MARRONE BIO INNOVATIONS INC
Form 10-Q
August 14, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2017

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

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company
Emerging growth Company		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period

for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the

Exchange Act.

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

Class	Shares Outstanding at August 8, 2017
Common Stock, $0.00001 par value	31,350,877

TABLE OF CONTENTS

	PAGE
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements (Unaudited)	3
Condensed Consolidated Balance Sheets as of June 30, 2017 and December 31, 2016	3
Condensed Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2017 and 2016	4
Condensed Consolidated Statements of Comprehensive Loss for the Three and Six Months Ended June 30, 2017 and 2016	5
Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2017 and 2016	6
Notes to Condensed Consolidated Financial Statements	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	19
Item 3. Quantitative and Qualitative Disclosures About Market Risk	35
Item 4. Controls and Procedures	36
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings	37
Item 1A. Risk Factors	37
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	39
Item 6. Exhibits	40
SIGNATURES	41
INDEX TO EXHIBITS	42

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

MARRONE BIO INNOVATIONS, INC.

Condensed Consolidated Balance Sheets

(In Thousands, Except Par Value)

	JUNE 30, 2017 (Unaudited)	DECEMBER 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	$ 10,242	$ 9,609
Restricted cash, current portion	1,444	1,444
Accounts receivable	5,794	3,592
Inventories, net	8,364	8,482
Deferred cost of product revenues	3,410	2,688
Prepaid expenses and other current assets	387	1,060
Total current assets	29,641	26,875
Property, plant and equipment, net	16,476	17,343
Restricted cash, less current portion	1,560	1,560
Other assets	140	205
Total assets	$ 47,817	$ 45,983
Liabilities and stockholders' deficit		
Current liabilities:		
Accounts payable	$ 3,197	$ 1,385
Accrued liabilities	6,730	5,508
Accrued interest due to related parties	1,596	1,618
Deferred revenue, current portion	6,755	5,647
Capital lease obligations, current portion	487	839
Debt, current portion	2,954	252
Total current liabilities	21,719	15,249
Deferred revenue, less current portion	2,186	1,787
Debt, less current portion	21,029	21,083
Debt due to related parties	37,240	36,667
Other liabilities	1,293	1,381
Total liabilities	83,467	76,167
Commitments and contingencies (Note 8)		
Stockholders' deficit:		
Preferred stock: $0.00001 par value; 20,000 shares authorized and no shares issued or outstanding at June 30, 2017 and December 31, 2016	—	—

Common stock: $0.00001 par value; 250,000 shares authorized, 31,351 shares issued and outstanding as of June 30, 2017 and 24,661 as of December 31, 2016	—	—
Additional paid in capital	214,011	204,463
Accumulated deficit	(249,661)	(234,647)
Total stockholders' deficit	(35,650)	(30,184)
Total liabilities and stockholders' deficit	$ 47,817	$ 45,983

See accompanying notes.

3

MARRONE BIO INNOVATIONS, INC.

Condensed Consolidated Statements of Operations

(In Thousands, Except Per Share Amounts)

(Unaudited)

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	JUNE 30,		JUNE 30,	
	2017	2016	2017	2016
Revenues:				
Product	$6,418	$4,957	$10,514	$7,534
License	58	92	116	184
Total revenues	6,476	5,049	10,630	7,718
Cost of product revenues	3,966	3,118	6,245	5,387
Gross profit	2,510	1,931	4,385	2,331
Operating Expenses:				
Research, development and patent	2,853	2,313	5,297	4,635
Selling, general and administrative	5,073	4,512	10,416	10,042
Total operating expenses	7,926	6,825	15,713	14,677
Loss from operations	(5,416)	(4,894)	(11,328)	(12,346)
Other income (expense):				
Interest income	—	10	1	25
Interest expense	(869)	(759)	(1,505)	(1,509)
Interest expense to related parties	(1,085)	(1,083)	(2,159)	(2,166)
Other income (expense), net	(15)	(57)	(23)	(63)
Total other expense, net	(1,969)	(1,889)	(3,686)	(3,713)
Loss before income taxes	(7,385)	(6,783)	(15,014)	(16,059)
Income taxes	—	—	—	—
Net loss	$(7,385)	$(6,783)	$(15,014)	$(16,059)
Basic and diluted net loss per common share	$(0.25)	$(0.28)	$(0.55)	$(0.65)
Weighted-average shares outstanding used in computing net loss per common share	29,401	24,598	27,070	24,584

See accompanying notes.

