

Ceres, Inc.  
Form 10-Q  
July 11, 2013  
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**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 May 31, 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: 001-35421

**Ceres, Inc.**

(Exact name of Registrant as specified in its charter)

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**Delaware**  
(State or Other Jurisdiction of

**33-0727287**  
(I.R.S. Employer

Incorporation or Organization)

Identification Number)

**1535 Rancho Conejo Boulevard**

**Thousand Oaks, CA 91320**

(Address of principal executive offices)

**Telephone: (805) 376-6500**

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

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

Under the Jumpstart Our Business Startups Act of 2012, or the JOBS Act, Ceres, Inc. qualifies as an "emerging growth company," as defined under the JOBS Act.

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

Class
Common Stock, \$0.01 par value per share

Outstanding at July 8, 2013
24,908,874

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**Table of Contents****PART I: FINANCIAL INFORMATION****Item 1. Financial Statements.****CERES, INC. AND SUBSIDIARY****Condensed Consolidated Balance Sheets****(In thousands, except share amounts)****(Unaudited)**

	<b>May 31, 2013</b>	<b>August 31, 2012</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 18,821	\$ 21,069
Marketable securities	18,554	33,565
Prepaid expenses	1,027	1,050
Accounts receivable	848	765
Inventories	352	841
Other current assets	232	278
<b>Total current assets</b>	<b>39,834</b>	<b>57,568</b>
Property and equipment, net	4,915	5,756
Marketable securities		5,720
Other assets	108	203
<b>Total assets</b>	<b>\$ 44,857</b>	<b>\$ 69,247</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 4,899	\$ 5,476
Other current liabilities	26	732
Current portion of long-term debt	84	134
<b>Total current liabilities</b>	<b>5,009</b>	<b>6,342</b>
Other non-current liabilities	97	88
Long-term debt, net of current portion	130	256
<b>Total liabilities</b>	<b>5,236</b>	<b>6,686</b>
Commitments and contingencies		
Stockholders' equity:		
Common stock and additional paid in capital, \$0.01 par value; 490,000,000 shares authorized; 24,800,624 shares issued and outstanding at May 31, 2013; 24,549,029 shares issued and outstanding at August 31, 2012	307,448	304,917
Accumulated other comprehensive loss	(572)	(283)
Accumulated deficit	(267,255)	(242,073)
<b>Total stockholders' equity</b>	<b>39,621</b>	<b>62,561</b>

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Total liabilities and stockholders' equity	\$ 44,857	\$ 69,247
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See accompanying notes to the unaudited condensed consolidated financial statements.

**Table of Contents****CERES, INC. AND SUBSIDIARY****Condensed Consolidated Statements of Operations****(In thousands, except share and per share amounts)****(Unaudited)**

	Three months ended May 31,		Nine months ended May 31,	
	2013	2012	2013	2012
<b>Revenues:</b>				
Product sales	\$ 389	\$ 42	\$ 462	\$ 429
Collaborative research and government grants	966	1,106	3,884	3,778
<b>Total revenues</b>	<b>1,355</b>	<b>1,148</b>	<b>4,346</b>	<b>4,207</b>
<b>Cost and operating expenses:</b>				
Cost of product sales	2,134	627	5,114	1,876
Research and development	4,074	5,255	12,784	15,522
Selling, general and administrative	4,464	3,344	11,700	8,962
<b>Total cost and operating expenses</b>	<b>10,672</b>	<b>9,226</b>	<b>29,598</b>	<b>26,360</b>
Loss from operations	(9,317)	(8,078)	(25,252)	(22,153)
Interest expense	(34)	(341)	(35)	(559)
Interest income	28	3	106	9
Other income (expense)				(84)
Loss before income taxes	(9,323)	(8,416)	(25,181)	(22,787)
Income tax benefit (expense)			(1)	(1)
<b>Net loss</b>	<b>\$ (9,323)</b>	<b>\$ (8,416)</b>	<b>\$ (25,182)</b>	<b>\$ (22,788)</b>
<b>Basic and diluted net loss per share attributable to common stockholders</b>	<b>\$ (0.38)</b>	<b>\$ (0.34)</b>	<b>\$ (1.02)</b>	<b>\$ (2.33)</b>
Weighted average outstanding common shares used for net loss per share attributable to common stockholders:				
Basic and diluted	24,801,705	24,423,042	24,765,664	9,787,652

See accompanying notes to the unaudited condensed consolidated financial statements.

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**CERES, INC. AND SUBSIDIARY**

**Condensed Consolidated Statements of Comprehensive Loss**

**(In thousands)**

**(Unaudited)**

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>May 31,</b>		<b>May 31,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
Net loss	\$ (9,323)	\$ (8,416)	\$ (25,182)	\$ (22,788)
Other comprehensive income (loss)				
Foreign currency translation adjustments	152	(69)	(288)	(121)
Net unrealized gains on marketable securities	(6)		(1)	
<b>Total comprehensive loss</b>	<b>\$ (9,177)</b>	<b>\$ (8,485)</b>	<b>\$ (25,471)</b>	<b>\$ (22,909)</b>

See accompanying notes to the unaudited condensed consolidated financial statements.

**Table of Contents****CERES, INC. AND SUBSIDIARY****Condensed Consolidated Statements of Cash Flows****(In thousands)****(Unaudited)**

	<b>Nine months ended May 31,</b>	
	<b>2013</b>	<b>2012</b>
<b>Cash flows from operating activities:</b>		
Net loss	\$ (25,182)	\$ (22,788)
<b>Adjustments to reconcile net loss to net cash used in operating activities:</b>		
Change in fair value of common and preferred stock warrants and convertible notes		84
Net loss on disposal of assets	166	55
Impairment of assets		100
Depreciation	1,464	1,584
Accretion (amortization) of premium/discount on marketable securities	503	
Non-cash interest income	(607)	
Stock compensation	2,461	1,283
Other	14	
<b>Changes in operating assets and liabilities:</b>		
Prepaid expenses	23	(371)
Accounts receivable	(73)	713
Inventories	295	
Other assets	53	2,775
Accounts payables and accrued expenses	(604)	(1,687)
Other liabilities	(696)	(163)
<b>Net cash used in operating activities</b>	<b>(22,183)</b>	<b>(18,415)</b>
<b>Cash flows from investing activities:</b>		
Purchases of property and equipment	(660)	(834)
Proceeds from insurance		1,000
Change in restricted cash and investments		3,000
Purchases of marketable securities	(1,545)	
Maturities of marketable securities	22,379	
<b>Net cash provided by investing activities</b>	<b>20,174</b>	<b>3,166</b>
<b>Cash flows from financing activities:</b>		
Repayment of debt	(286)	(6,854)
Proceeds from issuance of debt		2,500
Proceeds from issuance of common stock	56	374
Proceeds from issuance of common stock in initial public offering, net of underwriters discounts and commission and offering expenses		65,158
<b>Net cash provided by (used in) financing activities</b>	<b>(230)</b>	<b>61,178</b>
Effect of foreign currency translation on cash	(9)	(120)
Net decrease in cash and cash equivalents	(2,248)	45,809
Cash and cash equivalents at beginning of period	21,069	21,911



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Cash and cash equivalents at end of period

\$ 18,821    \$ 67,720

See accompanying notes to the unaudited condensed consolidated financial statements.

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**CERES, INC. AND SUBSIDIARY**

**Notes to Condensed Consolidated Financial Statements (Unaudited)**

**(In thousands, except share and per share data)**

**(1) The Company**

Ceres, Inc. (Company) is an agricultural biotechnology company selling seeds to produce dedicated energy crops renewable bioenergy feedstocks that can enable the large-scale replacement of petroleum and other fossil fuels. The Company uses a combination of advanced plant breeding and biotechnology to develop seed products.

In January 2010, the Company incorporated a subsidiary, Ceres Sementes do Brasil Ltda. The Company's ownership in this subsidiary is 99.9% and the Company's Chief Executive Officer owns the remaining interest.

On January 24, 2012, the Company filed an amended and restated certificate of incorporation which effected a 1 for 3 reverse stock split of the Company's issued and outstanding shares of common stock. The par value of the common stock was not adjusted as a result of the reverse stock split. All issued and outstanding shares of common stock and stock options and per share amounts contained in the Company's condensed consolidated financial statements have been retroactively adjusted to reflect this reverse stock split for all periods presented.

On February 27, 2012, the Company closed its initial public offering (IPO) of 5,750,000 shares of common stock (including 750,000 shares purchased by the underwriters upon the exercise of their option to purchase up to an additional 750,000 shares) at an offering price of \$13.00 per share, resulting in net proceeds to the Company of approximately \$65,158, after deducting underwriting discounts and commissions and offering expenses. Upon closing of the IPO, all of the Company's outstanding shares of convertible preferred stock were automatically converted into 15,353,221 shares of common stock, all of the Company's outstanding convertible subordinated notes (Convertible Notes) were automatically converted into 1,098,575 shares of common stock and all of the Company's outstanding convertible preferred stock warrants were automatically converted into warrants to purchase a total of 20,511 shares of common stock.

The Company has incurred substantial net losses from operations since its inception and its accumulated deficit as of May 31, 2013 was \$267,255. The Company expects to incur additional losses related to the continued development and expansion of its business, including research and development, seed production and operations, and sales and marketing. The Company plans to finance its operations for at least the next twelve months with cash and investments currently on hand, with cash inflows from collaboration and grant funding and product sales.

**(2) Summary of Significant Accounting Policies**

***Basis of Presentation***

The accompanying interim condensed consolidated financial statements have been prepared in accordance with the accounting principles generally accepted in the United States of America (GAAP) and with the instructions for Form 10-Q and Regulation S-X. Accordingly, they do not include all of the information and notes required 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 Form 10-K dated November 20, 2012 filed with the Securities and Exchange Commission (SEC).

The accompanying interim condensed consolidated financial statements and related disclosures are unaudited, have been prepared on the same basis as the annual consolidated financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary for a fair presentation of the results of operations for the periods presented. The condensed consolidated results of operations for any interim period are not necessarily indicative of the results to be expected for the full year or for any other future year or interim period.

***Principles of Consolidation***

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

***Use of Estimates***

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In preparing the unaudited condensed consolidated financial statements, management makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the unaudited condensed consolidated financial statements and reported amounts of revenue and expenses during the reporting period. Significant items subject to such estimates and assumptions include the valuation of property and equipment, inventory, deferred tax assets, common stock, convertible preferred stock, stock options, warrant liabilities and convertible notes. Actual results could differ from those estimates.

