Ceres, Inc.
Form 10-Q
April 12, 2012
Table of Contents

# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

**(Mark One)**

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

**For the quarterly period ended February 29, 2012**

**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)**

| | |
|---|---|
| **Delaware** | **33-0727287** |
| **(State or Other Jurisdiction of** | **(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 x

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x 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 x (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 x

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

| **Class** | **Outstanding at March 28, 2012** |
|---|---|
| Common Stock, $0.01 par value per share | 24,453,250 |

Table of Contents

**TABLE OF CONTENTS**

Table of Contents

**PART I: FINANCIAL INFORMATION**

Item 1. Financial Statements

**CERES, INC.**

**Condensed Consolidated Balance Sheets**

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

**(Unaudited)**

| | February 29, 2012 | August 31, 2011 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 79,271 | $ 21,911 |
| Prepaid expenses | 591 | 631 |
| Trade receivables | 880 | 1,292 |
| Other current assets | 1,477 | 3,000 |
| Total current assets | 82,219 | 26,834 |
| Property and equipment, net | 5,256 | 6,780 |
| Restricted cash and investment | 3,000 | 3,000 |
| Other assets | 117 | 183 |
| Total assets | $ 90,592 | $ 36,797 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | $ 7,006 | $ 6,972 |
| Current portion of long-term debt | 2,997 | 2,168 |
| Other current liabilities | 1,169 | 955 |
| Total current liabilities | 11,172 | 10,095 |
| Long-term debt, net of current portion | 2,743 | 2,013 |
| Convertible notes | | 13,630 |
| Common and preferred stock warrant liabilities | | 17,726 |
| Other non-current liabilities | 123 | 149 |
| Contingencies and commitments | | |
| Convertible preferred stock; 50,854,383 shares authorized, 46,059,819 shares issued and outstanding at August 31, 2011; no shares issued and outstanding at February 29, 2012. | | 197,502 |
| Stockholders equity (deficit): | | |
| Preferred stock; $0.01 par value; 10,000,000 shares authorized, no shares issued and outstanding at February 29, 2012 | | |
| Common stock and additional paid-in capital; $0.01 par value; 25,000,000 shares authorized; 2,014,168 shares issued and outstanding at August 31, 2011; 490,000,000 shares authorized; 24,234,573 shares issued and outstanding at February 29, 2012. | 303,668 | 8,372 |
| Accumulated other comprehensive income | (79) | (27) |
| Accumulated deficit | (227,035) | (212,663) |

| | | | | |
|---|---|---|---|---|
| Total stockholders equity (deficit) | | 76,554 | | (204,318) |
| Total liabilities and stockholders equity (deficit) | $ | 90,592 | $ | 36,797 |

See accompanying notes to the unaudited condensed consolidated financial statements.

3

Table of Contents

**CERES, INC.**

**Condensed Consolidated Statements of Operations**

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

**(Unaudited)**

| | Three months ended February 29, 2012 | Three months ended February 28, 2011 | Six months ended February 29, 2012 | Six months ended February 28, 2011 |
|---|---|---|---|---|
| Revenues: | | | | |
| Product sales | $ 111 | $ 7 | $ 387 | $ 9 |
| Collaborative research and government grants | 1,200 | 1,607 | 2,672 | 3,320 |
| Total revenues | 1,311 | 1,614 | 3,059 | 3,329 |
| Cost and operating expenses: | | | | |
| Cost of product sales | 487 | 271 | 1,249 | 1,330 |
| Research and development | 4,991 | 4,348 | 10,267 | 8,641 |
| Selling, general and administrative | 2,813 | 2,200 | 5,618 | 4,339 |
| Total cost and operating expenses | 8,291 | 6,819 | 17,134 | 14,310 |
| Loss from operations | (6,980) | (5,205) | (14,075) | (10,981) |
| Interest expense | (107) | (121) | (218) | (248) |
| Interest income | 2 | 3 | 6 | 34 |
| Other income (expense) | 254 | (86) | (84) | (85) |
| Loss before income taxes | (6,831) | (5,409) | (14,371) | (11,280) |
| Income tax benefit (expense) | | 29 | (1) | (1) |
| Net loss | $ (6,831) | $ (5,380) | $ (14,372) | $ (11,281) |
| Net loss per share: | | | | |
| Basic and diluted | $ (2.48) | $ (2.72) | $ (6.01) | $ (5.74) |
| Shares used in calculation of net loss per share: | | | | |
| Basic and diluted | 2,760,016 | 1,976,345 | 2,389,543 | 1,966,892 |

See accompanying notes to the unaudited condensed consolidated financial statements.

