ORGANOVO HOLDINGS, INC.
Form 10-Q
February 06, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-Q

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

For the quarterly period ended December 31, 2013

OR

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

For the transition period from ______ to ______

Commission File Number 001-35996

Organovo Holdings, Inc.

(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of** **incorporation or organization)**	**27-1488943** **(I.R.S. Employer** **Identification No.)**
6275 Nancy Ridge Drive, Suite 110, **San Diego, CA 92121** **(Address of principal executive offices and zip code)**	**(858) 224-1000** **(Registrant s telephone number, including area code)**

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x 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 x No ¨

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

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

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

As of February 1, 2014, a total of 77,816,787 shares of the Registrant s Common Stock, $0.001 par value, were outstanding.

Organovo Holdings, Inc.

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PART I. FINANCIAL INFORMATION

PART II. OTHER INFORMATION

Organovo Holdings, Inc.

(A development stage company)

Condensed Consolidated Balance Sheets

(in thousands except per share data)

	December 31, 2013 (Unaudited)	March 31, 2013 (Audited)
Assets		
Current Assets		
Cash and cash equivalents	$ 49,818	$ 15,628
Grant receivable	7	101
Inventory	82	88
Prepaid expenses and other current assets	622	327
Total current assets	50,529	16,144
Fixed assets Net	915	1,045
Restricted cash	79	88
Other assets Net	92	98
Total assets	$ 51,615	$ 17,375
Liabilities and Stockholders Equity		
Current Liabilities		
Accounts payable	$ 311	$ 641
Accrued expenses	1,559	780
Deferred revenue	15	53
Capital lease obligation	10	10
Warrant liabilities	1,006	6,898
Total current liabilities	2,901	8,382
Deferred revenue, net of current portion	5	9
Capital lease obligation, net of current portion	8	15
Total liabilities	$ 2,914	$ 8,406
Commitments and Contingencies (Note 5)		
Stockholders Equity		
Common stock, $0.001 par value; 150,000,000 shares authorized, 77,424,956 and 64,686,919 shares issued and outstanding at December 31, 2013 and March 31, 2013, respectively	77	65
Additional paid-in capital	134,355	75,269
Deficit accumulated during the development stage	(85,731)	(66,365)
Total stockholders equity	48,701	8,969
Total Liabilities and Stockholders Equity	$ 51,615	$ 17,375

The accompanying notes are an integral part of these condensed consolidated financial statements.

Organovo Holdings, Inc.

(A development stage company)

Unaudited Condensed Consolidated Statements of Operations

(in thousands except per share data)

	Three Months Ended December 31, 2013	Three Months Ended December 31, 2012	Nine Months Ended December 31, 2013	Nine Months Ended December 31, 2012	Period from April 19, 2007 (Inception) Through December 31, 2013
Revenues					
Product	$	$	$	$	$ 224
Collaborations	97	282	214	915	2,110
Grants	38	67	50	162	993
Total Revenues	135	349	264	1,077	3,327
Cost of product revenue					134
Selling, general, and administrative expenses	2,402	2,141	8,807	6,178	21,346
Research and development expenses	2,359	1,130	5,420	2,889	13,502
Loss from Operations	(4,626)	(2,922)	(13,963)	(7,990)	(31,655)
Other Income (Expense)					
Fair value of warrant liabilities in excess of proceeds received					(19,019)
Change in fair value of warrant liabilities	(586)	(4,740)	(5,397)	3,575	(27,369)
Financing transaction costs in excess of proceeds received					(2,130)
Loss on inducement to exercise warrants		(1,904)		(1,904)	(1,904)
Gain (loss) on disposal of fixed assets			(4)	(158)	(162)
Interest expense			(13)		(3,484)
Interest income	4	2	11	5	22
Other income (expense)					(30)
Total Other Income (Expense)	(582)	(6,642)	(5,403)	1,518	(54,076)
Net loss	$ (5,208)	$ (9,564)	$ (19,366)	$ (6,472)	$ (85,731)

Net loss per common share basic and diluted	$ (0.07)	$ (0.20)	$ (0.27)	$ (0.14)
Weighted average shares used in computing net loss per common share basic and diluted	77,235,976	48,428,186	71,606,724	45,224,906

The accompanying notes are an integral part of these condensed consolidated financial statements.

Organovo Holdings, Inc.

(A development stage company)

Unaudited Condensed Consolidated Statements of Stockholders Equity (Deficit) (in thousands)

Period from April 19, 2007 (Inception) through December 31, 2013

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Deficit Accumulated During the Development Stage	Total
Balance at inception (April 19, 2007)		**$**	**$**	**$**	**$**
Issuance of common stock					
Stock-based compensation expense					
Net loss					
Balance at December 31, 2007		**$**	**$**	**$**	**$**
Issuance of common stock to founders	1,730	2	(2)		
Issuance of restricted common stock	12,628	12	(12)		
Stock-based compensation expense			2		2
Net loss				(98)	(98)
Balance at December 31, 2008	**14,358**	**$ 14**	**$ (12)**	**$ (98)**	**$ (96)**
Issuance of restricted common stock	130				
Stock-based compensation expense			2		2
Net loss				(872)	(872)
Balance at December 31, 2009	**14,488**	**$ 14**	**$ (10)**	**$ (970)**	**$ (966)**
Issuance of restricted common stock	219				
Stock-based compensation expense			4		4
Net loss				(1,339)	(1,339)
Balance at December 31, 2010	**14,707**	**$ 14**	**$ (6)**	**$ (2,309)**	**$ (2,301)**
Issuance of common stock through conversion of notes payable	7,677	8	3,482		3,490
Issuance of restricted common stock	61				
Warrants issued with convertible notes and conversion of notes			1,111		1,111
Beneficial conversion feature of convertible notes payable			239		239
Stock-based compensation expense			9		9
Net loss				(4,383)	(4,383)
Balance at December 31, 2011	**22,445**	**$ 22**	**$ 4,835**	**$ (6,692)**	**$ (1,835)**
Issuance of common stock in connection with the merger	6,000	6	(6)		

