole voting and dispositive power with respect to the shares. Messrs. Donelan, Hendy and Ruyan disclaim beneficial ownership of these share, except to the extent of their direct pecuniary interest in Redwood Holdings, LLC.

(3) Includes options to purchase our common stock which are exercisable on or before September 28, 2005 as follows: Mr. Hays 950,000 shares; Mr. Luther 31,250 shares.

(4) Includes a warrant to purchase 250,000 shares of our common stock for $0.17 per share held by Remington Capital, LLC. The warrant is exercisable at any time, in whole or in part, through September 1, 2010. Remington Capital, LLC is indirectly owned 100% by Redwood Holdings, LLC. Mr. Donelan is a 24.9% beneficial owner , Mr. Hendy is a 24.9% beneficial owner and Mr. Ruyan is a 49.8% beneficial owner of Redwood Holdings, LLC. Messrs. Donelan, Hendy and Ruyan disclaim beneficial ownership of these shares, except to the extent of their direct pecuniary interest in Redwood Holdings, LLC.

(5) Mr. Hays is the owner of 100 shares of Series C preferred stock of Synbiotics Corporation. The shares are convertible at any time into such number of shares of common stock determined by dividing each share of Series C preferred stock, valued at $1,000, by the conversion price initially set at $0.12846.

(6) Redwood West Coast, LLC is the record owner of 1,231 shares of Series C preferred stock of Synbiotics Corporation. The shares are convertible at any time into such number of shares of common stock determined by dividing each share of Series C preferred stock, valued at $1,000, by the conversion price initially set at $0.12846. Mr. Donelan is a 17.7572% owner of Redwood West Coast, LLC owning 16.7581% individually and 0.9991% through Redwood Holdings, LLC (Mr. Donelan is a 24.9% owner of Redwood Holdings, LLC). Mr. Hendy is a 20.0038% owner of Redwood West Coast, LLC owning 19.0347% individually and 0.9991% through Redwood Holdings, LLC (Mr. Hendy is a 24.9% owner of Redwood Holdings, LLC). Mr. Ruyan is a 56.0053% owner of Redwood West Coast, LLC owning 54.0071% individually and 1.9982% through Redwood Holdings, LLC (Mr. Ruyan is a 49.8% owner of Redwood Holdings, LLC). In addition, Messrs. Donelan, Hendy and Ruyan serve on the Management Committee of Redwood West Coast, LLC, which has sole voting and dispositive power with respect to the shares. Messrs. Donelan, Hendy and Ruyan disclaim beneficial ownership of the shares reflected above, except to the extent of their direct and indirect pecuniary interests in Redwood West Coast, LLC.

(7) Includes 100 shares of Series C preferred stock of Synbiotics Corporation owned by Redwood Holdings, LLC. The shares are convertible at any time into such number of shares of common stock determined by dividing each share of Series C preferred stock, valued at $1,000, by the conversion price initially set at $0.12846. Mr. Donelan is a 24.9% owner of Redwood Holdings, LLC, Mr. Hendy is a 24.9% owner of Redwood Holdings, LLC, and Mr. Ruyan is a 49.8% owner of Redwood Holdings, LLC. Messrs. Donelan, Hendy and Ruyan disclaim beneficial ownership of the shares reflected above, except to the extent of their direct pecuniary interests in Redwood Holdings, LLC.

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**PRIOR STOCK PURCHASES BY AFFILIATES**

The following table sets forth information regarding purchases of our voting stock by each of our directors and affiliated shareholders:

| Quarter Ended | Shares | Type of Stock | Price Range | Average Price |
|---|---|---|---|---|
| *Thomas A. Donelan:* | | | | |
| March 31, 2003 | 176,668 | Common(1) | $ 0.12846 | $ 0.12846 |
| June 30, 2003 | 43,423 | Common(1) | $ 0.12846 | $ 0.12846 |
| March 31, 2004 | 37,563 | Common(1) | $ 0.44550 | $ 0.44550 |
| September 30, 2004 | 74,559 | Common(1) | $ 0.23600 | $ 0.23600 |
| December 31, 2004 | 49,989 | Common(1) | $ 0.17600 | $ 0.17600 |
| March 31, 2005 | 68,488 | Common(1) | $ 0.12846 | $ 0.12846 |
| *Paul R. Hays:* | | | | |
| June 30, 2003 | 1,600,000 | Common option | $ 0.08000 | $ 0.08000 |
| December 31, 2003 | 400,000 | Common option | $ 0.34000 | $ 0.34000 |
| September 30, 2004 | 100 | Series C preferred | $ 1,000.00000 | $ 1,000.00000 |
| December 31, 2004 | 10,653 | Common(1) | $ 0.17600 | $ 0.17600 |
| December 31, 2004 | 400,000 | Common option | $ 0.14000 | $ 0.14000 |
| March 31, 2005 | 14,596 | Common(1) | $ 0.12846 | $ 0.12846 |
| *Christopher P. Hendy:* | | | | |
| March 31, 2003 | 214,522 | Common(1) | $ 0.12846 | $ 0.12846 |
| June 30, 2003 | 52,727 | Common(1) | $ 0.12846 | $ 0.12846 |
| March 31, 2004 | 45,612 | Common(1) | $ 0.44550 | $ 0.44550 |
| September 30, 2004 | 84,688 | Common(1) | $ 0.23600 | $ 0.23600 |
| December 31, 2004 | 56,779 | Common(1) | $ 0.17600 | $ 0.17600 |
| March 31, 2005 | 77,792 | Common(1) | $ 0.12846 | $ 0.12846 |
| *Redwood Holdings, LLC:* | | | | |
| March 31, 2003 | 476,555 | Common(1) | $ 0.12846 | $ 0.12846 |
| June 30, 2003 | 117,133 | Common(1) | $ 0.12846 | $ 0.12846 |
| March 31, 2004 | 353,535 | Common(1) | $ 0.44550 | $ 0.44550 |
| September 30, 2004 | 17,852 | Common(1) | $ 0.23600 | $ 0.23600 |
| September 30, 2004 | 100 | Series C preferred | $ 1,000.00000 | $ 1,000.00000 |
| December 31, 2004 | 22,622 | Common(1) | $ 0.17600 | $ 0.17600 |
| March 31, 2005 | 30,995 | Common(1) | $ 0.12846 | $ 0.12846 |
| *Jerry L. Ruyan:* | | | | |
| March 31, 2003 | 694,045 | Common(1) | $ 0.12846 | $ 0.12846 |
| June 30, 2003 | 170,591 | Common(1) | $ 0.12846 | $ 0.12846 |
| March 31, 2004 | 147,570 | Common(1) | $ 0.44550 | $ 0.44550 |
| September 30, 2004 | 240,287 | Common(1) | $ 0.23600 | $ 0.23600 |
| December 31, 2004 | 161,101 | Common(1) | $ 0.17600 | $ 0.17600 |
| March 31, 2005 | 220,721 | Common(1) | $ 0.12846 | $ 0.12846 |

(1) These shares of common stock were acquired pursuant to elections of Redwood West Coast, LLC, as the majority holder of our Series C preferred stock, to receive shares of common stock in lieu of cash dividends on our Series C preferred stock, as permitted by the Certificate of Determination of our Series C preferred stock. Each share of our Series C preferred is entitled to an annual dividend of $75 per share, payable quarterly on January 31, April 30, July 31 and October 31 of each year. In the event that the election to receive shares of our common stock in lieu of the cash dividends is made, the number of shares of common stock to be issued in lieu of the cash dividends is calculated by dividing the cash amount of the dividend by

the 20-day trailing average of the closing price of our common stock, but in no event less then $0.12846 per share. Our board of directors and the Affiliates did not consider the price per share of these stock dividends in determining the fairness of the $0.13 cash-out price because the dividend prices were based on fluctuating prices determined in accordance with a formula that was set in our Certificate of Determination of our Series C preferred stock.