MARRONE BIO INNOVATIONS, INC.

Condensed Consolidated Statements of Comprehensive Loss

(In Thousands)

(Unaudited)

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2017	2016	2017	2016
Net loss	$(7,385)	$(6,783)	$(15,014)	$(16,059)
Other comprehensive loss	—	—	—	—
Comprehensive loss	$(7,385)	$(6,783)	$(15,014)	$(16,059)

See accompanying notes.

MARRONE BIO INNOVATIONS, INC.

Condensed Consolidated Statements of Cash Flows

(In Thousands)

(Unaudited)

	SIX MONTHS ENDED JUNE 30,	
	2017	2016
Cash flows from operating activities		
Net loss	$(15,014)	$(16,059)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,034	1,150
Loss (gain) on disposal of equipment	(4)	58
Share-based compensation	1,169	1,327
Non-cash interest expense	730	657
Net changes in operating assets and liabilities:		
Accounts receivable	(2,202)	(2,196)
Inventories	118	1,068
Prepaid expenses and other assets	738	403
Deferred cost of product revenues	(722)	(430)
Accounts payable	1,595	196
Accrued and other liabilities	1,242	(1,419)
Accrued interest due to related parties	(22)	425
Deferred revenue	1,507	1,449
Deferred revenue from related parties	—	(168)
Net cash used in operating activities	(9,831)	(13,539)
Cash flows from investing activities		
Purchases of property, plant and equipment	(160)	(93)
Net cash used in investing activities	(160)	(93)
Cash flows from financing activities		
Proceeds from issuance of common stock, net of offering costs	8,223	—
Repayment of debt	(134)	(129)
Proceeds from secured borrowings	6,151	—
Reductions in secured borrowings	(3,281)	—
Repayment of capital leases	(352)	(346)
Change in restricted cash	—	15,412
Exercise of stock options	17	16
Net cash provided by financing activities	10,624	14,953
Net increase in cash and cash equivalents	633	1,321
Cash and cash equivalents, beginning of period	9,609	19,838

Cash and cash equivalents, end of period	$10,242	$21,159
Supplemental disclosure of cash flow information		
Cash paid for interest	$2,938	$2,595
Supplemental disclosure of non-cash investing and financing activities		
Property, plant and equipment included in accounts payable and accrued liabilities	$7	$24
Financing costs in accounts payable	$215	$—
Equipment acquired under capital leases	$—	$1,586

See accompanying notes.

MARRONE BIO INNOVATIONS, INC.

Notes to Condensed Consolidated Financial Statements

June 30, 2017

(Unaudited)

1. Summary of Business, Basis of Presentation 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. These 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 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 (i) there are no available conventional chemical pesticides or (ii) the use of conventional chemical pesticides may not be desirable or permissible either 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. 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.

In April 2017, the Company completed an underwritten public offering of 6,571,000 registered shares of its common stock (inclusive of 857,000 shares of its common stock to cover over-allotments). The public offering price of the shares sold in the offering was $1.40 per share. The total gross proceeds to the Company from the offering were approximately $9,200,000, and after deducting underwriting discounts and commissions and estimated offering expenses payable by the Company, the aggregate net proceeds to the Company totaled approximately $8,200,000.

The Company is an early stage company with a limited operating history and has a limited number of commercialized products. As of June 30, 2017, the Company had an accumulated deficit of $249,661,000, has incurred significant losses since inception and expects to continue to incur losses for the foreseeable future. The Company has funded operations primarily with net proceeds from public offerings of common stock, private placements of convertible preferred stock, convertible notes, and promissory notes and term loans, as well as with the proceeds from the sale of its products and payments under strategic collaboration and distribution agreements and government grants. The Company will need to generate significant revenue growth to achieve and maintain profitability. As of June 30, 2017, the Company had working capital of $7,922,000, including cash and cash equivalents of $10,242,000. As of June 30, 2017, the Company had debt and debt due to related parties of $23,983,000 and $37,240,000, respectively, for which the underlying debt agreements contain various financial and non-financial covenants, as well as a material adverse change clause. In addition, as of June 30, 2017, the Company had a total of $3,004,000 of restricted cash relating to a debt agreement (see Note 6).

