

Edgar Filing: INTERMOLECULAR INC - Form 10-Q

INTERMOLECULAR INC  
Form 10-Q  
October 31, 2014  
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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, 2014

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 001-35348

Intermolecular, Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware

(State or Other Jurisdiction of

Incorporation or Organization)

20-1616267

(I.R.S. Employer

Identification No.)

3011 N. First Street

San Jose, California

(Address of Principal Executive Offices)

(408) 582-5700

(Registrant's Telephone Number, Including Area Code)

N/A

(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 ☐

Accelerated filer ☒

Non-accelerated filer ☐

Smaller reporting company ☐

(Do not check if a 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 ☒

Shares outstanding of the registrant's common stock:

Class

Outstanding as of October 27, 2014

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Common stock, \$0.001 par value

47,593,025

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INTERMOLECULAR, INC.

FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2014

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## PART I — FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## INTERMOLECULAR, INC. AND SUBSIDIARIES

## Condensed Consolidated Balance Sheets

(In thousands, except share and per share data)

(Unaudited)

	September 30, 2014	December 31, 2013
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$22,050	\$72,083
Short-term investments	44,076	—
Accounts receivable, net of allowance for doubtful accounts of \$0 as of September 30, 2014 and December 31, 2013	6,014	6,791
Accounts receivable, due from related parties	238	231
Inventory, current portion	72	—
Prepaid expenses and other current assets	1,505	2,247
Total current assets	73,955	81,352
Inventory	7,387	6,510
Property and equipment, net	21,745	28,485
Intangible assets, net	8,080	7,855
Other assets	270	280
Total assets	\$111,437	\$124,482
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$221	\$2,157
Accrued liabilities	2,437	3,672
Accrued compensation and employee benefits	2,748	3,655
Deferred revenue	2,188	2,087
Related party deferred revenue	815	385
Note payable	2,000	2,000
Total current liabilities	10,409	13,956
Deferred revenue, net of current portion	1,895	830
Deferred rent, net of current portion	2,676	1,844
Note payable, net of current portion	21,500	23,000
Other long-term liabilities	104	—
Total liabilities	36,584	39,630
Commitments and contingencies (note 5)		
Stockholders' equity:		
Preferred stock, \$0.001 par value, 5,000,000 shares authorized, no shares issued and outstanding as of September 30, 2014 and December 31, 2013	—	—
Common stock, par value \$0.001 per share—200,000,000 shares authorized; 47,808,338 and 46,486,372 shares issued and outstanding as of September 30, 2014 and December 31, 2013, respectively	48	46
Additional paid-in capital	200,632	194,930
Accumulated other comprehensive loss	(30)	) —
Accumulated deficit	(125,797)	) (110,124)
Total stockholders' equity	74,853	84,852

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Total liabilities and stockholders' equity	\$111,437	\$124,482
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See accompanying notes to unaudited condensed consolidated financial statements

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## INTERMOLECULAR, INC. AND SUBSIDIARIES

## Condensed Consolidated Statements of Operations

(In thousands, except share and per share data)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenue:				
Collaborative development program and services revenue	\$7,699	\$11,156	\$23,450	\$34,858
Product revenue	—	2,748	—	5,852
Licensing and royalty revenue	3,156	3,844	13,244	11,079
Total revenue	10,855	17,748	36,694	51,789
Cost of revenue:				
Cost of collaborative development program and services revenue	6,090	7,545	18,044	21,283
Cost of product revenue	—	1,452	—	2,585
Cost of licensing and royalty revenue	77	67	327	179
Total cost of revenue	6,167	9,064	18,371	24,047
Gross profit	4,688	8,684	18,323	27,742
Operating expenses:				
Research and development	5,023	6,107	18,191	17,727
Sales and marketing	1,321	1,544	4,348	4,759
General and administrative	3,134	3,008	9,544	9,042
Restructuring charges	—	—	1,361	—
Total operating expenses	9,478	10,659	33,444	31,528
Loss from operations	(4,790)	) (1,975)	) (15,121)	) (3,786)
Other income (expense):				
Interest expense, net	(159)	) (168)	) (532)	) (649)
Other (expense) income, net	(13)	) (2)	) (13)	) 66
Total other income (expense), net	(172)	) (170)	) (545)	) (583)
Loss before provision for income taxes	(4,962)	) (2,145)	) (15,666)	) (4,369)
Provision for income taxes	1	26	7	32
Net loss	\$(4,963)	) \$(2,171)	) \$(15,673)	) \$(4,401)
Net loss per share of common stock, basic and diluted	\$(0.11)	) \$(0.05)	) \$(0.34)	) \$(0.10)
Weighted-average number of shares used in computing net loss per share of common stock, basic and diluted	46,842,055	45,191,514	46,655,187	44,657,529

## Related Party Transactions

The Condensed Consolidated Statements of Operations shown above include the following related party transactions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenue:				
Collaborative development program and services revenue	\$3	\$1,792	\$1,111	\$5,604
Licensing and royalty revenue	1,147	1,358	2,647	4,082
Total revenue	\$1,150	\$3,150	\$3,758	\$9,686

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Cost of Revenue:

Cost of collaborative development program and services revenue	\$—	\$1	\$—	\$1
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Total cost of revenue	\$—	\$1	\$—	\$1
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See accompanying notes to unaudited condensed consolidated financial statements

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INTERMOLECULAR, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Comprehensive Loss

(In thousands)

(Unaudited)

	Three Months Ended September		Nine Months Ended September	
	30,	2013	30,	2013
	2014		2014	
Net loss	\$(4,963	) \$(2,171	) \$(15,673	) \$(4,401
Unrealized losses on	(12	) —	(30	) —
available-for-sale-securities				
Other comprehensive loss	(12	) —	(30	) —
Comprehensive loss, net of income tax	\$(4,975	) \$(2,171	) \$(15,703	) \$(4,401

See accompanying notes to unaudited condensed consolidated financial statements



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## INTERMOLECULAR, INC. AND SUBSIDIARIES

## Condensed Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2014	2013
Cash flows from operating activities:		
Net loss	\$(15,673)	\$(4,401)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation, amortization, and accretion	8,149	6,951
Stock-based compensation	4,529	4,088
Loss on disposal of property and equipment	—	9
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	656	244
Inventory	50	(1,694)
Accounts receivable	770	(2,052)
Accounts payable	(1,231)	2,057
Accrued and other liabilities	(440)	1,199
Deferred revenue	1,166	(855)
Related party deferred revenue	430	433
Net cash (used in) provided by operating activities	(1,594)	5,979
Cash flows from investing activities:		
Purchase of short-term investments	(45,171)	(1,001)
Redemption of short-term investments	785	751
Purchase of property and equipment	(2,568)	(9,054)
Purchased and capitalized intangible assets	(1,160)	(1,113)
Net cash used in investing activities	(48,114)	(10,417)
Cash flows from financing activities:		
Proceeds from debt	—	25,000
Payment of debt	(1,500)	(26,514)
Proceeds from exercise of common stock options	1,175	1,935
Net cash (used in) provided by financing activities	(325)	421
Net decrease in cash and cash equivalents	(50,033)	(4,017)
Cash and cash equivalents at beginning of period	72,083	78,283
Cash and cash equivalents at end of period	\$22,050	\$74,266
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$471	\$618
Cash paid for income taxes, net of refunds received	\$33	\$8
Noncash investing/operating activities:		
Transfer of property and equipment to inventory	\$999	\$393

See accompanying notes to unaudited condensed consolidated financial statements

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INTERMOLECULAR, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying condensed consolidated financial statements of Intermolecular, Inc. and subsidiaries (the "Company") have been prepared without audit in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information, the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission ("SEC"). Accordingly, certain information and disclosures normally included in complete financial statements prepared in accordance with GAAP have been condensed or omitted. The information in this report should be read in conjunction with the Company's audited consolidated financial statements and notes thereto included in its Annual Report on Form 10-K for the fiscal year ended December 31, 2013, as filed with the SEC on March 10, 2014.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the Company's financial position, results of operations and cash flows for the interim periods presented. The operating results for the three and nine months ended September 30, 2014 are not necessarily indicative of the results that may be expected for any other future interim period or full year. The condensed consolidated balance sheet as of December 31, 2013 is derived from the audited consolidated financial statements as of the year then ended.

Use of Estimates

The preparation of the accompanying condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions about future events. These estimates and the underlying assumptions affect the amounts of assets and liabilities reported, disclosures about contingent assets and liabilities, and reported amounts of revenue and expenses. Management uses estimates and judgments in determining recognition of revenues, valuations of accounts receivable, inventories, intangible assets, debt, capital stock, warrants and assumptions used in the calculation of income taxes and stock-based compensation, among others. These estimates and assumptions are based on management's best estimates and judgment. Management evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors, and adjusts such estimates and assumptions when facts and circumstances dictate. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentration of credit risk consist of cash, cash equivalents, short-term investments and accounts receivable. The Company's cash, cash equivalents and short-term investments consist of demand deposits, money market accounts, certificates of deposit, corporate bonds and commercial paper maintained with high quality financial institutions. The Company's accounts receivable consist of non-interest bearing balances due from credit-worthy customers.

Cash, Cash Equivalents and Short-Term Investments

The Company holds its cash and cash equivalents in checking, money market and investment accounts with high credit quality financial institutions. The Company considers all highly liquid investments with original maturities of three months or less when purchased to be cash equivalents.

Short-term investments consist principally of corporate debt securities and commercial paper. If applicable, the Company considers marketable securities with remaining time to maturity greater than one year and that have been in a consistent loss position for at least nine months to be classified as long-term, as it expects to hold them to maturity. As of September 30, 2014, the Company did not have any such securities. The Company considers all other marketable securities to be short-term marketable securities. The short-term marketable securities are classified as current assets because they can be readily converted into securities with a shorter remaining time to maturity or into cash. The Company determines the appropriate classification of its marketable securities at the time of purchase and

re-evaluates such designations as of each balance sheet date. All marketable securities and cash equivalents in the portfolio are classified as available-for-sale and are stated at fair value, with all the associated unrealized gains and losses reported as a component of accumulated other comprehensive income (loss). Fair value is based on quoted market rates or direct and indirect observable markets for these investments. The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization and accretion are included in interest income. The cost of securities sold and any gains and losses on sales are based on the specific identification method.

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The Company reviews its investment portfolio periodically to assess for other-than-temporary impairment in order to determine the classification of the impairment as temporary or other-than-temporary, which involves considerable judgment regarding factors such as the length of the time and the extent to which the market value has been lower than the amortized cost, the nature of underlying assets, and the financial condition, credit rating, market liquidity conditions and near-term prospects of the issuer. If the fair value of a debt security is less than its amortized cost basis at the balance sheet date, an assessment would have to be made as to whether the impairment is other-than-temporary. If the Company considers it more likely than not that it will sell the security before it will recover its amortized cost basis, an other-than-temporary impairment will be considered to have occurred. An other-than temporary impairment will also be considered to have occurred if the Company does not expect to recover the entire amortized cost basis of the security, even if it does not intend to sell the security. The Company has recognized no other-than-temporary impairments for its marketable securities.

### Inventory

Inventories are stated at the lower of cost or market value, with cost determined on an average cost basis. Current inventories consist of work-in-process for products that are expected to be sold in the next twelve months. Noncurrent inventories consist of raw materials in the amount of \$6.8 million and \$6.5 million as of September 30, 2014 and December 31, 2013, respectively, and work-in-process for products that are not expected to be sold during the next twelve months in the amount of \$0.6 million and zero as of September 30, 2014 and December 31, 2013, respectively. Inventories in excess of salable amounts and spare parts inventories that are considered obsolete are recorded as a cost of revenue in the period in which they occur. The Company recorded inventory impairments of \$0.6 million during the nine months ended September 30, 2014 and \$16,000 of impairments during the nine months ended September 30, 2013.

### Impairment of Long-Lived Assets

The Company evaluates its long-lived assets, which consist of property and equipment and intangible assets, for indicators of possible impairment when events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Impairment exists if the carrying amounts of such assets exceed the estimates of future net undiscounted cash flows expected to be generated by such assets. Should impairment exist, the impairment loss would be measured based on the excess carrying value of the asset over the estimated fair value of the asset. The Company had no impairment of long-lived assets during the three and nine months ended September 30, 2014 and 2013.

### Revenue Recognition

The Company derives its revenue from three principal sources: collaborative development programs and other services; product sales; and technology licensing and royalty fees. Revenue is recognized when all of the following criteria are met:

- Persuasive evidence of an arrangement exists;
- Delivery has occurred;
- The fee is fixed or determinable; and
- Collectability of the fee is probable.

Persuasive evidence of the arrangement represents a written contract signed by both the Company and the customer, or a customer purchase order. The Company assesses whether a price is fixed or determinable by, among other things, reviewing

contractual terms and conditions related to payment terms. The Company assesses collectability based on factors such as the

customer's creditworthiness and past collection history, if applicable. If collection is not probable, revenue recognition is deferred until receipt of payment.

Collaborative development programs and other services - The Company enters into collaborative development programs ("CDPs") and other research and development service agreements with customers under which the Company conducts research and development activities jointly with the customer. The agreements specify minimum levels of research effort required to be performed by the Company. Payments received under the agreements are not refundable if the research effort is not successful. The Company retains rights to certain elements of technology

developed in the course of its performance, which the customer has an option to license in the future under the terms defined in the agreement. Most arrangements with customers have fixed monthly fees and requirements to provide regular reporting of research and development activities performed, and revenue is recognized in a manner consistent with the fixed monthly fee. Payments received prior to performance are deferred and recognized as revenue when earned over future performance periods.

The Company considers arrangements that include specifically identified, dedicated equipment to contain a lease provision, as these arrangements convey the right to the customer to use specific equipment and provide the ability to the customer to direct the use of the equipment as well as control more than a minor amount of the output of the equipment. To date the Company has determined these arrangements to contain operating leases, with a lease term that corresponds to the term of the CDP arrangement. The amount of revenue allocated for the lease element is based on its relative fair value, but the

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impact of the allocation does not change the amount of revenue recognized for the total arrangement as the lease term is consistent with the CDP term. Operating lease income recorded in CDP and services revenue during the nine months ended September 30, 2014 and 2013 was \$0.8 million and \$5.6 million, respectively.

Future minimum operating lease payments associated with CDP arrangements that contain operating leases were zero and \$0.8 million as of September 30, 2014 and December 31, 2013, respectively.

Product maintenance and support services - Included in CDP and other services revenue, these services entitle customers to receive product updates and enhancements or technical support and maintenance, depending on the offering. The related revenue is recognized ratably over the period the services are delivered.

Product revenue - The Company recognizes revenue from the sale of products once delivery has occurred (title and risk of loss have passed to the customer), and customer acceptance, if required, has been achieved.

Licensing and royalty revenue - The Company recognizes revenue for licenses to intellectual property when earned pursuant to the terms of the agreements. Time-based license revenue is recognized ratably over the license term.

Licensing and royalty revenue that becomes triggered by specific customer actions, such as exercise of a license option or by sales volume, is recognized when it occurs based on royalty reports or other information received from the licensee. Minimum and prepaid royalties and license fees are recognized ratably over the related periods. Revenue on the sale of intellectual property is recognized in full when title transfers if there are no remaining deliverables related to the intellectual property purchase.

Software - The Company includes software with product sales that is considered essential to the product's functionality. The Company also sells software with advanced features that can be used independent of products sold or in conjunction with products sold, which is considered non-essential to the product's functionality. Software related revenue is included in licensing and royalty revenue and is recognized ratably over the license period once delivered.

Multiple-element arrangements - Certain of the Company's customer arrangements involve the delivery or performance of multiple products, services or licenses. Product sale arrangements include product maintenance and support. CDP and other research and development services include licenses of technology, and may also include sales of products. For multiple-element arrangements entered into after January 1, 2011 that include hardware products containing software essential to the hardware product's functionality, undelivered software elements that relate to the hardware product's essential software, and undelivered non-software services, the Company allocates revenue to all deliverables based on their relative selling prices. For multiple-element arrangements entered into prior to January 1, 2011 that included hardware products containing software essential to the hardware product's functionality, undelivered software elements that related to the hardware product's essential software, and undelivered non-software services, the Company assessed whether there was objective and reliable evidence of fair values of all undelivered elements. The Company could not establish vendor-specific objective evidence of selling price ("VSOE") for undelivered elements and recognized revenue once the last element of the multiple-element arrangement was delivered.