**MARKET FOR COMMON STOCK**

Information regarding the market for our common stock is located at Item 5 Market for Registrant s Common Equity, Stockholder Matters and Issuer Purchases of Equity Securities of our Annual Report on Form 10-K, which is included as Exhibit A to this proxy statement.

On April 18, 2005, the last full trading day before we announced the proposed Split Transaction, the closing price for our common stock in the over-the-counter market was $0.07.

On July 28, 2005, the last trading day before the record date, the closing price for our common stock in the over-the-counter market was $0.06.

The market price for our common stock is subject to fluctuation and shareholders are urged to obtain current market quotations.

**FINANCIAL AND OTHER INFORMATION**

This information is located at Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations ; Item 7A Quantitative and Qualitative Disclosures About Market Risk ; Item 8 Financial Statements and Supplementary Data ; and Item 9 Changes in and Disagreements With Accountants on Accounting and Financial Disclosure of our Annual Report on Form 10-K for the year ending December 31, 2004, which is included as Exhibit A to this proxy statement; Item 1 Financial Statements , Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations and Item 3 Quantitative and Qualitative Disclosures About Market Risk of our Quarterly Report on Form 10-Q for the quarter ending June 30, 2005, which is included as Exhibit B to this proxy statement; the pro forma financial information which is included as Exhibit C to this proxy statement; and the ratio of earnings to fixed charges and preference securities dividends which is included as Exhibit D to this proxy statement.

**SHAREHOLDER PROPOSALS**

To have been included in our proxy materials for the Annual Meeting of Shareholders to be held in 2005, a shareholder proposal must have been received at our offices, 11011 Via Frontera, San Diego, CA 92127, no later than April 25, 2005. We expect to hold the 2005 Annual Meeting of Shareholders in December 2005. In addition, our bylaws provide that no shareholder proposal may be presented at the 2005 Annual Meeting of Shareholders (i.e., even if it is not included in the proxy materials) unless the shareholder gives written notice of intent to do so to the Secretary of the corporation between 60 and 90 days before the 2005 Annual Meeting of Shareholders.

By order of the Board of Directors

Keith A. Butler

Secretary

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**Exhibit A**

# U.S. SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

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# FORM 10-K/A

## Amendment No. 2

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

**For the year ended December 31, 2004**

**OR**

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

**Commission file number 0-11303**

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# 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)**

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

**Securities registered pursuant to Section 12(b) of the Exchange Act: None**

**Securities registered pursuant to Section 12(g) of the Exchange Act: Common Stock**

**Preferred Stock Purchase Rights**

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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 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 ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and no disclosure will be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

The aggregate market value of the common stock held by non-affiliates of the registrant as of June 30, 2004 was approximately $3,041,000 based on the closing sale price as reported by the NASD over-the-counter bulletin board. Shares of common stock held by each officer, director and holder of 10% or more of the outstanding common stock, if any, have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of March 21, 2005, there were 21,606,126 shares of our common stock outstanding.

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## EXPLANATORY NOTE

On April 20, 2005, we filed a Schedule 13-E3 and a preliminary proxy statement with the Securities and Exchange Commission ( SEC ) pertaining to a proposed going-private transaction. Our Annual Report on Form 10-K for the year ending December 31, 2004 was included as Exhibit A to the preliminary proxy statement. We are amending certain portions of our Form 10-K, originally filed with the SEC on March 22, 2005 and amended on June 15, 2005, in response to additional comments received from the SEC.

## SYNBIOTICS CORPORATION

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## PART I

### Item 1. Business

### General

Synbiotics Corporation is a leading developer, manufacturer and provider of rapid diagnostic and laboratory diagnostic products for the animal health care industry. We are one of a small number of companies that focuses exclusively on animal health and we are a major provider of diagnostic products to the animal health market. Our product portfolio consists of 93 diagnostic test kits and detection devices. Many of our products hold strong positions in their specific markets. In recent years we have been moving to refocus our business on our core diagnostics products. Our primary source of revenues is the sale of our diagnostic products; likewise our primary source of expenses relate to the development, manufacturing and sales and marketing of those products.

In 2004, we successfully restructured our bank debt by entering into an amendment to our credit agreement with Comerica Bank, in connection with which we reduced the outstanding principal amount of a loan payable to Comerica, the remaining principal was sold by Comerica to an affiliate of our controlling shareholder, and we issued an amended promissory note to the affiliate.

In 2003, Agen Biomedical, Ltd., the former contract manufacturer of our Witness® products, terminated its supply agreement with us due to late payment of invoices for test kits. These Witness® products represented $4,345,000 and $8,069,000 of our net sales during 2003 and 2002, respectively. We identified a replacement, U.S.-based contract manufacturer and began the re-introduction of these Witness® products to the market in January 2004.

In 2002, we sustained a cash crisis, and at times we were on credit hold with several of our key suppliers. In response, we implemented a cost reduction program, sold our instrument manufacturing operations, which were located in Rome, New York, and disposed of our PennHIP® business, which was located in Malvern, Pennsylvania.

In 2001, we ended our participation in the veterinary vaccines business.

In 2000, we acquired our poultry diagnostic products business, and we disposed of W3COMMERCE, an Internet marketing services subsidiary.

### Market and Product Overview

We sell our products globally to veterinary practices, laboratories and poultry producers. We believe that our current and intended future products will offer veterinarians and other professionals an opportunity to improve the quality and expand the scope of animal health care services.

Our diagnostic products currently detect and/or measure the following diseases and/or conditions in animals:

| *Bovine:* | Brucellosis<br>Coagulation<br>Dermatophytes<br>Gastrointestinal parasites<br>Leukosis<br>Mastitis<br>Paratuberculosis<br>Rhinotracheitis<br>Tuberculosis<br>Viral diarrhea |
| --- | --- |

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| | |
|---|---|
| *Canine:* | Arthritis<br>Coagulation<br>Brucellosis<br>Dermatophytes<br>Ehrlichiosis<br>Gastrointestinal parasites<br>Heartworm<br>Leishmaniasis<br>Ovulation<br>Parvovirus<br>Pregnancy<br>Titer testing for distemper and parvovirus |
| *Equine:* | Coagulation<br>Dermatophytes<br>Infectious anemia<br>Gastrointestinal parasites |
| *Feline:* | Coagulation<br>Coronavirus<br>Dermatophytes<br>Gastrointestinal parasites<br>Heartworm<br>Immunodeficiency virus<br>Leukemia virus<br>Ovulation |
| *Poultry:* | Anemia virus<br>Bordetella avium<br>Encephalomyelitis virus<br>Hemorrhagic enteritis virus<br>Infectious bronchitis virus<br>Infectious bursal disease<br>Influenza virus<br>Laryngotracheitis<br>Leukosis virus<br>Mycoplasma gallisepticum<br>Mycoplasma meleagridis<br>Mycoplasma synoviae<br>Newcastle disease virus<br>Pasteurella multocida<br>Reovirus |
| *Primates:* | Coagulation<br>Dermatophytes<br>Gastrointestinal parasites<br>Tuberculosis |

Our most commercially successful products are our canine heartworm diagnostics (representing 24% of our net sales in 2004 and 2003, and 36%, of our net sales in 2002). We estimate that we have approximately a 15% share of the estimated $30 million U.S. canine heartworm diagnostics market. Sales of these products have historically been strongest during the first half of the year when distributors purchase merchandise to sell to veterinarians for the heartworm season.

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**Marketing and Distribution**

We sell our products throughout the world. In the United States, we market our line both directly and through independent distributors which, taken together, have approximately 90 outlets, 600 field sales representatives, and 200 telemarketing representatives covering the 25,000 veterinary clinics throughout the country. We also sell directly to laboratories and other centralized facilities. Outside the United States, we sell our small-animal products through distributors, and our food animal products directly to laboratories. We maintain a marketing and sales force, which trains distributor representatives, responds to technical inquiries and promotes products directly to veterinarians, laboratories and poultry producers.

