

CODEXIS INC
Form 10-Q
November 07, 2011
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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 September 30, 2011

OR

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

For the transition period from to

Commission file number: 001-34705

Codexis, Inc.

(Exact name of registrant as specified in its charter)

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Delaware (State or other jurisdiction of incorporation or organization)	71-0872999 (I.R.S. Employer Identification No.)
200 Penobscot Drive, Redwood City (Address of principal executive offices)	94063 (Zip Code)
(650) 421- 8100	

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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. (Check one)

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input checked="" type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>

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

As of October 31, 2011, there were 35,948,053 shares of the registrant's Common Stock, par value \$0.0001 per share, outstanding.

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Codexis, Inc.

Quarterly Report on Form 10-Q

For The Three Months Ended September 30, 2011

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Table of Contents**Codexis, Inc.****Condensed Consolidated Balance Sheets****(Unaudited)****(In Thousands)**

	September 30, 2011	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	\$ 30,132	\$ 72,396
Marketable securities	19,503	
Accounts receivable, net of allowances of \$58 at September 30, 2011 and December 31, 2010, respectively	19,325	15,333
Inventories	5,240	2,817
Prepaid expenses and other current assets	2,837	1,646
Total current assets	77,037	92,192
Restricted cash	1,511	1,466
Non-current marketable securities	21,020	1,650
Property and equipment, net	23,321	21,452
Intangible assets, net	17,372	20,158
Goodwill	3,241	3,241
Other non-current assets	1,120	1,141
Total assets	\$ 144,622	\$ 141,300
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 7,509	\$ 9,208
Accrued compensation	6,165	8,107
Other accrued liabilities	12,100	5,630
Deferred revenues	8,632	4,539
Total current liabilities	34,406	27,484
Deferred revenues, net of current portion	1,871	5,074
Other long-term liabilities	1,870	1,381
Commitments and contingencies		
Stockholders' equity:		
Common stock	4	4
Additional paid-in capital	285,650	275,540
Accumulated other comprehensive income (loss)	223	(34)
Accumulated deficit	(179,402)	(168,149)
Total stockholders' equity	106,475	107,361
Total liabilities and stockholders' equity	\$ 144,622	\$ 141,300

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Revenues:				
Product	\$ 12,199	\$ 9,491	\$ 33,528	\$ 24,250
Collaborative research and development	19,201	17,243	54,073	49,450
Government grants	1,882	379	2,771	3,593
Total revenues	33,282	27,113	90,372	77,293
Costs and operating expenses:				
Cost of product revenues	9,958	8,563	28,713	19,856
Research and development	16,786	13,070	45,502	39,056
Selling, general and administrative	8,871	7,940	27,160	25,192
Total costs and operating expenses	35,615	29,573	101,375	84,104
Loss from operations	(2,333)	(2,460)	(11,003)	(6,811)
Interest income	76	61	195	135
Interest expense and other, net	(411)	(35)	(378)	(1,047)
Loss before provision for income taxes	(2,668)	(2,434)	(11,186)	(7,723)
Provision for income taxes	74	298	68	324
Net loss	\$ (2,742)	\$ (2,732)	\$ (11,254)	\$ (8,047)
Net loss per share of common stock, basic and diluted	\$ (0.08)	\$ (0.08)	\$ (0.32)	\$ (0.38)
Weighted average common shares used in computing net loss per share of common stock, basic and diluted	35,919	34,200	35,576	21,272

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

	Nine Months Ended September 30,	
	2011	2010
Operating activities:		
Net loss	\$ (11,254)	\$ (8,047)
Adjustments to reconcile net loss to net cash used in operating activities:		
Amortization of intangible assets	2,787	402
Depreciation and amortization of property and equipment	5,678	5,298
Revaluation of redeemable convertible preferred stock warrant liability		677
Gain from extinguishment of asset retirement obligation	(124)	
Loss on disposal of property and equipment	31	
Stock-based compensation	7,393	6,466
Accretion of asset retirement obligation	27	
Amortization of debt discount		70
Accretion (amortization) of premium/discount on marketable securities	501	511
Changes in operating assets and liabilities:		
Accounts receivable	(3,991)	(8,132)
Inventories	(2,423)	(331)
Prepaid expenses and other current assets	(844)	(213)
Other assets	20	2,602
Accounts payable	(1,699)	(1,360)
Accrued compensation	(1,942)	(472)
Other accrued liabilities	7,355	(4,247)
Deferred revenues	891	(9,276)
Net provided by (used in) in operating activities	2,406	(16,052)
Investing activities:		
Change in restricted cash	(46)	65
Purchase of property and equipment	(7,813)	(4,740)
Purchase of marketable securities	(50,900)	(49,051)
Proceeds from sale of marketable securities	5,008	1,605
Proceeds from maturities of marketable securities	6,500	70,696
Net provided by (used in) in investing activities	(47,251)	18,575
Financing activities:		
Principal payments on financing obligations		(3,979)
Payments in preparation for initial public offering		(3,870)
Proceeds from issuance of common stock on IPO		72,551
Proceeds from exercises of stock options	2,476	279
Net cash provided by (used in) financing activities	2,476	64,981
Effect of exchange rate changes on cash and cash equivalents	105	(15)
Net increase (decrease) in cash and cash equivalents	(42,264)	67,489
Cash and cash equivalents at the beginning of the period	72,396	31,785
Cash and cash equivalents at the end of the period	\$ 30,132	\$ 99,274

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Reclassification of preferred stock warrant from liability to additional paid-in capital	\$	\$	2,686
Conversion of preferred stock to common stock and additional paid-in capital	\$	\$	179,672

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Codexis, Inc.

Notes to Condensed Consolidated Financial Statements

(UNAUDITED)

1. Description of Business

Codexis, Inc. (us , we or Codexis) is a developer of proprietary biocatalysts, which are enzymes or microbes that initiate or accelerate chemical reactions. We are currently selling our biocatalysts to customers in the pharmaceutical industry and are engaged in a multi-year research and development collaboration with Equilon Enterprises LLC dba Shell Oil Products US (Shell) to develop biocatalysts for use in producing advanced biofuels. We are also pursuing opportunities in the bio-based chemicals market, including developing sustainable detergent alcohol for use in the household products market in collaboration with Chemtex, a wholly owned subsidiary of Italy s Gruppo Mossi & Ghisolfi (M&G). Additionally, we are using our technology platform to pursue biocatalyst-enabled solutions in other bioindustrial markets, including carbon management and water treatment. We were incorporated in Delaware in January 2002.

2. Summary of Significant Accounting Policies

Basis of Presentation and Consolidation

The accompanying interim condensed consolidated balance sheet as of September 30, 2011 and the interim condensed consolidated statements of operations for the three and nine months ended September 30, 2011 and 2010 and cash flows for the nine months ended September 30, 2011 and 2010 are unaudited. These interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and the applicable rules and regulations of the Securities and Exchange Commission (SEC) for interim financial information. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. These interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in our Annual Report on Form 10-K filed with the SEC on February 10, 2011. The December 31, 2010 condensed consolidated balance sheet included herein was derived from the audited financial statements as of that date, but does not include all disclosures including notes required by GAAP for complete financial statements.

The unaudited interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and, in the opinion of management, reflect all adjustments of a normal recurring nature considered necessary to present fairly our financial position as of September 30, 2011 and results of our operations for the three and nine months ended September 30, 2011 and 2010, and cash flows for the nine months ended September 30, 2011 and 2010. The interim results for the three and nine months ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

The unaudited interim condensed consolidated financial statements include the accounts of Codexis and our wholly-owned subsidiaries. We have subsidiaries in United States, Brazil, Germany, Hungary, India, Mauritius, The Netherlands and Singapore. All significant intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and such differences may be material to the condensed consolidated financial statements.

