CODEXIS INC
Form 10-Q
November 12, 2013

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 September 30, 2013
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: 001-34705

Codexis, Inc.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	71-0872999 (I.R.S. Employer Identification No.)
200 Penobscot Drive, Redwood City (Address of principal executive offices)	94063 (Zip Code)

650 421 8100
(Registrant's telephone number, including area code)
(Former name, former address and former fiscal year, if changed since last report)

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

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

As of October 25, 2013, there were 38,105,532 shares of the registrant's Common Stock, par value $0.0001 per share, outstanding.

Codexis, Inc.
Quarterly Report on Form 10-Q
For The Three Months Ended September 30, 2013

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Codexis, Inc.
Condensed Consolidated Balance Sheets
(In Thousands)

	September 30, 2013 (Unaudited)	December 31, 2012 *
Assets		
Current assets:		
Cash and cash equivalents	$26,911	$32,003
Marketable securities	3,009	13,524
Accounts receivable, net of allowances of $478 and $150 at September 30, 2013 and December 31, 2012, respectively	2,688	7,545
Inventories	2,101	1,302
Prepaid expenses and other current assets	1,935	5,395
Total current assets	36,644	59,769
Restricted cash	911	1,511
Non-current marketable securities	1,067	3,623
Property and equipment, net	13,809	16,650
Intangible assets, net	10,403	12,934
Goodwill	3,241	3,241
Other non-current assets	361	2,237
Total assets	$66,436	$99,965
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$1,490	$3,654
Accrued compensation	3,340	3,495
Other accrued liabilities	2,140	6,948
Deferred revenues	2,248	2,186
Total current liabilities	9,218	16,283
Deferred revenues, net of current portion	1,161	1,299
Other long-term liabilities	5,183	3,943
Commitments and contingencies (note 8)		
Stockholders' equity:		
Common stock	4	4
Additional paid-in capital	297,776	294,128
Accumulated other comprehensive income (loss)	139	(136)
Accumulated deficit	(247,045)	(215,556)
Total stockholders' equity	50,874	78,440
Total liabilities and stockholders' equity	$66,436	$99,965

* The Condensed Consolidated Balance Sheet as of December 31, 2012 has been derived from the audited consolidated financial statements as of that date, but does not include all disclosures including notes required by GAAP for complete financial statements.

See accompanying notes to the unaudited condensed consolidated financial statements

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Codexis, Inc.
Condensed Consolidated Statements of Operations
(Unaudited)
(In Thousands, Except Per Share Amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Revenues:				
Product	$1,076	$7,140	$15,161	$29,090
Collaborative research and development	2,867	18,569	7,236	49,049
Government awards	—	632	—	2,247
Total revenues	3,943	26,341	22,397	80,386
Costs and operating expenses:				
Cost of product revenues	494	6,397	9,790	24,868
Research and development	6,831	14,191	22,776	46,190
Selling, general and administrative	5,832	7,909	21,126	24,093
Total costs and operating expenses	13,157	28,497	53,692	95,151
Loss from operations	(9,214)	(2,156)	(31,295)	(14,765)
Interest income	9	61	53	210
Other expenses	(22)	(45)	(288)	(320)
Loss before (benefit) provision for income taxes	(9,227)	(2,140)	(31,530)	(14,875)
(Benefit) provision for income taxes	35	169	(41)	443
Net loss	$(9,262)	$(2,309)	$(31,489)	$(15,318)
Net loss per share, basic and diluted	(0.24)	(0.06)	(0.83)	(0.42)
Weighted average common shares used in computing net loss per share, basic and diluted	38,102	37,116	38,002	36,494

See accompanying notes to the unaudited condensed consolidated financial statements

Codexis, Inc.
Condensed Consolidated Statements of Comprehensive Loss
(Unaudited)
(In Thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net loss	$(9,262)	$(2,309)	$(31,489)	$(15,318)
Other comprehensive income (loss):				
Foreign currency translation adjustments	—	—	—	165
Unrealized gain (loss) on marketable securities, net of tax of $17 and $172 for the three and nine months ended September 30, 2013, and $58 and $58 for the three and nine months ended September 30, 2012	32	724	275	88
Other comprehensive income	32	724	275	253
Total comprehensive loss	$(9,230)	$(1,585)	$(31,214)	$(15,065)