Table of Contents

**CERES, INC.**

**Condensed Consolidated Statements of Cash Flows**

**(In thousands)**

**(Unaudited)**

| | Six months ended February 29, 2012 | Six months ended February 28, 2011 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net loss | $ (14,372) | $ (11,281) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Change in fair value of common and preferred stock warrants and convertible notes | 84 | 85 |
| Net loss on disposal of assets | 48 | |
| Impairment of assets | 1,100 | |
| Depreciation | 1,078 | 1,106 |
| Stock compensation | 1,008 | 595 |
| Changes in operating assets and liabilities: | | |
| Prepaid expenses | 40 | 63 |
| Trade receivables | 412 | 4 |
| Other assets | 1,587 | (100) |
| Accounts payable and accrued expenses | 69 | 182 |
| Other liabilities | 188 | 74 |
| Net cash used in operating activities | (8,758) | (9,272) |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | (702) | (204) |
| Net cash used in investing activities | (702) | (204) |
| Cash flows from financing activities: | | |
| Repayment of debt | (976) | (1,124) |
| Net proceeds from issuance of debt | 2,500 | |
| Proceeds from issuance of common stock | 60 | 34 |
| Proceeds from issuance of common stock in initial public offering, net of underwriters discounts and commission and offering expenses | 65,288 | |
| Net cash provided by (used in) in financing activities | 66,872 | (1,090) |
| Effect of foreign currency translation on cash | (52) | |
| Increase (decrease) in cash and cash equivalents | 57,360 | (10,566) |
| Cash and cash equivalents at beginning of period | 21,911 | 33,055 |
| Cash and cash equivalents at end of period | $ 79,271 | $ 22,489 |
| Supplemental disclosure of cash flow information | | |
| Cash paid during the period for interest | $ 172 | $ 207 |
| Cash paid during the period for income taxes | 1 | 1 |

See accompanying notes to the unaudited condensed consolidated financial statements.

5

Table of Contents

**CERES, INC.**

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

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

**(1) The Company**

Ceres, Inc. (the Company ) is an agricultural biotechnology company selling seeds to produce 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 dedicated energy crops.

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 right 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 $65,288, after deducting underwriting discounts, commissions and estimated 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 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 February 29, 2012 was $227,035. 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 the foreseeable future with cash and investments currently on hand, with cash inflows from collaboration and grant funding and from 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 Prospectus dated February 21, 2012 and filed with the Securities and Exchange Commission ( SEC ).

***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***

In preparing the unaudited condensed consolidated financial statements, management must make 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. Actual results could differ from those estimates.

**CERES, INC.**

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

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

***Unaudited Interim Financial Information***

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.

***Cash Equivalents***

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

***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 Measurements***

The Company applies Financial Accounting Standards Board (FASB) ASC Topic 820, *Fair Value Measurements and Disclosures* to measure the fair value of financial assets and financial liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. The Company applies the provisions of ASC Topic 820 to measure the fair value of nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. ASC Topic 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy 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.

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

The Company utilized an option pricing valuation model to determine the fair value of its outstanding common and convertible preferred stock warrant liabilities. The inputs to the model included fair value of the stock related to the warrant, exercise price of the warrant, expected term, expected volatility, risk-free interest rate and dividend yield. As several significant inputs were not observable, the overall fair value measurement of the warrants were classified as Level 3.

The following table summarizes the Company s common and convertible preferred stock warrant liabilities and convertible notes measured at fair value as of August 31, 2011:

| | | Fair value measurements at reporting date using | | |
|---|---|---|---|---|
| | Total fair value as of August 31, 2011 | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant other unobservable inputs (Level 3) |
| Common stock warrants | $ 17,450 | $ | $ | $ 17,450 |
| Convertible preferred stock warrants | 276 | | | 276 |
| Convertible notes | 13,630 | | | 13,630 |
| Total | $ 31,356 | $ | $ | $ 31,356 |

7

Table of Contents

**CERES, INC.**

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

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

The changes in fair value of the Company s Level 3 warrants and convertible notes from August 31, 2011 through February 29, 2012 were as follows:

| | Common Stock Warrant Liabilities | Preferred Stock Warrant Liabilities | Convertible Notes |
|---|---|---|---|
| Fair value, August 31, 2011 | $ 17,450 | $ 276 | $ 13,630 |
| Fair value adjustments | (516) | (52) | 652 |
| Conversion upon closing of IPO | (16,934) | (224) | (14,282) |
| Fair value, February 29, 2012 | $ | $ | $ |

***Accounts Receivable***

Accounts receivable represents amounts owed to the Company from product sales and collaborative research and government grants. The Company performs ongoing credit evaluation of its customers, does not require collateral, and maintains allowance for potential credit losses on customer accounts when deemed necessary. To date, there have been no such losses and the Company has not recorded an allowance for doubtful accounts.