Table of Contents***Foreign Currency Translation***

The assets and liabilities of foreign subsidiaries, where the local currency is the functional currency, are translated from their respective functional currencies into U.S. dollars at the exchange rates in effect at the balance sheet date, with resulting foreign currency translation adjustments recorded in accumulated other comprehensive income (loss) in the condensed consolidated balance sheets. Revenue and expense amounts are translated at average rates during the period. For the nine months ended September 30, 2011 and 2010, we recorded a translation adjustment gain of \$13,000 and loss of \$25,000, respectively. For the three months ended September 30, 2011 and 2010, we recorded a translation adjustment loss of \$31,000 and gain of \$41,000, respectively. Where the U.S. dollar is the functional currency, nonmonetary assets and liabilities originally acquired or assumed in other currencies are recorded in U.S. dollars at the exchange rates in effect at the date they were acquired or assumed. Monetary assets and liabilities denominated in other currencies are translated into U.S. dollars at the exchange rates in effect at the balance sheet date with resulting foreign currency translation amounts recorded as part of interest expenses and other net in the condensed consolidated statements of operations.

Fair Value of Financial Instruments

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

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

Cash, Cash Equivalents and Marketable Securities

We consider all highly liquid investments with maturity dates of three months or less at the date of purchase to be cash equivalents. Cash and cash equivalents consist of cash on deposit with banks and money market funds. The majority of our cash and cash equivalents are maintained with major financial institutions in North America. Deposits with these financial institutions may exceed the amount of insurance provided on such deposits. Marketable securities included in current assets are primarily comprised of commercial paper and corporate bonds. Marketable securities included in non-current assets are primarily comprised of corporate bonds, government-sponsored enterprise securities and U.S. Treasury obligations that have a maturity date greater than 1 year. Our investment in common shares of CO₂ Solution, Inc. (CQSolution) is also included in non-current marketable securities.

Our investments in debt and equity securities are classified as available-for-sale and are carried at estimated fair value. Unrealized gains and losses are reported as a component of accumulated other comprehensive income (loss). Amortization of purchase premiums and accretion of purchase discounts, realized gains and losses of debt securities and declines in value deemed to be other than temporary, if any, are included in interest income or interest expense and other, net. The cost of securities sold is based on the specific-identification method. There were no significant realized gains or losses from sales of marketable securities during the three months and nine months ended September 30, 2011 and 2010. At September 30, 2011, we did not have any other than temporary declines in the fair value of our marketable securities.

Restricted Cash

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

Revenue Recognition

In October 2009, the Financial Accounting Standards Board (FASB) amended the accounting standards for multiple-element revenue arrangements (ASU 2009-13) to:

provide updated guidance on whether multiple deliverables exist, how the elements in an arrangement should be separated, and how the consideration should be allocated;

require an entity to allocate revenue in an arrangement using estimated selling prices (ESP) of each element if a vendor does not have vendor-specific objective evidence of selling price (VSOE) or third-party evidence of selling price (TPE); and

eliminate the use of the residual method and require a vendor to allocate revenue using the relative selling price method.

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In April 2010, the FASB amended the accounting standards for revenue recognition related to milestones (ASU 2010-17) to:

provide updated guidance on accounting for revenue using the milestone method, clarifying that the milestone method is a valid application of the proportional performance model when applied to research or development arrangements. We already applied a milestone method approach to its research or development arrangements, established the milestone method and provided guidance to the substantive nature of the milestone.

We adopted the above accounting guidance on January 1, 2011, for applicable arrangements entered into or materially modified after January 1, 2011 (the beginning of our fiscal year). We have determined that adoption of this new guidance did not have a material impact on our results of operations, cash flows or financial position. The potential future impact of the adoption of the ASU 2009-13 guidance will depend on the nature of any new arrangements or material modifications of existing arrangements that are entered into in the future.

Our primary sources of revenues consist of collaborative research and development agreements, product revenues and government grants. Collaborative research and development agreements typically provide us with multiple revenue streams, including up-front fees for licensing, exclusivity and technology access, fees for full-time employee equivalent (FTE) services and the potential to earn milestone payments upon achievement of contractual criteria and royalty fees based on future product sales or cost savings by our customers. Our collaborative research and development revenues consist of revenues from related parties and revenues from other customers with collaborative research and development agreements.

For each source of collaborative research and development revenues, product revenues and grant revenues, we apply the following revenue recognition criteria:

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

Revenues related to FTE services are recognized as research services are performed over the related performance periods for each contract. We are required to perform research and development activities as specified in each respective agreement. The payments received are not refundable and are based on a contractual reimbursement rate per FTE working on the project. When up-front payments are combined with FTE services in a single unit of accounting, we recognize the up-front payments using the proportionate performance method of revenue recognition based upon the actual amount of research and development labor hours incurred relative to the amount of the total expected labor hours to be incurred by us, up to the amount of cash received. In cases where the planned levels of research services fluctuate substantially over the research term, we are required to make estimates of the total hours required to perform our obligations. Research and development expenses related to FTE services under the collaborative research and development agreements approximate the research funding over the term of the respective agreements.

A payment that is contingent upon the achievement of a substantive milestone is recognized in its entirety in the period in which the milestone is achieved. A milestone is an event (i) that can only be achieved based in whole or in part on either our performance or on the occurrence of a specific outcome resulting from our performance, (ii) for which there is substantive uncertainty at the date the arrangement is entered into that the event will be achieved and (iii) results in additional payments being due to us. Milestones are considered substantive when the consideration earned from the achievement of the milestone (i) is commensurate with either our performance to achieve the milestone or the enhancement of value of the item delivered as a result of a specific outcome resulting from our performance; (ii) relates solely to past performance and (iii) is reasonable relative to all deliverable and payment terms in the arrangement.

Other payments received for which such payments are contingent solely upon the passage of time or the result of a collaborative partner's performance are recognized as revenue when earned in accordance with the contract terms and when such payments can be reasonably estimated and collectability is reasonably assured.

We recognize revenues from royalties based on licensees' sales of products using our technologies. Royalties are recognized as earned in accordance with the contract terms when royalties from licensees can be reasonably estimated and collectability is reasonably assured.

Product revenues are recognized once passage of title and risk of loss has occurred and contractually specified acceptance criteria have been met, provided all other revenue recognition criteria have also been met. Product revenues consist of sales of biocatalysts, intermediates, active pharmaceutical ingredients and Codex Biocatalyst Panels and Kits. Cost of product revenues includes both internal and third party fixed and variable costs including amortization of purchased technology, materials and supplies, labor, facilities and other overhead costs associated with our product revenues.

We license mutually agreed upon third party technology for use in our research and development collaboration with Shell. We record the license payments to research and development expense and offset related reimbursements received from Shell. These payments made by Shell to us are direct reimbursements of our costs. We account for these direct reimbursable costs as a net amount, whereby no expense or revenue is recorded for the costs reimbursed by Shell. For any payments not reimbursed by Shell, we will recognize these as expenses in the statement of operations. We elected to present the reimbursement from Shell as a component of our research and development expense since presenting the receipt of payment from Shell as revenues does not reflect the substance of the arrangement.

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We receive payments from government entities in the form of government grants. Government grants are agreements that generally provide us with 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 we have only perfunctory obligations outstanding.