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**CERES, INC. AND SUBSIDIARY**

**Notes to Condensed Consolidated Financial Statements (Unaudited)**

**(In thousands, except share and per share data)**

***Cash Equivalents***

The Company considers all highly liquid investments, with an original maturity of three months or less when purchased, to be cash equivalents.

***Marketable Securities***

Marketable securities are classified as available for sale and are recorded at fair value, with the unrealized gains and losses, if any, net of taxes, reported as a component of shareholders' equity (deficit) until realized or until a determination is made that an other-than-temporary decline in market value has occurred.

In determining whether an other-than-temporary impairment exists for debt securities, management considers: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Management has determined that there has been no other-than-temporary impairments of its marketable securities.

The cost of marketable securities sold is based upon the specific identification method and any realized gains or losses on the sale of investments are reflected as a component of interest income or expense. There were no sales of marketable securities during the nine months ended May 31, 2013.

The Company classifies marketable securities as current or non-current based upon whether such assets are reasonably expected to be realized in cash or sold or consumed during the normal operating cycle of the business.

***Financial Instruments***

The carrying value of financial instruments such as cash and cash equivalents, receivables, accounts payable, and accrued expenses approximate their fair value due to the short-term nature of these instruments. At each period end, the fair value of the long-term debt approximated carrying value based on interest rates currently available to the Company.

***Fair Value of Financial Instruments***

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 that 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 are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 inputs are unobservable inputs for the asset or liability.

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The following tables present the Company's financial assets that were measured at fair value on a recurring basis as of May 31, 2013 and August 31, 2012 by level within the fair value hierarchy:

	May 31, 2013			Total
	Level 1	Level 2	Level 3	
<b>Financial Assets</b>				
Money Market Funds	\$ 16,584	\$	\$	\$ 16,584
Commercial Paper available for sale		1,000		1,000
Corporate Bonds available for sale		17,554		17,554
<b>Total</b>	<b>\$ 16,584</b>	<b>\$ 18,554</b>	<b>\$</b>	<b>\$ 35,138</b>

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(In thousands, except share and per share data)

	August 31, 2012			Total
	Level 1	Level 2	Level 3	
<b>Financial Assets</b>				
Money Market Funds	\$ 16,769	\$	\$	\$ 16,769
Commercial Paper available for sale		10,187		10,187
Corporate Bonds available for sale		29,098		29,098
<b>Total</b>	<b>\$ 16,769</b>	<b>\$ 39,285</b>	<b>\$</b>	<b>\$ 56,054</b>

**Accounts Receivable**

Accounts receivable represents amounts owed to the Company from product sales and collaborative research and government grants. The Company had no amounts reserved for doubtful accounts at May 31, 2013 and August 31, 2012 as the Company expected full collection of the accounts receivable balances.

Customers representing greater than 10% of accounts receivable were as follows (in percentages):

Customers	As of May 31, 2013	As of August 31, 2012
Customer A	28.3	47.9
Customer B	26.5	*
Customer D	**	13.6
Customer E	*	15.2

\* Less than 10%

\*\* No accounts receivable balance

Customers representing greater than 10% of revenues were as follows (in percentages):

Customers	Three Months Ended May 31,		Nine Months Ended May 31,	
	2013	2012	2013	2012
Customer A	21.6	27.5	18.6	24.2
Customer B	18.5	14.6	18.3	19.0
Customer D	**	13.6	17.4	18.5
Customer F	19.5	20.7	23.9	**
Customer G	15.9	**	*	**

\* Less than 10%

\*\* No revenues

*Inventories*

At May 31, 2013, seed inventory consisted of work-in-process costs related to sweet sorghum seeds. At August 31, 2012, seed inventory consisted of work in process and finished good costs related to sweet sorghum seeds. Seed inventory costs are computed on a first in, first out basis and valued at the lower of cost or market with any excess cost recognized during the period within cost of product sales. A full valuation reserve has been recorded on all seed products.

**Table of Contents****CERES, INC. AND SUBSIDIARY****Notes to Condensed Consolidated Financial Statements (Unaudited)****(In thousands, except share and per share data)*****Property and Equipment***

Property and equipment is stated at cost. Depreciation is provided using the straight-line method over the shorter of the estimated useful lives or the remaining life of the lease. Depreciation periods for the Company's property and equipment are as follows:

Automobiles and trucks	3-5 years
Office, laboratory, farm and warehouse equipment and furniture	3-5 years
Leasehold improvements	3-10 years
Buildings	14-39 years

***Impairment of Long-Lived Assets***

Long-lived assets, such as property and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. To the extent that an impairment indicator has occurred, recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. For all periods presented, no impairment charges have been recognized.

On February 3, 2012, the Company's plant breeding and field research station located near College Station, Texas was damaged by a tornado. The impact was limited to structural damage to the building that houses office space and a small laboratory used to evaluate biomass samples and work space. A small greenhouse and tractor sheds, and some agricultural equipment were also damaged.

In fiscal year 2012, the Company impaired \$1,026 in assets related to damage at the Texas facility and received insurance proceeds of \$1,000 for repair costs. The remainder of the repairs, which totaled approximately \$150, were completed by November 30, 2012. These remaining repairs were also covered by insurance, subject to the Company's deductible.

***Common and Convertible Preferred Stock Warrant Liabilities***

Prior to the closing of the IPO, the Company determined that common stock warrants issued to certain holders of convertible preferred stock were not considered indexed to the Company's common stock and therefore required liability classification. In addition, the Company accounted for its warrants to purchase shares of the Company's convertible preferred stock that were contingently redeemable as liabilities at fair value on the consolidated balance sheets. These common and convertible preferred stock warrants were subject to re-measurement at each balance sheet date and the changes in fair value, if any, were recognized as other (expense) income.

Upon the closing of the IPO, certain common and convertible preferred stock warrants, previously classified as liabilities were revalued and reclassified to additional paid-in capital as they no longer met the requirements for liability classification given the automatic conversion of the convertible preferred stock to common stock upon consummation of the IPO.

***Revenue Recognition***

Revenues are recognized when the following criteria are met: (1) persuasive evidence of an arrangement exists; (2) transfer of product or technology has been completed or services have been rendered; (3) the fee is fixed or determinable; and (4) collectability is reasonably assured. To date, the Company's primary source of revenues has been derived from collaborative research agreements and government grants and to a lesser extent, product sales.



*Product Sales*

Product sales are derived from sales of seeds, trait fees, crop management services and biomass that was delivered under certain of our sales incentive and performance based programs for the 2012-2013 growing season in Brazil. Product sales are recognized, net of discounts and allowances, once passage of title and risk of loss have occurred and contractually specified acceptance criteria have been met, provided all other revenue recognition criteria have also been met. To date, product sales have not been significant.

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**CERES, INC. AND SUBSIDIARY**

**Notes to Condensed Consolidated Financial Statements (Unaudited)**

**(In thousands, except share and per share data)**

*Collaborative Research and Government Grants*

From time to time, the Company enters into research and development collaboration agreements with third parties, including several biofuel producers and government agencies, such as the Department of Energy (DOE) and the United States Department of Agriculture (USDA). The research and development collaboration agreements typically provide the Company with multiple revenue streams, which may include up-front, non-refundable fees for licensing certain of the Company's technologies, government grants and fees for research and development activities and contingent milestone payments based upon achievement of contractual criteria.

*Technology License Fees* For collaboration agreements in which the Company has continuing involvement, license fees are recognized on a straight-line basis over the term of the arrangement. Licensing fees are non-refundable and not subject to future performance.

*Government Grants* The Company receives payments from government entities in the form of government grants. Government grants generally provide the Company with partial cost reimbursement for certain types of expenditures in return for research and development activities over a contractually defined period. Revenues from government grants are recognized in the period during which the related costs are incurred, provided that the conditions under which the government grants were provided have been met and the Company has only perfunctory obligations outstanding.

*Research and Development Fees* Generally, fees for research and development activities are recognized as the services are performed over the performance period, as specified in the respective agreements. Certain of the Company's collaboration agreements require the Company to deliver research data by specific dates and that the collective program plan will result in reaching specific crop characteristics by certain dates. For such arrangements, the Company recognizes revenues based on the approximate percentage of completion of services under the agreement, but the revenue recognized cannot exceed payments received by the Company to date under the agreement. The research and development period is estimated at the inception of each agreement and is periodically evaluated.

*Milestone Fees* Fees that are contingent based on achievement of substantive performance milestones at inception of the agreement are recognized based on the achievement of the milestone, as defined in the respective agreements.

*Deferred Revenue*

The Company recognizes deferred revenue to the extent that cash received under the collaboration agreement is in excess of the revenues recognized related to the agreement since the work under the agreement has not yet been performed at the time of cash receipt, which is classified as other current liabilities on the accompanying condensed consolidated balance sheet.

*Development and License Agreement*

The development and license agreement between the Company and Campbell Soup Company, dated December 20, 2007, as amended, was terminated and cancelled on November 19, 2012 following Campbell's sale of its vegetable seed assets to a third party in September 2012. In connection with the termination, Campbell paid the Company the amount of \$550 in full and complete satisfaction of all remaining financial obligations under the development and license agreement.

*Research and Development*

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Research and development expenses principally consist of personnel costs related to the Company's research and development staff as well as depreciation of research and development assets. Research and development expenses also include costs incurred for laboratory supplies, reimbursable costs associated with government grants and collaborative agreements, third-party contract payments, consultants, facility and related overhead costs.

### *Stock-Based Compensation*

The Company accounts for stock-based compensation arrangements with employees using a fair value method which requires the recognition of compensation expense for costs related to all stock-based payments including stock options. The fair value method requires the Company to estimate the fair value of stock-based payment awards on the date of grant using an option pricing model. The Company uses an option pricing model to estimate the fair value of options granted that are expensed on a straight-line basis over the vesting period. The Company accounts for stock options issued to non-employees based on the estimated fair value of the awards using the option pricing model. The measurement of stock-based compensation to non-employees is subject to periodic adjustments as the underlying equity instruments vest, and the resulting change in value, if any, is recognized in the Company's consolidated statements of operations during the period the related services are rendered.

**Table of Contents****CERES, INC. AND SUBSIDIARY****Notes to Condensed Consolidated Financial Statements (Unaudited)****(In thousands, except share and per share data)*****Income Taxes***

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

For all periods presented the Company had no material unrecognized tax benefits or expenses that, if recognized, would affect the Company's effective income tax rate in future periods. The Company is currently unaware of any issues under review that could result in significant payments, accruals, or material deviations from its recognized tax positions.