See accompanying notes to the unaudited condensed consolidated financial statements

Codexis, Inc.
Condensed Consolidated Statements of Cash Flows
(Unaudited)
(In Thousands)

	Nine Months Ended September 30,	
	2013	2012
Operating activities:		
Net loss	$(31,489)	$(15,318)
Adjustments to reconcile net loss to net cash used in operating activities:		
Amortization of intangible assets	2,531	2,665
Depreciation and amortization of property and equipment	5,307	6,822
Loss on disposal of property and equipment	62	93
Allowance for bad debt	328	—
Stock-based compensation	3,361	4,543
Accretion of asset retirement obligation	—	22
Impairment of marketable securities		753
(Accretion of discount) amortization of premium on marketable securities	(63)	508
Changes in operating assets and liabilities:		
Accounts receivable	833	2,390
Inventories	(614)	1,727
Prepaid expenses and other current assets	4	(2,824)
Other assets	(37)	(1,321)
Accounts payable	(2,164)	(4,077)
Accrued compensation	(155)	(2,077)
Other accrued liabilities	1,080	581
Deferred revenues	1,923	(1,642)
Net cash used in operating activities	(19,093)	(7,155)
Investing activities:		
Decrease in restricted cash	600	—
Purchase of property and equipment	(447)	(2,632)
Purchase of marketable securities	—	(20,638)
Proceeds from sale of marketable securities	—	8,376
Proceeds from maturities of marketable securities	13,410	20,800
Proceeds from disposal of property and equipment	150	—
Net cash provided by investing activities	13,713	5,906
Financing activities:		
Proceeds from exercises of stock options	288	894
Net cash provided by financing activities	288	894
Effect of exchange rate changes on cash and cash equivalents	—	166
Net decrease in cash and cash equivalents	(5,092)	(189)
Cash and cash equivalents at the beginning of the period	32,003	25,762
Cash and cash equivalents at the end of the period	$26,911	$25,573
Long term deposit in other assets transferred to property and equipment	$1,912	$—

See accompanying notes to the unaudited condensed consolidated financial statements

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Notes to Condensed Consolidated Financial Statements
(Unaudited)

1. Description of Business
Codexis, Inc. (the "Company") was incorporated in the state of Delaware in January 2002. The Company engineers enzymes for the pharmaceutical and complex chemistry industries. Its proven technologies enable scale-up and implementation of biocatalytic solutions to meet customer needs for rapid, cost-effective and sustainable process development, from research to manufacturing.
The Company has commercialized its technology and products in the pharmaceuticals market, which is its primary business focus. There are currently over 50 pharmaceutical firms using its technology, products and services in their manufacturing process development, including in the production of some of the world's bestselling and fastest growing drugs.
The Company assists customers in discovering or enhancing enzymes variants by applying its CodeEvolver® directed evolution technology platform, which introduces genetic mutations into microorganisms, giving rise to changes in the enzymes that they produce. Once the Company identifies potentially beneficial mutations, it tests combinations of these mutations until it has created variant enzymes that exhibit marketable performance characteristics superior to competitive products. This process allows the Company to make continuous, efficient improvements to the performance of its enzymes.
In these Notes to Condensed Consolidated Financial Statements, the “Company” refers to Codexis, Inc. and its subsidiaries on a consolidated basis.
2. Basis of Presentation and Summary of Significant Accounting Policies
Basis of Presentation and Principles of Consolidation
The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and the applicable rules and regulations of the Securities and Exchange Commission (“SEC”) for interim financial information. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. These interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2012. The condensed consolidated balance sheet at December 31, 2012 has been derived from the audited consolidated financial statements at that date, but does not include all disclosures including notes required by GAAP for complete financial statements.
The unaudited interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and, in the opinion of management, reflect all adjustments of a normal recurring nature considered necessary to present fairly its financial position as of September 30, 2013 and results of its operations, comprehensive loss and cash flows for the three and nine months ended September 30, 2013 and 2012. The interim results are not necessarily indicative of the results for any future interim period or for the entire year. Certain prior period amounts have been reclassified to conform to current period presentation.
The unaudited interim condensed consolidated financial statements include the amounts of Codexis, Inc. and its wholly-owned subsidiaries in the United States, Brazil, Hungary, India, Mauritius, The Netherlands and Singapore. All significant intercompany balances and transactions have been eliminated in consolidation.
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, disclosures of contingent liabilities at the date of the condensed consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. The Company's management regularly assesses these estimates which primarily affect revenue recognition, the valuation of marketable securities and accounts receivable, intangible assets, goodwill arising out of business acquisitions, inventories, accrued liabilities, common stock, and stock options and the valuation allowances associated with deferred tax assets. Actual results could differ from those estimates and such differences may be

