MARRONE BIO INNOVATIONS INC
Form 10-Q
November 10, 2015
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended March 31, 2015

or

¨ **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from __________ to __________

Commission File Number: 001-36030

Marrone Bio Innovations, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**20-5137161**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

1540 Drew Avenue, Davis, CA 95618

(Address of principal executive offices and zip code)

(530) 750-2800

(Registrant s telephone number, including area code)

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

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

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

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	**Shares Outstanding at November 2, 2015**
Common Stock, $0.00001 par value	**24,464,582**

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

MARRONE BIO INNOVATIONS, INC.

Condensed Consolidated Balance Sheets

(In Thousands, Except Par Value)

	MARCH 31, 2015 (Unaudited)	DECEMBER 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	$ 22,352	$ 35,324
Restricted cash, current portion	1,856	1,856
Accounts receivable	2,170	1,787
Inventories, net	11,775	12,644
Deferred cost of product revenues, including deferred cost of product revenues to related parties of $251 and $333 as of March 31, 2015 and December 31, 2014, respectively	1,939	1,797
Prepaid expenses and other current assets	1,008	1,315
Total current assets	41,100	54,723
Property, plant and equipment, net	20,072	20,166
Restricted cash, less current portion	1,560	1,560
Other assets	711	733
Total assets	$ 63,443	$ 77,182
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 4,060	$ 5,841
Accrued liabilities	5,646	6,321
Deferred revenue, current portion	3,259	2,861
Deferred revenue from related parties	461	660
Customer refund liabilities	1,044	1,044
Capital lease obligations, current portion	1,475	1,839
Debt, current portion	12,704	12,636
Total current liabilities	28,649	31,202
Deferred revenue, less current portion	1,967	2,050
Capital lease obligations, less current portion	57	185
Debt, less current portion	9,566	9,667
Other liabilities	797	847

Total liabilities		41,036		43,951
Commitments and contingencies *(Note 8)*				
Stockholders equity:				
Common stock: $0.00001 par value; 250,000 shares authorized, 24,465 shares issued and outstanding as of March 31, 2015 and December 31, 2014				
Additional paid in capital		194,169		193,079
Accumulated deficit		(171,762)		(159,848)
Total stockholders equity		22,407		33,231
Total liabilities and stockholders equity	$	63,443	$	77,182

See accompanying notes.

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MARRONE BIO INNOVATIONS, INC.

Condensed Consolidated Statements of Operations

(In Thousands, Except Per Share Amounts)

(Unaudited)

	THREE MONTHS ENDED MARCH 31, 2015	2014
Revenues:		
Product	$ 1,774	$ 2,054
License	83	45
Related party	199	605
Total revenues	2,056	2,704
Cost of product revenues, including cost of product revenues to related parties of $82 and $161 for the three months ended March 31, 2015 and 2014, respectively	1,998	1,793
Gross profit	58	911
Operating Expenses:		
Research, development and patent	3,422	4,297
Selling, general and administrative	7,887	6,324
Total operating expenses	11,309	10,621
Loss from operations	(11,251)	(9,710)
Other income (expense):		
Interest income	9	10
Interest expense	(669)	(606)
Other expense, net	(3)	(9)
Total other expense, net	(663)	(605)
Loss before income taxes	(11,914)	(10,315)
Income taxes		
Net loss	$ (11,914)	$ (10,315)
Basic and diluted net loss per common share	$ (0.49)	$ (0.53)
Weighted-average shares outstanding used in computing net loss per common share	24,465	19,518

See accompanying notes.

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MARRONE BIO INNOVATIONS, INC.

Condensed Consolidated Statements of Comprehensive Loss

(In Thousands)

(Unaudited)

	THREE MONTHS ENDED MARCH 31,	
	2015	**2014**
Net loss	$ (11,914)	$ (10,315)
Other comprehensive loss		
Comprehensive loss	$ (11,914)	$ (10,315)

See accompanying notes.

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MARRONE BIO INNOVATIONS, INC.

Condensed Consolidated Statements of Cash Flows

(In Thousands)

(Unaudited)

	THREE MONTHS ENDED MARCH 31, 2015	THREE MONTHS ENDED MARCH 31, 2014
Cash flows from operating activities		
Net loss	$ (11,914)	$ (10,315)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	833	488
Loss on disposal of equipment	4	
Share-based compensation	1,090	1,522
Non-cash interest expense	133	265
Amortization of investment securities premiums/discounts, net		9
Net changes in operating assets and liabilities:		
Accounts receivable	(383)	(1,460)
Accounts receivable from related parties		(327)
Inventories	869	(874)
Deferred cost of product revenues	(142)	(46)
Prepaid expenses and other assets	277	(298)
Accounts payable	(1,638)	2,737
Accrued and other liabilities	(605)	(1,548)
Deferred revenue	315	246
Deferred revenue from related parties	(199)	(281)
Net cash used in operating activities	(11,360)	(9,882)
Cash flows from investing activities		
Purchases of property, plant and equipment	(1,030)	(5,044)
Sale of property and equipment	7	
Purchase of short-term investments		(49)
Maturities of short-term investments		11,053
Net cash provided by (used in) investing activities	(1,023)	5,960
Cash flows from financing activities		
Repayment of debt	(97)	(67)
Repayment of capital leases	(492)	(69)
Proceeds from exercise of stock options		851
Proceeds from exercise of common stock warrants		50
Net cash provided by (used in) financing activities	(589)	765
Net decrease in cash and cash equivalents	(12,972)	(3,157)

Cash and cash equivalents, beginning of period		35,324		24,455
Cash and cash equivalents, end of period	$	22,352	$	21,298
Supplemental disclosure of cash flow information				
Cash paid for interest, net of capitalized interest of $4 and $469 for the three months ended March 31, 2015 and 2014, respectively	$	536	$	341
Supplemental disclosure of non-cash investing and financing activities				
Property, plant and equipment included in accounts payable and accrued liabilities	$	132	$	2,040
Equipment acquired under capital leases	$		$	453

See accompanying notes.

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MARRONE BIO INNOVATIONS, INC.

Notes to Condensed Consolidated Financial Statements

March 31, 2015

(Unaudited)

1. Summary of Business, and Liquidity

Marrone Bio Innovations, Inc. (Company), formerly Marrone Organic Innovations, Inc., was incorporated under the laws of the State of Delaware on June 15, 2006, and is located in Davis, California. In July 2012, the Company formed a wholly-owned subsidiary, Marrone Michigan Manufacturing LLC (MMM LLC), which holds the assets of a manufacturing plant the Company purchased in July 2012. The Company makes bio-based pest management and plant health products. The Company targets the major markets that use conventional chemical pesticides, including certain agricultural and water markets where its bio-based products are used as alternatives for, or mixed with, conventional chemical pesticides. The Company also targets new markets for which there are no available conventional chemical pesticides, the use of conventional chemical pesticides may not be desirable or permissible because of health and environmental concerns (including organically certified crops) or because the development of pest resistance has reduced the efficacy of conventional chemical pesticides. The Company delivers EPA-approved and registered biopesticide products and other bio-based products that address the global demand for effective, safe and environmentally responsible products.

The Company is an early stage company with a limited operating history and has a limited number of commercialized products. As of March 31, 2015, the Company had an accumulated deficit of $171,762,000, has incurred significant losses since inception and expects to continue to incur losses for the foreseeable future. Until the completion of the initial public offering (IPO) in August 2013, the Company had funded operations primarily with the net proceeds from private placements of convertible preferred stock, convertible notes, promissory notes and term loans, as well as with the proceeds from the sale of its products and payments under strategic collaboration agreements and government grants. The Company will need to generate significant revenue growth to achieve and maintain profitability. As of March 31, 2015, the Company had working capital of $12,451,000, including cash and cash equivalents of $22,352,000. In addition, as of March 31, 2015, the Company had debt totaling $22,270,000 for which the underlying debt agreements contain various financial and non-financial covenants, as well as certain material adverse change clauses. If the Company breaches any of the covenants contained within the debt agreements or if the material adverse change clauses are triggered, the entire unpaid principal and interest balance would be due and payable upon demand. The Company believes that currently available resources combined with the additional $40,000,000 in proceeds raised from the issuance of senior secured promissory notes in August 2015 (see Note 10) will be sufficient to fund the Company s cash requirements through at least March 31, 2016.

The Company participates in a heavily regulated and highly competitive crop protection industry and believes that adverse changes in any of the following areas could have a material effect on the Company s future financial position, results of operations or cash flows: inability to obtain regulatory approvals, increased competition in the pesticide market, market acceptance of the Company s products, weather and other seasonal factors beyond the Company s control, litigation or claims against the Company related to intellectual property, patents, products or governmental regulation, and the Company s ability to support increased growth.

Although the Company recognizes that it will likely need to raise additional funds in the future, there can be no assurance that such efforts will be successful or that, in the event that they are successful, the terms and conditions of such financing will not be unfavorable. Any future equity financing may result in dilution to existing shareholders and any debt financing may include additional restrictive covenants. Any failure to obtain additional financing or not to achieve the revenue growth necessary to fund the Company with cash flows from operations will have a material adverse effect upon the Company and will likely result in a substantial reduction in the scope of the Company s operations and impact the Company s ability to achieve its planned business objectives. In addition, any future breach of covenants included in the Company s debt agreements which could result in the lender demanding payment of the unpaid principal and interest balances will have a material adverse effect upon the Company and would likely require the Company to seek to renegotiate these debt arrangements with the lenders. If such negotiations are unsuccessful, the Company may be required to seek protection from creditors through bankruptcy proceedings.