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

| Customers | As of February 29, 2012 | As of August 31, 2011 |
|---|---|---|
| Customer A | 32.4 | 20.0 |
| Customer B | 12.9 | 21.3 |
| Customer C | 14.0 | 30.4 |
| Customer D | 35.5 | 20.0 |

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

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| Customers | February 29, 2012 | February 28, 2011 | February 29, 2012 | February 28, 2011 |
| Customer A | 29.1 | 17.3 | 23.0 | 19.0 |
| Customer B | 28.5 | 19.3 | 20.7 | 15.2 |
| Customer C | * | 18.3 | 10.6 | 19.5 |
| Customer D | 17.8 | 26.1 | 20.3 | 27.3 |

* Less than 10%

***Seed Inventory***

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. Due to the early stage of commercialization of the Company s seed products and with no established market for these products, a full valuation reserve has been recorded against U.S. seed inventory for all periods presented.

Table of Contents

**CERES, INC.**

**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.

On February 3, 2012, the Company s plant breeding and field research station located near College Station, Texas was damaged by a tornado. The Company believes the impact was limited to structural damage to the building that houses office space, a small laboratory used to evaluate biomass samples and work space, the small greenhouse and tractor sheds, and damage to some agricultural equipment. The cost to construct the damaged buildings was approximately $1,500, and the Company believes the cost to repair the damage will be covered by insurance, subject to the Company s deductible.

At February 29, 2012, the Company impaired $1,100 in assets related to damage at the Texas facility. A receivable of $1,000 has been recorded in other current assets as of February 29, 2012 related to insurance proceeds that have been committed to date. The Company is continuing to assess the damage from this incident, and does not believe it will have a material effect on operations.

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

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.

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 income (expense).

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.

***Convertible Preferred Stock***

In connection with the Company s decision to file a registration statement with the Securities Exchange Commission for an IPO of the Company s common stock, the Company adopted the provisions of ASC Topic 480-10-S99-3A, *Classification and Measurement of Redeemable Securities*.

The convertible preferred stock was not redeemable by the Company or at the option of the preferred stockholders. The holders of the Company s outstanding convertible preferred stock, voting or consenting together as a separate class, controlled the vote of the Company s stockholders. As a result, the holders of all series of the Company s convertible preferred stock could vote to approve a change in control under circumstances that would trigger a deemed liquidation under the Company s certificate of incorporation. As redemption of the convertible preferred stock through a deemed liquidation was outside the control of the Company, all shares of convertible preferred stock were classified as temporary equity rather than as a component of stockholders (deficit) equity in the

**CERES, INC.**

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

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

Company s condensed consolidated balance sheets. The carrying value of convertible preferred stock was recorded at its fair value at the date of issue. All series of convertible preferred stock are collectively referred to in the consolidated financial statements as convertible preferred stock.

As discussed in Note (1), all of the outstanding shares of convertible preferred stock were automatically converted into shares of common stock upon the closing 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 is derived from collaborative research agreements and government grants.

*Product Sales*

Product sales are derived from sales of seeds. 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. Shipping and handling costs charged to customers are recorded as revenues and included in cost of product sales. To date, product sales have not been significant.

*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.

**CERES, INC.**

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

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

***Research and Development***

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

***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 the Federal Republic of Brazil. All tax years from 1997 to present are subject to examination by the United States federal jurisdiction and by a state tax authority.

***Foreign Currency Translation and Comprehensive Loss***

The financial statements of the Company s Brazilian subsidiary use the local currency, the Brazilian Real, as their functional currency. Assets and liabilities of the foreign operations are translated at the rate of exchange at the balance sheet date. Revenues and expenses are translated at the weighted average rate of exchange during the reporting period. Translation gains or losses are included in accumulated other comprehensive loss in the stockholders deficit section of the consolidated balance sheets.