**Manufacturing**

We manufacture most of our products at our facilities located in San Diego, California and Lyon, France. However, we rely on outside manufacturers for our WITNESS® canine heartworm, feline leukemia and canine parvovirus diagnostic products, and our SCA 2000 instrument products. We manufacture the key biological materials contained in our WITNESS® canine heartworm, feline leukemia and canine parvovirus diagnostic products.

Until early 2003, we relied on Agen Biomedical Limited as the contract manufacturer of our key Witness® products. After Agen terminated the supply agreement, we identified a replacement, U.S.-based contract manufacturer and began the re-introduction of these Witness® products to the market in January 2004.

**Patents and Trade Secrets**

We believe that our proprietary technology is an important competitive factor in our business, and that protection of our intellectual property rights is a high priority. The basic hybridoma (the cell that produces the monoclonal antibody) technology is in the public domain and is therefore not patentable. However, numerous improvements, variations and applications of hybridoma technology may prove to be patentable. Considering the difficulty of enforcing any patent rights to such improvements, and the rapid advancements in the field, we generally seek, and will continue to seek, to protect our interests by treating our particular variations in the production of monoclonal antibodies as trade secrets. We also pursue, and intend to continue to aggressively pursue, protection for new products, new methodological concepts, and compositions of matter through the use of patents where obtainable. At present, we have been granted 8 U.S. patents. We believe that certain products sold by Agen and by Heska Corporation infringed our heartworm detection patent, and we separately sued each of them for patent infringement. We settled our litigation with Agen in 2004, and we settled our litigation with Heska in 2003. Our heartworm detection patent expires in December 2005.

**Government Regulation**

Most diagnostic test kits for animal health applications marketed in the U.S. require approval by the United States Department of Agriculture ( USDA ). Certain foreign countries in which we market our diagnostic products also require governmental approval for animal diagnostic products. Our instrumentation products are not subject to USDA regulation. Our canine semen freezing products and canine ovulation timing diagnostic products fall within the definition of devices as that term is defined in the Federal Food, Drug, and Cosmetic Act and, therefore, may be subject to regulation by the FDA.

To our knowledge, all of our diagnostic products comply with the regulations of the USDA, FDA and comparable foreign governmental authorities to the extent applicable, and have been in compliance for the past three years.

Our manufacturing facilities in San Diego and Lyon, France are licensed by the USDA and adhere to Good Manufacturing Practices ( GMP ) standards. Our French manufacturing facility, which is ISO 9002 certified, is not licensed by any foreign regulatory agency as there is no licensing requirement. The manufacturing facilities of our important suppliers are subject to licensing and regulatory approval in both the United States and Europe.

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In addition to the foregoing, 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.

**Competition**

We are a major provider of diagnostic products to the animal health market. Most of our competitors are either small divisions of larger human health and chemical companies or smaller companies that sell veterinary products while trying to diversify into the higher profile, and more regulated, human health field. The principal competitor in the industry is IDEXX Laboratories, Inc., a publicly traded company with annual revenues of $549,000,000 (for 2004) that develops, manufactures, and distributes detection and diagnostic products for animal health, food, and environmental testing applications.

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 IDEXX Laboratories, a significantly larger company, Heska Corporation, to whom we granted a non-exclusive license of our canine heartworm patent in 2003, and Agen Biomedical Limited, to whom we granted a non-exclusive license of our canine heartworm patent in 2004, the former contract manufacturer of certain of our WITNESS® diagnostic products. These companies 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 core canine heartworm diagnostic products can be subject to significant additional competition, affecting both our market share and our average selling price. We sued Heska for infringing our patent; the suit was settled in 2003 and Heska agreed to pay us a royalty. We also sued Agen, which entered the U.S. market in 2003, for infringing our patent; the suit was settled in 2004 and Agen agreed to pay us a royalty. However, our patent expires in December 2005. Despite expiration of the patent, the biological component of our in-clinic canine heartworm diagnostic test is proprietary to us; however, pursuant to our settlement with Agen, we supply Agen with our biological materials for their competing tests in this area and in the canine parvovirus area.

**Research and Development**

We spent approximately $1,486,000 and $1,177,000 on research and development activities during the years ended December 31, 2004 and 2003, respectively. These figures include both internal research and development and expenditures under contracts for research and development activities with outside parties relating to certain veterinary diagnostic products which utilize licensed technology.

**Employees**

As of December 31, 2004, we had a total of 96 employees worldwide, 93 of whom were full-time. In March 2005, we effected a two-person reduction in force at SBIO-E.

**Raw Materials**

The manufacturing of diagnostics and diagnostic instruments requires raw materials which generally are, and have been, readily available from several sources, or which (in the case of certain proprietary biological materials) we culture ourselves.

**Financial Information About Industry Segments and Financial Information About Foreign and Domestic Operations and Export Sales**

See Note 14 to our financials statements in Item 8 of Part II of this Form 10-K.

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**Item 2. Properties**

We lease two buildings in San Diego, California. The buildings contain approximately 42,000 square feet of space, and house our corporate and sales headquarters, executive offices, U.S. research and development laboratories and manufacturing facilities. We also lease an approximately 25,000 square foot building in Lyon, France which houses Synbiotics Europe s ( SBIO-E ) corporate and sales headquarters, executive offices, research and development laboratories and manufacturing facilities. In addition, we lease a small research office in College Park, Maryland.

We believe that these facilities are adequate for our current level of operations.

**Item 3. Legal Proceedings**

None.

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

The Annual Meeting of Shareholders was held on October 7, 2004. The following matters were submitted to a vote, with the results below:

(a) Election of directors:

| Nominee | For | Withheld |
|---|---|---|
| Thomas A. Donelan | 36,746,936 | 698,908 |
| Paul R. Hays | 36,727,791 | 718,053 |
| Christopher P. Hendy | 36,727,271 | 718,573 |

(b) Approval of the 2004 Stock Option/Stock Issuance Plan:

| For | Against | Abstain | Broker Non-Votes |
|---|---|---|---|
| 28,144,839 | 1,197,937 | 73,695 | 8,029,373 |

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PART II

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

Our common stock is quoted in the over-the-counter market under the symbol SBIO. Price ranges reported are the high and low sale price information as reported by the over-the-counter market, or, in some periods, the NASD s OTC Bulletin Board. All such market quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission. As of March 21, 2005, there were approximately 567 shareholders of record of our common stock.

| Year | Quarter | High | Low |
|---|---|---|---|
| 2003 | 1st Quarter | $ 0.09 | $ 0.07 |
| | 2nd Quarter | $ 0.20 | $ 0.06 |
| | 3rd Quarter | $ 0.19 | $ 0.11 |
| | 4th Quarter | $ 0.93 | $ 0.13 |
| 2004 | 1st Quarter | $ 0.61 | $ 0.31 |
| | 2nd Quarter | $ 0.44 | $ 0.21 |
| | 3rd Quarter | $ 0.27 | $ 0.10 |
| | 4th Quarter | $ 0.22 | $ 0.12 |

We have never paid cash dividends on our common stock and do not expect to do so in the foreseeable future. In addition, the terms of our bank loan and of our Series C preferred stock restrict our ability to pay any cash dividends on our common stock.