2. Significant Accounting Policies

Basis of Presentation

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary. All significant intercompany balances and transactions have been eliminated in consolidation.

The accompanying financial information as of March 31, 2015, and for the three months ended March 31, 2015 and 2014, has been prepared by the Company, without audit, in accordance with generally accepted accounting principles in the United States (GAAP) and applicable rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting. Certain information and note disclosures normally included in annual financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such SEC rules and regulations and accounting principles applicable for interim periods. However, the Company believes that the disclosures are adequate to make the information presented not misleading. The information included in this Quarterly Report on Form 10-Q should be read in connection with the consolidated financial statements and accompanying notes included in the Company s Annual Report filed on Form 10-K for the fiscal year ended December 31, 2014.

In the opinion of management, the condensed consolidated financial statements as of March 31, 2015, and for the three months ended March 31, 2015 and 2014, reflect all adjustments, which are normal recurring adjustments, necessary to present a fair statement of financial position, results of operations, comprehensive loss and cash flows. The results of operations for the three months ended March 31, 2015 are not necessarily indicative of the operating results for the full fiscal year or any future periods.

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Use of Estimates

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

Cash and Cash Equivalents

The Company considers all highly liquid financial instruments purchased with a maturity of three months or less to be cash equivalents. Cash and cash equivalents consists of cash on deposit, money market funds and certificates of deposit accounts with United States (U.S.) financial institutions. The Company is exposed to credit risk in the event of default by financial institutions to the extent that cash and cash equivalents balances with financial institutions are in excess of amounts that are insured by the Federal Deposit Insurance Corporation. The Company has not experienced any losses on these deposits.

Restricted Cash

The Company s restricted cash consists of cash that the Company is contractually obligated to maintain on deposit at a bank in accordance with the promissory note entered into in June 2014. See Note 6 for further discussion.

Concentrations of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash, cash equivalents, accounts receivable and debt. The Company deposits its cash and cash equivalents with high credit quality domestic financial institutions with locations in the U.S. Such deposits may exceed federal deposit insurance limits. The Company believes the financial risks associated with these financial instruments are minimal.

The Company s customer base is dispersed across many different geographic areas, and currently most customers are pest management distributors in the U.S. Generally, receivables are due up to 120 days from the invoice date and are considered past due after this date, although the Company may offer extended terms from time to time.

For the three months ended March 31, 2015 and 2014, 2% and 17%, respectively, of the Company s revenues were generated from international customers.

The Company s principal sources of revenues are its Regalia and Grandevo product lines. For the three months ended March 31, 2015 and 2014, these two product lines accounted for 97% and 86%, respectively, of the Company s total revenues.

Customers to which 10% or more of the Company s total revenues are attributable for any one of the periods presented consist of the following:

	CUSTOMER A	CUSTOMER B	CUSTOMER C	CUSTOMER D (1)	CUSTOMER E (1)	CUSTOMER F
For the three months ended March 31,						

2015	24%	17%	14%	10%	*	*
2014	6%	25%	14%	10%	12%	11%

(1) Represents revenues from related parties. See Note 9 for further discussion.

* Represents less than 1% of total revenues.

Customers to which 10% or more of the Company s outstanding accounts receivable are attributable as of either March 31, 2015 or December 31, 2014 consist of the following:

	CUSTOMER A	CUSTOMER B	CUSTOMER C	CUSTOMER D	CUSTOMER E
March 31, 2015	35%	22%	10%	*	*
December 31, 2014	10%	9%	1%	37%	23%

* Represents less than 1% of outstanding accounts receivable.

Concentrations of Supplier Dependence

The active ingredient in the Company s Regalia product line is derived from the giant knotweed plant, which the Company obtains from China. The Company s single supplier acquires raw knotweed from numerous regional sources and performs an extraction process on this plant, creating a dried extract that is shipped to the Company s manufacturing plant. A disruption at this supplier s manufacturing site or a disruption in trade between the U.S. and China could negatively impact sales of Regalia. The Company currently uses one supplier and does not have a long-term supply contract with this supplier. Although the Company has identified additional sources of raw knotweed, there can be no assurance that the Company will continue to be able to obtain dried extract from China at a competitive price.

Inventories

Inventories are stated at the lower of cost or market value (net realizable value or replacement cost) and include the cost of material and external and internal labor and manufacturing costs. Cost is determined on the first-in, first-out basis. The Company provides for inventory reserves when conditions indicate that the selling price may be less than cost due to physical deterioration, obsolescence, changes in price levels or other factors. Additionally, the Company provides reserves for excess and slow-moving inventory on hand that is not expected to be sold to reduce the carrying amount of excess and slow-moving inventory to its estimated net realizable value. The reserves are based upon estimates about future demand from the Company s customers and distributors and market conditions.

Deferred Cost of Product Revenues

Deferred cost of product revenues are stated at the lower of cost or net realizable value and include product sold where title has transferred but the criteria for revenue recognition have not been met. As of March 31, 2015 and December 31, 2014, the Company recorded deferred cost of product revenues of $1,939,000 and $1,797,000, respectively, including deferred cost of product revenues to related parties of $251,000 and $333,000, respectively.

Revenue Recognition

The Company recognizes revenues when persuasive evidence of an arrangement exists, transfer of title has occurred or services have been rendered, the price is fixed or determinable and collectability is reasonably assured. If contractual obligations, acceptance provisions or other contingencies exist which indicate that the price is not fixed or determinable, revenue is recognized after such obligations or provisions are fulfilled or expire.

Product revenues consist of revenues generated from sales of the Company s products to distributors and direct customers, net of rebates and cash discounts. For sales of products made to distributors, the Company recognizes revenue either on a sell-in or sell-through basis depending on the specific facts and circumstances of the transaction(s) with the distributor. Factors considered include, but are not limited to, whether the payment terms offered to the distributor are structured to correspond to when product is resold, the distributor history of adhering to the terms of its contractual arrangements with the Company, whether the Company has a pattern of granting concessions for the benefit of the distributor and whether there are other conditions that may indicate that the sale to the distributor is not substantive.

In some cases, the Company recognizes distributor revenue as title and risk of loss passes, provided all other revenue recognition criteria have been satisfied (the sell-in method). For certain sales to certain distributors, the revenue recognition criteria for distributor sales are not satisfied at the time title and risk of loss passes to the distributor; specifically, in instances where inventory protection arrangements were offered to distributors that would permit these distributors to return to the Company certain unsold products, the Company considers the arrangement not to be fixed or determinable, and accordingly, revenue is deferred until products are resold to customers of the distributor (the sell-through method). As of March 31, 2015 and December 31, 2014, the Company recorded current deferred product revenues of $3,389,000 and $3,190,000, respectively, including current deferred product revenues from related parties of $461,000 and $660,000, respectively. The cost of product revenues associated with such deferral are also deferred and classified as deferred cost of product revenues in the condensed consolidated balance sheets. Cash received from customers related to delivered product that may not represent a true sale is classified as customer refund liabilities in the condensed consolidated balance sheets and the related cost of inventory remains in inventory in the condensed consolidated balance sheets until the product is returned or is resold to customers of the distributor and revenue is recognized. For the three months ended March 31, 2015 and 2014, 32% and 52%, respectively, of total revenues were recognized on a sell-through basis.

From time to time, the Company offers certain product rebates to its distributors and growers, which are estimated and recorded as reductions to product revenues, and an accrued liability is recorded at the later of when the revenues are recorded or the rebate is being offered.

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The Company recognizes license revenues pursuant to strategic collaboration and distribution agreements under which the Company receives payments for the achievement of testing validation, regulatory progress and commercialization events. As these activities and payments are associated with exclusive rights that the Company provides in connection with strategic collaboration and distribution agreements over the term of the agreements, revenues related to the payments received are deferred and recognized over the term of the exclusive distribution period of the respective agreement. For the three months ended March 31, 2015, the Company received payments totaling $750,000 under these agreements. No payments were received under these agreements for the three months ended March 31, 2014. For the three months ended March 31, 2015 and 2014, the Company recognized $83,000 and $45,000, respectively, as license revenues, excluding related party revenues.

The Company has a strategic collaboration and distribution agreement with Syngenta, an affiliate of a former 5% stockholder, Syngenta Ventures Pte. LTD (Syngenta Ventures). In connection with the Company s secondary offering in June 2014, Syngenta Ventures sold 600,000 shares of the Company s common stock, reducing its ownership percentage below 5%. Accordingly, revenue recognized under this agreement subsequent to June 2014 has not been included in related party revenues. For the three months ended March 31, 2014, the Company recognized $324,000 of related party revenues under this agreement prior to Syngenta Ventures reducing its ownership stake.