Shipping and handling costs charged to customers are recorded as revenues. Shipping costs are included in our cost of product revenues. Such charges were not significant in any of the periods presented.

Income Taxes

We use the liability method of accounting for income taxes. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets are recognized for deductible temporary differences, along with net operating loss (NOL) carryforwards, if it is more likely than not that the tax benefits will be realized. To the extent a deferred tax asset cannot be recognized under the preceding criteria, a valuation allowance is established. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled.

We recognize the financial statement effects of an uncertain tax position when it is more likely than not, based on the technical merits, that the position will be sustained upon examination.

Stock-Based Compensation

We account for stock-based transactions based on the fair value of the stock awards granted. We use the straight-line method to allocate stock-based compensation expense to the appropriate reporting periods. We account for stock options issued to non-employees based on their estimated fair value determined using the Black-Scholes option-pricing model. The fair value of the options granted to non-employees is remeasured as they vest, and the resulting change in value, if any, is recognized as an increase or decrease in stock compensation expense during the period the related services are rendered.

Comprehensive Loss

Comprehensive loss consists of net loss, unrealized gain (loss) on marketable securities and foreign currency translation adjustments. The following table presents comprehensive loss (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net loss	\$ (2,742)	\$ (2,732)	\$ (11,254)	\$ (8,047)
Currency translation adjustments	(31)	41	13	(25)
Unrealized gain (loss) on marketable securities	(161)	(225)	244	229
Comprehensive loss	\$ (2,934)	\$ (2,916)	\$ (10,997)	\$ (7,843)

Table of Contents**Net Loss per Share of Common Stock**

Basic and diluted net loss per share of common stock is computed by dividing the net loss by the weighted average number of shares of common stock outstanding during the period, less the weighted-average number of shares common stock that remain subject to our right to repurchase. Basic and diluted net loss per share of common stock was the same for each period presented, because inclusion of all potential common shares outstanding was anti-dilutive. The following table presents the calculation of basic and diluted net loss per share of common stock (in thousands, except per share amounts):

The following table presents the securities not included in the net loss per share calculations for the three and nine months ended September 30, 2011 and 2010 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
<i>Numerator:</i>				
Net loss	\$ (2,742)	\$ (2,732)	\$ (11,254)	\$ (8,047)
<i>Denominator:</i>				
Weighted-average shares of common stock outstanding	35,919	34,202	35,576	21,276
Less: Weighted-average shares of common stock subject to repurchase		(2)		(4)
Weighted-average shares of common stock used in computing net loss per share of common stock, basic and diluted	35,919	34,200	35,576	21,272
Net loss per share of common stock, basic and diluted	\$ (0.08)	\$ (0.08)	\$ (0.32)	\$ (0.38)

The following table presents the equity instruments excluded from the EPS calculations (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Common stock subject to repurchase		2		2
Options to purchase common stock	8,079	8,516	8,079	8,516
Unvested restricted stock units	561		561	
Warrants to purchase common stock	266	297	266	297
Total	8,906	8,815	8,906	8,815

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Certain amounts in prior period financial statements including the related party collaboration revenue (see Note 3), related party receivable, related party deferred revenue, our investment in CO₂ Solution (See Note 4), asset retirement obligation (see Note 8) and the composition of our deferred tax assets have been reclassified to conform to the current period presentation.

3. Collaborative Research and Development Agreements***Shell***

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

In November 2007, we entered into a new and expanded five-year collaborative research agreement and a license agreement with Shell. In connection with the new and expanded collaborative research agreement and license agreement, Shell paid us a \$20.0 million up-front exclusivity fee, purchased Series E redeemable convertible preferred stock for gross proceeds of \$30.5 million, and agreed to pay us (1) research funding at specified rates per FTE working on the project during the research term, (2) milestone payments upon the achievement of milestones and (3) royalties on future product sales.

In March 2009, we amended our collaborative research agreement and license agreement with Shell. In connection with these amendments Shell purchased Series F redeemable convertible preferred stock for gross proceeds of \$30.0 million and agreed to pay us (1) additional research funding at specified rates per FTE working on the project during the research term and (2) additional milestone payments upon the achievement of milestones. Shell has the right to reduce the number of funded FTEs, subject to certain limitations, with a required advance notice period ranging from 30 to 270 days and a subsequent period ranging from 90 to 360 days during which notices of further FTE reductions cannot be made by Shell. The length of these periods varies dependent on the number of funded FTEs reduced. Effective August 2011, Shell reduced the number of funded FTEs engaged in our research and development collaboration by 12 from 128 to 116 FTEs.

In accordance with our revenue recognition policy, the \$20.0 million up-front exclusivity fee and the research funding fees to be received for FTE services are recognized in proportion to the actual research efforts incurred relative to the amount of total expected effort to be incurred by us over the five-year research period commencing November 2007. Milestones payments to be earned under this agreement have been determined to be at risk at the inception of the arrangement and substantive and are expected to be recognized upon achievement of the applicable milestone and when collectability of such payment is reasonably assured. We recorded \$3.1 million and \$1.5 million of milestone revenues during the three months ended September 30, 2011 and 2010, respectively. We recorded milestone revenues of \$3.1 million and \$2.9 million during the nine months ended September 30, 2011 and 2010, respectively.

For the three months ended September 30, 2011 and 2010, our collaborative research and development revenue from Shell was \$17.3 million and \$16.2 million, respectively. For the nine months September 30, 2011 and 2010, our collaborative research and development revenues from Shell was \$47.0 million and \$46.9 million, respectively.

Under the agreements with Shell, we have the right to license technology from third parties that will assist us in meeting objectives under the collaboration. If third-party technology to be licensed is identified and mutually agreed upon by both parties, Shell is obligated to reimburse us for the licensing costs of the technology. Payments made by us to the third-party providers were recorded as research and development expenses related to our collaborative research agreement with Shell. None of the acquired licenses are expected to be used in products that will be sold within the next year and the phase of the project has not reached technological feasibility. Shell reimbursed us for \$51,000 and \$1.1 million of licensing costs during the three months ended September 30, 2011 and 2010, respectively. Shell reimbursed us for licensing costs of \$116,000 and \$1.3 million for the nine months ended September 30, 2011 and 2010, respectively. We record these reimbursements against the costs incurred.

In June 2011, Shell completed the transfer of all of its equity interests in us, together with the associated right to appoint one member to our board of directors, to Raízen Energia Participações S.A., (Raízen) Shell's joint venture with Cosan S.A. in Brazil. At the time of transfer, Raízen became our largest stockholder by owning approximately 5.6 million shares. Notwithstanding the above, Shell did not transfer our collaborative research agreement to Raízen and we continue to collaborate with Shell. Additionally in September 2011, we entered into a joint development agreement directly with Raízen. Under the agreement, we will deploy our CodeEvolver directed evolution technology platform to develop an improved first generation ethanol process for producing ethanol made from sugar.

Table of Contents**Manufacturing Collaboration****Arch**

Since October 2005, we have partnered with Arch Pharmed Labs, Ltd. (Arch), a company based in India engaged in the manufacturing and sale of active pharmaceutical ingredients (APIs), and intermediaries to pharmaceutical companies worldwide.