material to the condensed consolidated financial statements.

Concentrations of Credit Risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash and cash equivalents, marketable securities, accounts receivable and restricted cash. Cash and cash equivalents, marketable securities and restricted cash are invested through banks and other financial institutions in the United States, as well as in other foreign countries. Such deposits may be in excess of insured limits.

Credit risk with respect to accounts receivable exists to the extent of amounts presented in the condensed consolidated financial statements. The Company estimates an allowance for doubtful accounts through specific identification of potentially uncollectible accounts receivable based on an analysis of its accounts receivable aging. Uncollectible accounts receivable are written off against the allowance for doubtful accounts when all efforts to collect them have been exhausted. Recoveries are recognized when they are received. Actual collection losses may differ from its estimates and could be material to its consolidated financial position, results of operations, and cash flows.

The Company's top five customers accounted for 59% and 81% of the Company's total revenues for the three and nine months ended September 30, 2013. Accounts receivable balances for the top five customers were 89% and 84% of total balances as of September 30, 2013 and December 31, 2012, respectively. Major customers that represent more than 10% of total Company revenue include Customer A at 34% and 47% and Customer B at 21% and 10% for the three and nine months ended September 30, 2013, respectively.

Fair Value of Financial Instruments

The carrying amounts of certain of the Company's financial instruments, including cash and cash equivalents, restricted cash, accounts receivable and accounts payable, approximate fair value due to their short maturities.

Fair value is considered to be the price at which an asset could be exchanged or a liability transferred (an exit price) in an orderly transaction between knowledgeable, willing parties in the principal or most advantageous market for the asset or liability. Where available, fair value is based on or derived from observable market prices or other observable inputs. Where observable prices or inputs are not available, valuation models are applied. These valuation techniques involve some level of management estimation and judgment, the degree of which is dependent on the price transparency for the instruments and the instruments' complexity.

Cash, Cash Equivalents and Marketable Securities

The Company considers all highly liquid investments with maturity dates of three months or less at the date of purchase to be cash equivalents. Cash and cash equivalents consist of cash on deposit with banks and money market funds. The majority of cash and cash equivalents are maintained with major financial institutions in North America. Deposits with these financial institutions may exceed the amount of insurance provided on such deposits. Marketable securities included in current assets are comprised of corporate bonds, commercial paper, and United States Treasury obligations. Marketable securities included in non-current assets are comprised of corporate bonds and United States Treasury obligations that have a maturity date greater than one year. The Company's investment in common shares of CO_2 Solutions Inc. ("CO_2 Solutions") is included in non-current marketable securities.

The Company performs separate evaluations of impaired debt and equity securities to determine if the unrealized losses as of the balance sheet date are other-than-temporary impairment.