***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.

Table of Contents

**CERES, INC.**

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

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

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

| | Three Months Ended February 29, 2012 | Three Months Ended February 28, 2011 | Six Months Ended February 29, 2012 | Six Months Ended February 28, 2011 |
|---|---|---|---|---|
| Basic and diluted net loss per common share: | | | | |
| Net loss attributable to common stockholders | $ (6,831) | $ (5,380) | $ (14,372) | $ (11,281) |
| Less minimum dividend available to preferred stockholders | | | | |
| Net loss attributable to common stockholders | $ (6,831) | $ (5,380) | $ (14,372) | $ (11,281) |
| Basic and diluted net loss per common share | $ (2.48) | $ (2.72) | $ (6.01) | $ (5.74) |
| Weighted average outstanding common shares used for net loss attributable to common stockholders: | | | | |
| Basic and diluted | 2,760,016 | 1,976,345 | 2,389,543 | 1,966,892 |

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:

| | February 29, 2012 | February 28, 2011 |
|---|---|---|
| Options to purchase common stock | 3,047,625 | 2,397,463 |
| Warrants to purchase common stock | 2,082,045 | 1,994,868 |
| Warrants to purchase convertible preferred stock | | 20,511 |
| Convertible preferred stock | | 15,353,226 |
| Total | 5,129,670 | 19,766,068 |

***Recent Accounting Pronouncements***

In December 2011, the FASB amended ASU 2011-05 *Presentation of Comprehensive Income* which provides two options for presenting the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amendments in this update do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The amendments do not change the option for an entity to present components of other comprehensive income either net of related tax effects or before related tax effects. The amendments do not affect how earnings per share is calculated or presented. The amendments in this update will be applied retrospectively and are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Company expects that, if adopted, this standard will not have a material impact on its consolidated financial statements.

Table of Contents

**CERES, INC.**

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

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

**(3) Property and Equipment**

Property and equipment are summarized as follows:

| | February 29, 2012 | August 31, 2011 |
|---|---|---|
| Land | $ 43 | $ 43 |
| Automobiles and trucks | 321 | 373 |
| Buildings | 2,184 | 3,391 |
| Office, laboratory, farm and warehouse equipment and furniture | 15,999 | 16,346 |
| Leasehold improvements | 5,713 | 5,759 |
| | 24,260 | 25,912 |
| Less accumulated depreciation | (19,004) | (19,132) |
| Property and equipment, net | $ 5,256 | $ 6,780 |

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

Accounts payable and accrued expenses consisted of the following:

| | February 29, 2012 | August 31, 2011 |
|---|---|---|
| Accounts payable | $ 4,192 | $ 3,790 |
| Accrued payroll and related expenses | 1,852 | 1,505 |
| Research and development contracts | 653 | 1,099 |
| Accrued grower commitments | | 90 |
| Other | 309 | 488 |
| | $ 7,006 | $ 6,972 |

**(5) Long-Term Debt**

Long-term debt is summarized as follows:

| | February 29, 2012 | August 31, 2011 |
|---|---|---|
| Equipment Loan | | |
| Tranche 1 matures June 2013, net of discount of $45 | $ 1,155 | $ 1,590 |
| Tranche 2 matures August 2013, net of discount of $61 | 1,939 | 2,586 |

| | | |
|---|---|---|
| Tranche 3 matures March 2015 | 2,500 | |
| | 5,594 | 4,176 |
| Other | 146 | 5 |
| | 5,740 | 4,181 |
| Less current portion | (2,997) | (2,168) |
| | $ 2,743 | $ 2,013 |

***Equipment Loans***

In January 2010, the Company entered into a Loan and Security Agreement (the Loan Agreement) with a commercial bank (the Bank). The Loan Agreement provides 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% (6.75% as of February 29, 2012), which is 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 is being recognized over the term of the equipment loan as interest expense. Upon closing of the Company s IPO, the convertible preferred stock warrants were converted to warrants to purchase common stock (see Note (1)).

Table of Contents

**CERES, INC.**

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

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

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 advance and (ii) a $1,000 term loan advance available upon satisfaction of additional term loan advance conditions. The interest rate for the Amended Loan Agreement is a fixed rate based on the Bank Prime Rate at the time of each loan advance. The Company will pay interest only (4%) until April 2012 and then repay principal plus interest in equal installments over 36 months commencing April 1, 2012. At February 29, 2012 and August 31, 2011, the Company held restricted cash of $3,000 in the form of a deposit related to the Amended Loan Agreement.

The Amended Loan Agreement is secured by certain of the Company s assets, excluding intellectual property, and requires compliance with covenants that require certain reporting and maintenance of certain specified ratios. At February 29, 2012, the Company was in compliance with the Amended Loan Agreement covenants.