The major jurisdictions in which the Company files income tax returns include the federal and state jurisdictions within the United States and Brazil, where it has a subsidiary. The tax years 2007 to 2011 remain open to examination by federal and state taxing jurisdictions and the tax years 2010 and 2011 remain open to examination by foreign jurisdictions. However, the Company has net operating loss carryforwards (NOLs) beginning in 1998 which would cause the statute of limitations to remain open for the year in which the NOL was incurred.

***Foreign Currency Translation***

The Brazilian real is the functional currency of the Company's subsidiary in Brazil. Accordingly, assets and liabilities of those operations are translated into United States dollars using the current exchange rate in effect at the balance sheet date and equity accounts are translated into United States dollars using historical rates. Revenues and expenses are translated at the weighted average rate of exchange during the reporting period. Gains and losses from foreign currency translation adjustments are represented as a component of accumulated other comprehensive loss.

***Basic and Diluted Net Loss Per Share***

Basic net loss per common share is computed by dividing net loss attributable to common stockholders by the weighted average number of common shares outstanding. Diluted net loss per common share is computed by dividing net loss available to common stockholders by the weighted average number of common shares and dilutive potential common share equivalents then outstanding, to the extent they are dilutive. Potential common shares consist of shares issuable upon the exercise of stock options and warrants (using the treasury stock method), and the weighted average conversion of the convertible preferred stock into shares of common stock (using the if-converted method). Dilutive net loss per share is the same as basic net loss per share for all periods presented because the effects of potentially dilutive items were anti-dilutive.

The following table sets forth the computation of basic and diluted net loss per common share:

	Three months ended		Nine months ended	
	May 31,		May 31,	
	2013	2012	2013	2012
Net loss	\$ (9,323)	\$ (8,416)	\$ (25,182)	\$ (22,788)
Basic and diluted net loss per common share	\$ (0.38)	\$ (0.34)	\$ (1.02)	\$ (2.33)
Basic and diluted weighted average outstanding common shares used for net loss:	24,801,705	24,423,042	24,765,664	9,787,652

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The following potentially dilutive, common share equivalents were excluded from the calculation of diluted net loss per common share because their effect was antidilutive for each of the periods presented:

	May 31,	
	2013	2012
Options to purchase common stock	2,673,232	2,917,416
Warrants to purchase common stock	2,082,045	2,082,045
<b>Total</b>	<b>4,755,277</b>	<b>4,999,461</b>

**Table of Contents****CERES, INC. AND SUBSIDIARY****Notes to Condensed Consolidated Financial Statements (Unaudited)****(In thousands, except share and per share data)****(3) Marketable Securities**

Marketable securities classified as available for sale consisted of the following:

	May 31, 2013			Fair Value
	Amortized	Unrealized	Unrealized	
Available for sale securities	Cost	Gain	Loss	
Commercial Paper	\$ 1,000	\$	\$	\$ 1,000
Corporate Bonds	17,549	6	(1)	17,554
<b>Total</b>	<b>\$ 18,549</b>	<b>\$ 6</b>	<b>\$ (1)</b>	<b>\$ 18,554</b>

	May 31, 2013	
	Cost	Fair Value
Marketable securities		
Due in 1 year or less	\$ 18,549	\$ 18,554
	\$ 18,549	\$ 18,554

	August 31, 2012			Fair Value
	Amortized	Unrealized	Unrealized	
Available for sale securities	Cost	Gain	Loss	
Commercial Paper	\$ 10,187	\$ 2	\$ (2)	\$ 10,187
Corporate Bonds	29,092	17	(11)	29,098
<b>Total</b>	<b>\$ 39,279</b>	<b>\$ 19</b>	<b>\$ (13)</b>	<b>\$ 39,285</b>

	August 31, 2012	
	Amortized	Fair Value

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	<b>Cost</b>	
Marketable securities		
Due in 1 year or less	\$ 33,567	\$ 33,565
Due in 1 2 years	5,712	5,720
	\$ 39,279	\$ 39,285

**(4) Inventories**

Inventories consisted of the following:

	<b>May 31, 2013</b>	<b>August 31, 2012</b>
Work in process	\$ 352	\$ 264
Seed inventory		577
<b>Total inventories</b>	<b>\$ 352</b>	<b>\$ 841</b>

**Table of Contents****CERES, INC. AND SUBSIDIARY****Notes to Condensed Consolidated Financial Statements (Unaudited)****(In thousands, except share and per share data)****(5) Property and Equipment**

Property and equipment are summarized as follows:

	May 31, 2013	August 31, 2012
Land	\$ 43	\$ 43
Automobiles and trucks	765	728
Buildings	3,180	3,252
Office, laboratory, farm and warehouse equipment and furniture	15,216	15,552
Leasehold improvements	5,716	5,709
	24,920	25,284
Less accumulated depreciation	(20,005)	(19,528)
Property and equipment, net	\$ 4,915	\$ 5,756

**(6) Accounts Payable and Accrued Expenses**

Accounts payable and accrued expenses consisted of the following:

	May 31, 2013	August 31, 2012
Accounts payable	\$ 935	\$ 1,865
Accrued payroll and related expenses	2,589	2,530
Research and development contracts	1,016	686
Accrued grower commitments	8	76
Other	351	319
	\$ 4,899	\$ 5,476

**(7) Long-Term Debt**

Long-term debt is summarized as follows:

	May 31, 2013	August 31, 2012
Capital Leases	\$ 214	\$ 390
Less current portion	(84)	(134)



***Equipment Loans***

In January 2010, the Company entered into a Loan and Security Agreement (Loan Agreement) with a commercial bank (Bank). The Loan Agreement provided financing for qualified equipment purchases. The Company borrowed a total of \$7,000 in two tranches at interest rates of Prime Rate plus 2.75%, which was to be repaid over 36 to 40 months. In connection with the Loan Agreement, the Company issued the Bank warrants to purchase shares of the Company's convertible preferred stock. The fair value of the warrants was recorded as a discount on the equipment loan and was being recognized over the term of the equipment loan as interest expense. Upon closing of the IPO, the convertible preferred stock warrants were converted to warrants to purchase common stock (see Note (1)).

In September 2011, the Company entered into an Amended Loan and Security Agreement (Amended Loan Agreement) with the Bank that provided for an additional \$3,500 term loan consisting of (i) a \$2,500 immediately available term loan, which was advanced to the Company in September 2011 and (ii) a \$1,000 term loan available upon satisfaction of additional term loan advance conditions, which was not drawn by the Company. In May 2012, the Company repaid all amounts due and owing to the Bank under the Amended Loan Agreement. Upon repayment, the unamortized portion of the loan discount was charged to interest expense.

**Table of Contents****CERES, INC. AND SUBSIDIARY****Notes to Condensed Consolidated Financial Statements (Unaudited)****(In thousands, except share and per share data)**

The aggregated maturities of debt as of May 31, 2013 are as follows:

Remaining three months of fiscal year 2013	\$ 22
2014	81
2015	64
2016	47
	\$ 214

**(8) Convertible Notes and Warrant Modification**

In August 2011, the Company completed the sale of \$11,425 aggregate principal amount of the Convertible Notes to nine existing investors in the Company in a private placement. The Convertible Notes were convertible subject to the terms and conditions set forth therein, into shares of the Company's common stock upon the consummation of a qualified initial public offering of the Company's common stock at a price per share equal to a 20% discount from the public offering price, or \$10.40. Additionally, so long as any investors who held warrants to purchase shares of the Company's common stock issued in connection with certain of the Company's preferred stock financings purchased at least their respective full pro rata portion of the Convertible Notes being offered, the Company agreed to amend the termination provisions of such investors existing warrants such that the warrants held by such investors no longer expired upon the IPO.

In connection with the offering of the Convertible Notes, warrants to purchase 539,972 shares of common stock issued in connection with the Series F Preferred Stock offering (Modified F warrants), and all of the warrants issued in connection with the Series G Preferred Stock offering were amended such that they would no longer expire upon the consummation of a qualified initial public offering. Warrants to purchase 229,257 shares of common stock issued in connection with the Series F Preferred Stock offering (Non-Modified F warrants) were not amended and remain outstanding.

Upon closing of the IPO, the Convertible Notes were revalued and converted into 1,098,575 shares of common stock.

**(9) Stock-Based Compensation*****Stock Option and Stock Issuance Plans***

The Company has established three stock option and stock issuance plans: the Ceres, Inc. 2000 Stock Option/Stock Issuance Plan (2000 Plan), the Ceres, Inc. 2010 Stock Option/Stock Issuance Plan (2010 Plan) and the Amended and Restated Ceres, Inc. 2011 Equity Incentive Plan (2011 Plan, and collectively with the 2000 Plan and the 2010 Plan, Option Plans). The Option Plans provide for grants of Incentive Stock Options (ISOs) to employees and Nonqualified Stock Options (NSOs) and restricted stock to employees, directors, and consultants. In addition, the 2011 Plan provides for the grant of other equity based awards such as restricted stock units, stock appreciation rights and deferred stock to employees, directors and consultants. The option term, as determined by the Company's Board of Directors, may not exceed ten years. Vesting, also determined by the Company's Board of Directors, generally occurs ratably over four to five years. ISOs and NSOs may be granted at a price per share not less than the fair market value at the date of grant.

During September 2012, the Company modified options to purchase 403,333 shares of common stock that were scheduled to expire on December 18, 2012 by extending the terms such that the options now expire on December 18, 2015. A modification charge of \$157 was recorded in September 2012.

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The total number of shares reserved for issuance under the Option Plans is 6,754,999. At the Company's 2013 Annual Meeting of Stockholders, the stockholders approved the amendment and restatement of the Ceres, Inc. 2011 Equity Incentive Plan, which increased the maximum aggregate number of shares that may be issued under the plan by 1.5 million shares and prohibits the repricing of stock options without stockholder approval. As of May 31, 2013, the Company had 2,134,691 shares available under the 2011 Plan for future grant. The Company does not intend to make further grants under the 2000 Plan or the 2010 Plan.

**Table of Contents****CERES, INC. AND SUBSIDIARY****Notes to Condensed Consolidated Financial Statements (Unaudited)****(In thousands, except share and per share data)****Stock Option Valuation and Compensation**

The Company uses a Black Scholes option pricing model to determine the fair value of stock options. The weighted average grant date fair value of stock option awards was \$2.27 and \$8.28 per option share for the three months ended May 31, 2013 and 2012, respectively, and \$3.02 and \$10.53 per option share for the nine months ended May 31, 2013 and 2012, respectively.