For the Company's investments in equity securities, its evaluation considers a number of factors including, but not limited to, the length of time and extent to which the fair value has been less than cost, the financial condition and near term prospects of the issuer, and its management's ability and intent to hold the securities until fair value recovers. The assessment of the ability and intent to hold these securities to recovery focuses on its current and forecasted liquidity requirements and capital requirements. Based on these evaluation criteria, the Company concluded during the third quarter of 2012 the unrealized losses related to its equity investment in the common shares of CO_2 Solutions were other-than-temporary and as a result, the Company recorded $0.8 million as a selling, general and administrative expense in its condensed consolidated statement of operations (see Note 6). As of September 30, 2013, there were no unrealized losses related to the Company's equity securities.

For the Company's investments in debt securities, management determines whether it intends to sell or if it is more-likely-than-not that the Company will be required to sell impaired securities. This determination considers current and forecasted liquidity requirements and capital requirements. For all impaired debt securities for which there was no intent or expected requirement to sell, the evaluation considers all available evidence to assess whether it is likely the amortized cost value will be recovered. The Company conducts a regular assessment of its debt securities with unrealized losses to determine whether the securities have other-than-temporary impairment considering, among other factors, the nature of the securities, credit rating or financial condition of the issuer, the extent and duration of the unrealized loss, expected cash flows of underlying collateral and market conditions. As of September 30, 2013, there were no unrealized losses related to the Company's debt securities.

The Company's investments in debt and equity securities are classified as available-for-sale and are carried at fair value. Unrealized gains and losses are reported on the condensed consolidated statement of comprehensive loss unless considered other-than-temporary. Amortization of purchase premiums and accretion of purchase discounts, realized gains and losses of debt securities and declines in value deemed to be other than temporary, if any, are included in interest income or other expenses. The cost of securities sold is based on the specific-identification method. There were no significant realized gains or losses from sales of marketable securities during the three and nine months ended September 30, 2013 and 2012.

Impairment of Long-Lived Assets and Intangible Assets

Long-lived and intangible assets with finite lives are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of these assets is measured by comparison of their carrying amounts to future undiscounted cash flows the assets are expected to generate.

The Company determined that it has a single entity wide asset group (“Asset Group”). The directed evolution technology patent portfolio acquired from Maxygen (“Core IP”) is the most significant component of the Asset Group since it is the base technology for all aspects of the Company's research and development, and represents the basis for all of its identifiable cash flow generating capacity. The Core IP consist of developed core technology, trade names, and the intellectual property (“IP”) rights associated with the acquisition of Maxygen, Inc.'s ("Maxygen") directed evolution technology in 2010.

The Core IP is the only finite-lived intangible asset on the balance sheet as of September 30, 2013 and is considered the primary asset within the Asset Group. The Core IP is being amortized ratably over the six years from the acquisition date. There has been no significant change in the utilization of the Core IP since the Company acquired the technology patent portfolio from Maxygen. Consequently, the Company does not believe that identification of independent cash flows associated with its long-lived assets is currently possible at any lower level than the Asset Group.

The Company evaluates recoverability of its long-lived assets and intangible assets based on the sum of the undiscounted cash flows expected to result from the use, and the eventual disposal of, the Asset Group. The Company makes estimates and judgments about the future undiscounted cash flows over the remaining useful life of the Asset Group. The anticipated future cash flows include the Company's estimates of existing or in process product revenues, production and operating costs, future capital expenditures, working capital needs, and assumptions regarding the ultimate sale of the Asset Group at the end of the life of the primary asset.

As of September 30, 2013, the Company determined that its projected annual operating losses, the potential impact of the Dyadic notice from Dyadic International, Inc. (see Note 8), and the decreasing market price of the Company’s common stock were indicators of impairment. Consequently, the Company tested its long-lived assets and intangible assets for impairment as of September 30, 2013. This approach is consistent with the Company’s impairment analysis performed as of December 31, 2012, as described in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