### Item 6. Selected Financial Data

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2004 | 2003 | 2002 | 2001 | 2000 |
| | (In Thousands, Except Per Share Data) | | | | |
| Consolidated Statement of Operations Data: | | | | | |
| Total revenues | $ 19,219 | $ 19,211 | $ 21,671 | $ 26,532 | $ 29,738 |
| (Loss) income from continuing operations | (647) | 1,287 | (6,862) | 626 | (13,193) |
| Net (loss) income | (647) | 1,287 | (14,401) | 431 | (18,518) |
| Basic (loss) income per share: | | | | | |
| (Loss) income from continuing operations | (0.04) | 0.06 | (0.48) | 0.06 | (1.43) |
| Net income (loss) | (0.04) | 0.06 | (1.00) | 0.04 | (2.00) |
| Diluted (loss) income per share: | | | | | |
| (Loss) income from continuing operations | (0.04) | 0.03 | (0.48) | 0.06 | (1.43) |
| Net (loss) income | (0.04) | 0.03 | (1.00) | 0.04 | (2.00) |

December 31,

| | 2004 | 2003 | 2002 | 2001 | 2000 |
|---|---|---|---|---|---|
| | | | (In Thousands) | | |
| Consolidated Balance Sheet Data: | | | | | |
| Total assets | $ 15,522 | $ 15,341 | $ 15,436 | $ 26,502 | $ 32,202 |
| Long-term obligations | 5,148 | 2,134 | 6,478 | 10,943 | 7,508 |

**Item 7. 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 Annual Report on Form 10-K contains both historical financial information and forward-looking statements. Forward-looking statements are characterized by words such as

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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 Certain Risk Factors , which could cause actual future results to differ materially from what is suggested by the forward-looking information.

***Overview***

We are still working to recover from the effects of our cash crisis in 2002. Our auditors report on our 2004 financial statements contains a going-concern explanatory paragraph a statement that there is substantial doubt about our ability to continue as a going concern. Our total revenues and net sales have been declining annually since 2000, although they were essentially flat in 2004 from 2003. We believe that our operations have stabilized and that, with continued attention to steady and careful execution of our turnaround business plan, we can increase shareholder value.

Our main challenge in 2005 will be to resolve our unsecured contractual obligations of $1,000,000 due in July 2005 and $1,500,000 due in July 2006, both to the same unrelated third party. We cannot afford to make these payments as scheduled. If we miss the July 2005 payment, the entire obligation will be accelerated and will begin bearing interest at 10.5%.

In September 2004, we successfully resolved a similar situation, where we were unable to pay at maturity the remaining $4,804,000 principal amount of our loan from Comerica Bank. The resolution involved extension and amendment of the loan terms and the sale by Comerica of most of the loan to a company affiliated with Redwood West Coast, LLC, our majority shareholder.

The profitability of our canine heartworm diagnostic products has diminished due to competition from new entrants to the in-clinic canine heartworm diagnostics market, Heska and Agen. We believe their products infringed our U.S. patent in this area, and we separately sued them for patent infringement. Although we incurred significant litigation costs, the final settlements of these cases in 2003 and 2004 did not include barring their products from the market. Agen s distributor appears to be following a price-cutting strategy, so this new competition is adversely affecting both our market share and our average selling price. In any event, our U.S. patent in this area expires in December 2005, and after then we would be unable to prevent any further additional competitors from entering this market.

We believe our results in 2005 and thereafter will benefit if we can avoid the heavy patent litigation expense we experienced in 2002, 2003 and, particularly, 2004. We currently are not involved in any litigation.

Our management and board of directors are beginning to explore a possible transaction that would result in our ceasing to be subject to SEC filing and reporting requirements. This possible transaction is a reverse stock split in which shareholders who do not hold a minimum number of shares of our common stock would have their shares converted into cash. Such a transaction would also result in a slight increase in the equity ownership of our shareholders whose shares are not converted into cash.

We have been monitoring the costs of operating as a publicly reporting company to determine whether, in our judgment, the direct and indirect costs outweigh the benefits to us and our shareholders. We incur significant costs associated with being a publicly traded company. Among other things, these costs include legal fees and audit fees (including fees for quarterly reviews performed by our auditors). In 2004, we began incurring

the direct and indirect costs associated with Sarbanes-Oxley Act Section 404 compliance, and these will add significantly to our costs. The expenses associated with implementing the additional processes and procedures necessary for Section 404 compliance, which was originally to take effect for our fiscal year 2005 but has now been delayed by the SEC until our fiscal year 2006, and the required attestation of those controls have been

estimated to be equal to the entire cost of the fiscal 2004 year-end audit. Moreover, Section 404 compliance will inevitably result in a diversion of management time and attention from other duties.

We have not reached any conclusion about whether the costs of being a publicly traded SEC reporting company outweigh the benefits, but as noted above we are evaluating a possible transaction the effect of which would be that we would no longer remain an SEC reporting company. Any such transaction would be designed to result in our having less than 300 stockholders of record, making us eligible to cease making SEC filings, such as annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and proxy statement disclosures, as well as our not having to comply with Section 404. While there would be a one-time cost to this transaction, which would be subject to shareholder approval, we believe that the decrease in ongoing direct costs would be approximately $150,000 per year.

If we decide to do a transaction as described above, public trading in our common stock, which is currently traded over-the-counter, would effectively become impossible after we opted out of our SEC filing obligations, due to the lack of publicly available information about us such as financial statements.

***Results of Operations***

*Year Ended December 31, 2004 Compared to Year Ended December 31, 2003*

Our net sales for 2004 decreased by $59,000 or less than 1% from 2003. The decrease reflects a decrease in our diagnostic product sales of $613,000 offset by an increase in our instrument product sales of $554,000, and also reflects a 10% increase in foreign currency exchange rates which affects the consolidation of SBIO-E and itself added $638,000 to our 2004 revenues. Sales of our diagnostic products decreased primarily due to additional competition in the canine heartworm diagnostic market from Agen Biomedical Ltd. ( Agen ), as well as disappointing performance at SBIO-E. Agen s in-clinic canine heartworm diagnostic product is similar to our Witness® canine heartworm diagnostic test kit. Our instrument product sales increased primarily due to increased placements of our SCA 2000 blood coagulation timing instrument and the resulting sales of the related consumables, as well as increases in the average selling prices of the consumables.

Agen is currently distributing its products in the U.S. through Vedco, a co-operative buying group. Several of the member-owners of this buying group also distribute our canine heartworm and other products, but have decided to promote Agen s canine heartworm product instead of ours. Additionally, Agen s distributors marketed the canine heartworm product with a price which is significantly less than previously established prices in this market. As a result, we have been forced to compete on price and our average selling price for our Witness® canine heartworm product during 2004 was 16% less than that during 2003. We do not believe that this price erosion will be easily reversed, especially after our U.S. canine heartworm detection patent expires in late 2005.

In April 2003, Agen terminated its supply agreement with us. Agen had been our contract manufacturer for certain of our Witness® in-clinic diagnostic products including canine heartworm, feline leukemia, feline heartworm and canine parvovirus, using key biological components which we manufacture at our facilities and had provided to Agen. We then identified a U.S.-based alternate contract manufacturer of the same Witness® products previously manufactured for us by Agen. We licensed the alternate-source Witness® canine heartworm product with the USDA, and we began selling this product in January 2004. We licensed the alternate-source Witness® feline leukemia product with the USDA, and began selling this product in August 2004. Our alternate-source canine parvovirus product was licensed by the USDA, and we began selling this product, in February 2005. In addition to the material impact during 2004, we also believe that our results of operations and financial condition could be materially adversely affected in 2005 and beyond if we are unable to fully succeed in reintroducing the alternate-source products into the market.

In December 2004, one of our distributor customers placed an order totaling $546,000, which was shipped and invoiced in December 2004. The order represented approximately 50% of the customer s prior twelve months purchases. We believe that due to the size of the order, the customer will not be placing any significant

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orders with us during the first quarter of 2005. Because the heartworm selling season straddles December and the first part of the next year, our year-to-year periodic results often vary as a result of such timing differences.