The Company believes that its existing cash and cash equivalents of $10,242,000 at June 30, 2017, expected revenues and incremental borrowings, if any, from LSQ Financing (as defined and discussed in Note 6) will not be sufficient to fund operations as currently planned through one year from the date of the issuance of these financial statements, which raises substantial doubt as to the Company's ability to continue as a going concern. The Company has based this belief on assumptions and estimates that may prove to be wrong, and the Company could spend its available financial resources less or more rapidly than currently expected. The Company will continue to require additional sources of cash for general corporate purposes, which may include operating expenses, working capital to improve and promote its commercially available products, advance product candidates, expand international presence and commercialization, general capital expenditures and satisfaction of debt obligations. Management intends to seek additional capital through equity and/or debt financings, collaborative or other funding arrangements with partners, or through other sources of financing. Should the Company seek additional financing from outside sources, the Company may not be able to raise such financing on terms acceptable to the Company or at all. If the Company is unable to raise additional capital when required or on acceptable terms, the Company may be required to scale back or to discontinue the promotion of currently available products, scale back or discontinue the advancement of product candidates, reduce headcount, sell assets, file for bankruptcy, reorganize, merge with another entity, or cease operations.

Additionally, if the Company breaches any of the covenants contained within the debt agreements or if the material adverse change clause is triggered, the entire unpaid principal and interest balances would be due and payable upon demand. Without entering into a continuation of its current waiver, which expires October 1, 2018, entering into strategic agreements that include significant cash payments upfront, significantly increasing revenues from sales or raising additional capital through the issuance of equity, the Company expects it will exceed its maximum debt-to-worth requirement under a promissory note with Five Star Bank. Further, a violation of a covenant in one debt agreement will cause the Company to be in violation of certain covenants under each of its other debt agreements. Breach of covenants included in the Company's debt agreements, which could result in the lenders 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. The Company's inability to maintain compliance with its debt covenants could have a negative impact on the Company's financial condition and ability to continue as a going concern.

The June 2014 Secured Promissory Note (as defined in Note 6) contains a material adverse change clause that could be invoked by the lender as a result of the uncertainty related to the Company's ability to continue as a going concern. If the lender were to declare an event of default, the entire amount of borrowings related to all debt agreements at that time would have to be reclassified as current in the financial statements. The lender has waived its right to deem recurring losses, liquidity, going concern, and financial condition a material adverse change through October 1, 2018. As a result, none of the long term portion of the Company's outstanding debt has been reclassified to current in these financial statements as of June 30, 2017.

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 is expected to result in dilution to existing shareholders and any debt financing is expected to include additional restrictive covenants. Any failure to obtain additional financing or 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.

The accompanying financial statements have been prepared under the assumption that the Company will continue to operate as a going concern, which contemplates the realization of assets and the settlement of liabilities in the normal course of business. The consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts of liabilities that may result from the Company's inability to continue as a going concern.

If the Company becomes unable to continue as a going concern, the Company may have to liquidate its assets, and might realize significantly less than the values at which they are carried on its financial statements, and stockholders may lose all or part of their investment in the Company's common stock.

2. Significant Accounting Policies

Basis of Presentation

The accompanying financial information as of June 30, 2017, and for the three and six months ended June 30, 2017 and 2016, have 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, 2016.

In the opinion of management, the condensed consolidated financial statements as of June 30, 2017, and for the three and six months ended June 30, 2017 and 2016, 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 and six months ended June 30, 2017 are not necessarily indicative of the operating results for the full fiscal year or any future periods.

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 in accordance with the terms of its June 2014 Secured Promissory Note (as defined in Note 6). 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.

Revenues generated from international customers were, for the three months ended June 30, 2017 and 2016, 6% and 1%, respectively. Revenues generated from international customers were, for the six months ended June 30, 2017 and 2016, 9 % and 4%, respectively.

The Company's principal sources of revenues are its Regalia and Grandevo product lines. These two product lines accounted for 73% and 77% of the Company's total revenues for the three months ended June 30, 2017 and 2016, respectively, and 74% and 78% for the six months ended June 30, 2017 and 2016, respectively.