The Company evaluates whether a delivered element has value to the customer without the remaining undelivered elements by determining whether the delivered element could be sold by the Company, or resold by the customer, on a stand-alone basis. The Company concluded that all of its products and services deliverables have value to the customers on a stand-alone basis, as all these deliverables have been or could be sold and used by customers on a stand-alone basis. Intellectual property license arrangements have value on a stand-alone basis if the customer could purchase and use them without the remaining elements of the arrangement. In instances where software is considered essential to the functionality of the product, only the software portion and post contract support is evaluated under industry specific software accounting guidance. For transactions entered into prior to January 1, 2011, the Company assessed whether there was objective and reliable evidence of fair values of all undelivered elements. Fair values of such elements were determined by reference to the Company-specific objective evidence, such as pricing of these elements when sold separately, substantive renewal prices for product maintenance and support and time-based licenses, or other available evidence. If the fair value of any undelivered elements in a multiple-element arrangement could not be objectively determined, revenue was deferred until all elements were delivered. If product maintenance and support and time-based licenses were the only undelivered elements without objective and reliable evidence of fair value, all revenue from the arrangement was amortized over the longer of the product maintenance and support

term or license period. For purposes of classification in the consolidated statements of operations, revenue is allocated between CDP and services revenue, product revenue and licensing and royalty revenue based on objective and reliable evidence of fair value for any elements for which it exists or based on the relative stated invoice amount for elements for which objective and reliable evidence of fair value does not exist.

For all transactions entered into on or after January 1, 2011, the Company recognizes revenue using estimated selling prices of the delivered goods and services based on a hierarchy of methods as required by GAAP. The Company has not established VSOE for the determination of estimated selling price of elements, and since third-party evidence ("TPE") is not available for those elements where vendor-specific objective evidence of selling price cannot be determined, the Company evaluates factors to determine its estimated selling prices ("ESP") for all other elements. In multiple-element arrangements

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where hardware and software are sold as part of the solution, revenue is allocated to the hardware and software as a group using the relative selling prices of each of the deliverables in the arrangement based upon the aforementioned selling price hierarchy.

Deferred Revenue - Deferred revenue represents amounts collected from customers for which the related revenue has not been recognized, because one or more of the revenue recognition criteria have not been met, net of the associated costs. The current portion of deferred revenue represents the amount that is expected to be recognized as revenue within one year from the balance sheet date. When deferred revenues are recognized as revenues, the associated deferred costs are also recognized as cost of revenues.

#### Accounts Receivable and Allowance for Doubtful Accounts

Trade accounts receivable are recorded at invoiced amounts and unbilled contractually obligated amounts. Trade accounts receivable are presented net of allowances for doubtful accounts, if applicable, and do not bear interest. The allowance for doubtful accounts is based on the Company's assessment of the collectability of its customer accounts. The Company reviews the allowance by considering certain factors such as historical experience, industry data, credit quality, age of balances and current economic conditions that may affect customers' ability to pay.

#### Concentration of Revenue and Accounts Receivable

Significant customers are those that represent more than 10% of the Company's total revenue or accounts receivable. For each significant customer, including related parties, revenue as a percentage of total revenue and accounts receivable as a percentage of total accounts receivable are as follows:

	Revenue				Accounts Receivable		
	Three Months Ended		Nine Months Ended		As of	As of	
	September 30,		September 30,		September 30,	December 31,	
	2014	2013	2014	2013	2014	2013	
Customer A *	12		% *	12	% *	*	
Customer B —	% 11		% 14	% 18	% —	% 13	%
Customer C	% *		—	% 12	% —	% —	%
(1)							
Customer D 22	% *		16	% *	26	% 15	%
Customer E *	*		*	14	% *	14	%
Customer F							
(1) 38	% 18		% 34	% *	47	% 41	%
Customer G —	% *		*	*	—	% *	
Customer H *	15		% *	*	—	% —	%

\* less than 10%

(1) Customer C was acquired by Customer F as of July 31, 2013. Revenue and accounts receivable attributed to Customers C and F are combined under Customer F for periods after July 31, 2013.

#### Stock-Based Compensation

The Company applies the fair value recognition and measurement provisions of ASC 718 Compensation — Stock Compensation. Stock-based compensation is recorded at fair value as of the grant date, determined using the Black-Scholes option-pricing model, and recognized as an expense over the employee's requisite service period (generally the vesting period), which the Company has elected to amortize on a straight-line basis.

The Company accounts for stock options issued to nonemployees based on the fair value of the options determined using the Black-Scholes option-pricing model. The fair value of stock options granted to nonemployees is remeasured each reporting period as the stock options 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.

#### Recent Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update No. 2014-09 (ASU 2014-09) "Revenue from Contracts with Customers." ASU 2014-09 supersedes the revenue recognition requirements in "Revenue Recognition (Topic



605)", and requires entities to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. ASU 2014-09 is effective for

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annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is not permitted. The Company is currently in the process of evaluating the impact of the adoption of ASU 2014-09 on the consolidated financial statements.

## 2. Fair Value of Financial Instruments

The Company measures and reports its cash equivalents and short- and long-term investments at fair value on a recurring basis. There have been no transfers between fair values during the nine months ended September 30, 2014 and the nine months ended September 30, 2013. The Company does not have any financial liabilities that are measured and reported at fair value.

The following tables set forth the fair value of the Company's cash equivalents by level within the fair value hierarchy (in thousands):

	As of September 30, 2014			
	Fair Value	Level I	Level II	Level III
Assets:				
Money market funds	\$228	\$228	\$—	\$—
Corporate debt securities and commercial paper	44,076	—	44,076	—
Total assets measured at fair value	\$44,304	\$228	\$44,076	\$—
As of December 31, 2013				
	Fair Value	Level I	Level II	Level III
Assets:				
Money market funds	\$49,117	\$49,117	\$—	\$—
Total assets measured at fair value	\$49,117	\$49,117	\$—	\$—

Cash equivalents and short-term investments are classified as "available-for-sale" and are carried at fair value based on quoted markets or other readily available market information. The Company's investment policy requires investments less than twenty four months and a minimum credit rating of A-. Unrealized gains and losses, net of taxes, are included in accumulated other comprehensive loss. Gains and losses are determined using the specific identification method. Cash, cash equivalents, and short-term investments consisted of the following as of September 30, 2014 (in thousands):

	As of September 30, 2014			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Assets:				
Cash	\$21,822	\$—	\$—	\$21,822
Money market funds	228	—	—	228
Corporate debt securities and commercial paper	44,106	—	(30	) 44,076
Total cash, cash equivalents and short-term investments	\$66,156	\$—	\$(30	) \$66,126

As of December 31, 2013 the Company did not have any unrealized gains or losses.



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## 3. Property and Equipment

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

	As of September 30, 2014	As of December 31, 2013
Lab equipment and machinery	\$53,392	\$49,264
Leasehold improvements	5,899	4,413
Computer equipment and software	3,743	3,563
Furniture and fixtures	195	182
Construction in progress	1,262	6,544
Total property and equipment	64,491	63,966
Less accumulated depreciation	(42,746)	(35,481)
Property and equipment, net	\$21,745	\$28,485

During 2013, the Company entered into a loan and security agreement ("Loan Agreement") with Silicon Valley Bank ("SVB") pursuant to which SVB made a term loan to the Company in the principal amount of \$25.0 million. Under the Loan Agreement, and as of both September 30, 2014 and December 31, 2013, SVB held a security interest in substantially all of the Company's assets, excluding all intellectual property.

The following table presents depreciation expense included in the Condensed Consolidated Statement of Operations and includes amortization of leasehold improvements (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Depreciation expense	\$2,434	\$2,249	\$7,268	\$6,493

The Company maintained dedicated equipment to support contractual customer capacity requirements as part of certain collaborative development programs that are classified as lab equipment and machinery, which had a net book value of zero and \$1.8 million as of September 30, 2014 and December 31, 2013, respectively.

## 4. Intangible Assets

Intangible assets consist of the following (in thousands):

	As of September 30, 2014	As of December 31, 2013
Patents issued	\$5,932	\$4,893
Patents pending	3,915	4,224
Trademarks	40	40
Total intangible assets	9,887	9,157
Less patent amortization	(1,807)	(1,302)
Intangible assets, net	\$8,080	\$7,855

Amortization commences upon patent issuance. The useful life of the patents, once issued, will not exceed 20 years, and will depend on the nature of the patent. The average estimated amortization period of the Company's current portfolio is approximately 17 years from the date of patent issuance. The average estimated remaining amortization period of patents acquired as part of the Symyx asset purchase transaction is approximately 4 years.

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The following table presents patent amortization expense included in the Condensed Consolidated Statement of Operations (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Amortization expense	\$175	\$156	\$505	\$458

## 5. Commitments and Contingencies

## Leases

The Company entered into an operating lease agreement in October 2013 that expires in June 2025. Rent expense is being recognized on a straight-line basis over the lease term.

The following table presents rent expense included in the Condensed Consolidated Statement of Operations (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Rent expense	\$567	\$324	\$1,701	\$972

Future commitments and obligations under this operating lease to be satisfied as they become due over the term are as follows (in thousands):

As of September 30, 2014:

Three months ending December 31, 2014	\$427
The years ending December 31,	
2015	1,757
2016	2,253
2017	2,399
2018	2,459
Thereafter	17,557
Total	\$26,852

During 2014, the Company has made payments of \$0.9 million related to this operating lease. The Company received free rent from December 2013 through March 2014 as part of the lease agreement.

## Silicon Valley Bank Loan Agreement

During 2013, the Company entered into the Loan Agreement with SVB in the amount of \$25.0 million that bears interest at a fixed rate equal to 3.25%. The Company is obligated to pay interest at the applicable rate and \$0.5 million of principal on a quarterly basis. The term loan matures on November 30, 2016 and the Company is obligated to pay all outstanding principal and accrued and unpaid interest on that date. At the Company's option, the Company may pre-pay the outstanding principal balance of the term loan in full or in part, subject to a pre-payment fee of 0.25% if repaid before November 30, 2014.

The following table presents payments made during 2014 for interest and principal owed under the terms of the Loan Agreement (in thousands):

	Three Months Ended September 30, 2014			Nine Months Ended September 30, 2014		
	Principal	Interest	Total	Principal	Interest	Total
SVB payments	\$500	\$197	\$697	\$1,500	\$469	\$1,969



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## Litigation

On August 23, 2013, the Company received a copy of a complaint from the California Division of Labor Standards and Enforcement ("DLSE") filed by an employee in the Company's research and development group claiming that the employee was owed back pay due to an incorrect classification as an exempt employee for overtime purposes. The Company commenced a review of the employee's claim as well as a review of the Company's policies regarding classification of employees for overtime purposes. The Company also agreed to enter mediation with the attorney who represented the employee that filed the claim with the DLSE as well as fourteen other current and former employees who were similarly situated. This mediation did not result in a settlement of the subject claims, and on February 18, 2014, the claimants filed a lawsuit against the Company in the United States District Court for the Northern District of California. As of September 30, 2014, the Company, without any admission of liability, had settled this matter with all claimants, including dismissal of the lawsuit, which required the Company to make cash payments in the amount of \$1.0 million in the aggregate.

## 6. Stockholders' Equity

## Stock-Based Compensation

The fair value of the employee stock options granted during the period was estimated on the respective grant date using a Black-Scholes option-pricing model with the following weighted-average assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,		
	2014	2013	2014	2013	
Expected term (in years)	6.1	6.0	5.8	6.0	
Risk-free interest rate	1.9	% 1.7	% 1.9	% 1.2	%
Expected volatility	57	% 59	% 57	% 60	%
Expected dividend rate	—	% —	% —	% —	%

Stock-based compensation expense, net of estimated forfeitures, was included in the following line items on the Condensed Consolidated Statements of Operations (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Cost of revenue	\$407	\$379	\$955	\$1,151
Research and development	296	285	876	969
Sales and marketing	412	302	1,072	859
General and administrative	621	358	1,626	1,109
Total stock-based compensation	\$1,736	\$1,324	\$4,529	\$4,088

The following table presents stock-based compensation expense, net of estimated forfeitures, by grant type (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Stock options	\$874	\$943	\$2,672	\$2,911
Restricted stock awards and restricted stock units (RSUs)	862	381	1,857	1,177
Total stock-based compensation	\$1,736	\$1,324	\$4,529	\$4,088





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The following table presents unrecognized compensation expense, net of estimated forfeitures, related to the Company's equity compensation plans as of September 30, 2014, which is expected to be recognized over the following weighted-average periods (in thousands, except for weighted-average period):

	Unrecognized Compensation Expense	Weighted- Average Period (in years)
Stock options	\$5,368	2.2
RSUs	\$4,725	1.7

The following table presents details on grants made by the Company for the following periods:

	Nine Months Ended September 30, 2014		Nine Months Ended September 30, 2013	
	Shares Granted	Weighted- Average Grant Date Fair Value	Shares Granted	Weighted- Average Grant Date Fair Value
Stock options	1,922,600	\$1.47	1,132,970	\$4.72
RSUs	1,410,450	\$2.78	699,000	\$8.97

The total intrinsic value of stock options exercised for the nine months ended September 30, 2014 and 2013 was \$0.7 million and \$10.1 million, respectively.

RSUs that vested during the nine months ended September 30, 2014 and 2013 had fair values of \$1.7 million and \$0.5 million, respectively, as of the vesting date.

**Common Stock Warrants**

As of September 30, 2014 and December 31, 2013, the Company had 90,000 and 912,368, respectively, outstanding warrants to purchase shares of common stock. Of these outstanding warrants, 90,000 were exercisable as of September 30, 2014 and December 31, 2013, respectively. During the year ended December 31, 2010, the Company issued warrants to purchase 822,368 shares of common stock in connection with a collaborative development agreement with an exercise price of \$6.08 per share, each of which expired without exercise during the three months ended September 30, 2014.

**Common Stock**

As of September 30, 2014 and December 31, 2013, the Company had reserved shares of common stock for issuance as follows:

	September 30, 2014	December 31, 2013
Number of stock options outstanding	6,699,670	6,468,743
Number of RSUs outstanding	1,830,805	850,351
Shares available for future grant	5,347,789	5,238,699
Number of warrants outstanding	90,000	912,368
Total shares reserved	13,968,264	13,470,161



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## 7. Net Loss per Share of Common Stock

The following table sets forth the computation of the Company's basic and diluted net loss per share of common stock during the three and nine months ended September 30, 2014 and 2013 (in thousands, except for share and per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net loss attributable to common stockholders	\$(4,963	) \$(2,171	) \$(15,673	) \$(4,401
Shares used in computing net loss per share of common stock, basic and diluted	46,842,055	45,191,514	46,655,187	44,657,529
Net loss per share of common stock, basic and diluted	\$(0.11	) \$(0.05	) \$(0.34	) \$(0.10

The following outstanding shares of common stock equivalents were excluded from the computation of diluted net loss per share of common stock for the periods presented because including them would have been antidilutive:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Stock options to purchase common stock	6,699,670	6,451,590	6,699,670	6,451,590
RSUs	1,830,805	778,924	1,830,805	778,924
Common stock warrants	90,000	912,368	90,000	912,368

## 8. Income Taxes

Income tax expense for the nine months ended September 30, 2014 was \$7,000, or 0.0% on a pre-tax loss of \$15.7 million. The difference between the Company's effective tax rate and the federal statutory rate of 35% is primarily attributable to the differential in foreign taxes, non-deductible stock-based compensation expense, other currently non-deductible items and movement in its valuation allowance. The Company maintained a valuation allowance as of September 30, 2014 against all of its deferred tax assets.

The Company intends to maintain a full valuation allowance until sufficient positive evidence exists to support its reduction.

## 9. Related Party Transactions

In March 2013, the Company amended the CDP agreement that it had entered into in March 2010 with a related party and that it and the related party had amended in March 2012. Under the amended agreement, the two companies agreed to work together to conduct research and development and other activities. Depending on the output of the research and development, the primary rightholder will be the Company or the other party. However, if the other party is not the primary rightholder, it will be able to license the developed technology from the Company. The CDP development program between the parties ended during the three months ended March 31, 2014, although certain licensing and royalty elements continue. The other party and the Company each have an independent board member that serves on both companies' boards of directors and the independent board member is also a managing member of a significant shareholder of the Company. As of September 30, 2014, this shareholder was a beneficial owner of approximately 9.0% of the Company's common stock. As of September 30, 2014 and December 31, 2013, the Company had accounts receivable in the amount of zero and \$0.1 million, respectively, related to the amended agreement. The following table presents related party revenue included in the Condensed Consolidated Statement of Operations from this amended agreement (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Related party revenue	\$313	\$1,030	\$1,570	\$3,347

In November 2006, the Company entered into an Alliance Agreement with a related party that was a beneficial owner of approximately 5.4% of the Company's common stock as of September 30, 2014. The other party and the Company each have an independent board member that serves on both companies' boards of directors. Since November 2006,

the agreement has been amended numerous times with the last amendment signed in December 2013. The December 2013 amendment did not extend or renew CDP services and decreased workflow support and licenses. As of September 30, 2014 and December 31,

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2013, the Company had accounts receivable in the amount of \$0.2 million and \$0.1 million, respectively, and had a deferred revenue balance in the amount of \$0.8 million and \$0.4 million, respectively, related to the amended agreement. The following table presents related party revenue and cost of revenue included in the Condensed Consolidated Statement of Operations from the amended agreement (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Related party revenue	\$837	\$2,120	\$2,188	\$6,339
Related cost of revenue	\$—	\$1	\$—	\$1

## 10. Information about Geographic Areas

## Revenue

Revenue by geography is based on the billing address of the customer. The following table sets forth revenue by geographic area (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
United States	\$9,626	\$10,172	\$32,897	\$35,016
Japan	685	3,694	1,942	11,501
APAC other	407	1,071	1,338	2,352
Europe and Middle East	137	2,811	517	2,920
Total	\$10,855	\$17,748	\$36,694	\$51,789

## Long-Lived Assets

Substantially all of the Company's long-lived assets are located in the U.S. An insignificant amount of long-lived assets reside in the Company's foreign subsidiaries and branches in Hong Kong, Japan and Taiwan.