The Company performed the recoverability test and calculated estimated cashflows through the remaining period of the estimated useful life of the Core IP. The expected residual value was determined by applying a Gordon Growth Model to normalized net cash flows using a discount rate of 18% (“Estimated Weighted-Average Cost of Capital”), long term growth rate of 2%, and a capitalization factor of 6.25. The 18% discount rate reflects the nature and the risk of the underlying forecast, and includes such financial components as the risk free rate, systemic stock price risk based on an evaluation with peer companies (“beta”), equity risk premium, size premium, and company specific risk. The long term growth rate of 2% reflects projected inflation and general economic conditions. While the methodology for determining recoverability was consistent with that used in the Company's impairment analysis performed as of December 31, 2012, certain assumptions changed in the third quarter based on activity within the quarter, including reduced anticipated future cashflows related to potential CodeXyme® and CodeXol® transactions and reduced future revenue growth to reflect the Company’s most recent outlook. Following this analysis, the Company determined that its estimated future undiscounted cash flows for the Asset Group are greater than the carrying value of the Asset Group Core IP asset fair value as of September 30, 2013.

The Company supplementally performed an analysis to determine the fair value of the Core IP. In determining the fair value, the Company prepared cash flow forecasts over the remaining economic life of the Core IP primarily related to final patent expiration from the Maxygen patent portfolio. The Company utilized the multi-period Excess Earnings model and obtained key financial inputs from review of market participants, Company specific factors and generally accepted valuation methods. The Company utilized a discount rate of 19% which reflects the nature and the risk of the underlying forecast and includes other financial components.

Based on these estimates, judgments and factors, the Company has determined that the fair value of the Core IP exceeded its carrying value by 38% as of September 30, 2013. No impairment loss was recorded as of September 30, 2013.

Valuation of Goodwill

The Company reviews goodwill impairment annually and whenever events or changes in circumstances indicate the carrying value of goodwill may not be recoverable.

The Company determined that it has only one operating segment and reporting unit under the criteria in ASC 280, Segment Reporting, and accordingly, all of the goodwill is associated with the Company. The Company's review of goodwill impairment indicators is performed at the Company level.

The goodwill impairment test consists of a two-step process. The first step of the goodwill impairment test, used to identify potential impairment, compares the fair value of the reporting unit to its carrying value. If the fair value of the reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired, and the second step of the impairment test is not required.

The Company uses its market capitalization as an indicator of fair value. The Company believes that since its reporting unit is publicly traded, the ability of a controlling shareholder to benefit from synergies and other intangible assets that arise from control might cause the fair value of our reporting unit as a whole to exceed its market capitalization. However, the Company believes that the fair value measurement need not be based solely on the quoted market price of an individual share of our common stock, but also can consider the impact of a control premium in measuring the fair value of its reporting unit.

Should the Company's market capitalization be less than the total stockholder's equity as of the Company's annual test date or as of any interim impairment testing date, the Company would also consider market comparables, recent trends in the Company's stock price over a reasonable period and, if appropriate, use an income approach to determine whether the fair value of its reporting unit is greater than the carrying amount.

The second step, if required, compares the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds its implied fair value, an impairment charge is recognized in an amount equal to that excess. Implied fair value is the excess of the fair value of the reporting unit over the fair value of all identified assets and liabilities.

The Company bases its fair value estimates on assumptions it believes to be reasonable. Actual future results may differ from those estimates. Goodwill was tested for impairment as of October 1, 2012, the date of the Company's annual impairment review. The Company concluded that the fair value of the reporting unit exceeded the carrying value and no impairment existed. No impairment charges were recorded through September 30, 2013.

Restricted Cash

Restricted cash consisted of amounts invested in money market accounts primarily for purposes of securing a standby letter of credit as collateral for the Company's Redwood City, California facility lease agreement and for the purpose of securing a working capital line of credit.

Revenue Recognition

The Company has generally recognized revenue from multiple element arrangements under collaborative research agreements, including license payments, research and development services, milestones, and royalties. Revenue arrangements with multiple deliverables are divided into separate units of accounting if certain criteria are met.

Revenues are recognized when the four basic revenue recognition criteria are met: (1) persuasive evidence of an arrangement exists; (2) products have been delivered, transfer of technology has been completed or services have been rendered; (3) the fee is fixed or determinable; and (4) collectability is reasonably assured.