In February 2010, we consolidated certain of the contractual terms in our agreements with Arch by simultaneously terminating all of our existing agreements with Arch, other than the Master Services Agreement with Arch entered into as of August 1, 2006, and entering into new agreements with Arch. The new agreements, among other things, provide for biocatalyst supply from us to Arch and intermediate supply from Arch to us. We sell the biocatalysts to Arch at an agreed upon price, and Arch manufactures the intermediates on our behalf. Arch sells the intermediates to us at a formula-based or agreed upon price. We then directly market and sell the intermediates to a specified group of customers in the generic pharmaceutical industry. Under the new agreements, Arch may also sell intermediates directly to other customers, and a license royalty is owed by Arch to us based on the volume of product they sell to us and their other customers. Royalties earned from Arch under this arrangement were \$230,000 and \$124,000 for the three months ended September 30, 2011 and 2010, respectively and \$550,000 and \$286,000 for the nine months ended September 30, 2011 and 2010, respectively.

4. Joint Development Agreement with CO₂ Solution

On December 15, 2009, we entered into an exclusive joint development agreement with CO₂ Solution, a company based in Quebec City, Quebec, Canada, whose shares are publicly traded in Canada on the TSX Venture Exchange. Under the agreement, we obtained a research license to CO₂ Solution's intellectual property and agreed to conduct research and development activities jointly with CO₂ Solution with the goal of advancing the development of carbon capture technology. We also purchased 10,000,000 common shares (approximately 16.6% of total common shares outstanding) of CO₂ Solution in a private placement subject to a four-month statutory resale restriction, which expired on April 15, 2010. In February of 2010, our Chief Executive Officer was appointed to the board of directors of CO₂ Solution.

The original joint development agreement with CO₂ Solution expired in January 2011, and at that time, we extended our joint development agreement with CO₂ Solution on essentially the same terms as the original agreement. The extended agreement will now expire on the later of September 30, 2012 or six months after the expiration of any third party collaborations.

We concluded that through September 30, 2011, we did not have the ability to exercise significant influence over CO₂ Solution's operating and financial policies. We consider our investment in CO₂ Solution common shares as an investment in a marketable security that is available for sale, and carry it at fair value in non-current marketable securities, with changes in fair value recognized in accumulated other comprehensive income (loss). We have estimated the fair value of common shares using the fair value as of September 30, 2011, as determined by trading on the TSX Venture Exchange. Accordingly, we have classified our investment in CO₂ Solution as a level 1 investment as discussed in Note 6.

At December 31, 2010, the estimated fair value of our investment in CO₂ Solution common stock was \$1.7 million and the unrealized gain was \$334,000. At September 30, 2011, the estimated fair value of our investment in CO₂ Solution common stock was \$2.0 million and the unrealized gain of \$0.7 million with a related tax expense of \$0.3 million recorded in accumulated other comprehensive income (loss). The unrealized loss for the three months ended September 30, 2011 was \$0.1 million with a related tax benefit of \$27,000 and was recorded in accumulated other comprehensive income (loss) on the condensed consolidated balance sheet.

5. Balance Sheets and Statements of Operations Details

Cash Equivalents and Marketable Securities At September 30, 2011, cash equivalents and marketable securities consisted of the following (in thousands):

	Cost or Amortized Cost	September 30, 2011		Estimated Fair Value	Average Contractual Maturities (in days)
		Gross Unrealized Gains	Gross Unrealized Losses		
Money market funds	\$ 23,889	\$	\$	\$ 23,889	n/a
Commercial paper	3,997			3,997	103

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Corporate bonds	30,563	11	(74)	30,500	352
U.S. Treasury obligations	998	4		1,002	366
Government-sponsored enterprise securities	3,004	12	(1)	3,015	313
Common shares of CO ₂ Solution	1,316	694		2,010	n/a
Total	\$ 63,767	\$ 721	\$ (75)	\$ 64,413	

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The total cash and cash equivalents balance of \$30.1 million as of September 30, 2011 was comprised of money market funds of \$23.9 million and \$6.2 million held as cash with major financial institutions worldwide.

At December 31, 2010, cash equivalents and marketable securities consisted of the following (in thousands):

	Cost or Amortized Cost	December 31, 2010		Estimated Fair Value	Average Contractual Maturities (in days)
		Gross Unrealized Gains	Gross Unrealized Losses		
Money market funds	\$ 64,956	\$	\$	\$ 64,956	n/a
Common shares of CO ₂ Solution	1,316	334		1,650	n/a
Total	\$ 66,272	\$ 334	\$	\$ 66,606	

Inventories

Inventories consisted of the following (in thousands):

	September 30, 2011	December 31, 2010
Raw materials	\$ 3,095	\$ 1,963
Work in process	149	38
Finished goods	1,996	816
Total inventories	\$ 5,240	\$ 2,817

Property and Equipment, net

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

	September 30, 2011	December 31, 2010
Laboratory equipment	\$ 33,354	\$ 29,931
Leasehold improvements	12,859	10,961
Computer equipment and software	4,170	3,050
Office equipment and furniture	947	865
Construction in progress (1)	1,766	838
	53,096	45,645
Less: accumulated depreciation and amortization	(29,775)	(24,193)
Property and equipment, net	\$ 23,321	\$ 21,452

(1) Construction in progress includes equipment received but not yet placed into service pending installation.

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Due to the extension of the lease period for certain currently occupied facilities, we re-evaluated the depreciable lives of existing leasehold improvements, totaling \$2.3 million in net book value at the time of reassessment in February 2011. Since leasehold improvements are typically depreciated over the lesser of the assets' useful life or the remaining lease period, the extension of contracted facilities leases through 2020 necessitated a change in our estimate of depreciable lives on leasehold improvements. While some lives have been shortened under this reassessment with the vacating of a portion of our facilities, the majority of depreciable lives have been extended up to as much as 5 years from the assets' in service date, in accordance with our leasehold improvements' standard useful lives. The net effect of this reassessment is lower monthly depreciation being recognized on leasehold improvements over a longer period of time. These changes' net effect on depreciation expense recognized is not expected to be material on a quarterly or annual basis.

Intangible Assets

Intangible assets consisted of the following (in thousands):

	September 30, 2011			December 31, 2010		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer relationships	\$ 3,098	\$ (3,016)	\$ 82	\$ 3,098	\$ (2,943)	\$ 155
Developed and core technology	1,534	(1,395)	139	1,534	(1,212)	322
Noncompete agreements	90	(90)		90	(90)	
Intellectual property	20,244	(3,093)	17,151	20,244	(563)	19,681
	\$ 24,966	\$ (7,594)	\$ 17,372	\$ 24,966	\$ (4,808)	\$ 20,158

Amortization expense for intangible assets totaled \$2.8 million and \$366,000 for the nine months ended September 30, 2011 and 2010, respectively. Amortization expense for intangible assets totaled \$928,000 and \$88,000 for the three months ended September 30, 2011 and 2010, respectively.