The aggregated maturities of debt as of February 29, 2012 are as follows:

| | |
|---|---|
| Remaining six months of fiscal year 2012 | $ 1,453 |
| 2013 | 2,949 |
| 2014 | 850 |
| 2015 | 488 |
| | $ 5,740 |

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

On August 1, 2011, the Company raised $11,425 from nine existing investors in the Company in a private placement by issuing noninterest bearing convertible subordinated notes. The conversion features of these notes were as follows: (i) the Convertible Notes automatically convert into common stock at a 20% discount to the IPO price and (ii) in the event that an IPO was not consummated within six months of the issuance date of the Convertible Notes, the Convertible Notes would convert into shares of Series G convertible preferred stock and the Convertible Note holders would receive common stock warrants. In addition, holders would receive repayment of an amount equal to two times the outstanding principal amount of the Convertible Notes, if prior to the automatic conversion of the Convertible Notes, a change of control transaction is consummated. In January 2012, the Company amended the Convertible Notes such that the notes would automatically convert into shares of Series G convertible preferred stock if the IPO was not consummated by June 30, 2012.

In connection with the issuance of the Convertible Notes, so long as any investors who held existing warrants to purchase shares of our common stock in connection with the original issuances of the Company Series F and G preferred stock purchased at least their respective full pro rata portion of the Convertible Notes being offered, the termination provisions of such investors existing warrants were amended such that those warrants 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 completion of an IPO at a price per share greater than or equal to $19.50 per share (subject to certain adjustments) and resulting in aggregate gross proceeds to the Company and any selling security holders of $40,000 or more.

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.

The Company calculated the fair value of the modified warrants immediately prior to and subsequent to the modification and determined that the cumulative incremental increase in the fair value of these liability classified warrants associated with this modification to be $9,633. Accordingly, the Company recorded the change in value to other expense in August 2011.

Until such time as the conversion features were triggered, the Company accounted for the Convertible Notes and various embedded derivatives in accordance with ASC 825-10, the Fair Value Option for Financial Liabilities, whereby the Company initially and subsequently measured this financial instrument in its entirety at fair value, with the changes in fair value recorded each quarterly reporting period in other income/expense.

**CERES, INC.**

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

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

The Company obtained the assistance of a third-party valuation firm in estimating the fair market value of the Convertible Notes as of August 31, 2011 to be $13,630. The Company estimated the fair value of the Convertible Notes upon the closing of the IPO to be $14,282. Accordingly, the change in fair value was recorded in other income/expense.

Upon closing of the IPO, the Convertible Notes were revalued and converted into shares of common stock (see Note (8)).

**(7) 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, as restated (2000 Plan), the Ceres, Inc. 2010 Stock Option/Stock Issuance Plan (2010 Plan) and the 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 Nonstatutory 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.

The Company has issued restricted stock awards under the Option Plans. Vesting of restricted stock awards is determined at the discretion of the Board of Directors. As of February, 29 2012 and August 31, 2011 there were 833 unvested restricted stock awards outstanding.

The total number of shares reserved for issuance under the Option Plans is 5,254,999. As of February 29, 2012, the Company had 833,530 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.

***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 $11.03 and $4.83 per option share for the three months ended February 29, 2012 and February 28, 2011, respectively, and $11.03 and $4.83 per option share for the six months ended February 29, 2012 and February 28, 2011, respectively.

The weighted average grant date estimated fair value of the Company s common stock was $15.08 and $7.44 per share for the three months ended February 29, 2012 and February 28, 2011, respectively, and $15.08 and $7.44 per share for the six months ended February 29, 2012 and February 28, 2011, respectively.

The fair value of employee stock options was estimated using the following weighted-average assumptions:

| | $0000,000000000 | $0000,000000000 | $0000,000000000 | $0000,000000000 |
|---|---|---|---|---|
| | Three months ended | | Six months ended | |
| | February 29, 2012 | February 28, 2011 | February 29, 2012 | February 28, 2011 |
| Expected term (in years) | 6.46 | 6.25 | 6.46 | 6.25 |
| Expected volatility | 81% | 70% | 81% | 70% |
| Risk free interest rate | 1.35% | 2.26% - 2.44% | 1.35% | 1.48% - 2.44% |

| | | | | |
|---|---|---|---|---|
| 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. The expected term for all employee option grants is an average of 6.26 years.

*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 on the fact that the Company does not yet have a long enough trading history to use for calculating the volatility of the Company s own common stock.