As of March 31, 2015, the Company recorded current and non-current deferred revenues of $331,000 and $1,967,000, respectively, related to payments received under these agreements. As of December 31, 2014, the Company recorded current and non-current deferred revenues of $331,000 and $2,050,000, respectively, related to payments received under these agreements.

Research, Development and Patent Expenses

Research and development expenses include payroll-related expenses, field trial costs, toxicology costs, regulatory costs, consulting costs and lab costs. Patent expenses include legal costs relating to the patents and patent filing costs. These costs are expensed to operations as incurred. For the three months ended March 31, 2015 and 2014, research and development expenses totaled $3,115,000 and $4,000,000, respectively, and patent expenses totaled $307,000 and $297,000, respectively.

Net Loss per Share

Net loss per share is computed by dividing the net loss by the weighted average number of common shares outstanding for the period. The calculation of basic and diluted net loss per share is the same for all periods presented as the effect of the potential common stock equivalents, which consist of stock options and warrants to purchase common stock, are anti-dilutive due to the Company s net loss position. Anti-dilutive common stock equivalents are excluded from diluted net loss per share. The anti-dilutive stock options that were not included in diluted net loss per share were 2,663,000 and 2,974,000 as of March 31, 2015 and 2014, respectively. The anti-dilutive warrants to purchase common stock that were not included in diluted net loss per share were 145,000 as of both March 31, 2015 and 2014.

Recently Issued Accounting Pronouncements

In July 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2015-11, *Inventory (Topic 330): Simplifying the Measurement of Inventory* (ASU 2015-11), which applies guidance on the subsequent measurement of inventory. ASU 2015-11 states that an entity should measure inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonable predictable costs of completion, disposal and transportation. The guidance excludes inventory measured using last-in, first-out or the retail inventory method. ASU 2015-11 is effective for interim and annual reporting periods beginning after December 15, 2016. Early adoption is permitted. The Company is not planning to early adopt ASU 2015-11 and is currently evaluating ASU 2015-11 to determine the potential impact to its condensed consolidated financial statements and related disclosures.

In April 2015, the FASB issued Accounting Standards Update No. 2015-03, *Interest Imputation of Interest (Topic 835-30): Simplifying the Presentation of Debt Issuance Costs* (ASU 2015-03). ASU 2015-03 requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs is not affected by ASU 2015-03. ASU 2015-03 is effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted. Upon adoption, the Company will reclassify debt issuance costs from prepaid expenses and other current assets and other assets as a reduction to debt in the condensed consolidated balance sheets. The Company is not planning to early adopt ASU 2015-03 and does not anticipate that the adoption of ASU 2015-03will materially impact its condensed consolidated financial statements.

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In August 2014, the FASB issued Accounting Standards Update No. 2014-15, *Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern* (ASU 2014-15). ASU 2014-15 requires management to evaluate for each annual and interim reporting period whether conditions or events give rise to substantial doubt that an entity has the ability to continue as a going concern within one year following issuance of the financial statements and requires specific disclosures regarding the conditions or events leading to substantial doubt. The new guidance is effective for annual and interim periods ending after December 15, 2016, with early adoption permitted. The Company is currently evaluating ASU 2014-15 to determine the potential impact to its condensed consolidated financial statements and related disclosures.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* (ASU 2014-09). ASU 2014-09 provides new, globally applicable converged guidance concerning recognition and measurement of revenue. As a result, significant additional disclosures are required about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The new guidance is effective for annual and interim periods beginning on or after December 15, 2018. Companies are allowed to transition using either the modified retrospective or full retrospective adoption method. If full retrospective adoption is chosen, three years of financial information must be presented in accordance with the new standard. The Company is currently evaluating the alternative methods of adoption and the effect on its condensed consolidated financial statements and related disclosures.

3. Fair Value Measurements

Accounting Standards Codification (ASC) 820, *Fair Value Measurements* (ASC 820), clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability.

ASC 820 requires that the valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. ASC 820 establishes a three tier value hierarchy, which prioritizes inputs that may be used to measure fair value as follows:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Inputs that are generally unobservable and typically reflect management s estimate of assumptions that market participants would use in pricing the asset or liability.

The following table presents the Company s financial assets measured at fair value on a recurring basis as of March 31, 2015 and December 31, 2014 (in thousands):

	MARCH 31, 2015			
	TOTAL	LEVEL 1	LEVEL 2	LEVEL 3
Assets				
Money market funds	$ 8,748	$ 8,748	$	$

	DECEMBER 31, 2014			
	TOTAL	LEVEL 1	LEVEL 2	LEVEL 3
Assets				
Money market funds	$ 14,746	$ 14,746	$	$

The Company s money market funds are held at registered investment companies and as of March 31, 2015 and December 31, 2014 were in active markets and, therefore, are measured based on the Level 1 valuation hierarchy.

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4. Inventories

Inventories, net consist of the following (in thousands):

	MARCH 31, 2015	DECEMBER 31, 2014
Raw materials	$ 5,717	$ 5,692
Work in progress	792	1,150
Finished goods	4,842	5,378
Finished goods held at customers	424	424
	$ 11,775	$ 12,644

As of each of March 31, 2015 and December 31, 2014, the Company had $668,000 in reserves against its inventories.

5. Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

	MARCH 31, 2015	DECEMBER 31, 2014
Accrued compensation	$ 1,393	$ 1,348
Accrued expenses	3,995	4,771
Accrued warranty costs	258	202
	$ 5,646	$ 6,321

The Company warrants the specifications and/or performance of its products through implied product warranties and has extended product warranties to qualifying customers on a contractual basis. The Company estimates the costs that may be incurred during the warranty period and records a liability in the amount of such costs at the time product is shipped. The Company s estimate is based on historical experience and estimates of future warranty costs as a result of increasing usage of the Company s products. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary. Changes in the Company s accrued warranty costs during the period are as follows (in thousands):

Balance as of December 31, 2014	$ 202
Warranties issued during the period	65
Settlements made during the period	(9)
Balance as of March 31, 2015	$ 258

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6. Debt

Debt consists of the following (in thousands):

	MARCH 31, 2015	DECEMBER 31, 2014
Term Loan (Term Loan) bearing interest at 7.00% per annum, which is payable monthly through April 2016, collateralized by all of the Company s inventories, chattel paper, accounts receivable, equipment and general intangibles (excluding certain financed equipment and intellectual property) pledged as collateral under the Term Loan, subordinated	$ 150	$ 183
Secured promissory notes (October 2012 and April 2013 Secured Promissory Notes) bearing interest at 12.00% per annum, which are payable monthly through October 2015, collateralized by substantially all of the Company s assets, net of unamortized debt discount as of March 31, 2015 and December 31, 2014 of $139 and $203, respectively	12,311	12,247
Secured promissory note (June 2014 Secured Promissory Note) bearing interest at prime plus 2% (5.25% as of March 31, 2015) per annum, which is payable monthly through June 2036, collateralized by all of the Company s deposit accounts and MMM LLC s inventories, chattel paper, accounts, equipment and general intangibles	9,809	9,873
Debt	22,270	22,303
Less current portion	(12,704)	(12,636)
	$ 9,566	$ 9,667

The fair value of the Company s outstanding debt obligations as of March 31, 2015 and December 31, 2014 was $22,466,000 and $22,587,000, respectively, which was estimated based on a discounted cash flow model using an estimated market rate of interest of 11.25% for the fixed rate debt and 5.25% for the variable rate debt, and is classified as Level 3 within the fair value hierarchy.

Term Loan

In March 2009, October 2010 and October 2011, the Company and Five Star Bank agreed to modify the terms of its existing revolving line of credit (Revolver). Under the modified terms of the Revolver, the Company s borrowings under the Revolver were limited to 75% of qualifying accounts receivable with a maximum borrowing limit of $500,000. In March 2012, the Company entered into a change in terms agreement with the bank under which the existing Revolver was replaced by the Term Loan in the amount of $500,000 with a rate of 7% per annum, maturing April 1, 2016. The Company s inventories, chattel paper, accounts receivable, equipment and general intangibles (excluding certain financed equipment and intellectual property) have been pledged as collateral under the Term Loan. The Term Loan provides for various events of default including breach of any term, obligation, covenant or condition under any other agreement between the Company and Five Star Bank. As of March 31, 2015, the Company was in breach of its covenants under the Term Loan as the Company was in breach of its covenants under its June 2014 Secured Promissory Note. However, this breach was cured in November 2015 as a result of the Company obtaining a waiver of certain of the Company s covenants with respect to the June 2014 Secured Promissory Note as discussed below. The Term Loan was fully paid off in August 2015.

Secured Promissory Notes

On October 2, 2012, the Company borrowed $7,500,000 pursuant to senior notes (October 2012 Secured Promissory Notes) with a group of lenders. The October 2012 Secured Promissory Notes have an initial term of three years and can be extended for an additional two years in one year increments at the option of the Company. During the initial three-year term, the October 2012 Secured Promissory Notes bear interest at 12% per annum. If the term of the October 2012 Secured Promissory Notes is extended an additional year, the interest rate is 13% during the fourth year. If the term of the October 2012 Secured Promissory Notes is extended for an additional two years, the interest rate is 14% during the fifth year. Interest on the October 2012 Secured Promissory Notes is payable monthly through the initial maturity date of the loan, which is October 2, 2015, or through any extension period. The principal and all unpaid interest are due on the maturity date, as may be extended.