The weighted average grant date estimated fair value of the Company's common stock was \$3.23 and \$12.42 per share for the three months ended May 31, 2013 and 2012, respectively, and \$4.20 and \$14.60 per share for the nine months ended May 31, 2013 and 2012, respectively. The fair value of employee stock options was estimated using the following assumptions:

	Three months ended				Nine months ended			
	May 31,		May 31,		May 31,		May 31,	
	2013	2012	2013	2012	2013	2012	2013	2012
Expected term (in years)	5.50	6.08	5.50	6.08	5.50	6.08	5.50	6.46
Expected volatility	88.1%		78.0%		87.2%		81.0%	
Risk free interest rate	1.06%	1.07%	1.39%	0.82%	1.07%	1.35%	1.39%	
Expected dividend yield	0%		0%		0%		0%	

**Expected Term** Because of limited employee share option exercises, the Company uses a simplified method in which the expected term of an award is presumed to be mid-point between the vesting date and the expiration date of the award.

**Expected Volatility** The Company estimates the volatility of its common stock by using the historical volatility of a group of comparable companies over the option's expected term. The decision to use historical volatility of comparable companies was based upon the fact there is limited history of trading activity of the Company's common stock.

**Risk-Free Interest Rate** The Company bases the risk-free interest rate used in the option valuation model on U.S. Treasury zero-coupon issues with remaining terms similar to the expected term on the options.

**Expected Dividend Yield** The Company does not anticipate paying any cash dividends in the foreseeable future.

Stock-based compensation expense included in operating expenses and total intrinsic value of stock options exercised are as follows:

	Three months ended		Nine months ended	
	May 31,		May 31,	
	2013	2012	2013	2012
Stock-based compensation costs for stock options	\$ 875	\$ 620	\$ 2,737	\$ 1,605
Fair value changes of collaboration warrants	(98)	(345)	(276)	(322)
	\$ 777	\$ 275	\$ 2,461	\$ 1,283
Intrinsic value of stock options exercised	\$	\$ 2,933	\$ 79	\$ 3,271



**Table of Contents****CERES, INC. AND SUBSIDIARY****Notes to Condensed Consolidated Financial Statements (Unaudited)****(In thousands, except share and per share data)****Stock Option Activity**

The following table summarizes the stock option transactions under the Option Plans during the nine months ended May 31, 2013:

	Shares	Weighted Average Exercise Price
Options outstanding at August 31, 2012	2,778,508	\$ 7.92
Options granted	133,013	4.25
Options exercised	(23,832)	2.36
Options forfeited	(214,457)	7.79
<b>Options outstanding at May 31, 2013</b>	<b>2,673,232</b>	<b>\$ 7.79</b>

The following table summarizes information about stock options outstanding and exercisable at May 31, 2013:

Range of Exercise Price	Number Outstanding	Average Remaining Contractual Life	Weighted- Average Exercise Price	Number Vested and Exercisable	Average Remaining Contractual Life	Weighted- Average Exercise Price
\$1.95	415,647	2.51	\$ 1.95	415,647	2.51	\$ 1.95
\$3.90-\$4.05	301,492	2.75	3.91	301,492	2.75	3.91
\$6.75	833,208	5.55	6.75	767,024	5.42	6.75
\$7.32	200,187	7.54	7.32	119,905	7.54	7.32
\$16.77	161,995	8.03	16.77	8,527	7.69	16.77
\$17.16	79,028	8.13	17.16	2,292	8.13	17.16
\$12.71	49,516	8.47	12.71	15,153	8.40	12.71
\$12.10	52,497	8.74	12.10	52,497	8.74	12.10
\$13.00	448,483	8.74	13.00			
\$8.97	750	9.05	8.97			
\$6.66	11,666	9.23	6.66			
\$3.60-\$7.70	29,100	9.27	5.96			
\$3.94	24,000	9.50	3.94			
\$3.32	64,163	9.67	3.32			
\$3.49	1,500	9.70	3.49			
	2,673,232			1,682,536		

No tax benefits have been recorded on compensation costs recognized for options exercised. As of May 31, 2013, there was \$5,722 of total unrecognized compensation cost related to stock options. That cost is expected to be recognized over a weighted average of 3.30 years. The Company's policy is to issue new shares for options exercised.



**Table of Contents****CERES, INC. AND SUBSIDIARY****Notes to Condensed Consolidated Financial Statements (Unaudited)****(In thousands, except share and per share data)*****Restricted Stock Activity***

The following summarizes the restricted stock transactions under the Option Plans during the nine months ended May 31, 2013:

	<b>Shares</b>	<b>Grant Date Fair Value</b>
Restricted stock outstanding and unvested at August 31, 2012	40,600	\$ 12.10
Restricted stock granted	238,125	5.64
Restricted stock vested	(12,500)	12.71
Restricted stock forfeited	(9,000)	12.71
Restricted stock outstanding and unvested at May 31, 2013	257,225	\$ 6.07

As of May 31, 2013, there was \$1,129 of total unrecognized compensation cost related to restricted stock awards. That cost is expected to be recognized over a weighted average of 2.19 years.

**(10) Stockholders' Equity*****Initial Public Offering***

Upon closing of the IPO (see Note (1)):

the Company's outstanding shares of convertible preferred stock were automatically converted into 15,353,221 shares of common stock;

the convertible notes were revalued and converted into 1,098,575 shares of common stock; and

the outstanding convertible preferred stock warrants were revalued and automatically converted into warrants to purchase a total of 20,511 shares of common stock.

***Common Stock***

Pursuant to the Company's amended and restated certificate of incorporation, the Company is authorized to issue 490,000,000 shares of common stock. Holders of the Company's common stock are entitled to dividends as and when declared by the Board of Directors, subject to rights and holders of all classes of stock outstanding having priority rights to dividends. There have been no dividends declared to date. Each share of common stock is entitled to one vote.

***Preferred Stock***



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Pursuant to the Company's amended and restated certificate of incorporation, the Company is authorized to issue 10,000,000 shares of preferred stock. The Board of Directors has the authority, without action by the Company's stockholders, to designate and issue shares of preferred stock in one or more series and to fix the rights, preferences, privileges and restrictions thereof.

### ***Common and Preferred Stock Warrants Financing***

#### *Warrants issued in connection with Series F Convertible Preferred Stock Financing*

In connection with the issuance of the Series F Convertible Preferred Stock in September 2007, the Company issued warrants to purchase 769,229 shares of common stock at an exercise price of \$19.50 per share. The warrants are immediately exercisable.

As discussed in Note (1), the common stock warrants issued to the holders of Series F Convertible Preferred Stock were reported as a liability at fair value as of each balance sheet date. Upon closing of the IPO, the common stock warrants no longer met the requirements for liability classification. The warrants were revalued as of the closing date and reclassified to additional paid-in capital.

#### *Warrants issued in connection with Series G Convertible Preferred Stock Financing*

In connection with the issuance of the Series G Convertible Preferred Stock in June 2010, the Company issued warrants to purchase 1,025,640 shares of common stock at an exercise price of \$19.50 per share. The warrants are immediately exercisable.

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**CERES, INC. AND SUBSIDIARY**

**Notes to Condensed Consolidated Financial Statements (Unaudited)**

**(In thousands, except share and per share data)**

As discussed in Note (1), the common stock warrants issued to the holders of Series G Convertible Preferred Stock were reported as a liability at fair value as of each balance sheet date. Upon closing of the IPO, the common stock warrants no longer met the requirements for liability classification. The warrants were revalued as of the closing date and reclassified to additional paid-in capital.

*Warrants issued in connection with Borrowing and Loan Agreements*

In July 2004, in connection with a borrowing agreement (Borrowing Agreement) entered into with the Bank, the Company issued the Bank warrants to purchase 18,461 shares of the Company's Series E Convertible Preferred Stock. Upon closing of the IPO, these preferred stock warrants were converted into warrants to purchase 6,153 shares of common stock at \$19.50 per share.

In February 2010, in connection with the Loan Agreement (see Note (6)), the Company issued the Bank warrants to purchase 43,076 shares of the Company's Series F Convertible Preferred Stock. Upon closing of the IPO, these preferred stock warrants were converted into warrants to purchase 14,358 shares of common stock at \$19.50 per share.

As discussed in Note (1), the preferred stock warrants issued in connection with the Borrowing Agreement and the Loan Agreement were reported as a liability at fair value as of each balance sheet date. Upon closing of the IPO, these preferred stock warrants no longer met the requirements for liability classification. These preferred stock warrants were revalued as of the closing date and reclassified to additional paid-in capital.

*Warrants issued in connection with Noble Agreement*

In May 2006, the Company entered into a collaboration agreement with The Samuel Roberts Noble Foundation, Inc. (Noble) (Noble Agreement) to establish a research program (see Note (13)). In connection with this collaboration, the Company granted Noble a warrant to purchase 133,333 shares of the Company's common stock for an exercise price of \$30.00 per share. The original terms were as follows: the warrant vests in equal installments of 33,333 shares on May 19, 2009, May 19, 2011, May 19, 2013, and May 19, 2015, respectively, and shall remain exercisable for a period of two years from the respective vesting dates. These warrants are accounted for at fair value and remeasured until vested. The fair value, including the resulting change in value as a result of remeasurement is being recognized as research and development expense. The inception to date expense recognized with respect to this warrant totals \$629 as of May 31, 2013. At May 31, 2013, 99,999 warrants had vested under this arrangement. The fair value of the warrants not yet vested at May 31, 2013 was \$5.4 using a risk-free rate of 0.79% based on the respective exercise periods of each installment, expected volatility of 75.3%, expected term of 3.97 years based on the respective exercise periods of each installment, which is also the remaining contractual term, and 0% dividend yield.

In June 2011, the Company and Noble agreed to modify the warrants issued to Noble as follows: the warrant vests in equal installments of 33,333 shares on May 19, 2013 and May 19, 2015, respectively and shall remain exercisable until the earliest of a period of five years from the respective vesting dates and May 18, 2017.