## 11. Restructuring Charges

During each of February and May 2014, the Company initiated reductions in force as part of an overall plan to reduce the Company's cost structure. The reductions in force constituted approximately 18% of the Company's workforce in February 2014 and 10% in May 2014. As a result of the reductions in force, the Company recorded expenses related to employee severance and termination benefits of approximately \$1.4 million, which was recognized during the nine months ended September 30, 2014. The following table presents severance and related expenses, payments and accrual adjustments (in thousands) as of September 30, 2014:

	As of December 31, 2013	Charges	Cash Payments	Adjustments	As of September 30, 2014
Severance and related expenses	\$—	\$1,423	\$(1,355)	(61)	\$7

## 12. Subsequent Events

During October 2014, the Company entered into separation agreements with its former Chief Executive Officer and General Counsel and will make cash payments in the amount of \$0.5 million in connection with those agreements during the three months ending December 31, 2014. In addition, the former Chief Executive Officer received accelerated vesting of equity awards that would have vested in the six months following the separation date.

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Our Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is provided in addition to the accompanying consolidated condensed financial statements and notes to assist readers in understanding our results of operations, financial condition, and cash flows. Our MD&A is organized as follows:

- **Overview.** Discussion of our business and overall analysis of financial and other highlights affecting the Company in order to provide context for the remainder of MD&A.

- **Strategy.** Our overall strategy.

- **Basis of Presentation.** A summary of the primary elements of our financial results.

- **Critical Accounting Estimates.** Accounting estimates that we believe are most important to understanding the assumptions and judgments incorporated in our reported financial results and forecasts.

- **Results of Operations.** An analysis of our financial results comparing the three and nine months ended September 30, 2014 to the three and nine months ended September 30, 2013.

- **Liquidity and Capital Resources.** An analysis of changes in our balance sheets and cash flows, and discussion of our financial condition and potential sources of liquidity.

The following discussion and analysis should be read in conjunction with our condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q ("Form 10-Q") and in our Annual Report on Form 10-K (the "2013 Form 10-K") and subsequent quarterly reports on Form 10-Q, as filed with the Securities and Exchange Commission. This Form 10-Q contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. The statements contained in this Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended.

Forward-looking statements are often identified by the use of words such as, but not limited to, "may," "will," "expect," "believe," "anticipate," "intend," "could," "should," "estimate," or "continue," and similar expressions or variations intended to identify forward-looking statements. These statements are based on the beliefs and assumptions of our management based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties and other important 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 identified below, and those discussed in the section titled "Risk Factors" in Part II, Item 1A of this Form 10-Q and in our 2013 Form 10-K and subsequent quarterly reports on Form 10-Q. Furthermore, such forward-looking statements speak only as of the date of this Form 10-Q. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

#### Overview

We have pioneered a proprietary approach to accelerate research and development ("R&D"), innovation and time-to-market for the semiconductor and clean energy industries. Through paid collaborative development programs ("CDPs") with our customers, we develop proprietary technology and intellectual property ("IP") for our customers focused on advanced materials, processes, integration and device architectures. This technology enables our customers to bring optimized, volume manufacturing-ready integrated devices to market faster and with less risk than conventional approaches to R&D. We provide our customers with proprietary technology through various fee arrangements and grant them rights to associated IP, primarily through royalty-bearing licenses. Through paid CDPs and our own development, we have established a portfolio of greater than 1,200 patents and patent applications. Our proprietary approach is broadly applicable to high-volume integrated device markets, which include the markets for semiconductors, flat-glass coatings and glass-based devices, solar cells, light-emitting diodes ("LEDs"), flat-panel displays, advanced batteries and other energy efficiency applications.

We were founded in 2004 and are headquartered in San Jose, California. Our total revenue decreased to \$10.9 million and \$36.7 million for the three and nine months ended September 30, 2014 from \$17.7 million and \$51.8 million for the three and nine months ended September 30, 2013. Our net loss increased to \$5.0 million for the three months

ended September 30, 2014, from a net loss of \$2.2 million for the three months ended September 30, 2013 and increased to a net loss of \$15.7 million during the nine months ended September 30, 2014 from a net loss of \$4.4 million during the nine months ended September 30, 2013. Since inception, we have incurred net losses leading to an accumulated deficit of \$125.8 million as of September 30, 2014.

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### Strategy

Our mission is to drive our customers' success by transforming R&D and accelerating innovation in markets that derive competitive advantage from the interaction of materials science, processes, integration and device architecture. We currently target semiconductor and high-growth emerging clean energy markets, including DRAM, stand-alone non-volatile memory, embedded memory, complex logic, flat glass coatings and glass-based devices, solar cells, LEDs, displays, advanced batteries and energy-efficiency technologies. Within these broad markets, we target customers that have track records of technological innovation, deploy significant resources and are pursuing technical advancements that are critical to their success and strategy, including ATMI, Elpida (a wholly owned subsidiary of Micron Technology), First Solar, GLOBALFOUNDRIES, Guardian Industries, Micron Technology, SanDisk, Taiwan Semiconductor Manufacturing Company ("TSMC"), Toshiba, and the Ulyanovsk Center for Technology Transfer of the Russian Federation ("UCTT"). ATMI and Elpida have commenced shipping products incorporating technology developed through our CDPs and pay us licensing and royalty fees. To date, we have received the majority of our revenue from customers in DRAM, stand-alone non-volatile memory, complex logic, solar cells and energy-efficiency applications in flat-glass coatings and glass-based devices, and we have not yet received a material amount of revenue from customers in embedded memory, LEDs, displays and other energy-efficiency technologies.

### Basis of Presentation

#### How We Generate Revenue

Our customer engagement process generates revenue in three ways: CDP and services revenue; product revenue; and licensing and royalty revenue. CDPs are our primary engagement model with customers, and are structured to result in licensing and/or royalty revenue. When we initially engage with a customer, we generate revenue from micro-CDPs, CDPs and licensing of our high productivity combinatorial ("HPC") platform. Our micro-CDPs are smaller, customer-paid programs that require significantly less investment from our customers but allow us to demonstrate the capabilities of our HPC platform to a customer without requiring them to commit to a multi-year agreement. We use these micro-CDPs to demonstrate the capabilities and value of our HPC platform to these new customers, with the objective of engaging with these customers in a full CDP. When technology developed through CDPs is incorporated in our customers' commercialized products, we generate licensing and/or royalty revenue. In certain cases, we sell HPC processing tools to our customers who pay a recurring license fee to operate those tools with our combinatorial processing capabilities.

**CDP and services revenue.** CDP revenue may include payments for full time equivalent employees, milestone payments, subscription payments for dedicated and shared workflow tools used in the CDP and reimbursed payments for consumables and outside services from third parties. Individual CDPs typically range from one to three years.

**Services revenue outside of CDPs** is substantially comprised of support and maintenance fees and extended warranty agreements. CDP and services revenue is recognized in a manner consistent with activities performed. During the year ending December 31, 2014, as a result of certain CDPs being completed in 2014, we expect a decrease in CDP and services revenue. As we engage new customers and negotiate extensions for existing customer agreements that are nearing completion, we expect CDP and services revenue to continue to fluctuate.

**Product revenue.** Product revenue consists of sales of our workflow hardware and embedded software. In support of our business strategy, we selectively sell our proprietary tools to increase opportunities for CDPs and licensing fees and royalties. As our other revenue streams increase we expect our product revenue to decrease as a percentage of our overall revenue. Product revenue is recognized upon shipment (title and risk of loss passed to the customer), and customer acceptance, if required, is achieved.

**Licensing and royalty revenue.** Licensing and royalty revenue consists of licensing fees and royalties for granting our customers rights to our proprietary technology and IP. Specifically, this includes licensing the HPC capabilities of our workflows, licensing our informatics and analysis software, and licensing fees and royalties on products commercialized by our customers that incorporate technology developed through our CDPs. In certain instances, minimum license fees and royalties may be guaranteed by customer contracts and are recognized as revenue ratably over the related periods. Over the long term, we expect licensing and royalty revenue to be an increasing and significant component of our revenue. During the three months ended March 31, 2014, we experienced an increase in licensing and royalty revenue attributable to an accelerated payment from a customer in connection with an amended



CDP agreement. We anticipate our licensing and royalty revenue to continue to fluctuate based on the timing and amount of minimum license fees guaranteed by certain customer contracts and the timing of customer reported volume-based royalties.

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### Cost of Revenue

Our cost of revenue is variable and depends on the product mix and type of revenue earned in each period relating to our customer programs. As customers commercialize products that incorporate technology developed through our CDPs, we expect our cost of revenue to decrease as a percentage of total revenue when licensing and royalty revenue become an increasing component of our revenue.

Cost of CDP and services revenue. Our cost of CDP and services revenue is primarily comprised of salaries and other personnel-related expenses (including stock-based compensation) for our collaborative research and development scientists, engineers and development fab process operations employees. Additionally, our cost of revenue includes costs of wafers, targets, materials, program-related supplies, third-party professional fees and depreciation of equipment used in CDPs.

Cost of product revenue. Our cost of product revenue primarily includes our cost of products sold. Our cost of product revenue will fluctuate based on the type of product and configuration sold. Cost of product revenue is recognized upon product shipment and customer acceptance, if required. The variability in cost of product revenue as a percentage of revenue is related to the quantity and configuration of products sold during the period.

Cost of licensing and royalty revenue. Our cost of licensing and royalty revenue is primarily comprised of the amortization of acquired patents and licensing obligations.

### Research and Development

Our R&D expenses consist of costs incurred for development and continuous improvement of our HPC platform, expansion of software capabilities and application R&D that are not associated with customer programs. R&D costs include personnel-related expenses (including stock-based compensation expenses) for our technical staff as well as consultant costs, parts and prototypes, wafers, chemicals, supply costs, facilities costs, utilities costs related to laboratories and offices occupied by technical staff, depreciation on equipment used by technical staff, and outside services, such as machining and third-party R&D costs. Overhead costs that are not allocated to a customer program are recognized as expenses within R&D. We expect our R&D expense to increase modestly in absolute dollars in the near-term periods as resources are reallocated from customer CDPs to R&D and as we continue to develop and improve our HPC platform and extend the applicability of our platform to a broader set of applications within the industries we serve.

### Sales and Marketing

Our sales and marketing expenses consist primarily of personnel-related costs (including stock-based compensation) for our sales and marketing employees, as well as payments of commissions to our sales employees, facility costs and professional expenses. Professional expenses consist of external website and marketing communication consulting costs and market research. We expect sales and marketing expense to remain relatively flat in absolute dollars in the near-term periods.

### General and Administrative

General and administrative expenses consist primarily of personnel-related costs (including stock-based compensation) as well as professional services and facilities costs related to our executive, finance, legal, human resources, management information systems and information technology functions. Professional services consist of outside accounting, information technology, consulting and legal costs. We also incur significant accounting and legal costs related to compliance with rules and regulations enacted by the Securities and Exchange Commission, including the costs maintaining compliance with Section 404 of the Sarbanes-Oxley Act, as well as insurance, investor relations and other costs associated with being a public company. In addition to these expenses, we expect that our general and administrative expenses will continue to increase for the foreseeable future. In October 2014, we entered into separation agreements with our former Chief Executive Officer and General Counsel and expect to recognize increased compensation expense in connection with those agreements during the three months ending December 31, 2014.

### Restructuring Expenses

After experiencing a reduced level of CDP activity, we initiated reductions in force in February 2014 and May 2014 with respect to approximately 18% and 10% of our workforce at such times, respectively. These reductions in force

were part of an overall plan to reduce our cost structure and were completed during the six months ended June 30, 2014. Restructuring expenses consist of personnel-related costs.

Interest Expense, net

Interest expense historically consisted of interest accrued on our note payable to Symyx in connection with the Symyx asset purchase transaction that closed in November 2011, which was paid in full in May 2013 with a credit facility from SVB.

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Interest expense after May 2013 consists primarily of interest accrued on our credit facility, which was converted in November 2013 to a three year note payable to SVB. Interest income represents interest earned on our cash, cash equivalents, and short-term investments. We expect interest income will vary each reporting period depending on our average investment balances during the period and market interest rates.

**Critical Accounting Estimates**

Our consolidated financial statements have been prepared in conformity with generally accepted accounting principles in the United States and include our accounts and the accounts of our wholly-owned subsidiaries. The preparation of our consolidated financial statements requires our management to make estimates, assumptions and judgments that affect the reported amounts of assets and liabilities and disclosures for contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenue and expenses during the applicable periods.

Management bases its estimates, assumptions and judgments on historical experience and on various other factors that management believed were reasonable under the circumstances. Different assumptions and judgments would change the estimates used in the preparation of our 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.

There have been no material changes in the matters for which we make critical accounting estimates in the preparation of our condensed consolidated financial statements during the three and nine months ended September 30, 2014 as compared to those disclosed in our 2013 Form 10-K. For further information on our critical and other significant accounting policies, see our 2013 Form 10-K.

**Recent Accounting Pronouncements**

See Note 1 of the Notes to Condensed Consolidated Financial Statements included in this Form 10-Q for recent accounting pronouncements that could have an effect on us.

**Results of Operations****Comparison of the Three and Nine Months Ended September 30, 2014 and 2013**

	Three Months Ended September 30,		\$ Change	% Change		Nine Months Ended September 30,		\$ Change	% Change
	2014	2013				2014	2013		
	(in thousands)					(in thousands)			
Revenue:									
Collaborative development program and services revenue	\$7,699	\$11,156	\$(3,457)	(31)%		\$23,450	\$34,858	\$(11,408)	(33)%
Product revenue	—	2,748	(2,748)	(100)%		—	5,852	(5,852)	(100)%
Licensing and royalty revenue	3,156	3,844	(688)	(18)%		13,244	11,079	2,165	20%
Total revenue	10,855	17,748	(6,893)	(39)%		36,694	51,789	(15,095)	(29)%
Cost of revenue:	6,167	9,064	(2,897)	(32)%		18,371	24,047	(5,676)	(24)%
Gross profit	4,688	8,684	(3,996)	(46)%		18,323	27,742	(9,419)	(34)%
Operating expenses:									
Research and development	5,023	6,107	(1,084)	(18)%		18,191	17,727	464	3%
Sales and marketing	1,321	1,544	(223)	(14)%		4,348	4,759	(411)	(9)%
General and administrative	3,134	3,008	126	4%		9,544	9,042	502	6%
Restructuring charges	—	—	—	—%		1,361	—	1,361	100%
Total operating expenses	9,478	10,659	(1,181)	(11)%		33,444	31,528	1,916	6%
Loss from operations	(4,790)	(1,975)	(2,815)			(15,121)	(3,786)	(11,335)	

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Other income

(expense):

Interest expense, net	(159	)	(168	)	9		(532	)	(649	)	117	
Other (expense)	(13	)	(2	)	(11	)	(13	)	66		(79	)
income, net												
Total other income	(172	)	(170	)	(2	)	(545	)	(583	)	38	
(expense), net												
Loss before provision	(4,962	)	(2,145	)	(2,817	)	(15,666	)	(4,369	)	(11,297	)
for income taxes												
Provision for income	1		26		(25	)	7		32		(25	)
taxes												
Net loss	\$ (4,963	)	\$ (2,171	)	\$ (2,792)		\$ (15,673	)	\$ (4,401	)	\$ (11,272)	

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## Revenue

Our revenue decreased by \$6.9 million, or 39%, to \$10.9 million during the three months ended September 30, 2014, from \$17.7 million during the three months ended September 30, 2013, due to decreases in CDP and services revenue and licensing and royalty revenue primarily as a result of CDPs that ended during 2014, including our engagements with GLOBALFOUNDRIES and SanDisk and Toshiba.

Our revenue decreased by \$15.1 million, or 29%, to \$36.7 million during the nine months ended September 30, 2014, from \$51.8 million during the nine months ended September 30, 2013, due to decreases in CDP and services revenue and product revenue offset by an increase in licensing and royalty revenue.

CDP and services revenue decreased by \$3.5 million, or 31%, to \$7.7 million during the three months ended September 30, 2014, from \$11.2 million during the three months ended September 30, 2013. This decrease was primarily attributable to \$5.2 million in revenue from the scheduled completion and reduction of CDP and service agreements. This was partially offset by \$1.0 million in revenue derived from the expansion of existing customer engagements and \$0.7 million in revenue derived from new customer engagements.

CDP and services revenue decreased by \$11.4 million, or 33%, to \$23.5 million during the nine months ended September 30, 2014, from \$34.9 million during the nine months ended September 30, 2013. This decrease was primarily attributable to the reduction of \$16.4 million in revenue attributable to the scheduled completion and reduction of CDP and service agreements. This was partially offset by \$3.8 million in revenue derived from the expansion of existing customer engagements and \$1.2 million in revenue derived from new customer engagements. Of the growth from new customer engagements, \$1.1 million in revenue was derived from three customer engagements.