As part of the terms of the October 2012 Secured Promissory Notes, the Company is required to pay a fee of 5% of the funded principal amount to the agent that facilitated the borrowing and provides management of the relationship with the group of lenders (Agent Fee). This Agent Fee is payable within 30 days after all interest and principal have been paid. For each year the Company extends the maturity date of the October 2012 Secured Promissory Notes beyond the initial term, the agent will receive an additional 1% fee based on the funded principal amount. The present value of the unpaid Agent Fee, based on 5% of the funded principal amount, or $261,000, as of the closing date of the October 2012 Secured Promissory

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Notes was recorded as both deferred financing costs as a component of current and non-current other assets and non-current other liabilities. The amortization of the deferred financing costs and the accretion of the Agent Fee are recorded to interest expense over the term of the arrangement. As of March 31, 2015, $586,000 of the Agent Fee, including the amounts relating to the additional funds received from the issuance of the April 2013 Secured Promissory Notes discussed below, was recorded under accrued liabilities. In addition, the Company incurred an additional $66,000 in financing-related costs, primarily legal fees. These costs were recorded as deferred financing costs as a component of current and non-current other assets and are being amortized to interest expense over the term of the arrangement.

The October 2012 Secured Promissory Notes are secured by the Company s ownership interest in MMM LLC, a security interest in the assets of the Company s manufacturing plant and all of the Company s other assets, subject to certain permitted liens. This security interest was subordinate to the security interest held by the holder of a previously outstanding promissory note issued in April 2012 and repaid in January 2013 (April 2012 Note), which also had a security interest in MMM LLC.

The Company also issued warrants (Common Stock Warrants) to the group of lenders to purchase a number of shares of common stock equal to 15% of the funded principal amount of the October 2012 Secured Promissory Notes divided by 70% of the value of common stock in a sale of the Company or a Qualified IPO, with such Common Stock Warrants having an exercise price of 70% of the value of common stock in a sale of the Company or a Qualified IPO. The Common Stock Warrants would be automatically exercised immediately prior to expiration on the earlier to occur of a Qualified IPO or a sale of the Company or the maturity of the October 2012 Secured Promissory Notes. The October 2012 Secured Promissory Notes could be prepaid six months after the initial funding date or earlier if a Qualified IPO or a sale of the Company occurs. As the predominant settlement feature of the Common Stock Warrants is to settle a fixed monetary amount in a variable number of shares, the Common Stock Warrants were accounted for under ASC 480, *Distinguishing Liabilities from Equity* (ASC 480). Accordingly, the Common Stock Warrants were recorded at estimated fair value on their issuance date and were adjusted to their estimated fair value as of each reporting date with the change in estimated fair value recorded as a component of change in estimated fair value of financial instruments in the Company s condensed consolidated statements of operations. The fair value of the Common Stock Warrants at the date of issuance of $282,000 was recorded as a discount to the October 2012 Secured Promissory Notes and is being amortized to interest expense over the term of the arrangement. Until the effective date of the IPO, the Company estimated the fair value of the Common Stock Warrants using a Probability-Weighted Expected Return Method (PWERM) valuation based on unobservable inputs, and, therefore, the Common Stock Warrants were classified as Level 3 liabilities in the fair value hierarchy. Upon closing of the IPO, the exercise price of the Common Stock Warrants was determined to be $8.40 per share and the number of shares to be issued upon exercise of the warrants was no longer variable. As a result of the IPO, the Common Stock Warrants were considered to be indexed to the Company s stock, and accordingly, the common stock warrants liability was reclassified and included in stockholders equity (deficit) during the year ended December 31, 2013.

The October 2012 Secured Promissory Notes contain certain covenant requirements, which include a requirement to maintain a minimum cash balance of the lesser of the April 2012 Note indebtedness described above or $5,000,000. As the April 2012 Note was fully paid off in January 2013, the Company no longer has a minimum cash balance requirement under the October 2012 Secured Promissory Notes. The Company is also precluded from adding additional debt without lender approval but allowance is made if such debt is subordinated to the October 2012 Secured Promissory Notes or if such additional debt is not more than $2,000,000 in the aggregate. In the event of default on the October 2012 Secured Promissory Notes, the lenders may declare the entire unpaid principal and interest immediately due and payable.

On April 10, 2013 (Conversion Date), the Company entered an amendment to increase, by up to $5,000,000, the amount available under the terms of the loan agreement with respect to the October 2012 Secured Promissory Notes. Under this amendment, an additional $4,950,000 was issued in partial consideration for $3,700,000 in cash received and in partial conversion for the cancellation of $1,250,000 of the total principal balance of the October 2012 Subordinated Convertible Note described below (collectively, April 2013 Secured Promissory Notes). The total amount borrowed under the amended loan agreement for the October 2012 Secured Promissory Notes and the April 2013 Secured Promissory Notes increased from $7,500,000 to $12,450,000 as of the Conversion Date. The accrued interest of $74,000 for the partially converted October 2012 Subordinated Convertible Note as of the Conversion Date shall be repaid or converted on the applicable maturity date of the October 2012 Subordinated Convertible Note.

In connection with the issuance of the April 2013 Secured Promissory Notes, the Company issued additional warrants (Additional Common Stock Warrants) to purchase a number of shares of common stock equal to 20% of the funded principal amount of the April 2013 Secured Promissory Notes divided by 70% of the value of common stock in a sale of the Company or a Qualified IPO, with such Additional Common Stock Warrants to have an exercise price of 70% of the value of common stock in a sale of the Company or a Qualified IPO. As the predominant settlement feature of the Additional Common Stock Warrants was to settle a fixed monetary amount in a variable number of shares, the Additional Common

Stock Warrants were accounted for under ASC 480. Accordingly, the Additional Common Stock Warrants were recorded at estimated fair value on their issuance date and were adjusted to their estimated fair value as of each reporting date with the change in estimated fair value recorded as a component of change in estimated fair value of financial instruments in the Company s condensed consolidated statements of operations. The fair value of the Additional Common Stock Warrants at the date of issuance was estimated to be $465,000. The Company estimated the fair value of the Additional Common Stock Warrants using a PWERM valuation based on unobservable inputs and, therefore, the Additional Common Stock Warrants were classified as Level 3 liabilities in the fair value hierarchy. Upon closing of the IPO, the exercise price of the Additional Common Stock Warrants was determined to be $8.40 per share and the number of shares to be issued upon exercise of the warrants was no longer variable. As a result of the IPO, the Additional Common Stock Warrants were considered to be indexed to the Company s stock, and accordingly, the common stock warrants liability was reclassified and included in stockholders equity (deficit) during the year ended December 31, 2013.

The debt holder who converted $1,250,000 principal balance of the October 2012 Subordinated Convertible Note (with a fair value of $1,360,000 on the date of conversion) also loaned an additional $2,500,000 in cash as part of the April 2013 Secured Promissory Notes (collectively, the $3,750,000 Notes). The Company accounted for the conversion as an extinguishment of debt in accordance with ASC 470-50-40, *Modifications and Extinguishments* (ASC 470-50-40). The $1,360,000 fair value of the partially converted October 2012 Subordinated Convertible Note on the Conversion Date was derecognized and the fair value of the $3,750,000 Notes with the portion of the fair value of the Additional Common Stock Warrants issued to this debt holder on the date of issuance was recorded. The Company recorded the $49,000 excess of the total fair value of the $3,750,000 Notes and the related Additional Common Stock Warrants on the issuance date over total consideration received as a gain on extinguishment of debt in the condensed consolidated statements of operations for the year ended December 31, 2013.

The following table shows the consideration received, fair values of the notes and common stock warrants issued and calculation of the gain on extinguishment of debt for the $3,750,000 Notes (in thousands):

Consideration received	
Fair value of October 2012 Subordinated Convertible Note	$ 1,360
Cash	2,500
Total consideration received (a)	$ 3,860
Notes and warrants issued	
Principal balance of notes issued	$ 3,750
Debt discount [(1)]	(291)
Fair value of notes issued	3,459
Fair value of Additional Common Stock Warrants issued	352
Total fair value of notes and warrants issued (b)	$ 3,811
Gain on extinguishment of debt (a-b)	$ 49

(1)

The amortization of this account is being recorded in interest expense in the condensed consolidated statements of operations over the term of the arrangement.

The remaining fair value of the Additional Common Stock Warrants of $113,000, net of the fair value of the Additional Common Stock Warrants issued of $352,000 related to the $3,750,000 Notes discussed above, was recorded as a debt discount to the April 2013 Secured Promissory Notes and is being amortized to interest expense over the term of the arrangement.

As a result of the amendment described above, the Company is also required to pay the Agent Fee, 5% of the $3,700,000 in cash received from the April 2013 Secured Promissory Notes, under the same terms as the October 2012 Secured Promissory Notes. In addition, the portion of the Agent Fee relating to the converted October 2012 Subordinated Convertible Note that would be due under the terms of the October 2012 Subordinated Convertible Note will be paid under the terms of the October 2012 and April 2013 Secured Promissory Notes. The present value of the unpaid Agent Fee of $172,000, based on 5% of the funded principal amount of $4,950,000, as of the closing date of the April 2013 Secured Promissory Notes was recorded as both deferred financing costs as a component of current and non-current other assets and non-current other liabilities. The amortization of the deferred financing costs and the accretion of the Agent Fee are being amortized to interest expense over the term of the arrangement.