*Warrants issued in connection with TAMU Agreement*

In August 2007, the Company entered into a sponsored research and intellectual property rights agreement with The Texas A&M University System (TAMU) to establish a research program (see Note (13)). In connection with this collaboration, the Company granted TAMU a warrant to purchase 66,666 shares of the Company's common stock for an exercise price of \$30.00 per share. The warrant vests based on certain research and commercialization milestones being met and shall remain exercisable until August 28, 2017. This warrant is accounted for at fair value and remeasured until the vesting targets are met. The fair value, including the resulting change in value as a result of remeasurement is being recognized as research and development expense. The inception to date expense recognized with respect to this warrant totals \$10 as of May 31, 2013. The fair value of the warrants at May 31, 2013 was \$12.7, using a risk-free rate of 0.79%, expected volatility of 75.3%, expected term of 4.24 years and 0% dividend yield. No warrants had vested under this arrangement as of May 31, 2013.

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In December 2011, pursuant to an Amended and Restated Intellectual Property Rights Agreement (IP Rights Agreement) (see Note (13)), the Company issued warrants to TAMU to purchase 66,666 shares of common stock at an exercise price of \$14.30 per share. The warrants expire on September 24, 2026 and, subject to certain conditions, vest in equal installments on the fifth, tenth and fifteenth anniversary of the IP Rights Agreement. The inception to date expense recognized with respect to this warrant totals \$19 as of May 31, 2013. The fair value of the warrants at May 31, 2013 was \$100, using a risk-free rate of 2.16%, expected volatility of 78.7%, expected term of 13.32 years and 0% dividend yield. No warrants had vested under this arrangement as of May 31, 2013.

**Table of Contents****CERES, INC. AND SUBSIDIARY****Notes to Condensed Consolidated Financial Statements (Unaudited)****(In thousands, except share and per share data)****(11) Income Taxes**

No provision for U.S. income taxes has been made, net of the valuation allowance, because the Company has incurred losses since its inception. The Company has deferred tax assets consisting primarily of net operating loss carryforwards that have been fully offset by a valuation allowance.

**(12) Commitments and Contingencies**

The Company leases certain of its facilities and equipment under various noncancelable operating leases expiring through 2023. The leases on the facilities contains provisions for future rent increases. The Company records monthly rent expense equal to the total of the payments due over the lease term, divided by the number of months of the lease term. The difference between rent expense recorded and the amount paid is credited or charged to deferred rent, which is included in other current liabilities and other non-current liabilities in the accompanying condensed consolidated balance sheets as of May 31, 2013 and August 31, 2012.

In connection with one of its facilities leases, the Company received a reimbursement for leasehold improvements of \$270. This reimbursement is a lease incentive which has been recognized as a liability in deferred rent and is being amortized to rent expense on a straight-line basis over the lease term. Total rental expense recognized was \$84 and \$97 for the three months ended May 31, 2013 and 2012, respectively, and \$373 and \$386 for the nine months ended May 31, 2013 and 2012, respectively.

Future minimum payments under noncancelable operating leases as of May 31, 2013 are as follows:

	<b>Operating Leases</b>
Remaining three months of fiscal year 2013	\$ 155
2014	597
2015	548
2016	550
2017	559
Thereafter	1,263
<b>Total minimum lease payments</b>	<b>\$ 3,672</b>

**(13) Research Collaboration Agreements**

The Company has a number of research agreements with academic collaborators, including among others, TAMU, Noble, and the Institute of Crop Sciences of the Chinese Academy of Agricultural Sciences. In connection with these agreements, the Company receives certain exclusive options or licensing rights to technology and intellectual property developed under these agreements. The Company expenses amounts under these agreements to research and development expense in the period in which the services are rendered. The Company also licenses technology from third parties. Initial payments under these license agreements are capitalized and expensed on a straight-line basis over the license term.

*Noble Agreement*

In May 2006, the Company entered into a collaboration agreement with Noble to establish a research program. Under the Noble Agreement, the Company agreed to fund certain research activities undertaken by Noble in an amount up to \$3,800 through July 31, 2012 and granted Noble a warrant to purchase 133,333 shares of the Company's common stock for an exercise price of \$30.00 per share (see Note (10)). Additional

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projects may be added under the agreement, if agreed to by both parties.

Under the collaboration agreement, in August 2012 the Company agreed to fund certain research activities undertaken by Noble through July 31, 2013 and 2014 of \$82.7 and \$85.3 per year, respectively.

### *TAMU Agreement*

In August 2007, the Company entered into a Sponsored Research and Intellectual Property Rights agreement with TAMU to establish a research program. Under the agreement, the Company agreed to fund certain research activities undertaken by TAMU in an amount up to \$5,100 through 2012 and granted TAMU a warrant to purchase 66,666 shares of the Company's common stock for an exercise price of \$30.00 per share (see Note (10)).

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**CERES, INC. AND SUBSIDIARY**

**Notes to Condensed Consolidated Financial Statements (Unaudited)**

**(In thousands, except share and per share data)**

On September 24, 2011, the Company entered into an Amended and Restated Sponsored Research Agreement and the IP Rights Agreement with TAMU which both expire on September 23, 2026. The specific research projects and budgets undertaken pursuant to such agreement will be determined by an Executive Committee comprised of two members from each of TAMU and the Company as set forth in the Amended and Restated Sponsored Research Agreement. In December 2011, pursuant to the IP Rights Agreement, the Company issued warrants to TAMU to purchase 66,666 shares of common stock at an exercise price of \$14.30 per share (see Note (10)).

At May 31, 2013, the future minimum payments under the Company's research collaboration agreements are as follows:

Remaining three months of fiscal year 2013	\$ 669
2014	2,505
2015	2,990
2016	2,952
2017 and beyond	613
	\$ 9,729

**Table of Contents****ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.  
Forward-Looking Statements**

*The following discussion and analysis of our financial condition and results of operations should be read together with our unaudited condensed consolidated financial statements and the other financial information appearing elsewhere in this Quarterly Report on Form 10-Q and the information under the heading Risk Factors and Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on November 20, 2012. This discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. All statements, other than statements of historical facts contained in this Quarterly Report on Form 10-Q, including statements regarding our efforts to develop and commercialize our products, anticipated yields and product performance, our short-term and long-term business strategies, market and industry expectations and future results of operations and financial position are forward-looking statements. In many cases, you can identify forward-looking statements by terms such as may, will, should, expect, plan, anticipate, could, intend, target, project, contemplate, believe, estimate, potential, continue or other similar words. We based these forward-looking statements largely on our current expectations and projections about future events or trends that we believe may affect our business and financial performance. These forward-looking statements involve known and unknown risks and uncertainties that may cause our actual results, performance or achievements to materially differ from any future results, performance or achievements expressed or implied by these forward-looking statements. We have described in the Risk Factors section in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on November 20, 2012 and elsewhere in this Quarterly Report on Form 10-Q the material risks and uncertainties that we believe could cause actual results to differ from these forward-looking statements. Because forward-looking statements are inherently subject to risks and uncertainties, some of which we cannot predict or quantify, you should not rely on these forward-looking statements as guarantees of future results, performance or achievements. The forward-looking statements in this Quarterly Report on Form 10-Q represent our views as of the date of this Quarterly Report on Form 10-Q. We undertake no obligation to update publicly, except to the extent required by law, any forward-looking statements for any reason after the date we file this Quarterly Report on Form 10-Q with the SEC to conform these statements to actual results or to changes in our expectations.*

**Overview**

We are an agricultural biotechnology company selling seeds to produce dedicated energy crops—renewable bioenergy feedstocks that can enable the large-scale replacement of petroleum and other fossil fuels. We use a combination of advanced plant breeding and biotechnology to develop seed products that we believe address the limitations of first-generation bioenergy feedstocks, such as corn and sugarcane, increase crop productivity, reduce crop inputs and improve cultivation on marginal land.

Our first large-scale commercial products are proprietary sweet sorghum hybrids that can be used as a drop-in feedstock to extend the operating season of Brazilian sugarcane-to-ethanol mills, the operating days of which are currently limited due to the inherent limitations of sugarcane physiology and growth patterns. Our dedicated energy crops can also be used for the production of second-generation biofuels and bio-based chemicals, including cellulosic ethanol, butanol, jet fuel, diesel-like molecules and gasoline-like molecules, from non-food biomass. Finally, baseload utility-scale electric power can also be generated from the biomass feedstocks grown from our seeds.

We operate in one segment, and accordingly, our results of operations are presented on a consolidated basis.

To date the majority of our revenue and expense has been denominated in U.S. dollars and foreign currency fluctuations have not had a significant impact on our historical results of operations. As we continue to penetrate the Brazilian market and enter markets outside the United States, we expect our product sales will be made in local currencies and accordingly, that foreign currency fluctuations will have a greater impact on our operating results. We generate our revenues from government grants, research and development collaboration agreements and from product sales.

We began selling products in 2008 and, while our product sales have been minimal to date, we expect product sales to eventually become the primary source of our revenues. We expect product revenues to primarily include a combination of seed sales and technology fees, similar to current business models used for food crops incorporating biotech traits. As we continue to develop traits for our products, we expect that a significant portion of our product revenues will be generated from the sale of seeds that include our traits. Our largest immediate commercial opportunity is selling sweet sorghum seeds into the Brazilian biofuel market. Our longer term strategies involve capitalizing on the development of the emerging cellulosic biofuel and biopower markets in the United States and Europe.

We have formed collaborations with major participants in the bioenergy value chain to evaluate yields and other performance or conversion characteristics of our products and the logistics related to the use of our products. Our collaborators have included ethanol mills, utilities, independent power producers, cellulosic biofuel companies, growers, grower cooperatives, equipment manufacturers, enzyme or fermentation

technology companies and other support technology providers.



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In row crops, like corn, cotton and soybean, we have out-licensed a portion of our traits and gene technology and we continue to pursue opportunities to out-license these technologies in other crops. We have chosen to be a technology provider or trait provider in these markets and our collaborators and customers in this area consist primarily of multi-national seed companies.

We market and sell our sorghum seeds in Brazil and our switchgrass and sorghum seeds in the United States under our Blade brand.

Since 2010, we have completed various commercial-scale evaluations of our sweet sorghum products in Brazil with ethanol mills and mill suppliers. During this time, our seeds have been planted and harvested using existing planting and harvesting equipment and fermented into ethanol without retrofitting or altering the existing mill. The remaining biomass was combusted for electricity production using existing mill boilers. We believe these experiences have demonstrated the drop-in nature of our sweet sorghum products, and along with higher yielding products in our pipeline, seed-based propagation, shorter growing cycles and lower water and fertilizer requirements of sweet sorghum relative to sugarcane, will serve as the basis for expanded adoption of this product line as a feedstock for ethanol and power production in Brazil and other markets.