6. Fair Value

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

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

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

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

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The following table presents our financial instruments that were measured at fair value on a recurring basis at September 30, 2011 by level within the fair value hierarchy (in thousands):

	September 30, 2011			Total
	Level 1	Level 2	Level 3	
Financial Assets				
Money market funds	\$ 23,889	\$	\$	\$ 23,889
Commercial paper		3,997		3,997
Corporate bonds		30,500		30,500
U.S. Treasury obligations		1,002		1,002
Government-sponsored enterprise securities		3,015		3,015
Common shares of CO ₂ Solution	2,010			2,010
Total	\$ 25,899	\$ 38,514	\$	\$ 64,413

The following table presents our financial instruments that were measured at fair value on a recurring basis at December 31, 2010 by level within the fair value hierarchy (in thousands):

	December 31, 2010			Total
	Level 1	Level 2	Level 3	
Financial Assets				
Money market funds	\$ 64,956	\$	\$	\$ 64,956
Common shares of CO ₂ Solution	1,650			1,650
Total	\$ 66,606	\$	\$	\$ 66,606

7. Related Party Transactions**Shell and Raízen**

Prior to June, 2011 Shell was our largest shareholder and transactions between us and Shell were considered related party transactions. As discussed in Note 3, Collaborative Research and Development Agreements, Shell transferred full ownership of our common stock to Raízen, Shell's joint venture with Cosan S.A. in Brazil. Based on our analysis and effective, as of July 1, 2011, Shell is no longer considered a related party. Before June 30, 2011, related party receivables, related party deferred revenue, and related party collaboration research and development revenue were primarily comprised of transactions under our five-year collaborative research agreement and a license agreement with Shell. These agreements expire in 2012. The revenues earned from Shell are included in the collaborative research and development on our statement of operations. Collaborative research and development revenue received from Shell accounted for 52% and 61% of our revenues for the nine months ended September 30, 2011 and 2010, respectively.

At the time of the transfer, Raízen became our largest shareholder with approximately 5.6 million shares of our common stock with rights to appoint a member to our board of directors. In September 2011, we entered into a joint development agreement directly with Raízen to deploy our CodeEvolver directed evolution technology platform to develop an improved first generation ethanol process for producing ethanol made from sugar. There has been no material financial activity under this agreement thru September 30, 2011.

Exela PharmaSci, Inc.

We signed a license agreement with Exela PharmaSci, Inc. (Exela) in 2007. A member of our board of directors is also on the board of directors of Exela. Under the terms of the agreement, Exela would pay us a royalty based on their achievement of certain commercial goals.

During the three and nine months ended September 30, 2011, we recognized \$120,000 and \$450,000, respectively of revenue related to this arrangement, shown in our condensed consolidated statement of operations as collaborative research and development revenue. We did not

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recognize any revenue from Exela prior to 2011. As of September 30, 2011, we have no amounts owed from Exela.

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Our headquarters are located in Redwood City, California where we occupy approximately 91,000 square feet of office and laboratory space in four buildings. On March 16, 2011, we entered into a Fifth Amendment to Lease (the *Fifth Amendment*) with Metropolitan Life Insurance Company (*MetLife*) with respect to our offices located at 200 and 220 Penobscot Drive, Redwood City, California, (the *Penobscot Space*), 400 Penobscot Drive, Redwood City, California (the *Building 2 Space*) and 640 Galveston Drive, Redwood City, California (the *Galveston Space*), and with respect to approximately 29,921 square feet of additional space located at 101 Saginaw Drive, Redwood City, California (the *Saginaw Space*). Under the Fifth Amendment, the term of the lease of the Penobscot Space, the Building 2 Space and the Saginaw Space lasts until January 31, 2020, with options to extend for two additional five year periods. The Fifth Amendment provides a number of incentives to us including forgiveness of rent payments for the initial two months of the lease term, a tenant improvement allowance (*TIA*) of \$2.4 million and additional special allowances for certain HVAC costs. We intend to apply TIA funds toward capital improvements to the expanded facility as well as upgrades and re-configuration of existing lab and office space. A portion of the TIA may be utilized by us to pay costs for furniture, furnishings and equipment. As of September 30, 2011 we have spent \$1.9 million on capital improvements related to the facilities. During October, 2011 we requested \$1.8 million of reimbursements from the landlord out of the TIA for the completed construction. The TIA will be recognized when cash is received and on a straight-line basis over the term of the lease as a reduction in rent expense. Additionally, the Fifth Amendment waived our existing asset retirement obligations for the impacted buildings, resulting in a \$0.3 million decrease in our obligation and a \$0.1 million gain on extinguishment of asset retirement obligations recorded in our condensed consolidated statement of operation as sales, general and administrative expenses.

The lease of the Galveston Space on this property was not extended with the Fifth Amendment and will expire as per the original agreement in January 2013, with an option for an additional term of up to two years.

Rent payments under the Fifth Amendment will increase at an annual rate of approximately 3%, with rent expense recognized on a straight-line basis over the term of the lease. In accordance with the terms of the lease, we exercised our right to deliver a letter of credit in lieu of a security deposit. This letter of credit increased from \$562,000 as of December 31, 2010 to \$707,000 as of September 30, 2011 and is recorded as restricted cash on the consolidated balance sheets.

We also rent facilities in Singapore and Hungary. Rent expense is being recognized on a straight-line basis over the respective terms of these leases.

Future minimum payments under non-cancellable operating leases at September 30, 2011 are as follows (in thousands):

	Operating leases
Three months ending December 31, 2011:	\$ 783
Years ending December 31, 2012:	3,268
2013	2,909
2014	2,731
2015	2,808
2016 and beyond	11,259
Total minimum payments	\$ 23,758

Litigation

We have been subject to various legal proceedings related to matters that have arisen during the ordinary course of business. Although there can be no assurance as to the ultimate disposition of these matters, we have determined, based upon the information available, that the expected outcome of these matters, individually or in the aggregate, will not have a material adverse effect on our consolidated financial position, results of operations or cash flows.

Indemnifications

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We are required to recognize a liability for the fair value of any obligations we assume upon the issuance of a guarantee. We have certain agreements with licensors, licensees and collaborators that contain indemnification provisions. In such provisions, we typically agree to

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indemnify the licensor, licensee and collaborator against certain types of third party claims. The maximum amount of the indemnifications is not limited. We accrue for known indemnification issues when a loss is probable and can be reasonably estimated. There were no accruals for expenses related to indemnification issues for any periods presented.

Other contingencies

In November 2009, one of our foreign subsidiaries sold intellectual property to us. Under the local laws of the subsidiary, the sale of intellectual property to a nonresident legal entity is deemed an export and is not subject to value added tax. However, there is uncertainty regarding whether the items sold represented intellectual property or research and development services, which would subject the sale to value added tax. We believe that the uncertainty results in an exposure to pay value added tax that is more than remote but less than likely to occur and, accordingly, have not recorded an accrual for this exposure. Should the sale be deemed a sale of research and development services, we could be obligated to pay an estimated amount of \$0.6 million.

9. Warrants

No warrants were exercised during the nine months ended September 30, 2011. At September 30, 2011, the following common stock warrants were issued and outstanding:

Issue Date	September 30, 2011		Expiration
	Shares Subject to Warrants	Exercise Price per Share	
October 25, 2005	6,066	\$ 1.05	October 25, 2012
May 25, 2006	184,895	\$ 5.96	May 25, 2013
July 17, 2007	2,384	\$ 12.45	February 9, 2016
September 28, 2007	72,727	\$ 8.25	September 28, 2017

10. Stockholders Deficit

In 2002, we adopted the 2002 Stock Plan (the 2002 Plan), under which our board of directors may issue incentive stock options, non-statutory stock options (options that do not qualify as incentive stock options) and restricted stock to our employees, officers, directors or consultants. In March, 2010, our board of directors and stockholders approved the 2010 Equity Incentive Award Plan (the 2010 Plan), which became effective upon the completion of our IPO in April 2010. A total of 1,100,000 shares of common stock were initially reserved for future issuance under the 2010 Plan and any shares of common stock reserved for future grant or issuance under our 2002 Plan that remained unissued at the time of completion of the IPO became available for future grant or issuance under the 2010 Plan. In addition, the shares reserved for issuance pursuant to the exercise of any outstanding awards under the 2002 Plan that expire unexercised will also become available for future issuance under the 2010 Plan. The 2010 Plan also provides for automatic annual increases in the number of shares reserved for future issuance, and during the nine months ended September 30, 2011 an additional 1,393,142 shares were reserved under the 2010 plan as a result of this provision. As of September 30, 2011, we had a total of 9,961,440 shares of common stock reserved for issuance under our 2010 Plan and no shares available for issuance under the 2002 Plan.