We recognize revenue from product sales when title and risk of loss transfers to our customer, which is generally upon shipment. Amounts we charge to our customers for shipping and handling are included in our net sales. We provide promotional discounts and rebates to certain of our distributors. Based upon the structure of these rebate programs and our past history, we are able to accurately estimate the amount of rebates at the time of sale. These rebates are recorded as a reduction of our net sales. We recognize license fee revenue ratably over the license term when we have further performance obligations to our licensee. In the event that we have no further performance obligations to our licensee, we recognize license fee revenue upon receipt.

Our cost of sales as a percentage of our net sales was 48% during 2004 as compared to 49% during 2003. The decrease is due to improved margins on our Witness® canine heartworm diagnostic and feline leukemia products due to a change in contract manufacturers (offset by decreased selling prices), and on our SCA 2000 consumables due to increased selling prices. A significant portion of our manufacturing costs are fixed.

Among our major products, our DiroCHEK® canine heartworm diagnostic products and our poultry products are manufactured at our facilities, whereas our WITNESS® in-clinic canine heartworm, feline leukemia, and canine parvovirus diagnostic products and our SCA 2000 instrument products are manufactured by third parties. We manufacture the key biological materials contained in our WITNESS® canine heartworm, feline leukemia and canine parvovirus diagnostic products. In addition to affecting our gross margins, outsourcing of manufacturing renders us relatively more dependent on the third-party manufacturers. Agen, the previous contract manufacturer of certain of our Witness® products, ceased to supply us with those products In April 2003. We then identified a U.S.-based alternate contract manufacturer of the same Witness® products previously contract manufactured for us by Agen, and the cost of these products to us is lower than the cost of those contract manufactured for us by Agen. However, we lost substantial sales during the hiatus between the two contract manufacturers. In 2004 we incurred costs to re-license the in-clinic feline leukemia and canine parvovirus diagnostic products with the USDA, and we incurred costs in 2003 to re-license the in-clinic canine heartworm diagnostic product with the USDA.

Our research and development expenses increased by $309,000 or 26% during 2004 as compared to 2003. The increase is a result of a $103,000 increase in research and development expenses contracted by us from a third party, and increase of $68,000 in laboratory supplies, and $56,000 directly reflecting an increase in foreign currency exchange rates over 2003 of 10%. The increase in the foreign currency exchange rates affects the consolidation of SBIO-E. Our research and development expenses as a percentage of our net sales were 8% and 6% during 2004 and 2003, respectively.

Our selling and marketing expenses did not change significantly during 2004 as compared to 2003. Our selling and marketing expenses as a percentage of our net sales were 22% during 2004 and 2003.

Our general and administrative expenses increased $2,139,000 or 61% during 2004 as compared to 2003. The increase is primarily due to $1,314,000 of legal expenses associated with our lawsuit with Agen. We hope to minimize legal expenses in 2005, and we are not currently involved in any litigation. In addition, an extra $158,000 of our 2004 general and administrative expenses were simply due to an increase in foreign currency exchange rates over 2003 of 10%. The increase in the foreign currency exchange rates affects the consolidation of SBIO-E. Our general and administrative expenses as a percentage of our net sales were 30% and 18% during 2004 and 2003, respectively.

In December 2004, the Financial Accounting Standards Board ( FASB ) issued FASB Statement No. 123R, Share-Based Payments ( FAS 123R ). FAS 123R is a revision of FASB Statement No. 123, Accounting for Stock-Based Compensation , and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees and its related implementation guidance.

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FAS 123R requires that the cost of all awards of equity instruments made to employees in exchange for employment services be recorded at fair value on the grant date, and the cost be charged to expense as the award vests. The determination of fair value is based upon option-pricing models (for example, Black-Scholes) adjusted for characteristics unique to the equity instrument.

We will be required to charge to expense the fair value of employee stock options which vest on or after July 1, 2005, and we expect to record compensation expense related to unvested employee stock options outstanding as of December 31, 2004, as follows: 2005 $33,000; 2006 $67,000; 2007 $46,000; 2008 $9,000.

In September 2003, we filed a lawsuit against Agen alleging that Agen infringed a patent owned by us relating to canine heartworm diagnostic technology. In June 2004, we entered into a settlement agreement with Agen which resolved all outstanding claims in the lawsuit. As part of the agreement, each party licensed certain intellectual property rights from the other party, including Agen licensing from us the patent relating to the canine heartworm diagnostic technology, and we received $425,000 in June 2004, and we will receive $425,000 in June 2005. As a result, we recorded a one-time credit to operating expenses totaling $850,000 during 2004. In addition, we agreed that we will continue to supply certain proprietary biologicals to Agen at specified prices, and we will receive a percentage of Agen s sales of Agen products containing the supplied biologicals. The Agen products compete directly with similar products of ours in the marketplace.

In November 1998, we filed a lawsuit against Heska Corporation alleging that Heska infringed a patent owned by us relating to heartworm diagnostic technology. In March 2003, we entered into settlement and license agreements with Heska which resolved all outstanding claims in the lawsuit. As part of those agreements, each party has licensed certain intellectual property rights from the other party, including Heska licensing from us the patent relating to the heartworm diagnostic technology. In addition, we received $250,000 in April 2003, and we are receiving $265,000 in 24 monthly installments of $11,000 beginning in January 2004. As a result, we recorded a one-time credit to operating expenses totaling $515,000 during 2003. In addition, Heska agreed to make royalty payments to us on its sales of licensed canine heartworm diagnostic products beginning April 2003, until our patent expires in December 2005.

As a result of these settlement agreements, our royalty income during 2004 increased by $67,000 or 17% as compared to 2003. Any future royalty income will, of course, depend on the other companies net sales, which tend to be at the expense of our own product sales; also, depressed pricing in the market will tend to reduce the other companies net sales and thus reduce our future royalty income.

Our net interest expense decreased by $46,000 or 9% during 2004 as compared to 2003. The decrease is due to decreases in the outstanding principal balance of our bank debt, and due to the restructuring of our bank debt in September 2004.

We recognized a benefit from income taxes of $60,000 during 2004 as compared to a benefit from income taxes of $2,000 during 2003. The change is due primarily to an $84,000 deferred foreign tax benefit related to SBIO-E in 2004, offset by current foreign income tax expense related to SBIO-E during 2004 and minimum state income taxes in 2004.

A review of our business, in light of the market, reveals that our food animal diagnostics are not meeting their relative geographic sales potentials. Food animal diagnostics measure the health of herds or flocks and provide information for the economic management of herds or flocks. We currently manufacture all our poultry products at our San Diego, California facility and the majority of our livestock products at our Lyon, France facility. Both lines perform better in their local markets. Our intent is to better internationalize those portfolios. We are also developing, both internally and through in-licensing arrangements, new food animal diagnostic products that would expand and enhance our existing product line. These growth opportunities will necessitate additional expenses in research and development as well as improved marketing to effectively target this market

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if the development projects come to fruition successfully. In March 2005, we effected a two-person reduction in force at SBIO-E, in part as a result of this review. The reduction in force related to senior management positions. Due to severance costs associated with this reduction in force, the impact on our 2005 results of operations will be negligible. The savings from the reduction in force will be more readily evident in our 2006 results of operations.

*Year Ended December 31, 2003 Compared to Year Ended December 31, 2002*

Our net sales for 2003 decreased by $2,557,000 or 12% from 2002. The decrease reflects a decrease in our diagnostic product sales of $2,858,000 offset by an increase in our instrument product sales of $301,000. Sales of our diagnostic products decreased due to the termination by Agen of our supply agreement under which Agen supplied us with certain of our Witness® diagnostic products, as discussed below, leaving us with no inventory of these products for over half the year. Our instrument product sales increased primarily due to increased placements of our SCA 2000 blood coagulation timing instrument, and the resulting sales of the related consumables.