Table of Contents

**CERES, INC.**

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

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

*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 costs included in operating expenses and total intrinsic value of options exercised are as follows:

| | Three months ended | | Six Months Ended | |
|---|---|---|---|---|
| | February 29, 2012 | February 28, 2011 | February 29, 2012 | February 28, 2011 |
| Stock-based compensation costs included in operating expenses | $ 455 | $ 396 | $ 1,008 | $ 595 |
| Intrinsic value of stock options exercised | 135 | 4 | 278 | 178 |

***Stock Option Activity***

The following summarizes the stock option transactions under the Option Plans during the six months ended February 29, 2012:

| | Shares | Weighted Average Exercise Price |
|---|---|---|
| Options outstanding at August 31, 2011 | 2,597,285 | $ 6.06 |
| Options granted | 499,803 | 13.00 |
| Options exercised | (18,610) | 3.15 |
| Options forfeited | (30,853) | 4.58 |
| Options outstanding at February 29, 2012 | 3,047,625 | $ 7.22 |

The following table summarizes information about stock options outstanding and exercisable at February 29, 2012:

| Range of Exercise Price | Number Outstanding and Exercisable | Average Remaining Contractual Life | Weighted-Average Exercise Price | Number Vested and Exercisable | Weighted-Average Exercise Price | Average Remaining Contractual Life |
|---|---|---|---|---|---|---|
| $1.80 to $1.95 | 686,154 | .54 | $ 1.90 | 686,154 | $ 1.90 | .54 |
| $3.90 to $4.05 | 385,985 | 3.99 | 3.90 | 385,985 | 3.90 | 3.99 |
| $6.75 | 953,269 | 6.71 | 6.75 | 727,594 | 6.75 | 6.34 |
| $7.32 | 269,226 | 8.79 | 7.32 | 65,167 | 7.32 | 8.79 |
| $16.77 | 166,661 | 9.27 | 16.77 | 24,217 | 16.77 | 9.25 |
| $17.16 | 86,527 | 9.39 | 17.16 | 10,614 | 17.16 | 9.39 |
| $13.00 | 499,803 | 9.99 | 13.00 | 496 | 13.00 | 9.99 |

| | | |
|---|---|---|
| | 3,047,625 | 1,900,227 |

No tax benefits have been recorded on compensation costs recognized for options exercised. As of February 29, 2012, there was $8,785 of total unrecognized compensation cost related to stock options. That cost is expected to be recognized over a weighted average of 4.40 years. The Company s policy is to issue new shares for options exercised.

**(8) Stockholders Equity**

***Initial Public Offering***

On February 27, 2012, the Company closed its 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 the Company of approximately $65,288, after deducting underwriting discounts, commissions and estimated offering expenses.

Table of Contents

**CERES, INC.**

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

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

Upon closing of the IPO:

- 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 (see Note (6)); 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. The holder of each share of common stock is entitled to one vote.

***Preferred Stock***

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 its 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 (2), 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 valued as of the closing date with changes being recorded to the statement of operations and were reclassified to additional paid in capital.

Upon closing of the IPO, the Company estimated the fair value of certain warrants (Non-Modified F warrants and Modified F warrants) to be $6,301 based on a risk free rate of 0.40%, expected volatility of 89%, expected term of 3.5 years and 0% dividend yield. The fair value of the Non-Modified F warrants at August 31, 2011 was estimated to be $1,229 based on a risk free rate of 0.41%, expected volatility of 86%, expected term of 1.9 years and 0% dividend yield. The estimated fair value of the Modified F warrants at August 31, 2011 was $5,454 based on a risk free rate of 0.96%, expected volatility of 98%, expected term of 4.0 years and 0% dividend yield.

*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.

As discussed in Note (2), 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 valued as of the closing date with changes being recorded to the statement of operations and were reclassified to additional paid in capital.

Upon closing of the IPO, the Company estimated the fair value of these warrants to be $10,633 based on a risk free rate of 1.64%, expected volatility of 73%, expected term of 8.3 years and 0% dividend yield. The fair value of the warrants at August 31, 2011 was estimated to be $10,767 based on a risk free rate of 2.23%, expected volatility of 66%, expected term of 8.8 years and 0% dividend yield.

Table of Contents

**CERES, INC.**

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

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

*Warrants issued in connection with Borrowing and Loan Agreements*

In July 2004, in conjunction with the Borrowing Agreement the Company issued the Bank warrants to purchase 18,461 shares of the Company s Series E Convertible Preferred Stock at a price of $6.50 per share. 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 (5)), the Company issued the Bank warrants to purchase 43,076 shares of the Company s Series F Convertible Preferred Stock at a price of $6.50 per share. 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 (2), the preferred stock warrants issued in connection with the Borrowing and Loan Agreements were reported as a liability at fair value as of each balance sheet date. Upon closing of the IPO, the preferred stock warrants no longer met the requirements for liability classification. The warrants were valued as of the closing date with changes being recorded to the statement of operations and were reclassified to additional paid in capital.