The Company's primary sources of revenues consist of product revenues, collaborative research and development agreements and government awards. Collaborative research and development agreements typically provide the Company with multiple revenue streams, including up-front fees for licensing, exclusivity and technology access, fees for full-time employee equivalent (“FTE”) services and the potential to earn milestone payments upon achievement of contractual criteria and royalty fees based on future product sales or cost savings by the Company's customers.

Up-front fees received in connection with collaborative research and development agreements, including license fees, technology access fees, and exclusivity fees, are deferred upon receipt, are not considered a separate unit of accounting and are recognized as revenues over the relevant performance periods.

Income Taxes

The Company uses the liability method of accounting for income taxes. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets are recognized for deductible temporary differences, along with net operating loss (“NOL”) carry forwards, if it is more likely than not that the tax benefits will be realized. To the extent a deferred tax asset cannot be recognized under the preceding criteria, a valuation allowance is established. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The Company recognizes the financial statement effects of an uncertain tax position when it is more likely than not, based on the technical merits, that the position will be sustained upon examination.

Net Loss per Share

Basic net loss per share of common stock is computed by dividing the net loss by the weighted average number of shares of common stock outstanding during the period. Diluted net loss per share of common stock is computed by giving effect to all potential common shares, consisting of stock options, warrants and redeemable convertible preferred stock, to the extent dilutive. Basic and diluted net loss per share of common stock was the same for each period presented as the inclusion of all potential common shares outstanding was anti-dilutive.

The following options to purchase common stock, restricted stock units and warrants to purchase common stock were excluded from the computation of diluted net loss per share of common stock for the three and nine months ended September 30, 2013 and 2012 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Options to purchase common stock	4,805	7,228	4,805	7,228
Restricted stock units	1,665	839	1,665	839
Warrants to purchase common stock	75	260	75	260
Total	6,545	8,327	6,545	8,327

Recently Issued and Adopted Accounting Guidance

In February 2013, the Financial Accounting Standard Board ("FASB") issued ASU 2013-02 related to the reporting of amounts reclassified out of accumulated other comprehensive income that requires entities to report, either on their income statement or in a footnote to their financial statements, the effects on earnings from items that are reclassified out of other comprehensive income. The Company adopted this accounting standard on January 1, 2013, and the adoption of this guidance did not have a material impact on the financial statements.

3. Collaborative Research and Development Agreements

Shell and Raízen

In November 2006, the Company entered into a collaborative research agreement and a license agreement with Shell to develop biocatalysts and associated processes that use such biocatalysts.

In November 2007, the Company entered into a new and expanded five-year collaborative research agreement (“Shell Research Agreement”) and a license agreement (the “Shell License Agreement”) with Shell. In connection with the Shell Research Agreement, the Company agreed to use its proprietary technology platform to discover and develop enzymes and microorganisms for use in converting cellulosic biomass into biofuels and related products and Shell agreed to pay (i) research funding at specified rates per FTE working on the project during the research term, (ii) payments upon the achievement of milestones, and (iii) royalties on future product sales. The Shell Research Agreement also specified certain minimum levels of FTE services that the Company was required to allocate to the collaboration efforts that increased over the term of the agreement, which was originally set to expire on November 1, 2012.

In September 2012, the Company entered into an agreement with Shell (the “New Shell Agreement”) which among other things, terminated the Shell Research Agreement effective August 31, 2012, except for certain provisions of the Shell Research

Agreement which survived such termination, including provisions regarding intellectual property rights, patent prosecution and maintenance, confidentiality and indemnification. The New Shell Agreement required Shell to pay approximately $7.5 million as full, complete and final satisfaction of amounts that Shell may have owed the Company under the Shell Research Agreement with respect to (i) FTEs assigned to the Shell Research Agreement and (ii) milestones achieved or achievable by the Company under the Shell Research Agreement. The $7.5 million was recognized as revenue during the third quarter of 2012 when all of the Company's obligations were fulfilled under the New Shell Agreement and was collected during the fourth quarter of 2012.