For the 2012-2013 sweet sorghum growing season in Brazil, our products were planted by or for more than 30 mills in Brazil through a combination of seed sales, agronomy and crop management services and product evaluations. These customers, which include approximately half of the top-20 ethanol producers in Brazil, were responsible for approximately 30% of the sugarcane crushed in Brazil during the 2011-2012 growing season, which we derive from the annual sugar and ethanol guide, *Anuario Da Cana 2012*. Our products for the 2012-2013 growing season were planted on approximately 3,000 hectares, which was less than we originally anticipated. This is due in part to the effects of a severe drought last season and the focus among our customers on the field performance of our new hybrids, which can be determined at relatively small scale.

We have collected yield results from approximately two-thirds of the mills that planted our hybrids during the 2012-2013 growing season; the remaining mills reported incomplete results, did not complete the evaluation or chose not to report results. For mills that reported results, yields of sugars that can be fermented into ethanol were approximately 50% higher on average than the previous season, primarily as a result of product improvements related to biomass quality and productivity, better crop management and more favorable growing conditions at most planting locations. A third-party fermentation lab in Brazil is currently confirming total fermentable sugar yields. Based on anecdotal customer reports, our portfolio of sweet sorghum hybrids has outyielded competitor products at multiple locations where side-by-side comparisons were available.

Ethanol yields from our products ranged from approximately 450 to 3,600 liters per hectare, according to mill and company calculations. Mills representing the top 20% of yields, and which generally followed established crop management practices, achieved average yields ranging from 2,100 to 3,300 liters per hectare. Lower yields were primarily due to deviations from recommended crop management practices, weather delays during planting and disease infection late in the growing season. Mills use a variety of measurements and a complex formula to determine ethanol yields per hectare, which we believe is a key metric in determining the profitability of sweet sorghum and its relative attractiveness to other competing opportunities. When calculating ethanol yield per hectare, mills consider the number of metric tons of sweet sorghum biomass per hectare and the amount of fermentable sugars per metric ton to determine the volumes of ethanol that can be produced. Methodologies and assumptions used in these calculations can vary, and are therefore subject to greater variability than a controlled environment.

Based on the best of these results, we believe that we have demonstrated that economically compelling yields can be achieved with our products within their area of adaptation provided that our crop management protocols are followed and plantings receive adequate rainfall. However, due in part to the variability in yields recorded this season, we anticipate that many of our mill customers will repeat small scale commercial plantings before committing to broad, large-scale adoption. As a result, we expect sweet sorghum seeds sales next season to grow more modestly than originally anticipated.

For the 2012-2013 growing season, the majority of our customers participated in various sales incentive and performance based promotional programs. We offered these programs to facilitate the adoption of our products in Brazil by demonstrating and encouraging best crop management practices. We also used the programs to encourage new customers, which may not have experience with sweet sorghum production, to adopt our products sooner and at larger scale.

Of the plantings this season, approximately 2,000 hectares were planted under certain sales incentives and promotions, whereby we either deferred revenue until the completion of 2012-2013 sweet sorghum harvest season, which occurred in our fiscal third quarter, or generated revenue through biomass sales. Under certain sales incentives and promotions we have incurred additional costs for crop management services and support, which have been capitalized as unharvested sweet sorghum biomass costs, subject to lower of cost or market adjustments. While these services were covered in part by biomass sales and reimbursements, we made the decision in certain cases to provide a higher level of service at our own expense to support market development.



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We have invested significantly in research, development and technology and applied our proprietary technology platforms to energy crops and expect to continue to invest in research and development. To develop high performing seeds and traits, we have integrated a suite of advanced research and development methods, which include conventional breeding, marker-assisted breeding, genomics and biotechnology, along with large, proprietary collections of germplasm (the collections of genetic resources covering the diversity of a crop, the attributes of which are inherited from generation to generation). We have utilized our existing germplasm assets along with our research and development methods to create improved seeds and traits. As a result, we believe that we have one of the leading pipelines of proprietary crop traits, based on the number and nature of our traits as well as the two-species approach we employ to validate and successfully select gene-trait combinations.

Our other operating expenses are related to selling, general and administrative expenses incurred to establish and build our market presence and business infrastructure. Seed inventory costs are computed on a first-in, first-out basis and valued at the lower of cost or market with any excess cost recognized during the period within cost of product sales. The recoverability of our sweet sorghum seed inventory is dependent on increased customer adoption and acceptance. A full valuation reserve has been recorded on all seed products.

Historically, we have funded our operations from the proceeds from issuances of convertible preferred stock, warrants, convertible notes, debt financing, payments from collaborators and government grants. We have experienced significant losses as we invested heavily in research and development, and those costs have exceeded revenues earned through collaboration agreements and government grants and were incurred prior to generating significant revenues from product sales. As of May 31, 2013, we had an accumulated deficit of \$267.3 million. We expect to incur additional losses related to the continued development and expansion of our business including research and development, seed production and operations, and sales and marketing. There is no assurance that profitable operations will be achieved, or if achieved, can be sustained on a continued basis.

### **Initial Public Offering**

On February 27, 2012, we closed our initial public offering, or the IPO, of 5,750,000 shares of common stock (including 750,000 shares purchased by the underwriters upon the exercise of their right to purchase up to an additional 750,000 shares) at an offering price of \$13.00 per share, resulting in net proceeds to us of approximately \$65.2 million, after deducting underwriting discounts and commissions and offering expenses.

Upon the closing of the IPO, our outstanding shares of convertible preferred stock were automatically converted into 15,353,221 shares of common stock and our outstanding convertible subordinated notes, or the Convertible Notes, were automatically converted into 1,098,575 shares of common stock. Additionally, our warrants to purchase shares of common stock issued in connection with our Series F Preferred Stock financing, or the Series F warrants, and Series G Preferred Stock financing, or the Series G warrants, were marked-to-market upon the IPO closing and we will no longer record any changes in the fair value of these warrants as they are now equity classified. Our warrants to purchase shares of convertible preferred stock issued in connection with certain financing arrangements converted to warrants to purchase shares of common stock upon the IPO closing, and are also now equity classified. As such, we will no longer record any changes in fair value for these warrants.

### **Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures. We base our estimates and assumptions on historical experience and on various other factors that we believe to be reasonable under the circumstances. We evaluate our estimates and assumptions on an ongoing basis. The results of our analysis form the basis for making assumptions about the carrying values of assets and liabilities that are not readily apparent from other sources. Our actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies involve significant areas of management's judgments and estimates in the preparation of our financial statements.

#### ***Revenue Recognition***

Revenues are recognized when the following criteria are met: (1) persuasive evidence of an arrangement exists; (2) transfer of product or technology has been completed or services have been rendered; (3) the fee is fixed or determinable; and (4) collectability is reasonably assured. To date, our primary source of revenues has been derived from research collaborations and government grants and, to a lesser extent, product sales.



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### ***Product Sales***

Product sales are derived from sales of seeds, trait fees, crop management services and biomass that was delivered under certain of our sales incentive and performance based programs for the 2012-2013 growing season in Brazil. Going forward, we may include trait fees in our seed prices. Product sales are recognized, net of discounts and allowances, once passage of title and risk of loss have occurred and contractually specified acceptance criteria have been met, provided all other revenue recognition criteria have also been met.

### ***Collaborative Research and Government Grants***

From time to time, we have entered into research and development collaboration agreements with third parties including a large agriculture supplier, a consumer goods conglomerate and several biofuel producers. In addition, we have received grants from government agencies such as the Department of Energy and the United States Department of Agriculture. The research and development collaboration agreements typically provide us with multiple revenue streams, which may include upfront, non-refundable fees for licensing certain of our technologies, fees for research and development activities, and contingent milestone payments upon achievement of contractual criteria.

*Technology License Fees.* For collaboration agreements in which we have continuing involvement, license fees are recognized on a straight-line basis over the term of the arrangement. Licensing fees are non-refundable and not subject to future performance.

*Government Grants.* We receive payments from government entities in the form of government grants. Government grants generally provide us with cost reimbursement for certain types of expenditures in return for research and development activities over a contractually defined period, as well as an allocated portion of our overhead expenses. Revenues from government grants are recognized in the period during which the related costs are incurred, provided that substantially all conditions under which the government grants were provided have been met and we only have perfunctory obligations outstanding.

*Research and Development Fees.* Generally, fees for research and development activities are recognized as the services are performed over the performance period, as specified in the respective agreements. Certain of our collaboration agreements require us to deliver research data by specific dates and that the collective program plan will result in reaching specific crop characteristics by certain dates. For such arrangements, we recognize revenues based on the approximate proportional performance of services under the agreement, but the revenue recognized cannot exceed the payments that have accrued to us to date under the agreement. The research and development period is estimated at the inception of each agreement and is periodically evaluated.

*Milestone Payments.* Fees that are contingent upon achievement of substantive performance milestones at inception of the agreement are recognized based on the achievement of the milestone, as defined in the respective agreements.

We recognize deferred revenue to the extent that cash received under the collaboration agreement is in excess of the revenues recognized related to the agreement since the work under the agreement has not yet been performed at the time of cash receipt.

### ***Development and License Agreement***

Our development and license agreement with Campbell Soup Company, dated December 20, 2007, as amended, was terminated and cancelled on November 19, 2012 following Campbell's sale of its vegetable seed assets to a third party. In connection with the termination, Campbell paid us \$0.55 million of the remaining \$0.63 million due under the agreement, which would otherwise have become payable by Campbell in 2013, in full and complete satisfaction of all remaining financial obligations under the development and license agreement.

### ***Stock-Based Compensation***

We account for stock-based compensation arrangements with employees using fair value methods which require the recognition of compensation expense for costs related to all stock-based payments. The fair value methods require us to estimate the fair value of stock-based payment awards on the date of grant. We use an option pricing model to estimate the fair value of options granted that are expensed on a straight-line basis over the vesting period. The fair value of restricted stock granted to employees is based on the grant date value of the underlying stock. We account for stock options issued to non-employees based on the estimated fair value of the awards using the option pricing

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model. The measurement of stock-based compensation to non-employees is subject to periodic adjustments as the underlying equity instruments vest, and the resulting change in value, if any, is recognized in our consolidated statements of operations during the period the related services are rendered.