Upon closing of the IPO, the Company estimated the fair value of the Series E and F preferred stock warrants to be $68 and $158, respectively, based on a risk-free interest rate of 1.35%, volatility of 81%, expected term of 7.96 - 8.01 years, and 0% dividend yield.

*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 Agreement) to establish a research program. 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 (see Note (7)). 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 $1,008 as of February 29, 2012 including a modification charge of $450 described below. At February 29, 2012, 66,666 warrants had vested under this arrangement. The fair value of the warrants not yet vested at February 29, 2012 was $545 using a risk-free rate of 0.87% based on the respective exercise periods of each installment, expected volatility of 91%, expected term of 5.22 years based on the respective exercise periods of each installment, and 0% dividend yield.

On June 20, 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. A modification charge of $450 was recorded in June 2011.

*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) (TAMU Agreement) to establish a research program. 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 $492 as of February 29, 2012. The fair value of the warrant at February 29, 2012 was $561, using a risk-free rate of 0.87%, expected volatility of 91%, expected term of 5.49 years and 0% dividend yield. No warrants had vested under this arrangement as of February 29, 2012.

In December 2011, pursuant to the IP Rights Agreement (see Note (11)), 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 $13 as of February 29, 2012. The fair value of the warrant at February 29, 2012 was $756, using a risk-free rate of 1.98%, expected volatility of 65%, expected term of 14.57 years and 0% dividend yield. No warrants had vested under this arrangement as of February 29, 2012.

Table of Contents

**CERES, INC.**

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

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

**(9) 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.

**(10) Commitments and Contingencies**

The Company leases certain of its facilities and equipment under various noncancelable operating leases expiring through 2023. The lease 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 in the accompanying condensed consolidated balance sheets as of February 29, 2012 and August 31, 2011.

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 during each period was $146 and $137 for the three months ended February 29, 2012 and February 28, 2011, respectively and $292 and $241 for the six months ended February 29, 2012 and February 28, 2011.

Future minimum payments under noncancelable operating leases as of February 29, 2012 are as follows:

| | Operating leases |
|---|---|
| Remaining six months of fiscal year 2012 | $ 357 |
| 2013 | 708 |
| 2014 | 455 |
| 2015 | 48 |
| 2016 | 16 |
| Thereafter | 91 |
| Total minimum lease payments | $ 1,675 |

**(11) Research Collaboration Agreements**

The Company has a number of research agreements with academic collaborators, including among others, Texas A&M University, The Samuel Roberts Noble Foundation, Inc. (Noble), and the Institute of Crop Sciences of the Chinese Academy of Agricultural Sciences. In conjunction with these agreements, the Company receives certain exclusive options or licensing rights to technology and intellectual property developed under these agreements. The Company expenses the services received under these agreements to research and development in the period in which the services are rendered. The Company also licenses technology from third parties. Initial payments under these license agreements are 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 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 (7)). Additional projects may be added under the agreement, if agreed to by both parties.

*TAMU Agreement*

In August 2007, the Company entered into a Sponsored Research and Intellectual Property Rights agreement with Texas A&M University 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 (8)).

Table of Contents

**CERES, INC.**

**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 an Amended and Restated Intellectual Property Rights Agreement (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 (7)).

At February 29, 2012, the future minimum payments under the Company s research collaboration agreements are as follows:

| | |
|---|---|
| Remaining six months of fiscal year 2012 | $ 1,458 |
| 2013 | 2,395 |
| 2014 | 2,047 |
| 2015 | 2,487 |
| 2016 and beyond | 3,058 |
| | $ 11,445 |

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 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 . This discussion contains forward-looking statements reflecting our current expectations which are subject to safe harbors under the Securities Act of 1933, as amended, or the Securities Act, and 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, 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 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.*

**Overview**

We are an agricultural biotechnology company selling seeds to produce 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 new crops, known as dedicated energy crops, that we believe address the limitations of first-generation bioenergy feedstocks, such as corn and sugarcane, increase biomass productivity, reduce crop inputs and improve cultivation on marginal land.

Our first large-scale commercial products are proprietary sweet sorghum varieties 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. During 2009, we changed our fiscal year-end to August 31 from December 31 to better match the seasonality of the production and selling cycles related to the seeds and traits business.

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 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. We believe our largest immediate market opportunity is selling sweet sorghum 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.

Table of Contents

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 our quarterly sales and profitability. Our product sales for the year ended August 31, 2011 and the six months ended February 29, 2012 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 any given quarter and cause fluctuations in our operating results.