We granted 18,468 and 578,267 restricted stock units (RSU) during the three and nine months ended September 30, 2011. The RSUs vest over four years with 25% of the RSUs vesting on each annual anniversary. The fair value of the RSUs was calculated based on the NASDAQ quoted stock price on the date of the grant with the expense recognized over the vesting period. For the three and nine months ended September 30, 2011, we recorded \$321,000 and \$818,000, respectively of stock compensation expense related to the RSUs.

During the three and nine months ended September 30, 2011, we issued 76,902 and 1,119,487 common shares for stock options exercised, respectively.

Stock-Based Compensation Expense

We estimate the fair value of stock-based awards granted to employees and directors using the Black-Scholes option-pricing model. The Black-Scholes option-pricing model requires the use of highly subjective and complex assumptions to determine the fair value of stock-based awards, including the expected life of the option and expected volatility of the underlying stock over the expected life of the related grants. Since we were not a publically traded entity prior to April 2010, company-specific historical volatility data is not available. As a result, we estimate the expected volatility based on the historical volatility of a group of unrelated public companies within our industry. We will continue to

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consistently apply this process until a sufficient amount of historical information regarding the volatility of our own stock price becomes available. Due to our limited history of grant activity, the expected life of options granted to employees is calculated using the simplified method permitted by the SEC as the average of the total contractual term of the option and its vesting period. The risk-free rate assumption was based on U.S. Treasury instruments whose terms were consistent with the terms of our stock options. The expected dividend assumption was based on our history and expectation of dividend payouts.

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The following table presents total stock-based compensation expense included in the condensed consolidated statements of operations (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Research and development	955	984	2,756	2,555
Sales, general and administrative	1,581	1,531	4,637	3,911
	\$ 2,536	\$ 2,515	\$ 7,393	\$ 6,466

11. Segment Reporting

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. Our chief operating decision makers are our Chief Executive Officer and our board of directors. The Chief Executive Officer and our board of directors review financial information presented on a consolidated basis, accompanied by information about revenues by geographic region, for purposes of allocating resources and evaluating financial performance. We have one business activity and there are no segment managers who are held accountable for operations, operating results beyond revenue goals or gross margins, or plans for levels or components below the consolidated unit level. Accordingly, we have a single reporting segment.

Operations outside of the United States consist principally of research and development and sales activities. Geographic revenues are identified by the location of the customer and consist of the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Revenues				
Americas (1)	\$ 19,680	\$ 19,038	\$ 54,816	\$ 52,571
Europe	3,889	1,400	9,245	5,994
Asia	9,713	6,675	26,311	18,728
	\$ 33,282	\$ 27,113	\$ 90,372	\$ 77,293

(1) Primarily United States

Geographic presentation of identifiable long-lived assets below shows those assets that can be directly associated with a particular geographic area and consist of the following (in thousands):

	September 30,	December 31,
	2011	2010
Long-lived assets		
Americas (1)	\$ 34,769	\$ 37,023
Europe	4,526	3,980
Asia	2,517	3,398
	\$ 41,812	\$ 44,401

(1) Primarily United States

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The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the unaudited condensed consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q and the audited consolidated financial statements and notes thereto and management's discussion and analysis of financial condition and results of operations for the year ended December 31, 2010 included in our Annual Report on Form 10-K filed with the SEC on February 10, 2011. This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, (the Exchange Act). These statements are often identified by the use of words such as may, will, expect, believe, anticipate, intend, could, should, estimate, or continue, and similar expressions or variations. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the section titled Risk Factors, set forth in Part II, Item 1A of this Quarterly Report on Form 10-Q and elsewhere in this Report. 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 anticipate that subsequent events and developments will cause our views to change. However, while we may elect to update these forward-looking statements at some point in the future, we have no current intention of doing so except to the extent required by applicable law. You should, therefore, not rely on these forward-looking statements as representing our views as of any date subsequent to the date of this Quarterly Report on Form 10-Q.

Overview

Our proprietary technology platform enables the creation of optimized biocatalysts that make existing industrial processes faster, cleaner and more efficient than current methods and has the potential to make new industrial processes possible on a commercial scale. We have focused our biocatalyst development efforts on large and rapidly growing markets, including pharmaceuticals, advanced biofuels and bio-based chemicals. We have commercialized our biocatalysts in the pharmaceutical industry and are developing biocatalysts for use in producing advanced biofuels under a multi-year research and development collaboration with Shell, for use in sustainable detergent alcohols under collaboration with M&G and to develop improved processes for the production of first generation ethanol in collaboration with Raízen. We have enabled biocatalyst-based drug manufacturing processes at commercial scale and have delivered biocatalysts and drug products to some of the world's leading pharmaceutical companies. In our research and development collaboration with Shell, we are developing biocatalysts for use in producing advanced biofuels from renewable sources of non-food plant materials, known as cellulosic biomass. In our collaboration with Raízen, we are deploying our CodeEvolver directed evolution technology platform to develop an improved first generation ethanol process for producing ethanol made from sugar. We are also pursuing opportunities in the bio-based chemicals market, including developing sustainable detergent alcohols for use in the household products market in collaboration with M&G. Additionally, we are using our technology platform to pursue biocatalyst-enabled solutions in other bioindustrial markets, including carbon management and water treatment.

Biocatalysts are enzymes or microbes that initiate or accelerate chemical reactions. Manufacturers have historically used naturally occurring biocatalysts to produce many goods used in everyday life. However, inherent limitations in naturally occurring biocatalysts have restricted their commercial use. Our proprietary technology platform is able to overcome many of these limitations, allowing us to evolve and optimize biocatalysts to perform specific and desired chemical reactions at commercial scale.

To date, we have generated revenues primarily from collaborative research and development funding, pharmaceutical product sales and government grants. Our revenues have increased in each of the last three fiscal years, growing from \$50.5 million in 2008, to \$82.9 million in 2009 to \$107.1 million in 2010. Our revenues increased from \$77.3 million for the nine months ended September 30, 2010 to \$90.4 million for the nine months ended September 30, 2011. As of September 30, 2011, we had an accumulated deficit of \$179.4 million. We incurred net losses of \$45.1 million, \$20.3 million and \$8.5 million in the years ended December 31, 2008, 2009 and 2010, respectively and a net loss of \$11.3 million for the nine months ended September 30, 2011.

Most of our revenues since inception have been derived from collaborative research and development arrangements, which accounted for 66%, 78% and 66% of our revenues in 2010, 2009 and 2008, respectively. Collaborative research and development arrangements accounted for 60% and 64% of our revenues for the nine months ended September 30, 2011 and 2010, respectively. Collaborative research and development revenue received from Shell accounted for 62%, 76% and 60% of our revenues in 2010, 2009 and 2008, respectively. Collaborative research and development revenue received from Shell accounted for 52% and 61% of our revenues for the nine months ended September 30, 2011 and 2010, respectively.