In addition, the Company incurred an additional $24,000 in financing-related costs, primarily legal fees. These costs were recorded as deferred financing costs as a component of current and non-current other assets and are being amortized to interest expense over the term of the arrangement.

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The amendment to the loan agreement also amended the interest provision applicable to the October 2012 and April 2013 Secured Promissory Notes to allow any holder of the October 2012 and April 2013 Secured Promissory Notes to request the Company to defer all interest due monthly to the applicable maturity date, and the optional prepayment provision applicable to the October 2012 and April 2013 Secured Promissory Notes to allow the Company to repay the outstanding amount of the October 2012 and April 2013 Secured Promissory Notes either (i) with the written consent of the lender or the agent on such lenders behalf or (ii) without such consent provided that the Company pays the interest that would have been due from the prepayment date to the initial maturity date.

Activity related to the October 2012 and April 2013 Secured Promissory Notes from December 31, 2014 through March 31, 2015 consisted of the following (in thousands):

	DECEMBER 31, 2014	ADDITIONS	AMORTIZATION OF DEBT DISCOUNT	PRINCIPAL PAYMENTS	MARCH 31, 2015
Principal	$ 12,450	$	$	$	$ 12,450
Debt discount related to the issuance of common stock warrants [1]	(106)		35		(71)
Discount related to the $3,750,000 Notes [1]	(97)		29		(68)
	$ 12,247	$	$ 64	$	$ 12,311

(1) The amortization of this account is included in interest expense in the condensed consolidated statements of operations and as non-cash interest expense in the condensed consolidated statements of cash flows.

As of March 31, 2015 and December 31, 2014, the Company was in breach of its covenants under the October 2012 and April 2013 Secured Promissory Notes as a result of its failure to provide annual financial statements in a timely manner and as the Company was in breach of certain of its covenants under its June 2014 Secured Promissory Note as described below. However, in November 2015, the Company received an extension from the lending agent with respect to compliance with the requirements to deliver annual financial statements to the earlier of (i) November 15, 2015 or (ii) such time such financial statements are filed with the SEC. Further, the covenant breach was cured in November 2015 as a result of obtaining this extension and the waiver of certain of the Company s covenants with respect to the June 2014 Secured Promissory Note as described below.

In August 2015, the terms of the notes were amended, resulting in an increase in the interest rate to 18% effective September 1, 2015 for the remaining term of the notes. The Company also provided a written notice in September 2015 to extend the maturity date to October 2, 2017.

Credit Facility

On June 14, 2013, the Company entered into a credit facility agreement (June 2013 Credit Facility) with a group of lenders that are, or that are affiliated with, existing investors in the Company. Under the June 2013 Credit Facility, the lenders have committed to permit the Company to draw an aggregate of up to $5,000,000, and, subject to the Company s obtaining additional commitments from lenders, such amount may be increased to up to $7,000,000. The

June 2013 Credit Facility expired on June 30, 2014 without having been drawn upon.

During the term of the June 2013 Credit Facility, the Company could request from the lenders up to four advances, with each advance equal to one-quarter of each lender s aggregate commitment amount. The Company would issue a promissory note in the principal amount of each such advance that would accrue interest at a rate of 10% per annum. The principal and all unpaid interest under the promissory notes would be due on the maturity date, and the Company could not prepay the promissory notes prior to the maturity date without consent of at least a majority in interest of the aggregate principal amount of the promissory notes then outstanding under the June 2013 Credit Facility.

In connection with the June 2013 Credit Facility, the Company agreed to pay a fee of 2% of the total commitment amount to the lenders. In addition, the Company incurred an additional $10,000 in financing-related costs, primarily legal fees. These costs were recorded as deferred financing costs as a component of current other assets and were fully amortized to interest expense as of December 31, 2014.

In connection with the June 2013 Credit Facility, the Company issued warrants (June 2013 Warrants) to purchase a number of shares of common stock equal to 10% of the total committed amount of the June 2013 Credit Facility divided by 70% of the value of common stock in a sale of the Company or a Qualified IPO, with such June 2013 Warrants to have an exercise price of 70% of the value of common stock in a sale of the Company or a Qualified IPO. The June 2013 Warrants expire upon the earlier of June 14, 2023 or the sale of the Company. As the predominant settlement feature of the June 2013 Warrants was to settle a fixed monetary amount in a variable number of shares, the June 2013 Warrants were accounted for under ASC 480. Accordingly, the June 2013 Warrants were recorded at estimated fair value on their issuance date and were adjusted to their estimated fair value as of each reporting date with the change in estimated fair value recorded as a component of change in estimated fair value of financial instruments in the Company s condensed consolidated statements of operations. The fair value of the June 2013 Warrants at the date of issuance of $435,000 was recorded as a deferred financing cost as a current other asset and was being amortized to interest expense over the term of the arrangement. Until the effective date of the IPO, the Company estimated the fair value of the June 2013 Warrants using a PWERM valuation based on unobservable inputs and, therefore, the June 2013 Warrants were classified as Level 3 liabilities in the fair value hierarchy. Upon closing of the IPO, the exercise price of the June 2013 Warrants was determined to be $8.40 per share and the number of shares to be issued upon exercise of the warrants was no longer variable. As a result of the IPO, the June 2013 Warrants were considered to be indexed to the Company s stock, and accordingly, the common stock warrants liability was reclassified and included in stockholders equity (deficit) during the year ended December 31, 2013.

Secured Promissory Note

On April 11, 2014, the Company entered into a $3,000,000 promissory note with Five Star Bank. On April 14, 2014, the Company entered into an agreement with the bank to modify the terms of the promissory note from a single payment loan to a revolving line of credit, which allowed the Company to borrow up to $3,000,000. On April 28, 2014, the Company entered into an agreement to modify the terms of the revolving line of credit to increase the borrowing limit up to $5,000,000. In June 2014, the $4,687,000 balance on the revolving line of credit was paid off and the line was closed when the Company borrowed $10,000,000 pursuant to a business loan agreement and promissory note (June 2014 Secured Promissory Note) with the bank (Lender) which bears interest at prime rate (3.25% as of March 31, 2015) plus 2.00% per annum. The interest rate is subject to change from time to time to reflect changes in the prime rate; however, the interest rate shall not be less than 5.25% or more than the maximum rate allowed by applicable law. If the interest rate increases, the Lender, may, at its option, increase the amount of each monthly payment to ensure that the note would be paid in full by the maturity date, increase the amount of each monthly payment to reflect the change in interest rate, increase the number of monthly payments or keep the monthly payments the same and increase the final payment amount.

The June 2014 Secured Promissory Note is repayable in monthly payments of $64,390 commencing in July 2014, with the final payment due in June 2036. Certain of the Company s deposit accounts and MMM, LLC s inventories, chattel paper, accounts, equipment and general intangibles have been pledged as collateral for the promissory note. The Company is required to maintain a deposit balance with the Lender of $1,560,000, which is recorded as restricted cash included in non-current assets. In addition, until the Company provides documentation that the proceeds were used for construction of the Company s manufacturing plant, proceeds from the loan will be maintained in a restricted deposit account. As of March 31, 2015, the Company had $1,856,000 remaining in this restricted deposit account, which was recorded as restricted cash included in current assets.

In addition, the Company incurred an additional $304,000 in financing-related costs, including USDA guarantee fees. These costs were recorded as deferred financing costs as a component of current and non-current other assets on the date of issuance and are being amortized to interest expense over the term of the arrangement.

The Company may prepay 20% of the outstanding principal loan balance each year without penalty. A prepayment fee of 10% will be charged if prepayments exceed 20% in the first year, and the prepayment fee will decrease by 1% each year for the first ten years of the loan.

The Company is required to maintain a current ratio of not less than 1.25-to-1.0, a debt-to-worth ratio of no greater than 4.0-to-1.0 and a loan-to-value ratio of no greater than 70% as determined by the lender. The Company is also required to comply with certain affirmative and negative covenants under the loan agreement discussed above. In the event of default on the debt, the lender may declare the entire unpaid principal and interest immediately due and payable. As of March 31, 2015 and December 31, 2014, the Company was in breach of certain of its covenants under the loan agreement as a result of its annual and quarterly reports not being filed within the prescribed time period and its being in breach of covenants on the October 2012 and April 2013 Secured Promissory Notes described above. Effective September 30, 2015, the Company s debt-to-worth ratio was greater than 4.0-to-1.0 as a result of the issuance of $40,000,000 in promissory notes in August 2015 as described in Note 10, which increased the Company s debt while the Company continued to incur net losses, which decreased stockholders equity. However, in November 2015, the Company received a waiver from the Lender with respect to compliance with the requirements to (i) deliver annual financial statements (extended to November 15, 2015), (ii) maintain a current ratio greater than 1.25-to-1.0 (extended to December 31, 2015) and (iii) maintain a debt-to-worth ratio less than 4.0-to-1.0 (extended to December 31, 2016). The receipt of this waiver and the extension to provide financial statements under the October 2012 and April 2013 Secured Promissory Notes cured the Company of being in breach of the covenants under the loan agreement.