Product revenue decreased by \$2.7 million during the three months ended September 30, 2014 and decreased by \$5.9 million during the nine months ended September 30, 2014, as there were no workflow sales during the three and nine months ended September 30, 2014.

Licensing and royalty revenue decreased by \$0.7 million, or 18%, to \$3.2 million during the three months ended September 30, 2014, from \$3.8 million during the three months ended September 30, 2013. This decrease was primarily attributable to a decrease in scheduled minimum license fees guaranteed by customer contracts.

Licensing and royalty revenue increased by \$2.2 million, or 20%, to \$13.2 million during the nine months ended September 30, 2014, from \$11.1 million during the nine months ended September 30, 2013. This increase was primarily attributable to a \$4.2 million accelerated payment from a customer in connection with the suspension of CDP activities with them and this was partially offset by decreases in scheduled minimum license fees guaranteed by other customer contracts.

The following table presents revenue by geographic region (based on invoiced locations) during the three and nine months ended September 30, 2014 and 2013 in dollars (in thousands) and as a percentage of revenue for the periods presented:

	Three Months Ended September 30,				Nine Months Ended September 30,				
	2014		2013		2014		2013		
	Revenues	% of Revenues	Revenues	% of Revenues	Revenues	% of Revenues	Revenues	% of Revenues	
United States	\$9,626	89	% \$10,172	57	% \$32,897	90	% \$35,016	67	%
Japan	685	6	% 3,694	21	% 1,942	5	% 11,501	22	%
APAC other	407	4	% 1,071	6	% 1,338	4	% 2,352	5	%
	137	1	% 2,811	16	% 517	1	% 2,920	6	%

Europe and  
Middle East

Total	\$ 10,855	100	%	\$ 17,748	100	%	\$ 36,694	100	%	\$ 51,789	100	%
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#### Cost of Revenue

Cost of revenue decreased by \$2.9 million, or 32%, to \$6.2 million during the three months ended September 30, 2014, from \$9.1 million during the three months ended September 30, 2013. This change was a result of a \$1.7 million decrease in direct labor, materials and other costs associated with the scheduled completion and reduction of certain CDP and service agreements and \$1.4 million decrease in direct product costs consistent with decreased product revenue. The decrease in cost of revenue is partially offset by a \$0.2 million increase in provisions for obsolete inventory.

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Cost of revenue decreased by \$5.7 million, or 24%, to \$18.4 million during the nine months ended September 30, 2014, from \$24.0 million during the nine months ended September 30, 2013. This change is a result of a \$3.9 million decrease in direct labor, materials and other costs associated with the scheduled completion and reduction of certain CDP and service agreements and a \$2.5 million decrease in direct product costs consistent with decreased product revenue. The decrease in cost of revenue is partially offset by a \$0.6 million increase in provisions for obsolete inventory and \$0.1 million in allocated rent expense.

### Gross Margin

Our gross profit as a percentage of net revenues, or gross margin, has been and will continue to be affected by a variety of factors, including the mix of CDP and services revenue, product revenue, and licensing and royalty revenue recognized during the period. We achieve a higher gross margin on licensing and royalty revenue as compared to CDP and services and product revenue.

Gross margin was 43.2% during the three months ended September 30, 2014 compared to 48.9% for the three months ended September 30, 2013. This decrease was primarily attributable to increased investments in customer CDPs and to a lesser extent decreases in licensing and royalty revenue, which are typically higher margin.

Gross margin was 49.9% during the nine months ended September 30, 2014 compared to 53.6% for the nine months ended September 30, 2013. This decrease was primarily attributable to increased investments in customer CDPs.

### Research and Development

R&D expenses decreased by \$1.1 million, or 18%, to \$5.0 million during the three months ended September 30, 2014, from \$6.1 million during the three months ended September 30, 2013. The change was primarily attributable to a decrease of \$1.9 million in employee and professional services related costs, offset by a \$0.3 million increase in rent expense and \$0.5 million increase in facility and depreciation expense due to assets utilized for R&D development previously assigned to customer CDPs. Research and development expense included stock-based compensation of \$0.3 million during the three months ended September 30, 2014 and 2013.

R&D expenses increased by \$0.5 million, or 3%, to \$18.2 million during the nine months ended September 30, 2014, from \$17.7 million during the nine months ended September 30, 2013. The change was primarily attributable to an increase of \$1.8 million in depreciation expense due to assets utilized for R&D development previously assigned to customer CDPs and increased costs for internal development, and to a lesser extent, increased rent expense of \$0.6 million. These increased expenses were partially offset by decreases in employee and professional services related costs of \$1.9 million. Research and development expense included stock-based compensation of \$0.9 million and \$1.0 million during the nine months ended September 30, 2014 and 2013, respectively.

### Sales and Marketing

Sales and marketing expenses decreased by \$0.2 million, or 14%, to \$1.3 million during the three months ended September 30, 2014, from \$1.5 million during the three months ended September 30, 2013. This decrease is primarily related to decreases in employee and professional services related costs. Sales and marketing expense included stock-based compensation of \$0.4 million and \$0.3 million during the three months ended September 30, 2014 and 2013, respectively.

Sales and marketing expenses decreased by \$0.4 million, or 9%, to \$4.3 million during the nine months ended September 30, 2014, from \$4.8 million during the nine months ended September 30, 2013. This decrease is primarily



related to decreases in employee and professional services related costs. Sales and marketing expense included stock-based compensation of \$1.1 million and \$0.9 million during the nine months ended September 30, 2014 and 2013, respectively.

#### General and Administrative

General and administrative expenses increased by \$0.1 million, or 4%, to \$3.1 million during the three months ended September 30, 2014, from \$3.0 million during the three months ended September 30, 2013. This increase is primarily attributable to rent expense. General and administrative expense included stock-based compensation of \$0.6 million and \$0.4 million during the three months ended September 30, 2014 and 2013, respectively.

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General and administrative expenses increased by \$0.5 million, or 6%, to \$9.5 million during the nine months ended September 30, 2014, from \$9.0 million during the nine months ended September 30, 2013. This increase is primarily attributable to personnel costs related to increased wages, stock-based compensation and other related benefits.

General and administrative expense included stock-based compensation of \$1.6 million and \$1.1 million during the nine months ended September 30, 2014 and 2013, respectively.

### Restructuring Charges

Restructuring expenses were zero during the three months ended September 30, 2014 and 2013.

Restructuring expenses were \$1.4 million during the nine months ended September 30, 2014, compared to zero for the nine months ended September 30, 2013. In January and May 2014, our Board of Directors authorized restructuring plans to reduce our workforce by 18% and 10%, respectively, pursuant to which charges of \$1.1 million and \$0.3 million were incurred for severance and other personnel related costs.

### Loss from Operations

Our operating loss increased by \$2.8 million, to an operating loss of \$4.8 million during the three months ended September 30, 2014, from an operating loss of \$2.0 million during the three months ended September 30, 2013. Our operating expenses decreased by \$1.2 million to \$9.5 million during the three months ended September 30, 2014, from \$10.7 million during the three months ended September 30, 2013.

Our operating loss increased by \$11.3 million, to an operating loss of \$15.1 million during the nine months ended September 30, 2014, from an operating loss of \$3.8 million during the nine months ended September 30, 2013. Our operating expenses increased by \$1.9 million to \$33.4 million, which includes \$1.4 million in restructuring related expenses, during the nine months ended September 30, 2014, from \$31.5 million during the nine months ended September 30, 2013.

### Interest Expense, net

On May 31, 2013, we entered into a loan and security agreement (the "Loan Agreement") with Silicon Valley Bank ("SVB") and repaid the remaining principal and accrued interest under the secured promissory note that we issued to Symyx in November 2011.

Interest expense, net, remained unchanged at \$0.2 million during the three months ended September 30, 2014 and 2013.

Interest expense, net, decreased by \$0.1 million to \$0.5 million during the nine months ended September 30, 2014, from \$0.6 million during the nine months ended September 30, 2013 and is primarily comprised of interest expense associated with the Loan Agreement with SVB during the nine months ended September 30, 2014 and interest on our note payable to Symyx and credit facility with SVB during the nine months ended September 30, 2013.

### Other (Expense) Income, net

Other (expense) income, net, for the three and nine months ended September 30, 2014 and 2013 consisted of municipal development grant proceeds and foreign exchange gains and losses that were not significant during these periods.

### Provision for Income Taxes

Provision for income taxes during the three and nine months ended September 30, 2014 and 2013 consisted of income taxes on our foreign entities and were not significant during these periods.

#### Net Loss

Our net loss increased by \$2.8 million, to a net loss of \$5.0 million during the three months ended September 30, 2014, from a net loss of \$2.2 million during the three months ended September 30, 2013. The difference between operating loss and net loss during the three months ended September 30, 2014 and 2013 was primarily related to interest expense associated with the Loan Agreement with SVB.

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Our net loss increased by \$11.3 million, to a net loss of \$15.7 million during the nine months ended September 30, 2014, from a net loss of \$4.4 million during the nine months ended September 30, 2013. The difference between operating loss and net loss during the nine months ended September 30, 2014 and 2013 was primarily related to interest expense associated with the Loan Agreement with SVB and interest expense associated with our note payable to Symyx.

### Liquidity and Capital Resources

Prior to our initial public offering in November 2011, we substantially satisfied our capital and liquidity needs through private placements of redeemable convertible preferred stock and, to a lesser extent, cash flow from operations. As of September 30, 2014 we had \$66.1 million of cash, cash equivalents and short-term investments and \$63.5 million of net working capital.

As of September 30, 2014, we had debt outstanding of \$23.5 million related to the Loan Agreement with SVB. We are obligated to pay interest at a fixed rate of 3.25% and \$0.5 million of principal on a quarterly basis. The term loan matures on November 30, 2016 and we are obligated to pay all outstanding principal and accrued and unpaid interest on that date. At our option, we may prepay the outstanding principal balance of the term loan in full or in part, subject to a pre-payment fee of 0.25% of the outstanding principal balance of the term loan if the term loan is repaid prior to November 30, 2014. Our obligations under the term loan require us to dedicate a substantial portion of our cash flow from operations to payments on interest and principal at or prior to maturity, thus reducing the availability of our cash flow to fund working capital, capital expenditures, research and development efforts, execution of our business strategy and other general corporate purposes. Such limitations increase our vulnerability to adverse general economic and industry conditions and limit our flexibility in planning for, or reacting to, changes in the economy, our industry and new opportunities that may arise. In addition, our obligations under the term loan and the security interests granted in favor of SVB may make it more difficult for us to borrow funds in the future to fund working capital, capital expenditures and other purposes, which could materially and adversely affect our business, financial condition and results of operations.

To date, we have incurred significant losses. During the nine months ended September 30, 2014 and 2013, we incurred net losses of \$15.7 million and \$4.4 million, respectively. As of September 30, 2014, our accumulated deficit was \$125.8 million.

We believe that we have the financial resources needed to meet business requirements for the next 12 months.

However, our forecast of the period of time through which our financial resources will be adequate to meet business requirements are forward-looking statements and involve risks and uncertainties. Our future capital requirements will depend on many factors, many of which are set forth in greater detail under the caption "Risk Factors," but generally include without limitation our rate of revenue growth, our expansion of our sales and marketing activities and overhead expenses, the timing and extent of our spending to support our R&D efforts and our ability to expand CDPs in the semiconductor and clean energy industries, whether we are successful in obtaining payments from customers, the financial stability of our customers, whether we can enter into additional collaborations in our target industries, the progress and scope of collaborative R&D projects performed by us and our customers, the effect of any acquisitions of other businesses or technologies that we may make in the future, the filing, prosecution and enforcement of patent claims, how much funding we may need to develop or enhance our solutions or HPC platform and any necessary responses to competitive pressures. To the extent that existing cash, cash equivalents, short-term investments and cash from operations are insufficient to fund our operations and repay our outstanding debt when it may become due, we may need to raise additional funds through public or private equity or debt financing. We may also seek to invest in or acquire complementary businesses, applications or technologies, any of which could also require us to seek additional equity or debt financing. Additional funds may not be available on terms favorable to us or at all. We maintain almost all of our cash and investments in the United States and therefore are not subject to restrictions or tax obligations as we access the cash.

### Cash Flows

The following summary of our cash flows for the periods indicated has been derived from our condensed consolidated financial statements included elsewhere in this filing (in thousands):

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	Nine Months Ended September	
	30,	
	2014	2013
Net cash (used in) provided by operating activities	\$(1,594	) \$5,979
Net cash used in investing activities	\$(48,114	) \$(10,417 )
Net cash (used in) provided by financing activities	\$(325	) \$421

Table of Contents**Cash Flows from Operating Activities**

We experienced negative cash flows from operating activities during the nine months ended September 30, 2014 in the amount of \$1.6 million as compared to positive cash flows for the same period ending 2013 in the amount of \$6.0 million.

Net cash used in operating activities during the nine months ended September 30, 2014 of \$1.6 million was primarily attributable to our net loss of \$15.7 million, non-cash charges of \$8.1 million for depreciation, amortization, and accretion and \$4.5 million for stock-based compensation. Depreciation, amortization and accretion increased by \$1.2 million due to a larger fixed asset install base. The net increase in cash flow from operating assets and liabilities of \$1.4 million was primarily a result of a \$0.8 million increase in collections from accounts receivable and a net increase in deferred revenue of \$1.6 million due to advance customer payments. Operating cash flow related to accounts payable and accrued liabilities decreased by \$1.7 million due to declines in purchasing activity and employee related liabilities.

**Cash Flows from Investing Activities**

Our investing activities consist primarily of purchases and maturities of short-term investments, capital expenditures to purchase property and equipment, and our investments in intangible assets relating to our patents and trademarks. In the future, we expect we will continue to make modest capital expenditures to support our operations, and to incur costs to protect our investment in our developed technology and IP.

During the nine months ended September 30, 2014, cash used in investing activities was \$48.1 million, primarily as a result of \$45.2 million in the purchase of short-term investments, \$2.6 million in capital expenditures and \$1.2 million in capitalized patent and trademark costs.

**Cash Flows from Financing Activities**

To date, we have financed our operations primarily with proceeds from the sale of our redeemable convertible preferred stock and proceeds received from our initial public offering. We have a term loan pursuant to the Loan Agreement with SVB with a remaining principal balance of \$23.5 million as of September 30, 2014.

During the nine months ended September 30, 2014, cash used in financing activities in the amount of \$0.3 million was primarily related to the scheduled principal payments on our SVB term loan in the amount of \$1.5 million, which was partially offset by the issuance of common stock as a result of option exercises in the amount of \$1.2 million.

**Contractual Obligations and Commitments**

The following summarizes our contractual obligations as of September 30, 2014 (in thousands):

	Payments Due by Period				
	Total	Due by December 31, 2014	1 - 3 Years	3 - 5 Years	More Than 5 Years
Operating lease obligations	\$26,852	\$427	\$6,409	\$4,980	\$15,036
Term loan	23,500	500	23,000	—	—
Contractual interest payments on term loan	1,701	196	1,505	—	—
Purchase obligations(1)	445	445	—	—	—
Total	\$52,498	\$1,568	\$30,914	\$4,980	\$15,036

(1) Purchase obligations consist of firm, non-cancelable agreements to purchase property and equipment and inventory related items.

Operating lease agreements represent our obligations to make payments under our non-cancelable lease agreement for our facility in San Jose, California. During the nine months ended September 30, 2014, we made regular lease payments of \$0.9 million under this operating lease agreement following a period of free rent from December 2013 through March 2014 in connection with the execution of the agreement in October 2013.

During 2013 we entered into a term loan pursuant to the Loan Agreement with SVB in the amount of \$25.0 million that bears interest at a fixed rate equal to 3.25%. We are obligated to pay interest at the applicable rate and \$0.5 million of principal on a quarterly basis. The term loan matures on November 30, 2016, and we are obligated to pay all outstanding principal and accrued and unpaid interest on that date. At our option, we may pre-pay the outstanding

principal balance of the term loan in full or in part, subject to a pre-payment fee of 0.25% of the outstanding principal balance of the term loan if the term loan is repaid

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prior to November 30, 2014. As of September 30, 2014, the remaining principal on the term loan was \$23.5 million, with remaining interest payments of \$1.7 million due over the term of the loan.

### Off-Balance Sheet Arrangements

As of September 30, 2014, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which are established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risks in the ordinary course of our business. Market risk represents the risk of loss that may impact our financial position due to adverse changes in financial market prices and rates. Our market risk exposure is primarily a result of fluctuations in interest rates and foreign currency exchange rates. We do not hold or issue financial instruments for trading purposes.