Under the New Shell Agreement, Shell granted the Company royalty-bearing, non-exclusive rights and licenses to develop, manufacture, use and sell biocatalysts and microbes in the field of converting cellulosic biomass into fermentable sugars on a worldwide basis, except for Brazil, where such sugars are converted into liquid fuels, fuel additives or lubricants (the “Field of Use”). Raízen Energia S.A. (“Raízen”) holds the exclusive rights to use the Company's enzymes and microbes for converting cellulosic biomass into fermentable sugars in Brazil, where such sugars are converted into ethanol.

Under the New Shell Agreement, the Company also granted to Shell a non-exclusive, royalty-free license to manufacture, use and import, solely for the use of Shell and its affiliates, (i) enzymes developed by the Company during the ten year period following August 31, 2012 outside of the Shell Research Agreement for use in the Field of Use and (ii) improvements to any microbe developed by the Company during the ten year period following August 31, 2012 outside of the Shell Research Agreement that is derivative of an identified microbe for use in the Field of Use. Shell remained subject to existing royalty obligations to the Company for future sales of products covered by the intellectual property and technology that remained exclusively licensed to Shell under the License Agreement.

The New Shell Agreement has a term that commences on August 31, 2012 and continues until the later of August 31, 2032 or the date of the last to expire patent rights included in the Company's collaboration that claim a biocatalyst or a microbe for use in the Field of Use.

Research and Development Collaboration

On February 1, 2012, the Company entered into a five year Sitagliptin Catalyst Supply Agreement ("Sitagliptin Agreement") whereby Merck Sharp and Dohme Corp. ("Merck") may obtain commercial scale substance for their use in the manufacture of their products. Merck may extend the term of the Sitagliptin Agreement for an additional five years at its sole discretion.

The Sitagliptin Agreement calls for Merck to pay an annual license fee for the rights to the Sitagliptin technology each year for the term of the Sitagliptin Agreement. As of September 30, 2013, the Company has a deferred revenue balance of $1.2 million from Merck related to the license fee. The license fee is being recognized as collaborative research and development revenue ratably over the five year term of the Sitagliptin Agreement. During the three and nine months ended September 30, 2013, the Company recognized $0.5 million and $1.3 million of the license fee as collaborative research and development revenue. Pursuant to the Sitagliptin Agreement, Merck may purchase substance from the Company for a fee based on contractually stated prices. No product revenue was recognized during the three months ended September 30, 2013 under the Sitagliptin Agreement. During the nine months ended September 30, 2013, the Company recognized $0.5 million in product revenue related to the agreement. No revenue was recognized under the Sitagliptin Agreement during the three and nine months ended September 30, 2012.

Manufacturing Collaboration

In November 2012, the Company entered into a commercial arrangement with Arch Pharmalabs Limited ("Arch") by simultaneously terminating all of the Company's existing supply agreements with Arch and entering into the New Arch Enzyme Supply Agreement pursuant to which Arch agreed to exclusively purchase enzymes from the Company for use in the manufacture of certain of Arch's products and the Company agreed to exclusively supply, with limited exceptions, certain of the Company's enzymes to Arch at an agreed upon price for use in such manufacture. Under the New Arch Enzyme Supply Agreement, Arch will no longer produce atorva-family active pharmaceutical ingredients (“APIs”) and intermediates for the Company. Arch will instead market these products directly to end customers, and as a result Arch will no longer pay the Company royalties on their sale of such APIs and intermediates to customers and the Company will no longer have exclusive rights to market such APIs and intermediates in certain markets. No revenue was recognized under the New Arch Enzyme Supply Agreement during the three months ended September 30, 2013. For the nine months ended September 30, 2013, the Company recognized $2.1 million in product revenue for the sale of enzyme inventory to Arch pursuant to the agreement. Royalty revenues earned from Arch under the prior agreements were $0.05 million and $0.1 million for the three and nine months ended September 30, 2012 and are reflected in collaborative research and development revenue on the condensed consolidated statement of operations.