7. Share-Based Plans

As of March 31, 2015, there were 2,663,000 options outstanding and 2,113,000 share-based awards available for grant under the outstanding equity incentive plans.

For the three months ended March 31, 2015 and 2014, the Company recognized share-based compensation of $1,090,000 and $1,522,000, respectively.

During the three months ended March 31, 2015, the Company did not grant any options and no options were exercised.

8. Commitments and Contingencies

Operating Leases

The Company has a non-cancelable lease for an aggregate of approximately 24,500 square feet of non-contiguous office space in an office complex in Davis, California under which a portion of the covered space terminated beginning in February 2014. The remaining portion of the space will terminate by October 2016. The lease includes negotiated annual increases in the monthly rental payments.

In September 2013 and then amended in April 2014, the Company entered into a lease agreement for approximately 27,300 square feet of office and laboratory space located in Davis, California. The initial term of the lease is for a period of 60 months and commenced in August 2014. The monthly base rent is $44,000 per month for the first 12 months with a 3% increase each year thereafter. Concurrent with this amendment, in April 2014, the Company entered into a lease agreement with an affiliate of the landlord to lease approximately 17,400 square feet of office and laboratory space in the same building complex in Davis, California. The initial term of the lease is for a period of 60 months and commenced in August 2014. The monthly base rent is $28,000 with a 3% increase each year thereafter.

Litigation

On September 5, 2014, September 8, 2014, September 11, 2014, September 15, 2014 and November 3, 2014, the Company, along with certain of its current and former officers and directors and others were named as defendants in putative securities class action lawsuits filed in the U.S. District Court for the Eastern District of California. On February 13, 2015, these actions were consolidated as *Special Situations Fund III QP, L.P. et al v. Marrone Bio Innovations, Inc. et al*, Case No 2:14-cv-02571-MCE-KJN. On September 2, 2015, an initial consolidated complaint was filed on behalf of (i) all persons who purchased or otherwise acquired the Company s publicly traded common stock directly in or traceable to the Company s August 1, 2013 initial public offering; (ii) all persons who purchased or otherwise acquired the Company s publicly traded common stock directly in the Company s June 6, 2014 secondary offering; and (iii) all persons who purchased or otherwise acquired the Company s publicly traded common stock on the open market between March 7, 2014 and September 2, 2014 (the Class Action). In addition to the Company, the initial consolidated complaint names certain of the Company s current and former officers and directors and the Company s independent registered public accounting firm as defendants. The initial consolidated complaint alleges violations of the Securities Act of 1933, the Securities Exchange Act of 1934 and SEC Rule 10b-5, arising out of the issuance of allegedly false and misleading statements about the Company s business and prospects, including its financial statements, product revenues and system of internal controls. Plaintiffs contend that such statements caused the Company s stock price to be artificially inflated. The action includes claims for damages, fees and expenses, including an award of attorneys and experts fees to the putative class. Pursuant to a stipulation between the parties, and by order of the Court, defendants need not respond to the initial consolidated complaint. An amended consolidated complaint is to be filed no later than 60 days after the Company announces the restatement(s) after which defendants will have 60 days to respond. The outcome of this matter is not presently determinable.

On September 9, 2014 and November 25, 2014, shareholder derivative actions were filed in the Superior Court of California, County of Yolo (Case No. CV14-1481) and the U.S. District Court for the Eastern District of California

(Case No. 1:14-cv-02779-JAM-CKD), purportedly on the Company s behalf, against certain current and former officers and members of its board of directors (the 2014 Derivative Actions). The plaintiffs in the 2014 Derivative Actions allege that the defendants breached their fiduciary duties, committed waste, were unjustly enriched and aided and abetted breaches of fiduciary duty by causing the Company to issue allegedly false and misleading statements. The issues in the 2014 Derivative Actions overlap substantially with those at issue in the Class Action described above. The plaintiffs in the 2014 Derivative Actions seek, purportedly on behalf of the Company, an unspecified award of damages including, but not limited to, various corporate governance reforms, an award of restitution, an award of reasonable costs and expenses, including attorneys fees, and other further relief as the Court may deem just and proper. The Courts have granted the parties stipulations to defer litigation activity, subject to certain conditions and pending certain developments in the Class Action.

On October 14, 2015, a shareholder derivative action was filed in the Superior Court of California, County of Yolo (Case No. CV15-1423), purportedly on the Company s behalf, against certain current and former officers and members of the Company s board of directors and the Company s independent registered public accounting firm (the 2015 Derivative Action, and with the 2014 Derivative Actions, the Derivative Actions). The plaintiff in the 2015 Derivative Action alleges that the director and officer defendants breached their fiduciary duties, committed waste and were unjustly enriched by causing the Company to issue allegedly false and misleading statements. The plaintiff in the 2015 Derivative Action also alleges that the Company s independent registered public accounting firm committed professional negligence and malpractice. The issues in the 2015 Derivative Action overlap substantially with those at issue in the 2014 Derivative Actions and the Class Action described above. The parties are negotiating a date by which the defendants response to the newly filed complaint will be due. Given the preliminary nature of the Derivative Actions, the Company is not in a position to express any opinion regarding the outcome in these matters.

The Company is currently unable to estimate a range of reasonably possible loss for the litigation because these matters involve significant uncertainties. Those uncertainties include the legal theory or the nature of the claims, the complexity of the facts, the results of any investigation or litigation and the timing of resolution of the investigations or litigation. Although the Company cannot estimate a reasonable range of loss based on currently available information, the resolution of these matters could have a material adverse effect on its financial position, results of operations or cash flows.

SEC Investigation

The Company advised the staff of the Division of Enforcement of the SEC in September 2014 that the Audit Committee of the Company s board of directors had commenced an internal investigation. The SEC commenced a formal investigation of these matters, with which the Company is cooperating. Though the investigation continues, the Company has engaged in discussions with the Division of Enforcement staff concerning the resolution of any enforcement action that it may recommend. In accordance with ASC 450, *Contingencies*, the Company has accrued $1,750,000 in its condensed consolidated balance sheets as of March 31, 2015 and December 31, 2014 for its estimate of the penalties arising from such enforcement action and has estimated the range of the reasonably possible loss to be between $1,750,000 and $4,000,000.

Publicity surrounding the foregoing or any enforcement action as a result of the Division of Enforcement s investigation, even if ultimately resolved favorably, could have an adverse impact on the Company s reputation, business, financial position, results of operations or cash flows.

9. Related Party Transactions

Les Lyman, a member of the Company s board of directors, is the chairman and significant indirect shareholder of The Tremont Group, Inc. For the three months ended March 31, 2015 and 2014, revenue of $199,000 and $277,000, respectively, was recognized on a sell-through basis relating to product purchased by The Tremont Group, Inc. that was resold by the Tremont Group, Inc. during the period. As of March 31, 2015 and December 31, 2014, the Company had no outstanding accounts receivable due from The Tremont Group, Inc. As of March 31, 2015 and December 31, 2014, the Company recorded deferred cost of product revenues of $251,000 and $333,000, respectively, and current deferred product revenues of $461,000 and $660,000, respectively, relating to product sold to The Tremont Group, Inc. where title has transferred but the criteria for revenue recognition have not been met. Although the Company anticipates sales of its products to The Tremont Group, Inc. to continue through 2015, the Company cannot estimate the amount of those sales.

The Company has a strategic collaboration and distribution agreement with Syngenta, an affiliate of a former 5% stockholder, Syngenta Ventures. In connection with the Company s secondary offering in June 2014, Syngenta Ventures sold 600,000 shares of the Company s common stock, reducing its ownership percentage below 5%. Accordingly, revenue recognized under this agreement subsequent to June 2014 has not been included in related party revenues. For the three months ended March 31, 2014, the Company recognized $324,000 of related party revenues under this agreement prior to Syngenta Ventures reducing its ownership stake.

10. Subsequent Events

Sale of Notes and Warrants

On August 20, 2015, the Company issued and sold to entities affiliated with Waddell & Reed Financial, Inc., one of its 5% stockholders, senior secured promissory notes in the aggregate principal amount of $40,000,000 and warrants to purchase up to 4,000,000 shares of common stock of the Company for aggregate consideration of $40,000,000, pursuant to a purchase agreement dated August 20, 2015.

The notes will bear interest at a rate of 8% per annum payable semi-annually on June 30 or December 31 of each year, commencing on December 31, 2015, with $10,000,000 payable three years from the closing, $10,000,000 payable four years from the closing and $20,000,000 payable five years from the closing. The notes contain customary covenants, in addition to the obligation to maintain cash and cash equivalents of at least $15,000,000. The notes provide for various events of default, including, among others, default in payment of principal or interest, breach of any representation or warranty by the Company or any subsidiary under any agreement or document delivered in connection with the notes, a continued breach of

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any other condition or obligation under any loan document, certain bankruptcy, liquidation, reorganization or change of control events, the acquisition by any person or persons acting as group, other than the lenders, of beneficial ownership of 40% or more of the outstanding voting stock of the Company and certain events in which Pamela G. Marrone Ph.D. ceases to serve as the Company s Chief Executive Officer. As of September 30, 2015, the Company was in breach of its covenants under the August 2015 Senior Secured Promissory Notes as the Company was in breach of its covenants under its October 2012 and April 2013 Secured Promissory Notes and June 2014 Secured Promissory Note. However, this covenant breach was cured in November 2015 as a result of the Company obtaining an extension to deliver its annual financial statements with respect to the October 2012 and April 2013 Secured Promissory Notes and the waiver of certain of the Company s covenants with respect to the June 2014 Secured Promissory Note. See Note 6 for further discussion.