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	
Three months ended June 30,				
2017	34	%	9	%
2016	34	%	6	%
Six months ended June 30,				
2017	27	%	10	%
2016	31	%	6	%

Customers to which 10% or more of the Company's outstanding accounts receivable are attributable as of either June 30, 2017 or December 31, 2016 consist of the following:

	CUSTOMER A		CUSTOMER B		CUSTOMER C		CUSTOMER D	
June 30, 2017	28	%	9	%	—		13	%
December 31, 2016	21	%	10	%	14	%	1	%

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 currently has one supplier of this plant. Such 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. While the Company does not have a long-term supply contract with this supplier, the Company does have a long term business relationship with this supplier. The Company maintains 6 months of knotweed extract at any given time, but an unexpected disruption in supply could have an effect on Regalia supply and revenues. 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 and net realizable value. 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 as well as 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 June 30, 2017 and December 31, 2016, the Company recorded deferred cost of product revenues of $3,410,000 and $2,688,000 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; for example, in instances where "inventory protection" arrangements were historically offered to distributors that permitted these distributors to return to the Company certain unsold products, the Company considers future arrangements with that distributor not to be fixed or determinable, and accordingly, revenue with that distributor is deferred until products are resold to customers of the distributor (the "sell-through" method). As of June 30, 2017 and December 31, 2016, the Company recorded current deferred product revenues of $6,503,000 and $5,411,000, respectively. In addition, the Company had $532,000 in deferred product revenue that was classified as long-term as of June 30, 2017. There was no deferred product revenues classified as long term as of December 31, 2016. Included in deferred revenue as of June 30, 2017 and December 31, 2016 but excluded from deferred product revenues is deferred revenue related to license revenues. As of June 30, 2017, the Company recorded current and non-current deferred revenues of $252,000 and $1,654,000, respectively, related to payments received under licensing agreements as discussed further below. As of December 31, 2016, the Company recorded current and non-current deferred revenues of $236,000 and

$1,787,000, respectively, related to payments received under licensing agreements as discussed further below. The cost of product revenues associated with such deferrals are also deferred and classified as deferred cost of product revenues in the 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 consolidated balance sheets and the related cost of inventory remains in inventory in the consolidated balance sheets until the product is returned or is resold to customers of the distributor and revenue is recognized. During the three months ended June 30, 2017 and 2016, 52% and 64%, respectively, and for the six months ended June 30, 2017 and 2016, 41% 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.

The Company recognizes license revenues pursuant to strategic collaboration and distribution agreements under which the Company receives payments for the achievement of certain 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. No payments were received under these agreements for the three and six months ended June 30, 2017. For the three and six months ended June 30, 2016, the Company had received payments

totaling $300,000 under these agreements. For the three months ended June 30, 2017 and 2016, the Company recognized $58,000 and $92,000, respectively, as license revenues. For the six months ended June 30, 2017 and 2016, the Company recognized $116,000 and $184,000, respectively, as license revenues.

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 June 30, 2017 and 2016, research and development expenses totaled $2,555,000 and $2,091,000, respectively, and patent expenses totaled $298,000 and $222,000, respectively. For the six months ended June 30, 2017 and 2016, research and development expenses totaled $4,693,000 and $4,157,000 , respectively, and patent expenses totaled $604,000 and $478,000, 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 following table sets forth the potential shares of common stock as of the end of each period presented that are not included in the calculation of diluted net loss per share because to do so would be anti-dilutive (in thousands):

	JUNE 30,	
	2017	2016
Stock options outstanding	3,300	2,822
Warrants to purchase common stock	4,232	4,027
Restricted stock units outstanding	522	415

Recently Adopted Accounting Pronouncements

In November 2015, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update No. 2015-17, Balance Sheet Classification of Deferred Taxes (“ASU 2015-17”), which amends the current requirement for organizations to present deferred tax assets and liabilities as current and noncurrent in a classified balance sheet. Organizations will now be required to classify all deferred tax assets and liabilities as noncurrent. ASU 2015-17 is effective for public companies for financial statements issued for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted. The amendments may be applied prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented. The Company adopted ASU 2015-17 effective January 1, 2017. Adoption of this standard did not have a material impact on the Company’s consolidated financial position, results of operations or cash flows.