4. Balance Sheets Details

Inventory, net

Inventory, net consisted of the following (in thousands):

	September 30, 2013	December 31, 2012
Raw materials	$802	$588
Work in process	235	52
Finished goods	1,064	662
Inventory, net	$2,101	$1,302

Property and Equipment, net

Property and equipment, net consisted of the following (in thousands):

	September 30, 2013	December 31, 2012
Laboratory equipment	$35,311	$33,776
Leasehold improvements	11,108	11,099
Computer equipment	3,419	4,388
Office furniture and equipment	1,503	1,531
	51,341	50,794
Less: accumulated depreciation	(37,780)	(34,172)
	13,561	16,622
Construction in progress	248	28
Property and equipment, net	$13,809	$16,650

Accumulated Other Comprehensive Income (Loss)

The changes in accumulated other comprehensive income (loss) by component and related tax effects were as follows (in thousands):

Balance as of December 31, 2012	$(136)
Unrealized gains (losses) on available-for-sale securities	447
Tax effects	(172)
Balance as of September 30, 2013	$139

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5. Cash Equivalents and Marketable Securities

At September 30, 2013, cash equivalents and marketable securities consisted of the following (in thousands):

	September 30, 2013				
	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Average Contractual Maturities (in days)
Money market funds	$21,079	$—	$—	$21,079	n/a
Corporate bonds (unamortized cost)	1,004	3	—	1,007	151
U.S. Treasury obligations (unamortized cost)	2,000	2	—	2,002	232
Common shares of CO2 Solutions	563	$504	$—	1,067	n/a
Total	$24,646	$509	$—	$25,155	

The total cash and cash equivalents balance of $26.9 million as of September 30, 2013 was comprised of money market funds of $21.1 million, and $5.8 million held as cash, primarily with major financial institutions in North America. At September 30, 2013, we had no marketable securities in an unrealized loss position.

At December 31, 2012, cash equivalents and marketable securities consisted of the following (in thousands):

	December 31, 2012				
	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Average Contractual Maturities (in days)
Money market funds	$24,789	$—	$—	$24,789	n/a
Commercial paper	1,499	1	—	1,500	70
Corporate bonds (unamortized cost)	9,512	10	—	9,522	156
U.S. Treasury obligations (unamortized cost)	5,510	5	—	5,515	262
Common shares of CO2 Solutions	563	47	—	610	n/a
Total	$41,873	$63	$—	$41,936	

The total cash and cash equivalents balance of $32.0 million as of December 31, 2012, was comprised of money market funds of $24.8 million and $7.2 million held as cash, primarily with major financial institutions in North America. At December 31, 2012, we had no marketable securities in an unrealized loss position.

6. Fair Value Measurements

Assets and liabilities recorded at fair value in the condensed consolidated financial statements are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels which are directly related to the amount of subjectivity associated with the inputs to the valuation of these assets or liabilities are as follows:

Level 1 - Inputs that are unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date.

Level 2 - Inputs (other than quoted prices included in Level 1) that are either directly or indirectly observable for the asset or liability through correlation with market data at the measurement date and for the duration of the instrument's anticipated life.

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities and which reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date.

For Level 2 financial instruments, the Company's investment adviser provides monthly account statements documenting the value of corporate bonds and U.S. Treasury obligations based on prices received from an independent third-party valuation service provider. This third party evaluates the types of securities in the Company's investment portfolio and calculates a fair value using a multi-dimensional pricing model that includes a variety of inputs, including quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, interest rates and yield curves observable at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks and default rates that are observable at commonly quoted intervals. As the Company is ultimately responsible for the determination of the fair value of these instruments, it performs quarterly analyses using prices obtained from another independent provider of financial instrument valuations, to validate that the prices the Company has used are reasonable estimates of fair value.

The following table presents the financial instruments that were measured at fair value on a recurring basis at September 30, 2013 by level within the fair value hierarchy (in thousands):

	September 30, 2013			
	Level 1	Level 2	Level 3	Total
Money market funds	$21,079	$—	$—	$21,079
Corporate bonds	—	1,007	—	1,007
U.S. Treasury obligations	—	2,002	—	2,002
Common shares of CO2 Solutions	—	1,067	—	