The notes are secured by substantially all the Company s personal property assets. The agent, acting behalf of the lenders, shall be entitled to have a first priority lien on the Company s intellectual property assets, pursuant to intercreditor arrangements with certain of the Company s existing lenders.

The warrants are immediately exercisable at an exercise price of $1.91 per share (subject to adjustments) and may be exercised at a holder s option at any time on or before August 20, 2023 (subject to certain exceptions). Proceeds from the sale of the notes and warrants will be allocated to the notes and warrants based on the relative fair value.

In connection with the above transaction, on August 19, 2015, the Company amended the October 2012 and April 2013 Secured Promissory Notes. As a result of the amendment, interest on loans was accrued at a rate of 12% per annum until September 1, 2015, and thereafter is accrued at a rate of 18% per annum, and the Company is permitted to prepay the outstanding indebtedness under the agreement without penalty at any time. In addition, in September 2015, the Company provided a written notice exercising its right to extend the maturity through October 2, 2017. The amendments will be accounted for as a modification of the loan agreement with the effective interest rate adjusted prospectively from the amendment date.

Separation Agreement

On January 14, 2015, James Iademarco was appointed as the Company s President and Chief Operating Officer, effective January 14, 2015. On August 20, 2015, the Company entered into a separation agreement with James Iademarco whereby he resigned effective August 31, 2015, but agreed to remain available to advise the Company in a consulting capacity for an additional period of up to 90 days to assist with the transition of various pending matters. Pursuant to the separation agreement, Mr. Iademarco is entitled to receive, among other things, an amount equal to one-twelfth of his prior base salary of $290,000 on or before the 15th day of each of the twelve months following August 31, 2015 and certain premium payments for health and vision insurance coverage, in partial consideration for Mr. Iademarco granting the Company a general release of liability and claims.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion of our financial condition and results of operations in connection with our condensed consolidated financial statements and the related notes included elsewhere in this Quarterly Report on Form 10-Q and with our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2014, as filed with the Securities and Exchange Commission. In addition to historical condensed consolidated financial information, the following discussion contains forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to these differences include those discussed below and elsewhere, including Part II, Item 1A, Risk Factors, in this Quarterly Report on Form 10-Q, and in Part I, Item 1A, Risk Factors of our Annual Report filed on Form 10-K for the fiscal year ended December 31, 2014.

Overview

We make bio-based pest management and plant health products. Bio-based products are comprised of naturally occurring microorganisms, such as bacteria and fungi, and plant extracts. Our current products target the major markets that use conventional chemical pesticides, including certain agricultural and water markets, where our bio-based products are used as alternatives for, or mixed with, conventional chemical products. We also target new markets for which there are no available conventional chemical pesticides, the use of conventional chemical pesticides may not be desirable or permissible because of health and environmental concerns (including for organically certified crops) or because the development of pest resistance has reduced the efficacy of conventional chemical pesticides. We believe our current portfolio of EPA-approved and registered biopesticide products and our pipeline address the growing global demand for effective, efficient and environmentally responsible products to control pests, increase crop yields and reduce crop stress.

The agricultural industry is increasingly dependent on effective and sustainable pest management practices to maximize yields and quality in a world of increased demand for agricultural products, rising consumer awareness of food production processes and finite land and water resources. In addition, our research has shown that the global market for biopesticides is growing substantially faster than the overall market for pesticides. This demand is in part a result of conventional growers acknowledging that there are tangible benefits to adopting bio-based pest management products into integrated pest management (IPM) programs, as well as increasing consumer demand for organic food. We seek to capitalize on these global trends by providing both conventional and organic growers with solutions to a broad range of pest management needs through strategies such as adding new products to our product portfolio, continuing to broaden the commercial applications of our existing product lines, leveraging growers positive experiences with existing product lines, educating growers with on-farm product demonstrations and controlled product launches with key target customers and other early adopters. We believe this approach enables us to stay ahead of our competition in providing innovative pest management solutions, enhances our sales process at the distributor level and helps us to capture additional value from our products.

Although our long-term, global vision for our business and our commitment to that vision remain fundamentally unchanged, to date, we have not achieved anticipated growth in sales of our products, which has resulted in an increase in inventory write-offs, higher proportional levels of operating expenses, increases in cost of product revenues and decreases in product margins. In response to the business challenges reflected in our financial results for recent periods, since the second half of 2014, we have been implementing a prioritization plan to focus our resources on continuing to improve and promote our commercially available products, advancing product candidates that are expected to have the greatest impact on near-term growth potential and expanding international presence and commercialization. Our goal has been to reduce expenses, to conserve cash and improve operating efficiencies, to extract greater value from our products and product pipeline and to improve our communication to and connection with the global sustainability movement that is core to our cultural values.

In connection with this new strategy, we have significantly reduced overall headcount, while building a new sales and marketing organization with increased training and ability to educate and support customers as well as providing our product development staff with greater responsibility for technical sales support, field trials and demonstrations to promote sales growth. In addition, while we believe that we have developed a robust pipeline of novel product candidates, we are currently limiting our internal efforts on five promising product candidates. Simultaneously, we are seeking collaborations with third parties to develop and commercialize more early stage candidates on which we have elected not to expend significant resources given our reduced budget. We believe collectively, these measures, together with our competitive strengths, including our leadership in the biologicals industry, commercially available products, robust pipeline of novel product candidates, proprietary discovery and development processes and industry experience, position us for growth.

We sell our crop protection products to leading agrichemical distributors while also working directly with growers to increase existing and generate new product demand. To date, we have marketed our bio-based pest management and plant health products for agricultural applications to U.S. growers, through distributors and our own sales force, and we have focused primarily on high value specialty crops such as grapes, citrus, tomatoes and leafy greens. A large portion of our sales are currently attributable to conventional growers who use our bio-based pest management products either to replace conventional chemical pesticides or enhance the efficacy of their IPM programs. In addition, a portion of our sales are attributable to organic farmers, who cannot use conventional pesticides and have few alternatives for pest management. As we continue to demonstrate the efficacy of our bio-based pest management and plant health products on new crops or for new applications, we may either continue to sell our products through our in-house sales force or collaborate with third parties for distribution to select markets.

Although we have historically sold a significant majority of our products in the United States, expanding our international presence and commercialization is an important component of our growth strategy. Regalia is currently available in select international markets under distribution agreements with major agrichemical companies. Going forward, our plan is to focus on key countries and regions with the largest and fastest growing biopesticide and plant health product markets for specialty crops and selected row crops. We intend to work with regional and country distributors who have brand recognition and established customer bases and who can conduct field trials and grower demonstrations and lead or assist in regulatory processes and market development.

We currently market our water treatment product, Zequanox, through our sales and technical workforce to a selected group of U.S. power and industrial companies. Due to prioritization constraints, we have not committed resources to Zequanox sufficient to market it full-scale. However, we are seeking sales and distribution partners for in-pipe and open water uses, and are currently in discussions with large water treatment companies to further develop Zequanox and expand it commercially. In addition, we continue to work with state, federal and bi-national partners to further develop Zequanox in the Great Lakes/Upper Mississippi River Basin as a habitat restoration tool and potential harmful algal bloom management tool. We believe that Zequanox presents a unique opportunity for generating long-term revenue, as there are limited water treatment options available to date, most of which are time-consuming, costly or subject to high levels of regulation. Our ability to generate significant revenues from Zequanox is dependent on our ability to persuade customers to evaluate the costs of our Zequanox products compared to the overall cost of the chlorine treatment process, the primary current alternative to using Zequanox, rather than the cost of purchasing chemicals alone. Sales of Zequanox have also remained lower than our other products due to the length of the treatment cycle, the longer sales cycle (the bidding process with utility companies and governmental agencies occurs on a yearly or multi-year basis) and the unique nature of the treatment approach for each customer based on the extent of the infestation and the design of the facility.

Although our initial EPA-approved master labels cover our products anticipated crop-pest use combinations, we launch early formulations of our pest management and plant health products to targeted customers under commercial labels that list a limited number of crops and applications that our initial efficacy data can best support. We then gather new data from experiments, field trials and demonstrations, gain product knowledge and get feedback to our research and development team from customers, researchers and agricultural agencies. Based on this information, we enhance our products, refine our recommendations for their use in optimal IPM programs, expand our commercial labels and submit new product formulations to the EPA and other regulatory agencies. For example, we began sales of Regalia SC, an earlier formulation of Regalia, in the Florida fresh tomatoes market in 2008, while a more effective formulation of Regalia with an expanded master label, including listing for use in organic farming, was under review by the EPA. In 2011, we received EPA approval of a further expanded Regalia master label covering hundreds of crops and various new uses for applications to soil and through irrigation systems, and we recently expanded sales of Regalia in large-acre row crops as a plant stimulus product, in addition to its beneficial uses as a fungicide. Similarly, ongoing field development research on the microbe used in Venerate, our insecticide product, led to our October 2015 registration of Majestene as a nematicide. We believe we have opportunities to broaden the commercial applications and expand the use of our existing product lines to help drive significant growth for our company.