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 include ethanol mills, utilities, independent power producers, cellulosic biofuel companies, growers, grower cooperatives, equipment manufacturers, enzyme or fermentation technology companies and other support technology providers.

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 will market our seeds and traits directly to ethanol mills, utilities, independent power producers, cellulosic biofuel companies, individual growers and grower cooperatives and to date we have sold our seeds mainly to customers who are testing them in various technologies and environments. We also work with technology providers and other market participants such as equipment manufacturers and enzyme or fermentation technology companies, to encourage the use of our proprietary products. We market our products to biorefineries and biopower facilities, regardless of conversion technology, end-molecule or end-use. In Brazil, where we have completed commercial-scale trials with leading ethanol mills, we have sold enough seed to plant greater than 3,000 hectares of our sweet sorghum hybrids for the 2011-2012 growing season. Harvests of our sweet sorghum hybrids for the 2011-2012 growing season in Brazil began in mid to late March, and are currently ongoing. In the United States and Europe, we have launched the first energy crops seed brand, Blade Energy Crops, under which we market proprietary switchgrass varieties and high biomass sorghum hybrids to the emerging biomass market.

We have invested significantly in research, development and technology and applied our proprietary technology platforms to energy crops. 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

The remainder of our operating expenses are related to selling, general and administrative expenses incurred to establish and build our market presence and business infrastructure as well as seed production costs. For the periods prior to the commencement of sales of our seeds, we expensed our seed production costs as research and development. We began selling seeds in the United States in 2008, and since then, seed production costs have been computed on a first-in, first-out basis and valued at the lower of cost or market and are included as cost of product sales. Due to the early stage of commercialization of our seed products and lack of pricing data, a full valuation reserve has been recorded against our U.S. inventory value. Our sales and marketing expenses have not been significant to date but we expect such expenses to increase as we pursue, enter and expand our market opportunities.

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 through product sales. As of February 29, 2012, we had an accumulated deficit of $227.0 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.

Table of Contents

**Initial Public Offering (IPO)**

On February 27, 2012, the Company closed its 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 the Company of approximately $65.3 million, after deducting underwriting discounts, commissions and estimated 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 Series F and 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 convertible preferred stock converted to warrants to purchase 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 is derived from research collaborations and government grants. As our business continues to grow, we expect product sales will be our primary source of revenue.

***Product Sales***

Product sales are derived from sales of seeds and trait fees. 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, 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 percentage of completion 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.

***Stock-Based Compensation***

Compensation cost for grants of all share-based payments is based on the estimated grant date fair value. We attribute the value of stock-based compensation to expense using the straight-line method. We estimate the fair value of our stock-based payment awards using the Black-Scholes option-pricing model, or the Black-Scholes model. The Black-Scholes model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. The Black-Scholes model requires the input of certain assumptions, including assumptions relating to risk-free interest rate, the expected term and expected volatility which materially affect the fair value estimates. The risk-free interest rate was based on the market yield currently available on United States Treasury securities with maturities approximately equal to the option s expected term. Expected term represents the period that our stock-based awards are expected to be outstanding. The simplified method was used to calculate the expected term. The expected volatility was based on the historical stock volatilities of several comparable publicly-traded companies over a period equal to the expected terms of the options, as we do not have a long enough trading history to estimate the volatility of our own common stock.

***Seed Inventory***

Seed inventory costs are computed on a first-in, first-out basis and valued at the lower of cost or market and are included as cost of product sales. Due to the early stage of commercialization of our seed products and with no U.S. established market for our seed products, a full valuation reserve has been recorded against our U.S. inventory.

***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 not more likely than not that any of our net deferred tax assets will 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

Table of Contents

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.

On February 3, 2012, the Company s plant breeding and field research stations located near College Station, Texas was damaged by a tornado. The Company believes the impact was limited to structural damage to the building that houses office space, a small laboratory used to evaluate biomass samples and work space, the small greenhouse and tractor sheds, and damage to some agricultural equipment. The cost to construct the damaged buildings was approximately $1,500, and the Company believes the cost to repair the damage will be covered by insurance, subject to the Company s deductible. At February 29, 2012 we impaired $1.1 million in assets related to the damage to our Texas facility. We are continuing to assess the damage from this incident, and do not believe it will have a material effect on our operations.

**Results of Operations**

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

| | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | **February 29, 2012** | **February 28, 2011** | **February 29, 2012** | **February 28, 2011** |
| Revenues: | | | | |
| Product sales | $ 111 | $ 7 | $ 387 | $ 9 |
| Collaborative research and government grants | 1,200 | 1,607 | 2,672 | 3,320 |