#### Interest Rate Sensitivity

The primary objectives of our investment activities are to preserve principal, provide liquidity and maximize income without exposing us to significant risk of loss. The securities we invest in are subject to market risk and a change in prevailing interest rates may cause the principal amount of our investments to fluctuate. We maintain our portfolio of cash equivalents and short-term investments in a variety of securities, including commercial paper, corporate debt securities and money market funds. As of September 30, 2014, our investments were primarily in commercial paper, corporate notes and bonds and money market funds. If overall interest rates fell 10% for the three and nine months ended September 30, 2014, our interest income would have decreased by an immaterial amount, assuming consistent investment levels.

During 2013 we entered into a Loan Agreement with SVB with a principal amount of \$25.0 million that bears interest at a fixed rate equal to 3.25%. We are obligated to pay interest at the applicable rate and \$0.5 million of principal on a quarterly basis. The term loan matures on November 30, 2016 and we are obligated to pay all outstanding principal and accrued and unpaid interest on that date. As the rates on the term loan are fixed, we do not have any further exposure to changes in our interest expense as a result of changes in rates. However, in the event we enter into other long-term debt arrangements, we could be subject to fluctuations in interest rates which could have a material impact on our future financial condition and results of operation. In addition, the Loan Agreement also includes several potential events of default such as payment default, material adverse change conditions and insolvency conditions that could cause interest to be charged at the rate that is otherwise applicable plus 5.0%. As of September 30, 2014, we were in compliance with the covenants in the Loan Agreement. If we are ever unable to meet the covenants in the Loan Agreement, we could also be required to renegotiate the terms of credit under the Loan Agreement, including the interest rate, and there can be no assurance that any renegotiated terms of credit would not materially impact our earnings.

#### Foreign Currency Exchange Risk

As we expand internationally, our consolidated results of operations and cash flows will become increasingly subject to fluctuations due to changes in foreign currency exchange rates. Our revenue is denominated in U.S. dollars. Our expenses are generally denominated in the currencies in which our operations are located, which is primarily in the United States, with an insignificant portion of expenses incurred in the local currencies of our wholly-owned subsidiaries in Hong Kong and Japan and our wholly-owned branch in Taiwan. The effect of a hypothetical 10% change in foreign currency exchange rates applicable to our business would not have a material impact on our consolidated financial statements. To date, we have not entered into any material foreign currency hedging contracts, although we may do so in the future.

### ITEM 4. CONTROLS AND PROCEDURES

#### Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2014. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), means controls and other procedures of a company that are designed to ensure that information



required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Based on the evaluation of our disclosure controls and procedures as of September 30, 2014, our Chief Executive Officer and

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Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There were no changes to our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Our management, including our Chief Executive Officer and Chief Financial Officer, believes that our disclosure controls and procedures and internal control over financial reporting are designed to provide reasonable assurance of achieving their objectives and are effective at the reasonable assurance level. However, our management does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a cost effective control system, misstatements due to error or fraud may occur and not be detected.

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PART II — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On August 23, 2013, we received a copy of a complaint from the California Division of Labor Standards and Enforcement ("DLSE") filed by an employee in the company's research and development group claiming that the employee is owed back pay due to an incorrect classification as an exempt employee for overtime purposes. We subsequently commenced a review of the employee's claim as well as a review of our policies regarding classification of employees for overtime purposes. On January 16, 2014, we participated in mediation with the attorney who represents the employee that filed the claim with the DLSE, as well as fourteen other current and former employees and contractors who are similarly situated. This mediation did not result in a settlement of the subject claims, and on February 18, 2014, the claimants filed a lawsuit against us in the United States District Court for the Northern District of California. Between May 19, 2014 and July 25, 2014 we entered into settlement agreements with all of the fifteen claimants, including full releases of legal claims and dismissals of their claims in the lawsuit, which required us to make cash payments in the amount of \$1.0 million in the aggregate.

From time to time, we may become involved in other legal proceedings and claims arising in the ordinary course of our business, including but not limited to legal proceedings and claims brought by employees or former employees relating to working conditions or other issues. We are not currently a party to any legal proceedings the outcome of which, if determined adversely to us, we believe would individually or in the aggregate have a material adverse effect on our business, operating results, financial condition or cash flows.

ITEM 1A. RISK FACTORS

We describe our business risk factors below. This description includes any material changes to and supersedes the description of the risk factors disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2013 as filed with the Securities and Exchange Commission on March 10, 2014 ("2013 Form 10-K") and our Quarterly Report on Form 10-Q for the second quarter of 2014. You should carefully consider the risks described below together with the other information set forth in this Form 10-Q, which could materially affect our business, financial condition or future results. The risks described below are not the only risks facing our company. Risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and operating results.

We have marked with an asterisk (\*) those risks described below that reflect material substantive changes from the risks described under "Risk Factors" included in our Quarterly Report on Form 10-Q for the second quarter of 2014. Risks Related to Our Business, Financial Condition and Results of Operations

We have a limited operating history, which makes it difficult for investors to evaluate our current business and future prospects.\*

We do not have a long history of operating results on which you can base your evaluation of our business. We are still proving our business model, and we have not yet demonstrated our ability to generate significant revenue, particularly licensing and royalty revenue (which represented 36% of total revenue in the nine months ended September 30, 2014 and 22%, 24%, and 27% in fiscal years 2013, 2012 and 2011, respectively). As a result, it may be difficult for analysts and investors to evaluate our future prospects. If we do not generate significant licensing and royalty revenue, we may never achieve sustained profitability. Furthermore, because of our limited operating history and because the semiconductor and clean energy industries are rapidly evolving, we have limited experience in analyzing and understanding the trends that may emerge and affect our business. If we are unable to obtain significant licensing and royalty revenue from products that use or incorporate technology developed under our collaborative development programs ("CDPs"), our financial condition and results of operations would be materially and adversely affected.

Our operating results may fluctuate from quarter to quarter, which may make it difficult to predict our future performance.\*

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Our revenue, expenses and operating results have fluctuated, and may in the future continue to fluctuate significantly from quarter to quarter due to a number of factors, many of which are outside our control. Factors that may contribute to these fluctuations include the following, as well as other factors described elsewhere in this Form 10-Q:

our dependence on a limited number of customers;

the length of our sales cycles for CDPs, which makes it difficult to predict the timing of new or expanded CDPs;

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the length of our development cycles for CDPs, which makes it difficult to predict the timeframe in which technology developed under CDPs will be available for commercialization;

fluctuations in the volume and prices of products manufactured and sold by our customers that use or incorporate technology developed under our CDPs ("CDP Products") and that generate licensing and royalty revenue for us;

our revenue mix, which may vary from quarter to quarter as (i) we enter into new CDPs and related customer arrangements; (ii) existing CDPs, particularly for significant customers, are completed, extended, or undergo a change in scope; (iii) licensing arrangements take effect; (iv) we enter into product sale transactions and/or (v) we enter into intellectual property ("IP") sale transactions;

the highly cyclical nature of and price volatility in the semiconductor industry;

the financial stability of any of our customers;

the timing and extent to which we enter into new CDPs or complete, extend the duration, expand the scope or reduce the duration or scope of existing CDPs;

non-cash charges relating to stock-based compensation, amortization of intangible assets, write-down expenses related to inventory, and impairment expenses related to long-lived assets;

any involvement in significant litigation, and in particular intellectual property litigation;

any payments resulting from our intellectual property indemnification policies and obligations;

any need for significant additional capital to finance our business;

any delay in shipments caused by shortages of components used or incorporated in products sold into the market, design errors, manufacturing problems, or difficulties or delays gaining required export licenses for such products;

warranty claims, product recalls and product liability for our HPC tools and for CDP Products; and

business interruptions such as earthquakes and other natural disasters.

You should not rely on quarter-to-quarter comparisons to predict our future performance. Unfavorable changes in any of these or other factors may adversely affect our business, financial condition and results of operations.

We have incurred operating losses since our inception and may not be able to achieve or maintain sustained profitability.\*

We have generated net losses each year since our inception, including \$15.7 million in the nine months ended September 30, 2014, and \$8.8 million, \$0.8 million, and \$30.0 million for the fiscal years ended December 31, 2013, 2012 and 2011, respectively. Our accumulated deficit as of September 30, 2014 was \$125.8 million. We will need to significantly increase revenue and operating margins (through greater licensing revenue and other mechanisms) to achieve sustained profitability, which we may not be able to accomplish.

Our ability to achieve and maintain profitability will depend, in large part, on our success in addressing the following four challenges, as well as the other risk factors in this Item 1A:

• We may be unable to achieve broad customer acceptance of our HPC platform and approach as an alternative to conventional research and development activities.

Historically, semiconductor companies have conducted R&D activities internally using conventional research methods, and they have vigorously protected the confidentiality of their R&D activities. In order for us to increase revenue, we must convince these companies that our technology and capabilities justify collaborating with us on their basic R&D programs. A significant cultural transition is required for a customer's internal R&D team to embrace us as a collaborative partner. This contributes to the long sales cycles we experience, and may

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require us to make significant investments in the expansion of our sales and marketing efforts. We must also convince potential customers in the clean energy industry that our HPC platform and approach are useful tools in an emerging industry. We may not achieve the levels of customer acceptance necessary for us to maintain and grow a profitable business. Failure to achieve the necessary customer acceptance to extend or add current or new customer relationships would adversely affect our revenue and profitability.

• We may be unable to successfully collaborate with all of our customers to achieve the technological innovations sought by our customers.

Even if we achieve sufficient levels of customer acceptance of our HPC platform as an effective tool for R&D, we will not achieve significant revenue or profitability from a CDP if a project to which we have devoted technology and significant resources fails to produce any measurable success or value to our customers in the form of differentiated technology and intellectual property. CDPs are extremely complex and time-consuming to implement and costly to maintain. We rely to some degree on the efforts and resources of the customer. Differences of opinion over the implementation and management of the program may occur, which could lead to material delays and/or a failure to achieve the successful development of technology. In addition, there are a limited number of CDPs to which we can commit our resources at any given time. For a variety of reasons, including but not limited to insufficient R&D budgets of our customers or us, we may fail to achieve the technological innovations sought by our customers in a reasonable amount of time or at all. We do not know whether our customers will have sufficient resources to maintain or increase the level of investment in R&D required for a successful CDP. If a customer reduces the scope of its CDP with us, it will result in a greater concentration of risk of success being placed upon the remaining scope of our engagement, and we cannot guarantee that the remaining scope of the engagement will lead to a successful result. If a CDP does not generate sufficient revenue to recover the upfront costs and cash we invested in the CDP, this would adversely affect our results of operations.

• Our customers may not be successful in commercializing products that use or incorporate technology and IP developed under our CDPs with them.

If we are successful in developing valuable technology for our customers, they still face significant challenges in commercializing products that use or incorporate such technology. The markets for products related to our engagements are intensely competitive and are characterized by rapid technological change. These changes result in frequent product introductions, short product life cycles and the necessity of continually increasing product capabilities. We cannot assure you that our customers will dedicate the resources necessary to successfully execute their business strategies for these products. Our customers are not contractually obligated to us to make or sell any CDP Products. They may not have the financial strength to cost-effectively manufacture the CDP Products at high volume and in quantities sufficient to meet demand, or the competitiveness to price, market and sell the CDP Products in intensely competitive markets. They may experience delays in shipments caused by shortages of components incorporated in the CDP Products, design errors or other manufacturing problems associated with the CDP Products. A decline in demand or average selling prices in the end markets for CDP Products could result in declining sales revenue for our customers and could adversely affect our business and results of operations. Any failure of a customer to achieve market success for CDP Products could also negatively affect such customer's willingness to work with us on other collaborations and could more generally harm our reputation and business prospects. Even if a customer is able to successfully commercialize a CDP Product, there may be a significant delay before we receive any licensing or royalty revenue due to the complexities inherent in production and manufacturing in our customers' target markets.

• Existing and potential customers may be resistant to paying license and royalty fees, and we may face challenges in monitoring and enforcing royalty agreements with existing customers.

Our royalty-bearing licenses with our customers lay the framework for ongoing royalty revenue from CDP Products. Although our R&D activities under CDPs generate revenue for us, in order to achieve profitability we must be able to structure, negotiate and enforce agreements for the calculation and payment of higher-margin license and royalty revenue. Unless we adequately demonstrate the value of our platform to our customers and potential customers, we may face resistance to structuring royalty arrangements in the future that are acceptable to us, or our customers and our potential customers may not agree to enter into royalty-bearing licenses with us at all.



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If we are able to negotiate appropriate agreements, we will need to rely on our customers to make those payments on a timely basis. Licensing and royalty revenue we may receive in the future may be based on sales of CDP Products. In order to accurately report our financial results on a timely basis, we will need to receive timely, complete and accurate information from our customers regarding their sales and resulting payments they owe us. If the information that we receive is not timely, complete or accurate, we may not receive the full amount of revenue to which we are entitled under these arrangements on a timely basis, which could result in adjustments to our financial results in a future period. Although we typically have audit rights with these parties, performing this type of audit could be harmful to our collaborative relationships, expensive and time-consuming and may not be sufficient to reveal any discrepancies in a timeframe consistent with our financial reporting requirements.

If a project to which we have devoted technology and significant resources fails to produce any measurable success or value to our customer in the form of differentiated technology and intellectual property that our customer can successfully commercialize, we may not earn licensing and royalty revenue sufficient to recover our upfront investment in the CDP, which could adversely affect our revenue and profitability.

In some cases, the revenue we receive from our customers during the development stage is not sufficient for us to fully recover our costs and cash invested in HPC platforms dedicated to customer engagements, and our business model relies on licensing and royalty revenue based on the sales by our customers in the end-markets of CDP Products. Our CDPs involve complex R&D, and our ability to develop the differentiated technology and intellectual property sought by our customers is inherently uncertain and difficult to predict. If a project fails to produce any measurable value to a customer, or if we are otherwise not successful in maintaining and managing a CDP, we may not receive sufficient amounts of licensing and royalty revenue to recover our upfront investment in the CDP.

We depend on a limited number of customers, and a loss of any of them, or a significant reduction in revenue from any of them, would adversely affect our business, financial condition and results of operations.\*

Our customer base is highly concentrated. Revenue has historically come from a few customers, and we expect that revenue from a small number of customers will continue to account for a high percentage of our revenue for the foreseeable future. Our three largest customers accounted for 64% of revenue in the nine months ended September 30, 2014, and our four largest customers accounted for 55% of our revenue in the fiscal year ended December 31, 2013. Our three largest customers during 2012 and 2011 (all of which are in the semiconductor industry), accounted for 67% and 64% of our revenue in the fiscal years ended December 31, 2012 and 2011, respectively. Our largest customer accounted for 34%, 17%, 28%, and 29% of our revenue in each of these periods, respectively, and as of September 30, 2014 our largest customer accounted for 47% of our account receivables. Our concentration of customers is somewhat a reflection of the concentrated nature of manufacturers in the DRAM, flash memory and complex logic markets, and our revenue is and may continue to be heavily reliant on key high-volume customers. In addition, as with any of our customers, our profitability and success are dependent, in part, upon the receipt of licensing and royalty revenue on the sale of CDP Products by our customers, and we cannot control the timing of customer product introductions or their success or failure in the marketplace. The loss of any of these customers or a decrease or delay in the manufacturing or sales volumes of the CDP Products, or a renegotiation of the licensing or royalty revenue owed to us by our customers, or their failure to pay amounts due to us or renew, extend or maintain their existing relationships with us, and the related impact on our future anticipated licensing and royalty revenue, would materially and adversely affect our business, financial condition and results of operations, and we may not be able to replace the business from these customers. Additionally, any significant decrease in revenue from one or more key customers may require reductions in our employee workforce, which could reduce our ability to grow as well as expose us to an increased risk of employment and labor claims against us.

As an example, in February 2014 our customer GLOBALFOUNDRIES, Inc. ("GLOBALFOUNDRIES") suspended development activities under its CDP with us through the remainder of calendar year 2014. Accordingly, we have

experienced a reduction in the scope of R&D activities, associated employee workforce and associated CDP revenue, which has adversely affected our business, financial condition and results of operations this fiscal year. Similarly, Toshiba and SanDisk did not renew or extend the term of our CDP with them. As of March 15, 2014, Toshiba and SanDisk no longer pay us fees for development services. In addition, our customer Elpida Memory, Inc. ("Elpida") filed for protection under the Corporate Reorganization Act in Japan in February 2012, and was subsequently acquired by Micron Technology, Inc. ("Micron"), a leading provider of memory chips, in July 2013. Future filings for bankruptcy protection by existing customers or further consolidation among existing or potential customers may increase our dependence on a limited number of customers, which would subject us to additional risk for the reasons set forth above.

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Our sales cycles are long, and we commit significant resources to a project before we have any commitment that a potential customer may agree to use our platform or service. One or more failures to enter into a CDP after we have devoted significant resources to a project could adversely affect our business, financial condition and results of operations.