In April 2003, we were notified by Agen that Agen was terminating its supply agreement with us due to late payment of invoices for test kits. Agen had been the contract manufacturer for certain of our Witness® in-clinic diagnostic products including canine heartworm, feline leukemia, feline heartworm and canine parvovirus, using key biological components which we manufacture at our facilities and had provided to Agen. These Witness® products represented $4,345,000 and $8,069,000 of our net sales during 2003 and 2002, respectively.

We identified a U.S.-based alternate contract manufacturer of the same Witness® products previously manufactured for us by Agen and began the process of licensing the alternate-source Witness® products with the USDA.

Agen introduced into the U.S. market in October 2003 a canine heartworm diagnostic product which is essentially identical to our Witness® canine heartworm diagnostic test kit, including biological components which incorporate our patented technology. In September 2003, we filed a patent infringement lawsuit against Agen claiming that Agen has willfully infringed our U.S. Patent No. 4,789,631 pertaining to heartworm detection technology. In addition to seeking damages, we asked for an injunction against Agen, preventing Agen from importing, selling or offering for sale their canine heartworm diagnostic test kit in the United States. The lawsuit was ultimately settled in June 2004.

Our cost of sales as a percentage of our net sales was 49% during 2003 and 2002. The preservation of margin despite reduced sales was heartening, because a significant portion of our internal manufacturing costs are fixed. Among our major products, our DiroCHEK® canine heartworm diagnostic products and our poultry products are manufactured at our facilities, whereas our WITNESS® in-clinic canine heartworm, feline leukemia, and canine parvovirus diagnostic products and our SCA 2000 instrument products are manufactured by third parties. We manufacture the key biological materials contained in our WITNESS® canine heartworm, feline leukemia and canine parvovirus diagnostic products. In addition to affecting our gross margins, outsourcing of manufacturing renders us relatively more dependent on the third-party manufacturers. Agen, the previous contract manufacturer of certain of our Witness® products, ceased to supply us with those products In April 2003. We identified a U.S.-based alternate contract manufacturer of the same Witness® products previously contract manufactured for us by Agen, and the cost of these products to us is lower than the cost of those contract manufactured for us by Agen. In 2003 we also incurred costs to re-license these products with the USDA.

Our research and development expenses decreased by $203,000 or 15% during 2003 as compared to 2002. The decreases are a result of a cost reduction program that was implemented at the end of the third quarter of 2002, offset by costs incurred 2003 related to the re-launching of our Witness® canine heartworm product. Our research and development expenses as a percentage of our net sales were 6% during 2003 and 2002.

Our selling and marketing expenses decreased $228,000 or 5% during 2003 as compared to 2002. The decreases are a result of a cost reduction program, including reductions in headcount, that were implemented at the end of the third quarter of 2002. Our selling and marketing expenses as a percentage of our net sales were 22% and 20% during 2003 and 2002, respectively.

Our general and administrative expenses decreased by $5,283,000 or 60% during 2003 as compared to 2002. The decrease during 2003 was primarily attributable to the non-recurrence of $3,682,000 of retention bonuses that became payable in the first quarter of 2002. The decrease was also attributable to a cost reduction program, including reductions in headcount, that was implemented at the end of the third quarter of 2002, and favorable effects of foreign currency exchange rates on our intercompany balances. 2002 expenses were also higher due to severance costs for three senior officers, including our former chief executive officer. Our general and administrative expenses as a percentage of our net sales were 19% and 41% during 2003 and 2002, respectively. Excluding the first quarter 2002 bonus expense our general and administrative expenses would have been $5,090,000 or 24% of our net sales during 2002.

In 2003 we incurred $421,000 of litigation expenses related to the Agen and Heska lawsuits. Our litigation expenses in 2002 were $161,000, all for the Heska lawsuit.

In November 1998, we filed a lawsuit against Heska Corporation alleging that Heska infringed our U.S. Patent No. 4,789,631 relating to heartworm diagnostic technology. In March 2003, we entered into settlement and license agreements with Heska which resolved all outstanding claims in the lawsuit. As part of those agreements, each party has licensed certain intellectual property rights from the other party, including Heska licensing from us the patent relating to the heartworm diagnostic technology. In addition, we received $250,000 in April 2003, we will receive $265,000 in 24 monthly installments of $11,000 beginning in January 2004. As a result, we recorded a one-time credit to operating expenses totaling $515,000 during 2003. We receive royalty payments on sales of licensed canine heartworm diagnostic products beginning April 2003. We recognized royalty income related to this license totaling $277,000 during 2003.

Our net interest expense decreased by $177,000 or 26% during 2003 as compared to 2002. The decrease was due to decreases in the prime rate, and to decreases in the outstanding principal balances of our bank debt.

We recognized a benefit from income taxes of $2,000 during 2003 as compared to a provision for income taxes of $7,000 during 2002. We are limited in the utilization of certain of our Federal and state net operating loss carryforwards. As a result of this limitation, $15,351,000 of our Federal net operating loss carryforwards, and $969,000 of our state net operating loss carryforwards, may expire before they can be utilized. In addition, California placed a moratorium on the utilization of net operating loss carryforwards for 2003.

In the first quarter of 2002, we adopted Statement of Financial Accounting Standards No. 142 ( FAS 142 ), Goodwill and Other Intangible Assets . In connection with the adoption of FAS 142, we performed a transitional goodwill impairment assessment. As a result of this impairment assessment, we recorded an impairment of $7,649,000, net of income tax benefit of $106,000, which is classified as a cumulative effect of a change in accounting principle in the first quarter of 2002. FAS 142 requires that we perform subsequent impairment assessments on an annual basis, or on an interim basis if events occur that may cause an impairment of our goodwill and other intangible assets. In 2002, as a result of the annual assessment based upon the market price of the our common stock on December 31, 2002, we recorded an additional impairment loss of $2,877,000. Based upon the market price of the Company s common stock on December 31, 2003, there was no impairment loss resulting from the annual impairment assessment in 2003.

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*Financial Condition and Liquidity*

The following table summarizes the future cash payments related to our contractual obligations (other than trade payables) as of December 31, 2004 (amounts are in thousands):

| | Total | 2005 | 2006 | 2007 | 2008 | 2009 | Thereafter |
|---|---|---|---|---|---|---|---|
| Long-term debt | $ 4,381 | $ 546 | $ 542 | $ 390 | $ 343 | $ 371 | $ 2,189 |
| Operating leases | 4,833 | 956 | 766 | 524 | 414 | 414 | 1,759 |
| Other long-term obligations | 2,500 | 1,000 | 1,500 | | | | |

On September 23, 2004, we entered into an amendment (the Credit Agreement Amendment ) of our credit agreement with Comerica Bank ( Comerica ), effective as of September 1, 2004. Our note to Comerica had matured on January 25, 2004, but we were unable to pay the matured amount and instead we commenced negotiations which ultimately led to the Credit Agreement Amendment. The outstanding principal balance of our bank debt immediately prior to the Credit Agreement Amendment was $4,472,000. Under the Credit Agreement Amendment, we issued an amended promissory note to Comerica in the amount of $599,000 (the Comerica Note ), and Comerica sold the remaining principal of $3,873,000 to Remington Capital, LLC ( Remington ), which is an affiliate of Redwood West Coast, LLC, our majority shareholder. We simultaneously issued an amended promissory note to Remington in the amount of $3,873,000 (the Remington Note ).

The Comerica Note bears interest at the rate of prime plus 2%, and is payable in monthly installments, from October 1, 2004 to August 1, 2007, of $9,000 plus accrued interest (except the payments due on September 1, 2005 and 2006 are in the amount of $151,000 plus accrued interest). The Remington Note, which is subordinate to the Comerica Note, bears interest at the fixed rate of 7.75%, and is payable in blended monthly installments of principal and interest, from September 25, 2004 to August 25, 2014, of $46,000. Both the Comerica Note and the Remington Note are secured by substantially all of our assets.