Our product sales accounted for 31%, 22% and 33% of our revenues in 2010, 2009 and 2008, respectively. Product sales accounted for 37% and 31% of our revenues for the nine months ended September 30, 2011 and 2010, respectively. Our product sales on a dollar basis have increased in each of the last three fiscal years, from \$16.9 million in 2008 to \$18.6 million in 2009 and to \$32.8 million in 2010. Our product sales increased from \$24.3 million for the nine months ended September 30, 2010 to \$33.5 million for the nine months ended September 30, 2011.

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Notwithstanding our revenue growth, we continue to experience significant losses as we have invested heavily in research and development and administrative infrastructure in connection with the growth of our business. In light of the growth in market acceptance of our products and services to date, we currently intend to increase our investment in research and development.

Our revenue stream is diversified across various industries, which should mitigate our exposure to cyclical downturns or fluctuations in any one market. Revenues during 2008, 2009 and 2010 were derived from the pharmaceuticals and biofuels markets, and consisted of collaborative research and development revenues, product sales and government grants, which are separately identified in our consolidated statements of operations.

Revenues and Operating Expenses

Revenues

Our revenues are comprised of collaborative research and development revenues, product revenues and government grants.

Collaborative research and development revenues include license, technology access and exclusivity fees, FTE payments, milestones, royalties, and optimization and screening fees.

Product revenues consist of sales of biocatalysts, intermediates, APIs and Codex Biocatalyst Panels and Kits.

Government grants consist of payments from government entities. The terms of these grants generally provide us with cost reimbursement for certain types of expenditures in return for research and development activities over a contractually defined period. Historically, we have received government grants from Germany, Singapore and the United States. We expect to receive additional grants from the United States and other governments in the future.

Cost of Product Revenues

Cost of product revenues includes both internal and third-party fixed and variable costs including amortization of purchased technology, materials and supplies, labor, facilities and other overhead costs associated with our product revenues.

Research and Development Expenses

Research and development expenses consist of costs incurred for internal projects as well as partner-funded collaborative research and development activities. These costs include our direct and research-related overhead expenses, which include salaries and other personnel-related expenses, facility costs, supplies, depreciation of facilities, and laboratory equipment and amortization of acquired technologies, as well as research consultants and the cost of funding research at universities and other research institutions, and are expensed as incurred. As a result of our purchase of the directed evolution intellectual property assets from Maxygen, Inc. (Maxygen) (Maxygen IP) in 2010, our obligation to pay biofuels royalties to Maxygen terminated. License and royalty fees paid to Maxygen prior to our acquisition of the Maxygen IP fluctuated depending on the timing and type of consideration received in connection with our biofuels research and development collaboration with Shell. Costs to acquire technologies that are utilized in research and development and that have no alternative future use are expensed when incurred.

Selling, General and Administrative Expenses

Selling, general and administrative expenses consist of compensation expenses (including stock-based compensation), hiring and training costs, consulting and service provider expenses (including patent counsel related costs), marketing costs, occupancy-related costs, depreciation and amortization expenses and travel and relocation expenses.

Critical Accounting Policies and Estimates

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The interim condensed consolidated financial statements have been prepared in conformity with GAAP and include our accounts and the accounts of our wholly-owned subsidiaries. The preparation of our condensed consolidated financial statements requires our management to make estimates, assumptions, and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the applicable periods. Management bases its estimates, assumptions and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. Different assumptions and judgments would change the estimates used in the preparation of our condensed consolidated financial statements, which, in turn, could change the results from those reported. Our management evaluates its estimates, assumptions and judgments on an ongoing basis.

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The following table shows the amounts from our condensed consolidated statements of operations for the periods presented (in thousands).

	Three Months Ended September 30, 2011		30% of Total Revenues		Nine Months Ended September 30, 2011		30% of Total Revenues		2010	
	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010
Revenues:										
Product	\$ 12,199	\$ 9,491	36%	35%	\$ 33,528	\$ 24,250	37%	31%		
Collaborative R&D	19,201	17,243	58%	64%	54,073	49,450	60%	64%		
Government grants	1,882	379	6%	1%	2,771	3,593	3%	5%		
Total Revenues	33,282	27,113	100%	100%	90,372	77,293	100%	100%		
Costs and operating expenses:										
Cost of product revenues	9,958	8,563	30%	32%	28,713	19,856	32%	26%		
Research and development	16,786	13,070	50%	48%	45,502	39,056	50%	51%		
Selling, general and administrative	8,871	7,940	27%	29%	27,160	25,192	30%	33%		
Total costs and operating expenses	35,615	29,573	107%	109%	101,375	84,104	112%	109%		
Loss from operations	(2,333)	(2,460)	nm	nm	(11,003)	(6,811)	nm	nm		
Interest income	76	61	0%	0%	195	135	0%	0%		
Interest expense and other, net	(411)	(35)	-1%	0%	(378)	(1,047)	0%	1%		
Loss before provision for income taxes	(2,668)	(2,434)	nm	nm	(11,186)	(7,723)	nm	nm		
Provision (benefit) for income taxes	74	298	0%	1%	68	324	0%	0%		
Net loss	\$ (2,742)	\$ (2,732)	nm	nm	\$ (11,254)	\$ (8,047)	nm	nm		

Three months ended September 30, 2011 compared to three months ended September 30, 2010.**Revenues**

(In Thousands)	Three Months Ended September 30,		Change	
	2011	2010	\$	%
Product	\$ 12,199	\$ 9,491	\$ 2,708	29%
Collaborative R&D	19,201	17,243	1,958	11%
Government grants	1,882	379	1,503	397%
Total revenues	\$ 33,282	\$ 27,113	\$ 6,169	23%

Revenues increased during the three months ended September 30, 2011 compared to the three months ended September 30, 2010 due to increased revenues from product sales, collaborative research and development and government grants.

Product revenues increased \$2.7 million during the three months ended September 30, 2011 compared to the three months ended September 30, 2010 primarily due to an increase in product sales to both generic and innovator pharmaceutical customers.

Collaborative research and development revenues increased \$2.0 million during the three months ended September 30, 2011 compared to the three months ended September 30, 2010 primarily due to milestones earned in our Shell collaboration and our expanded activities in our collaborations in carbon management and collaborations with pharmaceuticals customers.

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Collaborative research and development revenues derived from Shell increased \$1.1 million to \$17.3 million during the three months ended September 30, 2011 compared to \$16.2 million during the three months ended September 30, 2010. This includes milestone payments of \$3.1 million and \$1.5 million earned in the three months ended September 30, 2011 and 2010 respectively. Effective August 2011, Shell reduced the number of funded FTEs engaged in our research and development collaboration with Shell by 12, from 128 to 116 FTEs. We had an average of 122 and 128 FTEs in this collaboration during the three months ended September 30, 2011 and September 30, 2010, respectively. The decrease in the number of Shell funded FTEs in our collaborative research and development revenues during the three months ended September 30, 2011 was partially offset by contractual increases in the billing rates for the FTEs engaged in our research and development collaboration with Shell.

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Government grant revenues increased \$1.5 million during the three months ended September 30, 2011 compared to the three months ended September 30, 2010 primarily due to a grant we recognized from the Singapore Economic Development Board (EDB) for \$1.3 million. Our grant revenues from the U.S. Department of Energy under the ARPA-E Recovery Act program increased \$0.2 million to \$0.6 million during the three months ended September 30, 2011 compared to \$0.4 million during the three months ended September 30, 2010.

Our top five customers accounted for 81% and 88% of our total revenues for the three months ended September 30, 2011 and 2010, respectively. Shell accounted for 52% and 60% of our total revenues for the three months ended September 30, 2011 and 2010, respectively.