Our sales efforts require us to educate our potential customers about the benefits of our solutions, which often requires significant time and expense, including a significant amount of our senior management's time and effort. Our sales cycles to date have typically ranged from 9 to 24 months and may be even longer in the future. Furthermore, we need to target those individuals within a customer's organization who have overall responsibility for the profitability of their products. These individuals tend to be senior management or executive officers. We may face difficulty identifying and establishing contact with these individuals. In addition, our customers' technology and product pipelines are highly confidential and they may choose to withhold certain information from us during the sales cycle to protect their own proprietary technology. Our ability to implement our HPC platform and methodology is heavily dependent upon the information provided to us by our customers. If our customers reveal the complexities of their specifications after we enter into a CDP with them, that complexity may cause delays unanticipated at the time we entered into the program. During our sales cycles, we incur significant expenses and, in many cases, may begin to build new systems, configure, modify, expand or customize existing systems, develop software and design workflows to meet our customers' requirements prior to obtaining contractual commitments, without any assurance of resulting revenue. Where a potential customer engagement requires a new dedicated HPC platform, we may invest in new capacity ahead of a customer commitment. Our cycles to build, configure, modify, expand or customize the HPC platform to date have ranged from three to nine months and may be even longer in the future. Investment of time and expense in a particular customer engagement that does not ultimately result in material revenue will adversely affect our revenue and other results of operations. Other factors impacting the length of our sales cycles include, but are not limited to, the following:

- the limited number of customers that are appropriate sales targets for our platform and that are willing to enter into licensing agreements with us;

- our ability to enter into CDPs with customers who are or will become market leaders in larger, growing market segments;

- our customers' budgetary constraints and internal review procedures that must be completed to begin collaboration with us, including but not limited to those customers whose R&D expenditure and product purchasing decisions are impacted by potential delays in or cancellation of funding by governmental agencies; and

- the significant cultural transition required for a customer's internal R&D team to embrace us as a collaborative partner.

Semiconductor industry technology is rapidly changing. If we are unable to anticipate trends in technology development and introduce new technologies reflecting the latest innovations, it could adversely affect our business, financial condition and results of operations.\*

Our customers expect us to be continuously innovative in their sectors and expect that the technology developed under our CDPs will help them develop new products that keep pace with or push the limits of technological innovation. We rely heavily on the judgment of our management and advisers to anticipate the technology trends in the semiconductor industry and we must continually devote significant engineering resources to keep up with the rapidly growing and evolving varieties of semiconductor architecture, materials, applications, processes and equipment used in semiconductor design and manufacturing. In particular, we must be prepared for the cost, technical complexity and timing of a proposed industry transition to the use of extreme ultraviolet (EUV) lithography.

These innovations are inherently complex and require long development cycles. If we are not able to accurately predict industry changes, or if we are unable to adapt our HPC platform to meet our customers' needs on a timely basis, our existing solutions will be rendered obsolete and our existing and potential customers may choose to develop their own solutions internally as an alternative to ours. If we lose customers, it could have a material adverse impact on our results of operations.

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The semiconductor industry is highly cyclical, subject to significant downturns, price volatility, and other dynamics that make the industry very unpredictable. These factors can have a material adverse impact on our business both directly, and indirectly through the impact on our customers in the industry.

The semiconductor industry is highly cyclical and has been subject to significant economic downturns at various times, characterized by diminished product demand, accelerated erosion of average selling prices and production overcapacity. The semiconductor industry also periodically experiences increased demand and production capacity constraints. The timing and length of these cycles is extremely difficult to predict, which makes it challenging for us to forecast our operating results, make business decisions and identify risks that may affect our business, financial condition and results of operations. In addition, the semiconductor industry has historically experienced price volatility. Because the substantial majority of our revenue comes from customers in the semiconductor industry, we may experience significant fluctuations in operating results due to the cyclical nature and price volatility of the industry.

The industry has also been affected in recent years by uncertainty in the credit markets. For example, pressures in the DRAM sector caused financial difficulties for our customer, Elpida, before it was acquired by Micron. In addition, future uncertainty may cause sudden changes in our customers' manufacturing capacity requirements and spending, which depend in part on capacity utilization, demand for products using or incorporating our technology by consumers, inventory levels relative to demand, and access to affordable capital.

Industry consolidation (including but not limited to consolidation of semiconductor manufacturing towards foundries and large-scale manufacturers, and the subsequent concentration of research and innovation in manufacturing process development) has increased in recent years, and we may continue to see consolidation in the future. This will likely result in a smaller number of companies, but more large companies with greater financial resources - companies that may be less likely to become our customers than smaller companies with more limited R&D resources. Furthermore, if any of our existing customers are acquired, the acquiror may not continue to engage in a CDP with us or may choose to focus its product development and commercialization on technologies not covered by our CDP.

The clean energy sector includes a number of industries that are in a very early stage of development, each of which may experience economic challenges. As a result, we may not earn significant revenue from our initiatives in these industries for an extended period.

The clean energy industry is comprised of several sectors, including energy-efficient glass, solar cells, light emitting diodes ("LEDs"), flat-panel displays, advanced batteries and other energy-efficiency technologies. Most sectors of the clean energy industry are in the very early stages of development. Many of the associated technologies have not yet achieved commercial viability in comparison to available alternatives, and may never achieve widespread market adoption. Many of the associated technologies will require substantial investments of capital to achieve scale, which may not be available on attractive terms, if at all. Certain technologies may depend on government subsidies to be commercially viable, and those subsidies may not be available from federal and state governments facing increasing financial constraints. If sectors of the clean energy industry take an extended period to achieve market acceptance, and to garner significant revenue, we may not earn material revenue from our initiatives in this area until market acceptance, if ever. Furthermore, it may be difficult for us to predict which clean energy companies and which technologies may become market leaders, and we may invest time and resources in collaborations with companies who are ultimately unsuccessful in the clean energy industry, which could adversely affect our operating results.

The clean energy industry may again experience a challenging environment as it has in the recent past. The demand for clean energy products is also influenced by macroeconomic factors such as global economic conditions. A global economic downturn that affects the availability of financing can slow enterprise clean energy projects; it can also affect individual customers, who may be reluctant to assume high up-front costs and will have more difficulty getting access to capital to cover those costs. Any negative market and industry trends in the clean energy industry could

materially and adversely affect our existing and potential customers in the clean energy segment and ultimately have a negative impact on our clean energy business.

If a project to which we have devoted technology and significant resources fails to produce any measurable success or value to our customers in the form of differentiated technology and intellectual property that they may use in their products, we may not receive meaningful amounts of, or any, licensing and royalty revenue. In this case, we may not recover the upfront costs and cash invested in the CDP, which could adversely affect our results of operations. In addition, even if we successfully develop differentiated technology and intellectual property under a CDP that our customer is able to commercialize, there may be a significant delay before we receive any licensing or royalty revenue due to the complexities inherent in production and manufacturing in our target markets.

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If we are unable to scale our development services to accommodate new CDPs, including as a result of our reductions in force, our growth prospects would be limited and our business, financial condition and results could be adversely affected.

Our customers require a significant amount of individualized attention and many of our customers also require lab space at our facilities for CDPs. We have limited space and internal capacity, both in terms of personnel as well as capital equipment resources, to meet these types of demands for our customers. In addition, because of the significant confidentiality concerns associated with the projects and products we work on and the restrictions on resource and information sharing we have implemented in response, we are not able to fully capitalize upon economies of scale. If the demand for our services and products exceeds our capacity to meet such demand, including as a result of our reductions in force, we may be required to turn down potential opportunities, which would cause us to lose potential revenue, and our potential customers may take their business to a competitor or decide to develop or expand internal R&D capabilities. If we are unable to scale our development services to meet demand, our future growth may be hindered and our business and operating results could be adversely affected.

We may be unable to make the substantial R&D investments required to remain competitive in our business.

The semiconductor and clean energy industries require substantial investment in R&D to develop and bring to market new and enhanced technologies and products. To remain competitive, we anticipate that we will need to continue to increase our levels of R&D expenditures to keep pace with the development efforts of our customers. We are continually working to develop and broaden our HPC platform, including our software and informatics capabilities, to address a wider range of markets and customers for multiple applications within semiconductors, flat glass, solar cells, LEDs, flat-panel displays, advanced batteries and other energy-efficiency technologies. This is an extremely complex and costly process. We expect R&D expenses to continue to increase in absolute dollars for the foreseeable future, due to the increasing complexity and number of platforms and solutions we plan to develop both for our customers and internally, the expansion of our customer base, and any associated increase in upfront R&D costs. If we are unable to build new systems, or configure, modify, expand or customize our existing systems for these fields and develop our expertise to support these fields, our business growth might be limited, and our business and results of operations could be materially and adversely affected.

Although we are making progress in certain fields of technology, we have limited expertise and experience in other fields. We may be required to invest significantly greater resources than anticipated in our R&D efforts. If we are unable to develop expertise or experience in these fields, or if the investment of our resources in these fields is unsuccessful, our business and results of operations could be materially and adversely affected.

Our strategy includes conducting proprietary R&D efforts in collaboration with and on behalf of multiple customers. Any failure on our part to adequately protect against potential conflicts of interest and breaches of confidentiality by us would harm our reputation and our relationships with our customers, and our business prospects and operating results would be materially and adversely affected. Moreover, some customers may hesitate to grant us access to their proprietary information, which could impair our ability to provide value for such customers.

Our strategy includes conducting proprietary R&D efforts in collaboration with and on behalf of customers who in some cases may have overlapping interests and technologies. We seek to structure our collaborative agreements and business practices to minimize any potential conflicts among customers and the possibility of any breaches of confidentiality. We may need access to some of our customers' proprietary information, and they may be reluctant to share it with us because of the risk of a potential conflict between us and/or our customers and other potential customers and the risk of a breach of confidentiality. In an effort to address these significant potential conflicts of interest and confidentiality concerns, we have implemented internal restrictions on resource and information sharing.

However, we cannot ensure that our existing and potential customers will perceive these measures to be adequate and effective, or that they will be, in all circumstances. Our failure to adequately and effectively address these concerns could result in our inability to attract new customers or retain existing customers, or lead to our having incomplete information with respect to existing customers that could impair our ability to fully address the customers' needs and demonstrate the value of our technology to the customers. Even though we make significant efforts to isolate each development activity from other development activities, we may fail to meet our contractual confidentiality commitments to one or more customers. Moreover, even if we meet these commitments, conflicts of interest between a customer and us, or between or among customers, could nevertheless arise. In either event, we may become involved in a dispute with our customers regarding the solutions developed during the collaboration or the rights to these solutions, including possible litigation. Disputes of this nature could harm the relationship between us and our customers, have a material adverse effect on our ability to enter into new CDPs, and cause our revenue and operating results



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to decline significantly.

Our business strategy requires us to evaluate, integrate and develop elements of our customers' value chains, including development and manufacturing processes. Our ability to evaluate these effectively may sometimes depend on the cooperation from our customers' materials suppliers and equipment manufacturers as well as access to their data and tools. If these third parties do not cooperate with us or provide us access to the necessary data, materials, tools or equipment, we may not be able to deliver effective solutions to our customers, which would adversely affect our business and results of operations.

We have to evaluate multiple elements of our customers' value chains to help them test and develop end products that meet their specifications, including the materials, tools and equipment used by them during the manufacturing process. Our ability to evaluate a customer's value chain effectively may sometimes depend on cooperation from such customer's materials suppliers and equipment manufacturers and on access to their data and tools. Our evaluation of the materials and equipment in the value chain must be unbiased to maintain credibility with our customers, and our evaluation sometimes results in recommendations that our customers change materials and tools providers or equipment manufacturers. Our recommendations may negatively impact our relationships with materials and tools providers and equipment manufacturers. Tensions in our relationships with these providers and manufacturers may cause these parties to limit or deny our access to their newest materials and equipment, which would in turn limit our ability to complete our development activities with our customers or control the quality of the combinatorial methods applied to our development efforts on their behalf, which would adversely affect our business and operations.

Failure of our suppliers to timely deliver sufficient quantities of the components or materials that we use in our collaborations may result in delays or other disruptions in executing our CDPs, which could adversely affect our business, financial condition and results of operations.

We have historically relied on a small number of contract manufacturing companies for the manufacture and assembly of a majority of our HPC tools. While we are not dependent on any single contract manufacturing company, key parts of our tools are currently available only from a limited number of sources. In addition, components of our capital equipment are available from only a few suppliers. If supplies from these vendors are delayed or interrupted for any reason, we may not be able to get equipment or components for our tools or our own research efforts in a timely fashion or in sufficient quantities or under acceptable terms, if at all. Even though alternative sources of supply would be available, it could be time-consuming and expensive for us to qualify new vendors and work with them to integrate our designs into the tools they manufacture for us. In addition, we depend upon our vendors to provide components of appropriate quality and reliability. Consequently, if supplies from these vendors were delayed or interrupted for any reason, it could materially and adversely affect our business.

Our future growth may present challenges to our management and administrative systems and resources, which could adversely affect our business, financial condition and results of operations.\*

In order to successfully expand our business we will need to grow in all operational areas and to successfully integrate new employees. In particular, we expect growth as we expand our R&D capacity for current and additional CDPs. The expansion of our business may place a strain on our management, as well as our operational systems and facilities, which may make it difficult for us to implement our business strategy. We have experienced employment and labor claims against us by our employees in the past, and we may experience such claims in the future. For example, on August 23, 2013, we received a copy of a complaint from the California Division of Labor Standards and Enforcement filed by an employee claiming that the employee is owed back pay due to an incorrect classification as an exempt employee for overtime purposes. Subsequently, we were informed of similar claims by fourteen other current and former employees and contractors. We have entered into settlement agreements with all of the fifteen claimants and we believe the matter has been resolved. Further information about this matter is set forth in Part II -

Other Information, Item 1: "Legal Proceedings" of this Form 10-Q. The addition of new employees may also increase the likelihood of employment and labor claims against us.

To effectively manage our operations and any future growth, we must continue to expend funds to enhance our operational, legal, financial and management controls, reporting systems and procedures, and to attract and retain sufficient numbers of talented employees. If we are unable to implement these enhancements efficiently, effectively and quickly, we will not be able to successfully grow our business in the future. Our future operating results will also depend on our management's ability to:

- improve our R&D efforts;

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- improve our sales, marketing and customer support programs;
- enhance our operational and financial control systems;
- expand, train and manage our employee base and promptly replace departing employees with key skills; and
- effectively address new issues related to our growth as they arise.

We may not manage our expansion successfully, which could materially and adversely affect our business, financial condition and results of operations.

Acquisitions, strategic investments, joint ventures or strategic asset sales may harm our business and operating results, cause us to incur debt or assume contingent liabilities, or dilute our stockholders.

We have made and may in the future make strategic investments, acquisitions, asset sales, or enter into joint ventures with third parties where there is an opportunity to expand the potential applications and reach of our capabilities, including our HPC platform. Exploring and implementing any investments, acquisitions, asset sales or joint ventures may place strain upon our ability to manage our future growth and may divert management attention from our core businesses. There are also other risks associated with this strategy. We cannot assure you that we will be able to make investments, acquire businesses or sell assets on satisfactory terms, that any business acquired by us or in which we invest will be integrated successfully into our operations or be able to operate profitably, or that we will be able to realize any expected growth, synergies or benefits from such investments, acquisitions, sales or joint ventures. Our relative inexperience in effecting such transactions heightens these risks. In addition, to finance any acquisitions, investments or joint ventures, we may utilize our existing funds, or might need to raise additional funds through public or private equity or debt financings. We may be unable to obtain financing to fund future acquisitions or investments on attractive terms, or at all. Additionally, equity financings may result in dilution to our stockholders. We cannot predict the number, timing or size of investments, acquisitions or joint ventures, or the effect that any such transactions might have on our operating results.

Our financial obligation to Silicon Valley Bank (“SVB”) could adversely affect our financial health and our ability to raise additional capital to fund our operations and limit our ability to react to changes in the economy or our industry.\*

On May 31, 2013, we entered into a loan and security agreement (“Loan Agreement”) with SVB pursuant to which SVB made available to us loans under a revolving line to refinance existing indebtedness (including the repayment of all remaining principal and accrued interest under the secured promissory note that we issued to Symyx Technologies, Inc. in November 2011) and for working capital and general business purposes, in a principal amount of up to \$26.5 million. Under the Loan Agreement, SVB funded an initial credit extension in the principal amount of \$25.0 million on May 31, 2013.

On November 29, 2013, we elected to convert the entire \$25.0 million of outstanding advances under the Loan Agreement into a term loan, as provided by the Loan Agreement. We are obligated to pay interest at the applicable rate and \$0.5 million of principal on a quarterly basis. The term loan is scheduled to mature on November 30, 2016, at which time we would be obliged to pay all outstanding principal and accrued and unpaid interest on that date. At our option, we may prepay the outstanding principal balance of the term loan in full or in part, subject to a pre-payment fee of 0.25% of the outstanding principal balance of the term loan if the term loan is repaid before November 30, 2014. During the nine months ended September 30, 2014, we paid SVB \$2.0 million of interest and principal under the Loan Agreement.