In March 2016, the FASB issued Accounting Standards Update No. 2016-09, Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting (“ASU 2016-09”). The amendments are effective for public companies for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Several aspects of the accounting for share-based payment award transactions are simplified, including: (a) income tax consequences; (b) classification of awards as either equity or liabilities; and (c) classification on the statement of cash flows. The Company adopted ASU 2016-09 effective January 1, 2017. Adoption of this standard did not have a material impact on the Company’s consolidated financial position, results of operations or cash

flows.

In July 2015, the 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 including interim periods within those fiscal years. Early adoption is permitted. The Company did not early adopt ASU 2015-11. The Company adopted ASU 2015-11 effective January 1, 2017. Adoption of this standard did not have a material impact on the Company's consolidated financial position, results of operations or cash flow.

Recently Issued Accounting Pronouncements

In August 2016, the FASB issued Accounting Standards Update No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments ("ASU 2016-15"). The amendments in this update clarify how certain cash receipts and

cash payments are presented and classified in the statement of cash flows. ASU No. 2016-15 will be effective for fiscal years beginning after December 15, 2017, with early adoption permitted. The Company has not elected to early adopt this guidance and is currently evaluating ASU 2016-15 to determine the impact to its consolidated financial statements.

In June 2016, the FASB issued Accounting Standards Update No. 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments ("ASU 2016-13"). ASU 2016-13 introduces a new forward-looking approach, based on expected losses, to estimate credit losses on certain types of financial instruments, including trade receivables. The estimate of expected credit losses will require entities to incorporate considerations of historical information, current information and reasonable and supportable forecasts. ASU 2016-13 also expands the disclosure requirements to enable users of financial statements to understand the entity's assumptions, models and methods for estimating expected credit losses. For public business entities that meet the definition of a Securities and Exchange Commission filer, ASU 2016-13 is effective for annual and interim reporting periods beginning after December 15, 2019, and the guidance is to be applied using the modified-retrospective approach. Earlier adoption is permitted for annual and interim reporting periods beginning after December 15, 2018. The Company is currently evaluating ASU 2016-13 to determine the impact to its consolidated financial statements and related disclosures.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, Leases (Topic 842) Leases: Amendments to the FASB Accounting Standards Codifications ("ASU 2016-02"), to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. ASU 2016-02 is effective for public companies for financial statements issued for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. Companies must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company is currently evaluating ASU 2016-02 to determine the potential impact to its consolidated financial statements and related disclosures.

In January 2016, the FASB issued Accounting Standards Update 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities ("ASU 2016-01"). ASU 2016-01 applies to all entities that hold financial assets or owe financial liabilities and is intended to provide more useful information on the recognition, measurement, presentation and disclosure of financial instruments. Among other things, ASU 2016-01 (i) requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (iii) eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (iv) eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (v) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (vi) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (vii) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (viii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with

the entity's other deferred tax assets. For public business entities, ASU 2016-01 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently evaluating ASU 2016-01 to determine the potential impact to its 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 and its related amendments provide new, globally applicable converged guidance concerning recognition and measurement of revenue. The new guidance requires the application of a five-step model to determine the amount and timing of revenue to be recognized. The underlying principle is that revenue is to be recognized for the transfer of goods or services to customers that reflects the amount of consideration that the Company expects to be entitled to in exchange for those goods or services. Additionally, 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, 2017. ASU 2014-09 allows for either full retrospective or modified retrospective adoption. The full retrospective method requires ASU 2014-09 be applied to each prior period presented in the year of adoption and the cumulative effect of adoption would be reflected at the beginning of the year of adoption. The modified retrospective method has the cumulative effect of applying ASU 2014-09 at the beginning of the year of adoption. The Company is currently evaluating the transition method that will be elected and the potential effects of adopting the provisions of ASU 2014-09.