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### ***Inventories***

Sweet sorghum seed inventory costs are computed on a first in, first out basis and valued at the lower of cost or market with any excess cost recognized during the period within cost of product sales. At May 31, 2013, seed inventory consisted of work-in-process costs related to sweet sorghum seeds. At August 31, 2012, seed inventory consisted of work in process and finished good costs related to sweet sorghum seeds. Seed inventory costs are computed on a first in, first out basis and valued at the lower of cost or market with any excess cost recognized during the period within cost of product sales. A full valuation reserve has been recorded on all seed products.

### ***Income Taxes***

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. We record a valuation allowance when it is more likely than not that some of our net deferred tax assets will not be realized. In determining the need for valuation allowances, we consider our projected future taxable income and the availability of tax planning strategies. We have recorded a full valuation allowance to reduce our net deferred tax assets to zero because we have determined that it is more likely than not that our net deferred tax assets will not be realized. If in the future we determine that we will be able to realize any of our net deferred tax assets, we will make an adjustment to the allowance, which would increase our income in the period that the determination is made.

We operate in various tax jurisdictions and are subject to audit by various tax authorities. We recognize the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs.

### ***Impairment of Long-Lived Assets***

Long-lived assets, such as property and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Our long-lived assets comprise a single asset group for evaluation purposes. We evaluate whether an impairment indicator occurs primarily based on progress achieved against our business plans. To the extent that an impairment indicator has occurred, recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. For all periods presented herein no resulting impairment charges have been recognized, except as described in the following paragraph.

On February 3, 2012, our plant breeding and field research station located near College Station, Texas was damaged by a tornado. The impact was limited to structural damage to the building that houses office space and a small laboratory used to evaluate biomass samples and work space. A small greenhouse and tractor sheds, and some agricultural equipment were also damaged. In fiscal year 2012, we impaired \$1.0 million in assets related to the damage to our Texas facility and received insurance proceeds of \$1.0 million for repair costs. The remainder of the repairs, which totaled approximately \$0.2 million, were completed by November 30, 2012. These remaining repairs were also covered by insurance, subject to the Company's deductible.

**Table of Contents****Results of Operations**

The following table sets forth our consolidated results of operations for the periods shown (in thousands):

	Three months ended May 31,		Nine months ended May 31,	
	2013	2012	2013	2012
<b>Revenues:</b>				
Product sales	\$ 389	\$ 42	\$ 462	\$ 429
Collaborative research and government grants	966	1,106	3,884	3,778
<b>Total revenues</b>	<b>1,355</b>	<b>1,148</b>	<b>4,346</b>	<b>4,207</b>
<b>Cost and operating expenses:</b>				
Cost of product sales	2,134	627	5,114	1,876
Research and development	4,074	5,255	12,784	15,522
Selling, general and administrative	4,464	3,344	11,700	8,962
<b>Total cost and operating expenses</b>	<b>10,672</b>	<b>9,226</b>	<b>29,598</b>	<b>26,360</b>
Loss from operations	(9,317)	(8,078)	(25,252)	(22,153)
Interest expense	(34)	(341)	(35)	(559)
Interest income	28	3	106	9
Other income (expense)				(84)
Loss before income taxes	(9,323)	(8,416)	(25,181)	(22,787)
Income tax benefit (expense)			(1)	(1)
<b>Net loss</b>	<b>\$ (9,323)</b>	<b>\$ (8,416)</b>	<b>\$ (25,182)</b>	<b>\$ (22,788)</b>

**Comparison of the Three Months Ended May 31, 2013 and 2012***Revenues*

	Three Months Ended May 31,		Change
	2013	2012	
	(In thousands)		
Product sales	\$ 389	\$ 42	\$ 347
Collaborative research and government grants	966	1,106	(140)
<b>Total revenue</b>	<b>\$ 1,355</b>	<b>\$ 1,148</b>	<b>\$ 207</b>

Our total revenues were \$1.4 million for the three months ended May 31, 2013 and \$1.1 million for the three months ended May 31, 2012. Product sales increased by \$0.4 million due to biomass sales as well as recognition of deferred revenue related to certain sales incentive and promotional programs during the 2012-2013 growing season. The increase was partially offset by reduced billings of \$0.1 million under our various grants and collaborations.



**Table of Contents***Cost and Operating Expenses*

	<b>Three Months Ended May 31,</b>		
	<b>2013</b>	<b>2012</b>	<b>Change</b>
	<b>(In thousands)</b>		
Cost of product sales	\$ 2,134	\$ 627	\$ 1,507
Research and development	4,074	5,255	(1,181)
Selling, general and administrative	4,464	3,344	1,120
 Total cost and operating expenses	 \$ 10,672	 \$ 9,226	 \$ 1,446

*Cost of Product Sales*

Our cost of product sales increased to \$2.1 million for the three months ended May 31, 2013 compared to \$0.6 million for the same period in the prior year. The increase was due to expenses of \$1.0 million for crop management services performed under our sales incentive and performance based promotional programs for the 2012-2013 growing season in Brazil and \$0.5 million for obsolete seed inventory relating to our sweet sorghum products.

*Research and Development Expenses*

Our research and development expenses decreased to \$4.1 million for the three months ended May 31, 2013 compared to \$5.3 million for the same period in the prior year. In the U.S., research and development expenses decreased by \$0.9 million due to reduced personnel and related expenses of \$0.7 million, and reduced external research and development expenses of \$0.2 million. In Brazil, research and development expenses decreased by \$0.2 million primarily as a result of reduced personnel and related expenses.

*Selling, General and Administrative Expenses*

Our selling, general and administrative expenses increased by \$1.1 million to \$4.5 million for the three months ended May 31, 2013 compared to the same period in the prior year. In Brazil, our expenses increased by \$1.3 million due to expanded business operations and market development support. Our U.S. general and administrative expenses decreased by \$0.2 million due to reduced patent, legal and professional fees of \$0.6 million, which was partially offset by increased personnel expenses of \$0.4 million.

*Interest Expense, Interest Income and Other Income (Expense)*

	<b>Three Months Ended May 31,</b>		
	<b>2013</b>	<b>2012</b>	<b>Change</b>
	<b>(In thousands)</b>		
Interest expense	\$ (34)	\$ (341)	\$ 307
Interest income	28	3	25
 Total	 \$ (6)	 \$ (338)	 \$ 332

*Interest Expense*

Interest expense decreased by \$0.3 million in the three months ended May 31, 2013 compared to the same period in the prior year. The decrease is attributable to reduced debt balances resulting from our repayment of all debt owed under our Loan Agreement with Silicon Valley Bank in May 2012.



**Table of Contents***Interest Income*

Interest income increased by \$25,000 in the three months ended May 31, 2013 compared to the same period in the prior year. The increase was primarily due to higher average cash invested balances.

**Comparison of the Nine Months Ended May 31, 2013 and 2012***Revenues*

	Nine Months Ended May 31,		Change
	2013	2012	
	(In thousands)		
Product sales	\$ 462	\$ 429	\$ 33
Collaborative research and government grants	3,884	3,778	106
<b>Total revenue</b>	<b>\$ 4,346</b>	<b>\$ 4,207</b>	<b>\$ 139</b>

Our total revenues were \$4.3 million for the nine months ended May 31, 2013 and \$4.2 million for the nine months ended May 31, 2012. Collaborative research and government grant billings increased by \$0.1 million for the comparative periods.

*Cost and Operating Expenses*

	Nine Months Ended May 31,		Change
	2013	2012	
	(In thousands)		
Cost of product sales	\$ 5,114	\$ 1,876	\$ 3,238
Research and development	12,784	15,522	(2,738)
Selling, general and administrative	11,700	8,962	2,738
<b>Total cost and operating expenses</b>	<b>\$ 29,598</b>	<b>\$ 26,360</b>	<b>\$ 3,238</b>

*Cost of Product Sales*

Our cost of product sales increased to \$5.1 million for the nine months ended May 31, 2013 compared to \$1.9 million for the same period in the prior year. The increase was due to expenses of \$1.9 million for obsolete seed inventory relating to our sweet sorghum products, and \$1.6 million for crop management services performed under our sales incentive and performance based promotional programs for the 2012-2013 growing season in Brazil, partially offset by \$0.3 million of reduced overhead expenses.

*Research and Development Expenses*

Our research and development expenses decreased to \$12.8 million for the nine months ended May 31, 2013 compared to \$15.5 million for the same period in the prior year. In the U.S., research and development expenses decreased by \$1.7 million due to reduced personnel and related expenses of \$1.2 million, reduced external research and development expenses of \$0.4 million and reduced licensing fees of \$0.1 million. In Brazil, research and development expenses decreased by \$1.0 million primarily as a result of reduced personnel and related expenses.

*Selling, General and Administrative Expenses*

Our selling, general and administrative expenses increased by \$2.7 million to \$11.7 million for the nine months ended May 31, 2013 compared to the same period in the prior year. The change is attributable to increases in U.S. personnel and related expenses of \$1.6 million, partially

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offset by reduced U.S. patent, legal and professional fees of \$0.7 million. In Brazil expenses were \$1.1 million higher due to an increase in business operations and market development support.

**Table of Contents***Interest Expense, Interest Income and Other Income (Expense)*

	Nine Months Ended May 31,		
	2013	2012	Change
	(In thousands)		
Interest expense	\$ (35)	\$ (599)	\$ 564
Interest income	106	9	97
Other income (expense)		(84)	84
Total	\$ 71	\$ (674)	\$ 745

*Interest Expense*

Interest expense decreased by \$0.6 million for the nine months ended May 31, 2013 compared to the same period in the prior year. The decrease is attributable to reduced debt balances resulting from our repayment of all debt owed under our Loan Agreement with Silicon Valley Bank in May 2012.

*Interest Income*

Interest income increased by \$97,000 for the nine months ended May 31, 2013 compared to the same period in the prior year. The increase was primarily due to higher average cash invested balances.

*Other Income (Expense)*

Other income (expense) decreased by \$0.1 million for the nine months ended May 31, 2013 compared to the same period in the prior year. The decrease was the result of the fair value changes associated with our warrants and Convertible Notes which upon completion of the IPO are no longer marked to market.

**Liquidity and Capital Resources**

Since our inception, we have incurred significant net losses, and, as of May 31, 2013, we had an accumulated deficit of \$267.3 million. We expect to incur additional losses related to the continued development and expansion of our business including research and development, seed production and operations, and sales and marketing. There is also no assurance that profitable operations will be achieved, or if achieved, can be sustained on a continued basis.