Our obligations to SVB will require us to dedicate a substantial portion of our cash flow from operations to payments on interest and principal, thus reducing the availability of our cash flow to fund working capital, capital expenditures, research and development efforts, execution of our business strategy and other general corporate purposes. Such limitations increase our vulnerability to adverse general economic and industry conditions and limit our flexibility in planning for, or reacting to, changes in the economy, our industry and new opportunities that may arise. In addition, we granted SVB a security interest in substantially all of our assets, excluding all intellectual property. Under the Loan Agreement, we cannot grant an interest in our intellectual property to any other person. We are also subject to certain affirmative and negative covenants under the Loan Agreement, including limitations on our ability to: undergo certain change of control events; dispose of our assets; merge or acquire other entities; create, incur, assume, guarantee or be liable with respect to indebtedness; grant liens on any assets; make any dividends in cash; and make or permit any payment on subordinated debt, in each case subject to certain exceptions. In addition, we are subject to a financial covenant under which, if our unrestricted cash, cash equivalents and other short-term investments are less than \$60

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million, we must maintain a ratio of our short-term assets (including cash, net accounts receivable and short-term investments) to certain liabilities (including our outstanding and owed obligations to SVB and any other liabilities maturing in less than one year) of 1.5:1.0. Under the Loan Agreement, subject to certain exceptions, we are also required to maintain with SVB our primary operating and other deposit accounts and securities accounts. The Loan Agreement also includes several potential events of default such as payment default, material adverse change conditions and insolvency conditions that could cause interest to be charged at the rate that is otherwise applicable plus 5.0%. Any uncured events of default may result in SVB's right to declare all outstanding obligations immediately due and payable and to exercise any other remedies permitted under the Loan Agreement. These obligations and restrictions may make it more difficult for us to borrow funds in the future to fund working capital, capital expenditures and other purposes, which could materially and adversely affect our business, financial condition and results of operations.

We may need additional capital in the future to finance our business.

Our future capital requirements may be substantial as we continue to develop our business and expand our collaborative development efforts. Although we believe that, based on our current level of operations and anticipated growth, our existing cash, cash equivalents and marketable securities, as well as our access to capital pursuant to the Loan Agreement with SVB, will provide adequate funds for ongoing operations, planned capital expenditures and working capital requirements for at least the next 12 months, we may need additional capital if our current plans and assumptions change. In particular we may be required to raise additional capital if we choose to expand our business through strategic investments or acquisitions. Our need for additional capital will depend on many factors, including our rate of revenue growth, our expansion of our sales and marketing activities and overhead expenses, the timing and extent of our spending to support our R&D efforts and our ability to expand CDPs in the semiconductor and clean energy industries, whether we are successful in obtaining anticipated levels of payments from customers, the financial stability of our customers, whether we can enter into additional collaborations in our target industries and markets, the progress and scope of collaborative R&D projects performed by us and our customers, the effect of any acquisitions of other businesses or technologies that we may make in the future, the filing, prosecution, maintenance and enforcement of patent claims, how much we need to develop or enhance our solutions or HPC platform, and any necessary responses to competitive pressures.

If our capital resources are insufficient to meet our capital requirements, and our revenue is insufficient to support any of these activities, then we will have to raise additional funds. If future financings involve the issuance of equity securities, our then-existing stockholders may suffer dilution. If we raise additional future debt financing, we may be subject to restrictive covenants similar to or more restrictive than those we are subject to under the Loan Agreement with SVB, which would further limit our ability to conduct our business. We may not be able to raise sufficient funds on terms that are favorable to us, if at all. If we fail to raise sufficient funds and continue to incur losses, our ability to fund our operations, take advantage of strategic opportunities, develop products or technologies or otherwise respond to competitive pressures could be significantly limited. If this happens, we may be forced to delay or terminate R&D programs, curtail or cease operations, obtain funds through collaborative and licensing arrangements that may require us to relinquish commercial rights, or grant licenses on terms that are not favorable to us. If adequate funds are not available, we may not be able to successfully execute our business plan or continue our business.

If we lose one or more of our key personnel without obtaining adequate replacements in a timely manner, or if we are unable to retain and recruit skilled personnel, our operations could become disrupted and the growth of our business could be delayed or restricted.\*

Our success depends, in large part, on the continued contributions of our senior management team. None of our senior management is bound by written employment contracts to remain with us for a specified period. The loss of any of our senior management could harm our ability to implement our business strategy and respond to the rapidly changing

market conditions in which we operate. Upon hiring or promotion, new senior management personnel must spend a significant amount of time learning our technology, business model and management systems and their new roles, in addition to performing their regular duties. Accordingly, until new senior personnel become familiar with our technology, business model and systems or with their new roles, we may experience disruption to our ongoing operations. Moreover, the loss of a member of our senior management or our professional staff would require the remaining management to divert attention to seeking a replacement.

Our future success and competitiveness depends on our ability to retain and motivate our unique team of highly skilled scientists and engineers, and to recruit and hire similarly qualified replacements for any who leave the company. These scientists and engineers have expertise across various disciplines, fields and technologies, including engineering, materials science, process development and integration, equipment, device process technologies and device integration. In addition, as we grow, we will have to continue to retain, attract and motivate qualified and talented personnel, including our scientists and engineers, management, sales and marketing and legal and finance personnel. Because our CDPs are customer-specific and

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project-specific and may last for a significant period of time, the loss of key scientists or engineers or other personnel could have an adverse effect on a particular CDP and on our ability to deliver results to a customer in a timely manner or at all. We do not know whether we will be able to retain all of these employees or hire appropriate replacements for any who leave the company, as we continue to pursue our business strategy. Competition for personnel is intense in the semiconductor and clean energy industries.

We may encounter difficulties in hiring qualified scientists and engineers because there is a limited pool of scientists and engineers with the specialized expertise required to understand and implement our platform in conjunction with our customers. Further, we may have difficulty or delays in obtaining deemed export licenses for some scientists and engineers who we may wish to hire, in obtaining visas permitting entry for some of our employees who are foreign nationals into the United States, and in obtaining visas permitting entry into other key countries for several of our key personnel, which could disrupt our ability to strategically locate our personnel. The loss of the services of key employees or our inability to retain, attract and motivate qualified scientists and engineers could have a material adverse effect on our business, financial condition and results of operations.

If we cannot compete successfully in our industry, our results of operations and financial condition would be adversely affected.

Competition in our markets may intensify in the future, which could slow our ability to grow or execute our strategy and could lead to increased pricing pressure, negatively impacting our revenue and ability to attain and maintain profitability. Our current and potential customers may choose to develop their own methods to accelerate R&D activities, including their own combinatorial development methods internally, particularly if we are slow in developing or deploying our solutions or improving them to meet market needs. We currently face indirect competition from the internal R&D groups of our current and potential customers, particularly those of our customers who work with us to develop knowledge of combinatorial methods and who may then use our methods independently. Several of them also design, develop, manufacture and market semiconductor and clean energy products based on their own solutions or other architectures and develop their own intellectual property internally. They often compete with each other and with us in various applications. Our customers are generally much larger and have significantly greater resources than us. We also face indirect competition from university collaborations, consortia and alliance partnerships. In addition, there may be other providers of high-throughput or combinatorial solutions for the design of and accelerating R&D relating to integrated devices of which we are not aware, and there may be new entrants to the industry in the future, particularly if acceptance of these solutions grows. In addition, we believe that the demand for solutions that address the need for better integration between the design and manufacturing processes may encourage direct competitors to enter into our market. Other potential competitors include fabrication facilities that may decide to offer solutions competitive with ours as part of their value proposition to their customers. If these potential competitors change the pricing environment or are able to attract industry partners or customers faster than we can, we may not be able to grow and execute our strategy as quickly or at all.

A substantial portion of our revenue is derived from business arrangements with related parties, and such arrangements could create conflicts of interest that could adversely affect our business and results of operations.\*

Some of our customers and other business partners hold a significant stake in our capital stock. Related party transactions, which includes transactions with both ATMI and SanDisk, disclosed in our financial statements accounted for \$3.8 million (10.2%) of our revenue in the nine months ended September 30, 2014, and \$12.8 million (19.0%), \$21.1 million (31.6%) and \$21.0 million (39.0%) of our revenue for the years ended December 31, 2013, 2012 and 2011, respectively. For more information about these transactions, see Note 9 to our condensed consolidated financial statements in this Form 10-Q.

We believe that the transactions and agreements that we have entered into with related parties are on terms that are at least as favorable as could reasonably have been obtained at such time from unrelated third parties. However, these relationships could create, or appear to create, potential conflicts of interest when our board of directors is faced with decisions that could have different implications for us and our related parties or their affiliates. In addition, conflicts of interest may arise between us and our related parties and their affiliates. The appearance of conflicts, even if such conflicts do not materialize, might adversely affect the public's perception of us, as well as our relationship with other companies and our ability to enter into new relationships in the future, including new CDPs with competitors of such related parties, which could have a material adverse effect on our ability to do business.

We may be subject to warranty claims, product recalls and product liability.\*

From time to time, we may be subject to warranty or product liability claims relating to our HPC tools used by our



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customers, whether such use is at our site in San Jose, CA or at the customer's site. Such claims could result in unanticipated expenses as we compensate affected customers for product quality issues. Although we maintain product liability insurance, the insurance is subject to significant deductibles and there is no guarantee that coverage will be available or adequate to protect against all such claims. Alternatively, we may elect to self-insure with respect to certain matters. If an HPC tool sold or licensed to our customers is recalled, we may incur repair, return and/or replacement costs, contract damage claims from our customers and reputational harm. Costs or payments made in connection with warranty and product liability claims and product recalls could materially and adversely affect our financial condition and results of operations.

Our inability to effectively manage our inventory could adversely affect our revenue and profitability.

Our CDPs generally consist of our provision of services to our customers, our licensing to customers of IP related to the CDP, and the sale of specialized tools to customers with which CDP activities are undertaken. For these specialized tools, we typically plan production and inventory levels based on internal forecasts of customer demand. These forecasts can be highly unpredictable and can fluctuate substantially, which could lead to excess inventory write-downs and resulting negative impacts on revenue and profitability. In addition, innovation in our industry, or the use of R&D methodologies other than our HPC technology, could render significant portions of our inventory obsolete. If we overestimate our customers' requirements, we may have excess inventory, which could lead to obsolete inventory and unexpected costs. Conversely, if we underestimate our customers' requirements, we may have inadequate inventory, which could lead to foregone revenue opportunities, loss of potential market share and damage to customer relationships as product deliveries may not be made on a timely basis, disrupting our customers' CDP activity schedules.

Our estimates of excess and obsolete inventory may prove to be inaccurate, in which case the provision required for excess and obsolete inventory may be understated or overstated. Although we make every effort to ensure the accuracy of our forecasts of future product demand, any significant unanticipated change in demand or technological developments could have a significant impact on the value of our inventory and operating results.

Rapid changes in our customer base as well as entry into new markets may cause substantial revisions in the methodologies used to value our inventory, and therefore increase the amounts related to our obsolete or reserved inventory. We have had write-offs related to obsolete inventory and may continue to have such write-offs in the future.

Compliance with environmental, health and safety laws and regulations could increase costs or cause us to incur substantial liabilities.

We are subject to various foreign, federal, state and local environmental laws and regulations governing, among other matters, emissions and discharges of hazardous materials into the air and water, the use, generation, storage, handling, transportation and disposal of, and exposure to, hazardous materials and wastes, remediation of contamination and employee health and safety. In addition, under certain of these environmental laws, liability can be joint and several and without regard to comparative fault. Our operations involve the use of hazardous materials and produce hazardous waste, and we could become liable for any injury or contamination that could arise due to such use or disposal of these materials. Failure to comply with environmental laws and regulations could result in the imposition of substantial civil and criminal fines and sanctions, could require operational changes or limits or the installation of costly equipment or otherwise lead to third party claims. Future environmental laws and regulations, stricter enforcement of existing laws and regulations, or the discovery of previously unknown contamination or violations of such laws and regulations could require us to incur costs or become the basis for new or increased liabilities, which could impair our operations and adversely affect our business and results of operations.

Global or regional economic, political and social conditions could adversely affect our business, financial condition and results of operations.

We operate in multiple jurisdictions throughout the world and are subject to foreign business, political and economic risks. In particular, we are subject to risks arising from adverse changes in global economic conditions. Global economic uncertainties in the key markets of many of our customers may cause our customers to delay or reduce R&D and technology purchases and investments. The impact of this on us is difficult to predict, but if businesses defer using our HPC platform or licensing our technology, require fewer CDPs or development tools, or if consumers defer purchases of new products that use or incorporate technology developed under our CDPs, our revenue could decline. A decline in revenue would have an adverse effect on our results of operations and our financial condition.

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In addition, some of our largest customers are located outside of the United States, primarily in Asia, which further exposes us to foreign risks. Also, a substantial portion of the consumer products market that serves as the end-market for the products we help our customers to develop is located in Asia. As a result, our operations are subject to substantial influence by political and economic conditions. Reduced end user demand as well as disruptions to the supply chain for our customers resulting from these or other events could lead to a reduction in our revenue and an adverse impact on our financial condition. Our licensing and royalty revenue is derived from sales of products that use or incorporate technology developed under our CDPs. To the extent that sales for these products are denominated in U.S. dollars, the currency conversion and foreign exchange laws and regulations in the foreign countries in which we do business may delay or preclude us from receiving payment from our customers, which would have an adverse impact on our operations and financial condition. Additionally, to the extent that sales for these customer products are denominated in a foreign currency, an increase in the value of the U.S. dollar relative to such foreign currencies could also adversely affect our licensing and royalty revenue irrespective of the volume of such products sold, which could adversely affect our business and operating results.

We derive a significant portion of our revenue from customers in foreign countries. We expect that a significant portion of our total future revenue will continue to be derived from companies based in foreign countries. If the U.S. dollar increases in value relative to the currencies in any of these countries, the cost of our CDPs, which have historically been billed in U.S. dollars, will be more expensive to existing and potential customers in those countries, which could adversely affect our ability to generate new or expand existing CDPs.

We are also subject to general geopolitical risks in connection with international operations, such as political, social, and economic instability, terrorism, interference with information or communication of networks or systems, potential hostilities, changes in diplomatic and trade relationships, and disease outbreaks, and any disruptive effect these events would have on our business operations. For example, an imposition of economic sanctions by the U.S. government against the Russian Federation may have an adverse impact on our ability to do further business with one of our current customers, Ulyanovsk Center for Technology Transfer of the Russian Federation. Although to date we have not experienced any material adverse effect on our operations as a result of these types of factors, we cannot assure investors that these factors will not have a material adverse effect on our business, financial condition, and operating results or require us to modify our current business practices. Inconsistencies among, and unexpected changes in, a wide variety of foreign laws and regulatory environments with which we are not familiar, including, among other issues, with respect to employees, currency controls, foreign exchange, protection of our intellectual property, and a wide variety of operational regulations and trade and export controls under domestic, foreign, and international law may also have unexpected, adverse impacts on our operations and financial condition.

Business interruptions could delay or prevent our business activities, which could have a material adverse effect on our business, financial condition and results of operations.

Our headquarters are located in the San Francisco Bay Area near known earthquake fault zones and are vulnerable to significant damage from earthquakes. We are also vulnerable to other types of natural disasters and other events that could disrupt our operations, such as cybersecurity breaches, terrorist acts and other events that may be beyond our control. We do not carry insurance for earthquakes and we may not carry sufficient business interruption insurance to compensate us for losses that may occur. Our business can also be impacted if our customers experience business interruptions as a result of natural disasters or other disruptive events. Any losses or damages we or our customers incur could have a material adverse effect on our cash flows and success as an overall business.

Our ability to use our net operating loss carryforwards to offset future taxable income, and our ability to use our tax credit carryforwards, may be subject to certain limitations.\*

In general, a corporation that undergoes an “ownership change” under Section 382 of the Internal Revenue Code is subject to limitations on its ability to utilize its pre-change net operating loss carryforwards (“NOLs”) to offset future taxable income and its ability to utilize tax credit carryforwards. During the three months ended September 30, 2014, we completed our 2013 tax return and finalized our U.S. federal NOLs in the amount of \$51 million. In general, an “ownership change” occurs if the aggregate stock ownership of certain stockholders (generally, 5% shareholders, applying certain aggregation and look-through rules) increases by more than 50 percentage points over such stockholders' lowest percentage ownership during the testing period (generally, three years). We have not determined whether an ownership change has occurred in the past. If we have experienced an ownership change in the past, our ability to utilize NOLs and tax credit carryforwards could be limited. Furthermore, future changes in our stock ownership, such as certain stock issuances and transfers between stockholders, some of which changes are outside of our control, could result in ownership changes under Section 382 of the Internal Revenue Code. For these reasons, we may not be able to utilize a material portion of our NOLs and tax credit carryforwards, even if we attain profitability.

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### Specific Risks Relating to Our Intellectual Property

We may be unable to effectively protect our intellectual property, which would negatively affect our ability to compete.\*

We depend on our proprietary HPC platform for our success and ability to compete. If others are able to reproduce our technology, our business will suffer significantly unless we can prevent them from competing with us. As of September 30, 2014, we owned or had exclusive licenses to 1,240 U.S. patents and patent applications (some of which also have foreign counterparts), which we believe protect our rights in our HPC platform and our rights in the technology developed internally and under the CDPs. While we have been filing patent applications to seek protection for the further advancements of our HPC platform, patent laws provide only limited protection. Furthermore, we may not be able to sustain the high rate of patenting we maintained in the previous two years due to the expense and resource-intensiveness of the patenting process. For these and other reasons, we cannot assure you that we have sought or that we will seek patent protection of all our rights in our HPC platform and our rights in the technology developed internally and under our CDPs in all jurisdictions. We also cannot assure you that all maintenance fees have been paid or that all filings have been made with the appropriate regulatory or governmental authorities with respect to any IP rights (including patents) registered or applied for outside of the U.S. In addition, patent protection in foreign countries may be limited or unavailable where we need this type of protection. A more detailed description of how we protect our IP rights (including patents) is set forth in Part I, Item 1: “Business - Intellectual Property” of our 2013 Form 10-K.