The Company is continuing to assess the impact of the new guidance on its accounting policies and procedures and is evaluating the new requirements as applied to existing revenue contracts. Although the Company is continuing to assess the impact of the new guidance, the Company believes the most significant impact will relate to the recognition of product sales made to distributors. The Company currently recognizes revenue from the sale of products made to distributors on either a sell-in or sell-through basis depending on the specific circumstances of the arrangement. The new guidance will likely result in an acceleration of revenue as under the new standard, the Company may no longer be required to defer revenues related to distributors that are currently recognized on the sell-through basis. This change will also impact our balance sheet presentation with an expected decrease in deferred revenues, deferred cost of product revenues and net period-specific increases to retained earnings for the change in revenue recognition for current sell-through basis contracts. The Company is reviewing its revenue contracts and working on its plan for implementation of the new guidance which it will adopt beginning in the first quarter of 2018.

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 June 30, 2017 and December 31, 2016 (in thousands):

	JUNE 30, 2017			
	TOTAL	LEVEL 1	LEVEL 2	LEVEL 3
Assets				
Money market funds	$—	$ —	$ —	$ —

	DECEMBER 31, 2016			
	TOTAL	LEVEL 1	LEVEL 2	LEVEL 3
Assets				
Money market funds	$3,752	$ 3,752	$ —	$ —

The Company's money market funds are held at registered investment companies. As of December 31, 2016, the money market funds were in active markets and, therefore, are measured based on the Level 1 valuation hierarchy.

4. Inventories

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

As of June 30, 2017 and December 31, 2016, the Company had $267,000 and $127,000, respectively, in reserves against its inventories.

	JUNE 30, 2017	DECEMBER 31, 2016
Raw materials	$2,774	$ 3,491
Work in progress	2,001	2,044
Finished goods	3,589	2,947
	$8,364	$ 8,482

13

5. Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

	JUNE 30, 2017	DECEMBER 31, 2016
Accrued compensation	$1,061	$ 1,403
Accrued warranty costs	608	754
Accrued legal costs	759	569
Accrued customer incentives	2,398	639
Accrued liabilities, other	1,904	2,143
	$6,730	$ 5,508

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. During the six months ended June 30, 2017, the Company recognized $124,000 in warranty expense associated with product shipments for the period. This expense was reduced by $260,000 as a result of the historical usage of warranty reserves being lower than previously estimated. The Company periodically assesses the adequacy of its recorded warranty liability and adjusts the amount as necessary. Changes in the Company's accrued warranty costs during the period are as follows (in thousands):

Balance at December 31, 2016	$754
Warranties issued (released) during the period	(136)
Settlements made during the period	(10)
Balance at June 30, 2017	$608

6. Debt

Debt, including debt due to related parties, consists of the following (in thousands):

	JUNE 30, 2017	DECEMBER 31, 2016
Secured promissory notes (“October 2012 and April 2013 Secured Promissory Notes”) bearing interest at 14.00% per annum, payable monthly through October 2018, collateralized by substantially all of the Company’s assets, net of unamortized debt discount as of June 30, 2017 and December 31, 2016 of $166 and $228, respectively, with an imputed interest rate of 15.5%	$ 12,284	$ 12,222
Secured promissory note (“June 2014 Secured Promissory Note”) bearing interest at prime plus 2% (6.0% as of June 30, 2017) per annum, payable monthly through June 2036, collateralized by certain of the Company’s deposit accounts and MMM LLC’s inventories, chattel paper, accounts, equipment and general intangibles, net of unamortized debt discount as of June 30, 2017 and December 31, 2016 of $237 and $247, respectively, with an imputed interest rate of 6.1%	8,990	9,113
Secured revolving borrowing (“LSQ Financing”) bearing interest at (12.8% annually) payable through	2,709	—

the lenders direct collection of certain accounts receivable through March 2018, collateralized by substantially all of the Company's personal property, net of unamortized debt discount as of June 30, 2017 and December 31, 2016 of $161 and $0, respectively, with an imputed interest rate of 145%		
Senior secured promissory notes due to related parties ("August 2015 Senior Secured Promissory Notes") bearing interest at 8% per annum, interest is payable biannually with principal payments due in increments at three, four and five years from the closing date, collateralized by substantially all of the Company's assets, net of unamortized discount as of June 30, 2017 and December 31, 2016 of $2,760 and $3,333, respectively with an imputed interest rate of 10.8% (see Note 9)	37,240	36,667
Debt, including debt due to related parties	61,223	58,002