Pursuant to the Credit Agreement Amendment, we issued to both Comerica and Remington warrants to purchase 250,000 shares of our unregistered common stock at an exercise price of $0.17 per share. The warrants are exercisable at any time through September 1, 2010.

In addition, on September 2, 2004, we entered into a Series C Purchase Agreement (the Series C Agreement ) with Redwood Holdings, LLC, Paul Hays and Fintan and Janice Molloy. Under the Series C Agreement, simultaneously with the closing under the Credit Agreement Amendment, we sold to the above named parties a total of 250 newly-issued shares of unregistered Series C preferred stock for consideration totaling $250,000 in cash. Redwood Holdings, LLC and Mr. Hays each received 100 shares at the September 23, 2004 closing, and Mr. and Mrs. Molloy received 50 shares at the September 23, 2004 closing. Each share of Series C preferred stock is convertible at any time into 7,785 unregistered shares of our common stock (subject to anti-dilution adjustments).

On October 3, 2004, we sold to an unrelated third party 50 newly-issued shares of our unregistered Series C preferred stock for consideration totaling $50,000 in cash. Each share of Series C preferred stock is convertible at any time into 7,785 unregistered shares of our common stock (subject to anti-dilution adjustments).

Remington is indirectly owned 100% by Jerry L. Ruyan, Thomas A. Donelan and Christopher P. Hendy (collectively Redwood ). Redwood also owns 94% of the remaining 2,800 shares of our Series C preferred stock originally outstanding and is our controlling shareholder. Mr. Donelan and Mr. Hendy, two of the three members of our board of directors, each own 24.9% of Redwood Holdings, LLC. Mr. Hays is our President and Chief Executive Officer, and is also a member of our board of directors.

As of December 31, 2004, we had working capital of $4,943,000. We have a $1,000,000 contractual obligation due in July 2005, and another $1,500,000 contractual obligation, to the same party, due in July 2006.

We do not believe that our cash position will be sufficient to fund our operations and service our bank debt for the next twelve months if we also pay the $1,000,000 contractual obligation when it becomes due. The contractual obligation is unsecured. In the event that we do not make the payment when it comes due, the $1,500,000 due in July 2006 becomes immediately due, and the entire $2,500,000 will begin bearing interest at 10.5%. We plan on approaching the party to whom we owe these contractual obligations in an effort to enter into a payment arrangement; however, there can be no assurance that any such renegotiation will be successful. As a result, we may well require additional financing in the future, and there can be no assurance that such financing would be available to us on favorable terms, or at all. Because our stock price is low, any equity financing would significantly dilute current shareholders.

Our operations are moderately seasonal due to the sales of our canine heartworm diagnostic products. Our sales and profits have historically tended 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. In addition, sales of our SCA 2000 instruments and supplies and our poultry diagnostic products reduce our seasonality.

***Certain Risk Factors***

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

**We have a short-term obligation that we cannot afford to pay in accordance with it terms; we may need additional capital in the future**

Our auditors report on our 2004 financial statements contains a going-concern explanatory paragraph.

As of December 31, 2004, we had working capital of $4,943,000. We have a $1,000,000 contractual obligation due in July 2005, and another $1,500,000 contractual obligation, to the same unrelated party, due in July 2006. We do not believe that our current working capital will be sufficient to fund our operations and service our bank debt for the next twelve months if we also pay the $1,000,000 contractual obligation when it becomes due. The contractual obligation is unsecured. In the event that we do not make the payment when it comes due, the $1,500,000 due in July 2006 becomes immediately due, and the entire $2,500,000 will begin bearing interest at 10.5%. We plan to renegotiate this unsecured debt; however, there can be no assurance that any such renegotiation will be successful. As a result, we may well require additional financing in the future, and there can be no assurance that such financing would be available to us on favorable terms, or at all. Because our stock price is low, any equity financing would significantly dilute current shareholders. 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 development programs, the cost of manufacturing scale-up, the costs involved in preparing, filing, prosecuting, maintaining and enforcing patent claims, 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. If adequate funds are not available, or are not available on acceptable terms, we may not be able to take advantage of market opportunities, to develop new products, or to otherwise respond to competitive pressures. This inability could materially harm our business.

If we are unable to fully succeed in responding to competition in the canine heartworm market and in other business, it could also hinder our ability to obtain any other necessary additional capital and/or create sooner the need to obtain financing.

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**We may be unable to fully succeed in reintroducing our key Witness® products**

Agen was the contract manufacturer of certain of our Witness® in-clinic diagnostic products, and Agen ceased supplying these products in April 2003. We have licensed the alternate-source Witness® canine heartworm, feline leukemia virus and canine parvovirus products with the USDA (now supplied by another contract manufacturer), and we began selling the canine heartworm product in January 2004, the feline leukemia virus product in August 2004 and the canine parvovirus product in February 2005. In addition to the risks that the alternate-source products will experience quality issues, cannot be supplied reliably, etc., we cannot ensure that after our products have been off the market for several months we will necessarily be able to regain our previous market share and our previous price points.

**The market in which we operate is intensely competitive, especially 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 IDEXX Laboratories, a significantly larger company, Heska Corporation and Agen. These companies 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 constituted 24% of our sales for the year ended December 31, 2004. In addition to our historic competition with IDEXX Laboratories, the sales leader in this product category, our sales have been substantially affected by Heska entering the market in 1999, and their benefiting from us being out of the market after Agen terminated our supply agreement. Since October 2003, Agen has also entered the market. Additional competition, including erosion of the average selling price, from Agen in this key market with this product has seriously damaged us. We could face renewed competition from other new competitors when our U.S. heartworm patent expires in December 2005.

Under our settlement with Agen in June 2004, we licensed Agen our U.S. heartworm patent. In addition we agreed to sell to Agen the same biological components as are used in our own Witness® in-clinic canine heartworm and canine parvovirus diagnostic products. Agen is therefore able to manufacture and sell canine heartworm diagnostic and canine parvovirus products that are substantially the same as ours. If Agen were to have its in-clinic canine heartworm diagnostic products made by the same contract manufacturer as we use, it would further diminish our ability to distinguish our products in the marketplace and achieve satisfactory pricing.

As previously mentioned, as a result of Agen ceasing to contract manufacture our Witness® products our sales were materially adversely affected in 2003 and 2004, and we believe that our sales could be materially adversely affected in 2005 and beyond if we are unable to fully succeed in reintroducing the alternate-source products into the market. There can be no assurances that we will be able to achieve our previous sales levels of these in-clinic products.

**We have a history of losses and an accumulated deficit**

Although we were profitable in 2003, we had a loss in 2004, and we have had a history of annual losses. We have incurred a consolidated accumulated deficit of $46,113,000 at December 31, 2004. 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.

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**We rely on third party distributors for a substantial portion of our sales**

We have historically depended upon distributors for a large portion of our sales, and we may not have the ability to establish and maintain an adequate independent sales and marketing capability in any or all of our targeted markets. 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. Also, the distributors are not bound to us by long-term agreements, and a decision by any major distributor to stop doing business with us could materially hurt our revenues. Agen is currently distributing its products through Vedco, a co-operative buying group. Several of the members/owners of this buying group also distribute our products, but have decided to promote Agen s canine heartworm product instead of ours. IDEXX Laboratories prohibition against its distributors carrying competitors products, including ours, has made, and could continue to make, some distributors unavailable to us. In the past, we have lost major distributors to IDEXX Laboratories.