The patent positions of technology companies, including ours, are often uncertain and involve complex legal and factual questions. We will be able to protect our proprietary rights from unauthorized use by third parties only to the extent that our proprietary technologies are covered by valid and enforceable patents, or are effectively maintained as trade secrets or other forms of legal protection. We apply for patents covering our HPC platform and further advancements of our HPC platform as we deem appropriate. However, we may not obtain patents on all inventions for which we seek patents. Further, any patent claims we file for may be challenged during prosecution or any patent claims we are issued may be challenged after issuance. This may result in the claims being narrowed in scope or extinguished as a result of these challenges. Additional uncertainty may result from the recent and ongoing consideration and passage of patent reform legislation by the United States Congress, legal precedent as handed down by the United States Federal Circuit and Supreme Court as they determine legal issues concerning the scope and construction of patent claims, and inconsistent interpretation of patent laws by the lower courts. For these reasons, among others, our existing patents and any future patents we obtain may not be sufficiently effective in preventing others from practicing our technologies or from developing similar or superior products. In that case, our revenue and operating results could decline.

Our strategy includes obtaining patent protection for technology developed in collaboration with our customers. A portion of our revenue from our customers derives from the licenses granted by us to our customers under these patents. In certain instances our ability to obtain patent protection may require customer approval. If the customer does not provide its approval, we cannot proceed with patent protection and the technology will be subject to trade secret protection only. If we are unable to obtain patent protection, we would not be able to enforce patent rights to the technologies in question.

In most instances, with respect to patents obtained for technology developed in collaboration with our customers, we grant our customers a specific field-of-use license under these patents thus reserving for us the right to grant licenses to third parties outside such field-of-use. We may not be able to grant such third party licenses outside the field-of-use, which would not allow us to realize additional revenue from licensing such patents.

We have developed in the past, and may develop in the future, patented technology with U.S. federal government funding. When new technologies are developed with U.S. government funding, the government obtains certain rights in any resulting patents, including a nonexclusive license authorizing the government to use the invention for non-commercial purposes. These rights may permit the government to disclose our confidential information to third parties and to exercise “march-in” rights to use or allow third parties to use our patented technology. The government can exercise its march-in rights if it determines that action is necessary because we fail to achieve practical application of the U.S. government-funded technology, because action is necessary to alleviate health or safety needs, to meet requirements of federal regulations, or to give preference to U.S. industry. In addition, U.S. government-funded technology may be subject to restrictions on transfer to foreign entities, and some U.S. government-funded data may be subject to public disclosure under the Freedom of Information Act.

Many of our customers and competitors have significant operations outside the United States. However, foreign laws may not afford us sufficient protections for our intellectual property, and we may not always seek patent protection outside the United States. We believe that our success depends, in part, upon our ability to obtain international protection for our IP

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rights. However, the laws and judicial systems of some foreign countries may not be as comprehensive as those of the United States and may not be sufficient to protect or enforce our proprietary rights abroad. Accordingly, our international competitors could obtain foreign patent protection for, and market overseas, products and technologies for which we are seeking patent protection in the United States, and may also be able to successfully enforce such patents in such foreign countries against us or against our customers.

Confidentiality agreements with employees and others may not adequately prevent disclosures of trade secrets and other proprietary information.

We rely in part on confidentiality and trade secret protection to protect our confidential and proprietary information and processes. However, trade secrets are difficult to protect. We have taken measures to protect our trade secrets and proprietary information, but these measures may not be effective. We require new employees and consultants to execute confidentiality agreements upon the commencement of an employment or consulting arrangement with us. These agreements generally require that all confidential information developed by the individual or made known to the individual by us during the course of the individual's relationship with us be kept confidential and not disclosed to third parties. These agreements also generally provide that all rights in and to the inventions conceived by the individual in the course of rendering services to us shall be assigned to us. Nevertheless, employees, collaborators or consultants may still disclose or misuse our confidential information, and we may not be able to meaningfully protect such information or our trade secrets. In addition, others may independently develop substantially equivalent information or techniques or otherwise lawfully gain access to our trade secrets, and thereafter communicate this information to others without maintaining its confidentiality. Costly and time-consuming litigation could be necessary to enforce and determine the scope of our proprietary rights, and failure to obtain or maintain trade secret protection or enforce our trade secrets could adversely affect our competitive business position.

Significant litigation over intellectual property in the industry may cause us to become involved in costly and lengthy litigation, which could subject us to liability, require us to stop licensing our developed technology or force us to develop new technology.

Whether or not patents are granted to us, litigation may be necessary to enforce our IP rights, to defend against a claim of infringement of IP rights of others or to determine the validity and scope of our proprietary rights or the proprietary rights of others. Because infringement is a fact-intensive inquiry, and because patent applications in the United States and many foreign jurisdictions are typically not published until eighteen months after filing (or, in some cases, are not published until they issue as patents), we cannot be certain that we do not now, and will not in the future, infringe a third party's patent rights. We may also become party to claims by our customers to IP rights developed by us in connection with a CDP. If our customers become involved in disputes with third parties over allegations that our customers' practice of our IP rights infringes the IP rights of such third parties, it may also become necessary for us to become involved in such disputes.

Any claim, even if without merit, could be time consuming to defend, result in costly litigation, or require us to enter into licensing agreements, resulting in unexpected operating costs and reduction in our operating profit. Moreover, our opponents in any litigation may have significantly more resources with which to defend against or assert claims in the litigation. A successful claim of infringement against us in connection with the use of our technologies could force us to stop using our technologies that incorporate the infringed IP; pay substantial monetary damages or royalties; grant cross-licenses to third parties relating to our own IP; obtain a license from the owner of the infringed IP, which may not be available to us on acceptable terms or at all; or re-engineer our platform or products to avoid further IP infringement, which may be technically impossible or commercially infeasible. The occurrence of any of these eventualities could adversely affect our business. Even if we are successful in defending such a claim, litigation could also divert our resources, including our managerial and engineering resources. Any infringement claim or other litigation against or by us could have a material negative effect on our business.

Our intellectual property indemnification policies and obligations may adversely impact our business and operating results.

Any assertion by a third party asserting ownership or other rights to technology developed under our CDPs could result in our customers becoming the target of litigation, and we may be bound to indemnify our customers under the terms of our license agreements. These obligations could result in substantial expenses to us, which could have a material adverse effect on our business, financial condition and results of operations. In addition to the time and expense required for us to satisfy our support and indemnification obligations to our customers, any litigation could severely disrupt or shut down the business of our customers, which in turn could damage our relations with them and have a material adverse effect on our reputation, business, financial condition and results of operations.



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### Risks Related to Ownership of Our Common Stock

Our stock price may be volatile, which may cause the value of our common stock to decline and subject us to securities class action litigation.

The market price of our common stock could be subject to significant fluctuations. Market prices for securities of early stage companies have historically been particularly volatile. The stock markets in general have experienced price and volume fluctuations that have affected, and continue to affect, the market prices of equity securities of many companies. A portion of most future fluctuations in our stock price will likely be related to the risk factors described in this section. However, as is the case for many companies with volatile stock prices, price fluctuations may be disproportionate, or even unrelated, to their operating performance. In the past, many companies that have experienced volatility in the market price of their stock have become subject to securities class action litigation. We may be the target of this type of litigation in the future. Securities litigation against us could result in substantial costs and divert our management's attention from other business concerns, which could seriously harm our business. Factors that could contribute to volatility in our stock price include but are not limited to the following:

- fluctuations in our financial results or outlook, or those of our customers or of companies perceived to be similar to us;

- changes in estimates of our financial results or recommendations by securities analysts;

- changes in market valuations of similar companies;

- changes in our capital structure, such as future issuances of securities or the incurring of debt;

- announcements by us or our competitors of significant contracts, acquisitions or strategic alliances;

- litigation involving us, our general industry or both;

- additions or departures of key personnel;

- regulatory developments in the U.S., countries in Asia, and/or other foreign countries;

- investors' general perception of us; and

- general economic and political conditions in the U.S. and globally, such as recessions, interest rate changes and international currency fluctuations.

We have incurred and will continue to incur increased costs and demands upon management as a result of complying with the laws and regulations affecting public companies, which could harm our results of operations.

As a public company, we have incurred and will continue to incur significant accounting, legal and other expenses that we did not incur as a private company, including costs associated with public company reporting requirements. We have incurred and will continue to incur costs associated with existing and evolving corporate governance requirements, including requirements under Section 404 and other provisions of the Sarbanes-Oxley Act, as well as rules implemented by the Securities Exchange Commission, or SEC, and the exchange on which we list our common stock. These rules and regulations have substantially increased our financial and legal compliance costs and may cause further increases in the future. These rules and regulations also make it more expensive for us to maintain director and officer liability insurance.

If we experience material weaknesses or otherwise fail to maintain an effective system of internal controls in the future, we may not be able to accurately report our financial condition or results of operations, which may adversely affect investor confidence in our company and, as a result, the value of our common stock.

As a public company, we are required, under Section 404 of the Sarbanes-Oxley Act, to conduct a comprehensive evaluation of our disclosure controls and procedures over financial reporting. The results of this assessment need to be included in our annual report and we are required to disclose any material weaknesses identified by our management in our internal control over financial reporting, as well as an opinion from our independent registered public accounting firm on the effectiveness of our internal control over financial reporting. A material weakness is a control deficiency or combination of

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control deficiencies that results in more than a remote likelihood that a material misstatement of annual or interim financial statements will not be prevented or detected.

We devoted significant resources to hiring personnel and compiling the system and processing documentation necessary to perform the evaluation needed to comply with Section 404 for the year ended December 31, 2013. In future years, we may need to devote more resources to Section 404 compliance, and we may not be able to complete our annual evaluations, testing and any required remediations in a timely fashion. During the evaluation and testing process, if we identify one or more material weaknesses in our internal control over financial reporting, we will be unable to assert that our internal controls are effective. Lack of effective controls could severely inhibit our ability to accurately report our financial condition or results of operations. We cannot assure you that there will not be material weaknesses and/or significant deficiencies in our internal controls in the future. If we are unable to conclude that our internal control over financial reporting is effective, or if our independent registered public accounting firm were to issue an adverse opinion on the effectiveness of our internal control over financial reporting, we could lose investor confidence in the accuracy and completeness of our financial reports, which would cause the price of our common stock to decline.

The concentration of our capital stock ownership by our executive officers, directors and 5% stockholders will limit your ability to influence corporate matters.\*

Our executive officers, directors, current five percent or greater stockholders and entities affiliated with them together beneficially owned approximately 80.9% of our common stock outstanding as of September 30, 2014. Entities affiliated with Raging Capital Management LLC, entities affiliated with Redpoint Ventures, entities affiliated with CMEA Ventures and entities affiliated with U.S. Venture Partners beneficially owned approximately 19.4%, 15.9%, 9.4% and 9.0%, respectively, of our common stock outstanding as of September 30, 2014. This significant concentration of share ownership may adversely affect the trading price for our common stock because investors often perceive disadvantages in owning stock in companies with concentrated stock ownership. Also, these stockholders, acting together, will be able to influence our management and affairs and determine the outcome of matters requiring stockholder approval, including the election of directors and the approval of significant corporate transactions, such as mergers, consolidations or the sale of substantially all of our assets. Consequently, this concentration of ownership may have the effect of delaying or preventing a change of control, including a merger, consolidation or other business combination involving us, or discouraging a potential acquiror from making a tender offer or otherwise attempting to obtain control, even if that change of control would benefit our other stockholders.

A significant portion of our total outstanding shares may be sold into the public market at any given time, which could cause the market price of our common stock to drop significantly, even if our business is doing well.\*

If our existing stockholders sell, or if the market believes our existing stockholders will sell, substantial amounts of our common stock in the public market, the market price of our common stock could decline significantly. As of September 30, 2014, we had 47,808,338 shares of common stock outstanding. All of these shares can be resold at any time, subject in some cases to the volume limitations and other restrictions of Rule 144 promulgated under the Securities Act of 1933, as amended, or the Securities Act, and upon the lapse of our right of repurchase with respect to any unvested shares. Certain of our officers and directors sell shares from time to time pursuant to 10b5-1 automated sales plans, and investors may react negatively to any insiders disposing of shares of our stock.

In addition, as of September 30, 2014, the holders of 16,081,084 shares of our common stock are entitled to certain rights with respect to the registration of such shares under the Securities Act. If we register such shares of common stock, these stockholders could sell those shares in the public market without being subject to the volume and other restrictions of Rule 144.

We also registered approximately 13.9 million shares of our common stock reserved for issuance under our equity plans. These shares can be freely sold in the public market upon issuance, subject to vesting restrictions and the lock-up restrictions described above.

If securities or industry analysts do not publish or cease publishing research or reports about us, our business or our market, or if they change their recommendations regarding our stock adversely, our stock price and trading volume could decline.

The trading market for our common stock will be influenced by the research and reports that industry or securities analysts may publish about us, our business, our market or our competitors. If any of the analysts who may cover us change their recommendations regarding our stock adversely, or provide more favorable relative recommendations about our

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competitors, our stock price would likely decline. If any analyst who may cover us were to cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline.

Anti-takeover provisions contained in our certificate of incorporation and bylaws, as well as provisions of Delaware law, could impair a takeover attempt.

Our amended and restated certificate of incorporation and our amended and restated bylaws contain provisions that could delay or prevent a change in control of our company. These provisions could also make it more difficult for stockholders to elect directors and take other corporate actions. These provisions include:

- staggered board of directors;
- authorizing the board to issue, without stockholder approval, preferred stock with rights senior to those of our common stock;
- authorizing the board to amend our bylaws and to fill board vacancies until the next annual meeting of the stockholders;
- prohibiting stockholder action by written consent;
- limiting the liability of, and providing indemnification to, our directors and officers;
- eliminating the ability of our stockholders to call special meetings; and
- requiring advance notification of stockholder nominations and proposals.

Section 203 of the Delaware General Corporation Law prohibits, subject to some exceptions, “business combinations” between a Delaware corporation and an “interested stockholder,” which is generally defined as a stockholder who becomes a beneficial owner of 15% or more of a Delaware corporation's voting stock, for a three-year period following the date that the stockholder became an interested stockholder.

These and other provisions in our amended and restated certificate of incorporation and our amended and restated bylaws could discourage potential takeover attempts, reduce the price that investors might be willing to pay in the future for shares of our common stock, and result in the market price of our common stock being lower than it would be without these provisions.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

Recent Sales of Unregistered Securities

None.

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ITEM 6. EXHIBITS		Incorporated by Reference			Filed
Exhibit Number	Exhibit Description	Form	Date	Number	Herewith
2.1	Asset Purchase Agreement by and between Intermolecular, Inc. and Symyx Technologies, Inc. dated as of July 28, 2011. (1)	S-1/A	09/09/11	2.1	
3.1	Amended and Restated Certificate of Incorporation of Intermolecular, Inc.	10-K	03/16/12	3.1	
3.2	Amended and Restated Bylaws of Intermolecular, Inc.	10-K	03/16/12	3.2	
4.1	Specimen Common Stock Certificate.	S-1/A	11/07/11	4.1	
4.2	Warrant to purchase shares of common stock issued to Timane S.a.r.l. dated June 20, 2008.	S-1	07/29/11	4.2	
4.3	Form of warrant to purchase shares of common stock issued to Toshiba Corporation and SanDisk Corporation dated March 15, 2010.	S-1/A	10/26/11	4.3	
4.4	Fourth Amended and Restated Investor Rights Agreement dated as of March 4, 2011, by and among Intermolecular, Inc. and certain stockholders named therein, as amended by Amendment No. 1 to Fourth Amended and Restated Investor Rights Agreement dated as of June 14, 2011.	S-1	07/29/11	10.1	
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.				X
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.				X
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.				X
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.				X
101.INS	XBRL Instance Document				X
101.SCH	XBRL Taxonomy Extension Schema Document				X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document				X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document				X
101.LAB	XBRL Taxonomy Extension Label Linkbase Document				X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document				X

(1) All exhibits, schedules and similar attachments to this exhibit have been omitted. Copies of such exhibits, schedules and similar attachments will be furnished supplementally to the SEC upon request.

† Certain portions have been omitted pursuant to a confidential treatment request. Omitted information has been filed separately with the SEC.

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SIGNATURES

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

Date: October 31, 2014

INTERMOLECULAR, INC.

(Registrant)

By: /s/ C. Richard Neely, Jr.  
C. Richard Neely, Jr.  
Chief Financial Officer