Our total revenues were $2.1 million and $2.7 million for the three months ended March 31, 2015 and 2014, respectively. We generate our revenues primarily from product sales, which are principally attributable to sales of our Regalia and Grandevo product lines. Various factors have impeded anticipated growth in sales of these products in recent years, and may continue to impede growth. For example, we believe adverse conditions in the U.S. agricultural industry, including low commodity prices, may have reduced demand for our products. Further delays in regulatory approvals of certain of our products in Europe and other jurisdictions may slow international growth, and any delay in a product launch that causes us to miss a growing season may require us to wait a year to enter that market. The extended drought in California and other markets has reduced demand for our products as fewer acres are planted, and certain of our strategic collaborations have not resulted in anticipated increases in sales of Regalia outside of the Unites States. Due to prioritization constraints, we have not committed resources to Zequanox sufficient to market it full-scale, and our collaboration efforts with regard to this product may not result in increased sales. In addition, the departure of our former chief operating officer and significant members of our sales staff in the third quarter of 2014 and subsequent turnover in our sales and marketing department disrupted the 2014 launch of Venerate as well as growth in sales of our other commercialized products, including Regalia and Grandevo.

Since 2011, we have also recognized revenues from our strategic collaboration and distribution agreements, which amounted to less than $0.1 million for each of the three months ended March 31, 2015 and 2014, excluding related party revenues. We have a strategic collaboration and distribution agreement with Syngenta, an affiliate of a former 5% stockholder, Syngenta Ventures Pte. LTD (Syngenta Ventures). In connection with our secondary offering in June 2014, Syngenta Ventures sold 0.6 million shares of our common stock, reducing its ownership percentage below 5%. Accordingly, revenue recognized under this agreement subsequent to June 2014 has not been included in related party revenues. For the three months ended March 31, 2014, we recognized $0.3 million of related party revenues under this agreement prior to Syngenta Ventures reducing its ownership stake.

We currently rely, and expect to continue to rely, on a limited number of distributors for a significant portion of our revenues since we sell through highly concentrated, traditional distribution channels. Distributors to which 10% or more of our total revenues are attributable for any one of the periods presented consist of the following:

	CHEM NUT, INC.	CROP PRODUCTION SERVICES	HELENA CHEMICALS	THE TREMONT GROUP (1)	SYNGENTA (1)	TITAN PRO
For the three months ended March 31,						
2015	24%	17%	14%	10%	*	*
2014	6%	25%	14%	10%	12%	11%

(1) Represents revenues from related parties. See Note 9 to the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q in Part I, Item 1, Financial Information for further discussion.

* Represents less than 1% of total revenues.

While we expect product sales to a limited number of distributors to continue to be our primary source of revenues, as we continue to develop our pipeline and introduce new products to the marketplace, we anticipate that our revenue stream will be diversified over a broader product portfolio and customer base.

Our cost of product revenues was $2.0 million and $1.8 million for the three months ended March 31, 2015 and 2014, respectively. Cost of product revenues included $0.1 million and $0.2 million of cost of product revenues to related parties for the three months ended March 31, 2015 and 2014, respectively. Cost of product revenues consists principally of the cost of inventory, which includes the cost of raw materials, and third party services and allocation of operating expenses of our manufacturing plant related to procuring, processing, formulating, packaging and shipping our products. Cost of product revenues also include charges recorded for write-downs of inventory, which has increased in recent years, and, beginning in 2014, idle capacity at our manufacturing plant when the manufacturing plant was placed into service. We expect our cost of product revenues related to the cost of inventory to increase and cost of product revenues relating to write-downs of inventory and idle capacity of our manufacturing plant to decrease as we expand sales and increase production of our existing commercial products Regalia, Grandevo, Venerate and Zequanox and introduce new products to the market. Our cost of product revenues related to the cost of inventory has increased as a percentage of total revenues primarily due to a change in product mix, with Grandevo representing an increased percentage of total revenues as Grandevo is early in its life cycle. We expect to see a gradual increase in gross margin over the life cycle of each of our products, including Grandevo, as we improve production processes, gain efficiencies and increase product yields. These increases may be offset by additional charges for inventory write-downs and idle capacity at our manufacturing plant until overall volume in the plant increases significantly.

Our research, development and patent expenses have historically comprised a significant portion of our operating expenses, amounting to $3.4 million and $4.3 million for the three months ended March 31, 2015 and 2014, respectively. We have reduced the size of our research and development staff compared to prior periods and are reducing costs spent on various research and development and patent efforts as part of our efforts to streamline business operations and focus on our pipeline product priorities. However, we have made, and will continue to make, substantial investments in research and development and we intend to continue to devote significant resources toward the advancement of product candidates that are expected to have the greatest impact on near-term growth potential. Simultaneously, we are seeking collaborations with third parties to develop and commercialize more early stage candidates, which we have elected not to expend significant resources on given our reduced budget.

Selling, general and administrative expenses incurred to establish and build our market presence and business infrastructure have generally comprised the remainder of our operating expenses, amounting to $7.9 million and $6.3 million for the three months ended March 31, 2015 and 2014, respectively. While we have reduced headcount in comparison to prior periods, in connection with our new strategy, we have been building a new sales and marketing organization which provides for increased training and a better ability to educate and support customers as well as transitioning our product development staff to undertake greater responsibility for technical sales support, field trials and demonstrations to promote sales growth. We expect that in the future, our selling, general and administrative expenses will increase due to our expanded product portfolio and due to additional costs incurred related to being a public company. In addition, for the three months ended March 31, 2015, we incurred $2.5 million in costs related to the Audit Committee s independent investigation, which commenced in September 2014, and subsequent restatement of our financial statements. We expect to incur significant costs through 2015 related to the Audit Committee s independent investigation and the restatement of our financial statements. In addition, we have engaged in discussions with the SEC s Division of Enforcement staff concerning the resolution of any enforcement action that it may recommend. Accordingly, we have accrued $1.8 million in our condensed consolidated balance sheets as of March 31, 2015 and December 31, 2014 for any potential penalties arising from such enforcement action.

Until the initial public offering (IPO) in August 2013, we have funded our operations from the issuance of shares of common stock, preferred stock, warrants and convertible notes, the issuance of debt and entry into financing arrangements, product sales, payments under strategic collaboration and distribution agreements and government grants, but we have experienced significant losses as we invested heavily in research and development. We expect to incur additional losses related to our investment in the continued development, expansion and marketing of our product portfolio.

In August 2015, we issued and sold to affiliates of Waddell & Reed Financial, Inc., in a private placement, senior secured promissory notes in the aggregate principal amount of $40.0 million and warrants to purchase up to 4.0 million shares of our common stock for aggregate consideration of $40.0 million.

Critical Accounting Policies and Estimates

Our condensed consolidated financial statements and the related notes included elsewhere in this Quarterly Report on Form 10-Q are prepared in accordance with accounting principles generally accepted in the United States (GAAP). The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, net revenue, costs and expenses, and any related disclosures. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Changes in accounting estimates are reasonably likely to occur from period to period. Accordingly, actual results could differ significantly from the estimates made by our management. We evaluate our estimates and assumptions on an ongoing basis. To the extent that there are material differences between these estimates and our actual results, our future financial statement presentation, financial condition, results of operations and cash flows will be affected.

We believe that the assumptions and estimates associated with revenue recognition, including assumptions and estimates used in determining the timing and amount of revenue to recognize for those transactions accounted for on a sell-through method, inventory valuation and share-based compensation have the greatest potential impact on our condensed consolidated financial statements. Therefore, we consider these to be our critical accounting policies and estimates. There have been no material changes to our critical accounting policies as described in our Annual Report filed on Form 10-K for the fiscal year ended December 31, 2014.

Key Components of Our Results of Operations

Product Revenues

Product revenues consist of revenues generated primarily from sales to distributors, net of rebates and cash discounts. Product revenues, not including related party revenues, constituted 86% and 76% of our total revenues for the three months ended March 31, 2015 and 2014, respectively. Product revenues in the United States, not including related party revenues, constituted 86% and 71% of our total revenues for the three months ended March 31, 2015 and 2014, respectively.

In some cases, we recognize distributor revenue as title and risk of loss passes, provided all other revenue recognition criteria have been satisfied (the sell-in method). For certain sales to certain distributors, the revenue recognition criteria for distributor sales are not satisfied at the time title and risk of loss passes to the distributor; specifically, in instances where inventory protection arrangements were offered to distributors that would permit these distributors to return to the Company certain unsold products, we consider the arrangement not to be fixed or determinable, and accordingly, revenue is deferred until products are resold to customers of the distributor (the sell-through method). The cost of goods sold associated with such deferral are also deferred and classified as deferred