**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, and may experience problems in obtaining supplies of our key products**

We contract for the manufacture of some of our products, including our Witness® in-clinic canine heartworm, feline leukemia virus and canine parvovirus diagnostic products and our SCA 2000 instrument products. 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 are licensed to us by their manufacturers. There are a number of risks associated with our dependence on third-party manufacturers including:

- the potential for a decision by the manufacturer to cease supplying us and/or to make and market competing products;
- reduced control over delivery schedules;
- quality assurance;
- manufacturing yields and costs;
- whether the manufacturer maintains financial and operational stability;
- the potential lack of adequate capacity during periods of excess demand;

limited warranties on products supplied to us;

increases in prices and the potential misappropriation of our intellectual property; and

limited negotiating leverage in the event of disputes with the third-party manufacturers.

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.

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

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As mentioned above, in 2003 Agen, the previous contract manufacturer of certain of our Witness® in-clinic products, ceased to supply us with those products, and entered the market with competing products.

**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, including our alternate-source in-clinic diagnostic 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 moderately seasonal**

Our operations are moderately seasonal due to the timing of sales of our canine heartworm diagnostic products. Our sales and profits have historically tended 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. One effect of this is a need to devote large amounts of cash to building canine heartworm diagnostic products inventory in preparation for the canine heartworm selling season at a time when our working capital is relatively low.

**Any failure to adequately establish or protect our proprietary rights may adversely affect us, and our canine heartworm diagnostic patent expires in December 2005**

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. 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. Litigation is costly regardless of its outcome and can require significant management attention. 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.

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

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. In any event, our important United States canine heartworm diagnosis patent will expire in December 2005.

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 generally maintained in secrecy for 18 months. 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.

**Redwood controls us**

The Series C preferred stock owned by Redwood represents a majority of the voting power of all our stock. Redwood can, and does, control the election of our entire Board of Directors, and also controls all fundamental strategic decisions. In addition, an affiliate of Redwood acquired from Comerica Bank a $3,873,000 note issued by us and secured by our assets. At December 31, 2004, the outstanding balance on this note was $3,809,000. Our ability to negotiate effectively with the note holder, if such negotiation were ever to be necessary or desirable, might be compromised by Redwood s multifaceted control of us.

**We use hazardous materials**

Our business requires that we store and use hazardous materials and chemicals. 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.

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**Item 7A. 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 long-term debt at December 31, 2004 was approximately $4,381,000, of which $572,000 has a variable interest rate based on the prime rate. A change in interest rates of five percentage points would not 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 generally denominated in Euros. Similarly, all of the foreign transactions of our U.S. operations are denominated in U.S. dollars. We do not generally hedge our cash flows on intercompany transactions, nor do we hold any other significant 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. For example, the increase in the value of the euro over the dollar as of and for the year ended December 31, 2004, resulted in a $638,000 increase in our revenues, a $728,000 increase in our expenses, a $371,000 increase in our assets and a $112,000 increase in our liabilities (other than shareholders equity). For the year ended December 31, 2004, 38% of our net sales were net sales of SBIO-E.

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

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| Consolidated Statement of Operations and Comprehensive (Loss) Income for the years ended December 31, 2004, 2003 and 2002 | 23 |
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All other schedules are omitted because they are not applicable or the required information is included in the consolidated financial statements and notes thereto.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors

and Shareholders of

**Synbiotics Corporation**

We have audited the consolidated financial statements listed in the accompanying index of Synbiotics Corporation and its subsidiary as of December 31, 2004 and 2003, and for each of the years in the three year period ended December 31, 2004. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Synbiotics Corporation and its subsidiary as of December 31, 2004 and 2003, and the consolidated results of their operations and their cash flows for each of the years in the three year period ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company has an accumulated deficit of $46,113,000, and the Company has a $1,000,000 contractual obligation due in July 2005, and another $1,500,000 contractual obligation, to the same party, due in July 2006. The Company does not believe that its cash position will be sufficient to fund its operations and service its debt for the next twelve months if it also pays the $1,000,000 contractual obligation when it becomes due in July 2005. These factors, among others, raise substantial doubt about its ability to continue as a going concern. Management s plans in regards to these matters are also described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

**LEVITZ, ZACKS & CICERIC**

**Certified Public Accountants**

San Diego, California

March 8, 2005

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**SYNBIOTICS CORPORATION**

**CONSOLIDATED BALANCE SHEET**

| | December 31, | |
|---|---|---|
| | **2004** | **2003** |
| **ASSETS** | | |
| Current assets: | | |
| Cash and equivalents | $ 792,000 | $ 1,045,000 |
| Accounts receivable (net of allowance for doubtful accounts of $151,000 and $125,000 in 2004 and 2003) | 2,574,000 | 2,686,000 |
| Inventories | 6,208,000 | 5,266,000 |
| Other current assets | 1,424,000 | 878,000 |
| | 10,998,000 | 9,875,000 |
| Property and equipment, net | 979,000 | 1,232,000 |
| Goodwill, net | 1,397,000 | 1,397,000 |
| Intangibles, net | 1,851,000 | 2,358,000 |
| Other assets | 297,000 | 479,000 |
| | $ 15,522,000 | $ 15,341,000 |
| **LIABILITIES AND SHAREHOLDERS EQUITY:** | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | $ 4,557,000 | $ 4,005,000 |
| Current portion of long-term debt | 546,000 | 4,804,000 |
| Other current liabilities | 952,000 | |
| | 6,055,000 | 8,809,000 |
| Long-term debt | 3,835,000 | |
| Other liabilities | 1,313,000 | 2,134,000 |
| | 5,148,000 | 2,134,000 |
| Commitments and contingencies (Note 13) | | |
| Shareholders equity: | | |
| Series C convertible preferred stock, $1,000 liquidation preference per share (aggregating $3,100,000 and $2,800,000 at December 31, 2004 and 2003), 4,000 shares authorized, 3,100 and 2,800 shares issued and outstanding at December 31, 2004 and 2003 | 2,904,000 | 2,604,000 |
| Common stock, no par value, 70,000,000 shares authorized, 21,154,000 and 20,025,000 shares issued and outstanding at December 31, 2004 and 2003 | 46,636,000 | 46,316,000 |
| Common stock warrants | 1,110,000 | 1,035,000 |
| Accumulated other comprehensive loss | (218,000) | (411,000) |
| Accumulated deficit | (46,113,000) | (45,146,000) |
| Total shareholders equity | 4,319,000 | 4,398,000 |

| | | |
|---|---|---|
| | $ 15,522,000 | $ 15,341,000 |

See accompanying notes to consolidated financial statements.

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**SYNBIOTICS CORPORATION**

**CONSOLIDATED STATEMENT OF OPERATIONS AND COMPREHENSIVE (LOSS) INCOME**

| | Year Ended December 31, | | |
|---|---|---|---|
| | **2004** | **2003** | **2002** |
| Revenues: | | | |
| Net sales | $ 18,746,000 | $ 18,805,000 | $ 21,362,000 |
| License fees | | | 300,000 |
| Royalties | 473,000 | 406,000 | 9,000 |
| | 19,219,000 | 19,211,000 | 21,671,000 |
| Operating expenses: | | | |
| Cost of sales | 9,051,000 | 9,133,000 | 10,450,000 |
| Research and development | 1,486,000 | 1,177,000 | 1,380,000 |
| Selling and marketing | 4,165,000 | 4,150,000 | 4,378,000 |
| General and administrative | 5,628,000 | 3,489,000 | 8,772,000 |
| Patent litigation settlement | (850,000) | (515,000) | |
| Impairment losses | | | 2,877,000 |
| | 19,480,000 | 17,434,000 | 27,857,000 |
| (Loss) income from operations | (261,000) | 1,777,000 | (6,186,000) |
| Other expense: | | | |
| Interest, net | (446,000) | (492,000) | (669,000) |
| (Loss) income before income taxes | (707,000) | 1,285,000 | (6,855,000) |
| (Benefit from) provision for income taxes | | | |