We believe that our existing cash and cash equivalents and marketable securities will provide adequate resources to fund our operations, including research and development expenses, planned capital expenditures and working capital requirements for at least the next 12 months. In order to fund our operations beyond that time, we may need to raise additional funds through the issuance of equity, equity-related or debt securities or through obtaining credit from government or financial institutions. We cannot be certain that additional funds will be available to us on favorable terms when required, or at all.

**Cash Flows**

	For the nine months ended May 31	
	2013	2012
	(In thousands)	
Net cash provided by (used in)		
Operating activities	\$ (22,183)	\$ (18,415)
Investing activities	\$ 20,174	\$ 3,166

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Finance activities

\$ (230)      \$ 61,178

Net cash outflows of \$22.2 million from operating activities during the nine months ended May 31, 2013 primarily resulted from our net loss of \$25.2 million, which included non-cash items of \$1.5 million in depreciation expense and \$2.5 million in stock-based compensation expense.

Net cash outflows of \$18.4 million from operating activities during the nine months ended May 31, 2012 primarily resulted from our net loss of \$22.8 million, which included non-cash items, including \$1.6 million in depreciation expense, \$1.3 million in stock-based compensation expense, \$0.1 million for impaired assets, and \$0.1 million in fair value of warrants and Convertible Notes.

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Net cash provided by investing activities of \$20.1 million during the nine months ended May 31, 2013 was due to net marketable securities activity of \$20.8 million, which was partially offset by \$0.7 million used to purchase property and equipment.

Net cash provided by investing activities was \$3.2 million during the nine months ended May 31, 2012, which included \$3.0 million provided by the release of restricted cash and \$1.0 million provided by insurance proceeds related to the tornado damage to our Texas facility, which was offset by \$0.8 million used to purchase property and equipment.

Net cash used by financing activities of \$0.2 million during the nine months ended May 31, 2013 was due to \$0.3 million of payments on capital leases, which was partially offset by \$0.1 million of cash received from the exercise of stock options.

Net cash provided by financing activities of \$61.2 million during the nine months ended May 31, 2012 was due to net IPO proceeds of \$65.2 and \$2.5 million of borrowings under our Loan Agreement with Silicon Valley Bank, which was offset by net principal repayments of approximately \$6.9 million, which represented all amounts due and owing under the Loan Agreement.

## **Off-Balance Sheet Arrangements**

As of May 31, 2013, we had no off-balance sheet arrangements as defined in Item 303(a)(4) of Regulation S-K as promulgated by the SEC.

## **Seasonality**

The sale of seeds is dependent upon planting and growing seasons, which vary from year to year, and are expected to result in both highly seasonal patterns and substantial fluctuations in quarterly sales and profitability. Our product sales for the year ended August 31, 2012 and for the nine months ended May 31, 2013 were minimal and, accordingly, we have not yet experienced the full nature or extent to which our business may be seasonal. We expect that the sale of our seeds in Brazil will typically be higher in our first and second fiscal quarters, due to the timing of the planting decisions made by our customers. As we increase our sales in our current markets, and as we expand into new markets in different geographies, it is possible we may experience different seasonality patterns in our business. Weather conditions and natural disasters, such as heavy rains, hurricanes, hail, floods, tornadoes, freezing conditions, drought or fire, also affect decisions by our customers about the types and amounts of seeds to plant and the timing of harvesting and planting such seeds. Disruptions that cause delays by our customers in harvesting or planting can result in the movement of orders to a future quarter, which would negatively affect the quarter and cause fluctuations in our operating results.

## **Inflation**

We believe that inflation has not had a material impact on our results of operations for the nine months ended May 31, 2013 and 2012, respectively. There can be no assurance that future inflation will not have an adverse impact on our operating results and financial condition.

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### **Item 3. Quantitative and Qualitative Disclosures about Market Risk.**

We are exposed to the effect of interest rate changes, foreign currency fluctuations and changes in commodity prices. We are also exposed to changes in the general economic conditions in the countries where we conduct business, which currently is substantially all in the United States and Brazil.

#### *Interest Rate Risk*

As of May 31, 2013 and August 31, 2012, our exposure to risk for changes in interest rates primarily related to our cash equivalents and marketable securities. We have investments in money market funds, commercial paper and corporate bonds, which all have relatively short term maturities. Accordingly, our interest income fluctuates with short term market conditions. All marketable securities are classified as available for sale and are expected to be liquid. Due to the relatively short-term nature of our investments, we do not believe that there would be a significant negative impact to our consolidated financial position or results of operations as a result of interest rate fluctuations in the financial markets. While we believe our cash equivalents do not contain excessive risk, we cannot provide absolute assurance that in the future our investments will not be subject to adverse changes in market value. In addition, we maintain significant amounts of cash and cash equivalents at one or more financial institutions that are in excess of federally insured limits. We cannot assure you that we will not experience losses on these deposits.

Prior to completion of the IPO, our exposure to risk for changes in interest rates had primarily related to our equipment loans with Silicon Valley Bank, which were variable-rate debt obligations. At August 31, 2012, we had paid off all amounts due and owing under the equipment loans and have limited interest rate risk related to our indebtedness.

#### *Foreign Currency Risk*

We have foreign currency risks related to our operating expenses denominated in currencies other than the U.S. Dollar. Changes in exchange rates between the U.S. Dollar and other currencies will result in increases or decreases in our costs and earnings, and also may affect the book value of our assets outside the United States. To date, most of our contracts have been entered into in the United States and accordingly have been denominated in U.S. Dollars. Going forward we anticipate that our sales will be denominated in the local currency of the country in which the sale occurs. In addition, our operating expenses to date have been denominated in the currencies of the countries in which our operations are located, primarily the United States and Brazil.

Through May 31, 2013, the fluctuations in the Brazil Real for our operations in Brazil had no adverse impact on our results of operations as the U.S. Dollar has been strengthening against the Brazil Real. As our international operations in Brazil grow, our results of operations and cash flows will become increasingly subject to fluctuations due to changes in the foreign currency exchange rates. In periods when the U.S. dollar declines in value as compared to the Brazil Real, our foreign-currency based expenses increase when translated into U.S. dollars. To date, we have not hedged the risks associated with foreign currency exchange exposure. As the risks associated with fluctuations in the Brazil Real become greater, we will continue to reassess our approach to managing this risk.

#### *Commodity Risk*

Our exposure to market risk for changes in commodity prices currently is minimal. As our commercial operations grow, our exposure will relate mostly to the demand side as our customers are highly exposed to fluctuations in prices of sugar and crude oil and somewhat exposed to fluctuations in agricultural commodities, especially soybean. For example, if the price of sugar, which is produced from sugarcane and which cannot be produced from sweet sorghum today, rises significantly relative to the price of ethanol, it may become more profitable for ethanol mill operators to grow sugarcane even in adverse conditions, such as through the expansion of sugarcane fields to marginal land or the extension of the sugarcane harvesting season. During sustained periods of significantly higher sugar prices, demand for our seeds may decrease, which could materially and adversely affect our operating results. We are also indirectly exposed to fluctuations in soft commodities prices like soybean when we negotiate production contracts with seed producers. We currently do not use derivative financial instruments to hedge any price volatility of agricultural commodities.

### **Item 4. Controls and Procedures.**

#### ***(a) Disclosure Controls and Procedures***

We maintain disclosure controls and procedures, as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, that are designed to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and



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forms, and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required financial disclosures.

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We conducted an evaluation, under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rules 13a-15(b) and 15d-15(b) under the Exchange Act. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of May 31, 2013.

***(b) Changes in Internal Control***

No changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the quarterly period ended May 31, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II: OTHER INFORMATION

**Item 1. Legal Proceedings.**

From time to time, we may be involved in litigation relating to claims arising out of our operations. We are not currently a party to any material litigation or other material legal proceedings. We may, however, be involved in material legal proceedings in the future. Such matters are subject to uncertainty and there can be no assurance that such legal proceedings will not have a material adverse effect on our business, results of operations, financial position or cash flows.

**Item 1A. Risk Factors.**

*You should carefully consider the risks and uncertainties set forth in Item 1A, Risk Factors in our Annual Report on Form 10-K filed with the SEC on November 20, 2012, together with all of the other information set forth in this Quarterly Report on Form 10-Q. If any of these risks actually occur, our business, financial condition, results of operations and future prospects could be materially and adversely affected. There have been no material changes to the risks discussed in the Form 10-K.*

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

**(a) Sales of Unregistered Securities**

None.

**(b) Use of Proceeds from Public Offering of Common Stock**

On February 27, 2012, we completed our initial public offering. We sold 5,750,000 shares of common stock at a price to the public of \$13.00 per share, which included the underwriters' exercise in full of their option to purchase 750,000 additional shares. The offer and sale of our common stock in our initial public offering was registered under the Securities Act pursuant to a registration statement on Form S-1 (File No. 333-174405), which was declared effective by the SEC on February 21, 2012. We raised approximately \$65.2 million in net proceeds after deducting underwriting discounts and commissions of \$5.2 million and other offering costs of \$4.9 million. There has been no material change in the planned use of proceeds from our initial public offering as described in our Prospectus dated February 21, 2012 and filed with the Securities and Exchange Commission.

**Item 3. Defaults Upon Senior Securities.**

None.

**Item 4. Mine Safety Disclosures.**

None.

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

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(a) The exhibits in the accompanying Exhibit Index on page E-1 are filed or furnished as part of this Quarterly Report.

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**SIGNATURES**

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

Ceres, Inc.

By:                   /s/ PAUL KUC  
                          Paul Kuc  
                          *Chief Financial Officer*  
                          *(Principal Financial Officer)*

Date: July 11, 2013

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**EXHIBIT INDEX**

<b>Number</b>	<b>Description</b>
10.1	Exclusive Consulting Agreement between Ceres, Inc. and Robert Goldberg, dated June 19, 2013.
31.1	Certification of Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a), of the Securities Exchange Act of 1934, as amended.
31.2	Certification of Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a), of the Securities Exchange Act of 1934, as amended.
<sup>1</sup> 32.1	Certification of Principal Executive Officer and Principal Financial Officer pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. §1350.
#101	Financial statements from the Quarterly Report on Form 10-Q of Ceres, Inc. for the quarterly period ended May 31, 2013, formatted in XBRL: (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Operations (iii) the Condensed Consolidated Statement of Comprehensive Loss, (iv) the Condensed Consolidated Statements of Cash Flows, and (v) the Notes to the Condensed Consolidated Financial Statements.

<sup>1</sup> This certification is furnished herewith and shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

# Pursuant to Rule 406T of Regulation S-T, this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.