Cost of Product Revenues

(In Thousands)	Three Months Ended September 30,		Change	
	2011	2010	\$	%
Cost of revenues:				
Product	\$ 9,958	\$ 8,563	\$ 1,395	16%
Gross profit:				
Product	\$ 2,241	\$ 928	\$ 1,313	141%
Product gross margin %	18%	10%		

Our cost of product revenues increased \$1.4 million during the three months ended September 30, 2011 compared to the three months ended September 30, 2010 primarily due to the \$2.7 million increase in our product sales. Gross margins increased to 18% from 10% in the three months ended September 30, 2011 and 2010, respectively. This shift was primarily due to a change in the weighting of the sales mix towards higher margin innovator products in the third quarter of 2011 compared to the lower margin generic product sales in the third quarter of 2010.

Operating Expenses

(In Thousands)	Three Months Ended September 30,		Change	
	2011	2010	\$	%
Research and development	\$ 16,786	\$ 13,070	\$ 3,716	28%
Selling, general and administrative	8,871	7,940	931	12%
Total operating expenses	\$ 25,657	\$ 21,010	\$ 4,647	22%

Research and Development. Research and development expenses increased \$3.7 million during the three months ended September 30, 2011 compared to the three months ended September 30, 2010 primarily due to the \$1.3 million increase in amortization expense related to our acquisition of the Maxygen IP, a \$1.3 million increase in compensation costs related to an increase in headcount and stock-based compensation, a \$0.7 million increase in expenses related to outside services and consultants supporting our research, a \$0.4 million increase in costs for lab supplies related to our lab expansion, a \$0.3 million increase in facility costs related to our expanded facilities in Redwood City, California, a \$0.2 million increase in costs for software and system support and a \$0.1 million increase in travel costs. This was partially offset by a \$0.5 million decrease in royalty fees paid to Maxygen as a consequence of our acquisition of the Maxygen IP and related termination of the IP license agreement. Research and development expenses included stock-based compensation expense of \$1.0 million during each of the three month periods ended September 30, 2011 and 2010.

Selling, General and Administrative. Selling, general and administrative expenses increased \$0.9 million during the three months ended September 30, 2011 compared to the three months ended September 30, 2010 primarily due to a \$0.4 million increase in compensation costs related to increased headcount and stock-based compensation, a \$0.3 million increase in outside services and consultants and a \$0.2 million increase in recruiting costs. Selling, general and administrative expenses included stock-based compensation expense of \$1.6 million and \$1.5 million during the three months ended September 30, 2011 and 2010, respectively.

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(In Thousands)	Three Months Ended September 30,		Change	
	2011	2010	\$	%
Interest income	\$ 76	\$ 61	\$ 15	25%
Interest expense and other, net	(411)	(35)	(376)	1,074%
Total other income (expense), net	\$ (335)	\$ 26	\$ 361	nm

Interest Income. Interest income increased due to higher average returns on our of cash, cash equivalents and marketable securities on hand during the three months ended September 30, 2011 compared to the three months ended September 30, 2010.

Interest Expense and Other, Net. Interest expense and other, net, increased \$0.4 million during the three months ended September 30, 2011 compared to the three months ended September 30, 2010 primarily related to increased foreign exchange losses of \$0.5 million partially offset by decreased interest expense of \$0.1 million due to the payoff of our debt obligation on a loan from the General Electric Capital Corporation and the Oxford Finance Corporation (GE Capital Loan).

Provision for Income Taxes. The tax provision of \$0.1 million and \$0.3 million for the three months ended September 30, 2011 and 2010, respectively, primarily consisted of income taxes attributable to foreign operations.

Restructuring Charges. There was no change in our restructuring accruals of \$63,000 during the three months ended September 30, 2011.

*Nine months ended September 30, 2011 compared to nine months ended September 30, 2010.**Revenues*

(In Thousands)	Nine Months Ended September 30,		Change	
	2011	2010	\$	%
Product	\$ 33,528	\$ 24,250	\$ 9,278	38%
Collaborative R&D	54,073	49,450	4,623	9%
Government grants	2,771	3,593	(822)	-23%
Total revenues	\$ 90,372	\$ 77,293	\$ 13,079	17%

Revenues increased during the nine months ended September 30, 2011 compared to the nine months ended September 30, 2010 primarily due to increased revenues from product sales and collaborative research and development projects which was partially offset by declines in revenues from government grants.

Product revenues increased \$9.3 million or 38% for the nine months ended September 30, 2011 compared to the nine months ended September 30, 2010, primarily due to an increase in product sales to both generic and innovator pharmaceutical customers.

Collaborative research and development revenues increased \$4.6 million during the nine months ended September 30, 2011 compared to the nine months ended September 30, 2010 primarily due to increased revenues of \$4.1 million in our collaborations in carbon management and increased collaboration revenues of \$0.5 million with new and existing pharmaceuticals customers.

Collaborative research and development revenues derived from Shell increased \$0.1 million to \$47.0 million during the nine months ended September 30, 2011 compared to \$46.9 million during the nine months ended September 30, 2010. This includes milestone payments \$3.1 million and \$2.9 million received in the nine months ended September 30, 2011 and 2010 respectively. Effective August 2011, Shell reduced the number of funded FTEs engaged in our research and development collaboration with them by 12, from 128 to 116 FTEs. We had an average of 126 and 128 FTEs in this collaboration during the nine months ended September 30, 2011 and September 30, 2010. The decrease in the number

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of funded FTEs in collaborative research and development revenues in 2011 was partially offset by contractual increases in the billing rates for the FTEs in that same period.

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Government grant revenues decreased \$0.8 million during the nine months ended September 30, 2011 compared to the nine months ended September 30, 2010 primarily due to the recognition of a grant from the EDB for \$1.3 million in the nine months ended September 30, 2011 compared with \$2.7 million in the same period of 2010. This decrease in government grant revenues was partially offset by a \$1.5 million grant we received from the U.S. Department of Energy during the nine months ended September 30, 2011 under the ARPA-E Recovery Act program compared to \$0.4 million in revenue we received under the ARPA-E Recovery Act program for the nine months ended September 30, 2010.

Our top five customers on a year to date basis accounted for 78% and 85% of our total revenues for the nine months ended September, 30, 2011 and 2010, respectively. Shell accounted for 52% and 61% of our total revenues for the nine months ended September 30, 2011 and 2010, respectively.

Cost of Product Revenues

(In Thousands)	Nine Months Ended September 30,		Change	
	2011	2010	\$	%
Cost of revenues:				
Product	\$ 28,713	\$ 19,856	\$ 8,857	45%
Gross profit:				
Product	\$ 4,815	\$ 4,394	\$ 421	10%
Product gross margin %	14%	18%		

Our cost of product revenues increased \$8.9 million during the nine months ended September 30, 2011 compared to the nine months ended September 30, 2010 primarily due to the \$9.3 million increase in our product sales. Gross margins decreased to 14% from 18% in the nine months ended September 30, 2011 and 2010, respectively, due to a change in sales mix towards lower margin product sales in the first half of 2011, partially offset by a change in sales mix towards higher margin innovator products in the three months ended September 30, 2011.

Operating Expenses

(In Thousands)	Nine Months Ended September 30,		Change	
	2011	2010	\$	%
Research and development	\$ 45,502	\$ 39,056	\$ 6,446	17%
Selling, general and administrative	27,160	25,192	1,968	8%
Total operating expenses	\$ 72,662	\$ 64,248	\$ 8,414	13%

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