Issuance of common stock through private placements in connection with the merger	13,723	14	13,709		13,723
Costs associated with the merger			(13,723)		(13,723)
Issuance of common stock through conversion of notes payable and accrued interest in connection with the merger	1,525	2	1,524		1,526
Issuance of warrants to consultants			890		890
Issuance of common stock from warrant exercises, net	13,424	14	10,977		10,991
Warrant liability removed due to exercise of warrants			23,321		23,321
Stock option exercises	224		18		18
Issuance of restricted common stock	1,380	1	(1)		
Restricted stock forfeitures	(186)				
Stock-based compensation expense			1,435		1,435
Loss on inducement to exercise warrants			1,904		1,904
Net loss				(43,553)	(43,553)
Balance at December 31, 2012	**58,535**	**$ 59**	**$ 44,883**	**$ (50,245)**	**$ (5,303)**
Issuance of common stock from warrant exercises, net	6,131	6	3,718		3,724
Issuance of restricted common stock	55				
Restricted stock forfeitures	(34)				
Stock-based compensation expense			848		848
Expense related to modification of warrants			65		65
Warrant liability removed due to exercises of warrants			23,869		23,869
Warrant liability reclassified to equity			1,886		1,886
Net loss				(16,120)	(16,120)
Balance at March 31, 2013	**64,687**	**$ 65**	**$ 75,269**	**$ (66,365)**	**$ 8,969**
Issuance of warrants to consultant			452		452
Issuance of common stock from warrant exercises, net	2,404	2	933		935
Warrant liability removed due to exercises of warrants			10,522		10,522
Warrant liability reclassified to equity			767		767
Stock option exercises	84		195		195
Issuance of restricted common stock	60				
Restricted stock forfeitures/adjustment	(160)				
Stock-based compensation expense			2,840		2,840
Expense related to modification of warrants			12		12
Issuance of common stock from public offering	10,350	10	43,365		43,375
Net loss				(19,366)	(19,366)
Balance at December 31, 2013	**77,425**	**$ 77**	**$ 134,355**	**$ (85,731)**	**$ 48,701**

The accompanying notes are an integral part of these condensed consolidated financial statements.

Organovo Holdings, Inc.

(A development stage company)

Unaudited Condensed Consolidated Statements of Cash Flows (in thousands)

	Nine Months Ended December 31, 2013	Nine Months Ended December 31, 2012	Period from April 19, 2007 (Inception) Through December 31, 2013
Cash Flows From Operating Activities			
Net loss	$ (19,366)	$ (6,472)	$ (85,731)
Adjustments to reconcile net loss to net cash used in operating activities:			
Amortization of deferred financing costs			438
Loss on disposal of fixed assets	4	158	162
Depreciation and amortization	288	178	719
Amortization of debt discount			2,084
Interest accrued on convertible notes payable			495
Fair value of warrant liabilities in excess of proceeds			19,019
Change in fair value of warrant liabilities	5,397	(3,575)	27,369
Loss on inducement to exercise warrants		1,904	1,904
Expense associated with warrant modification	12		77
Stock-based compensation	2,840	1,431	5,140
Amortization of warrants issued for services	182	556	999
Warrants issued in connection with exchange agreement			528
Increase (decrease) in cash resulting from changes in:			
Grants receivable	94	(162)	(7)
Inventory	6	(414)	(745)
Prepaid expenses and other assets	(25)	(36)	(280)
Accounts payable	(330)	(16)	311
Accrued expenses	779	580	1,559
Deferred revenue	(42)	(269)	20
Net cash used in operating activities	(10,161)	(6,137)	(25,939)
Cash Flows From Investing Activities			
Deposits released from restriction (restricted cash deposits)	9	(50)	(79)
Purchases of fixed assets	(156)	(351)	(1,077)
Purchases of intangible assets			(114)
Net cash used in investing activities	(147)	(401)	(1,270)

Cash Flows From Financing Activities			
Proceeds from issuance of convertible notes payable			4,630
Proceeds from issuance of common stock and exercise of warrants, net	44,310	10,991	72,748
Proceeds from exercise of stock options	195	18	213
Proceeds from issuance of related party notes payable			250
Principal payments on capital lease obligation	(7)	(7)	(16)
Repayment of related party notes payable			(250)
Repayment of convertible notes and interest payable			(110)
Deferred financing costs			(438)
Net cash provided by financing activities	44,498	11,002	77,027
Net Increase in Cash and Cash Equivalents	34,190	4,464	49,818
Cash and Cash Equivalents at Beginning of Period	15,628	10,353	
Cash and Cash Equivalents at End of Period	$ 49,818	$ 14,817	$ 49,818
Supplemental Disclosure of Cash Flow Information:			
Interest	$	$	$ 10
Income Taxes	$	$	$ 3

The accompanying notes are an integral part of these condensed consolidated financial statements.

Supplemental Disclosure of Noncash Investing and Financing Activities ($ in thousands):

During the nine months ended December 31, 2013, the warrant liability was reduced by approximately $10,522 as a result of warrant exercises and $767 for warrants reclassified as equity instruments.

During the period from inception through December 31, 2013, the Company issued certain convertible notes payable that included warrants. The related beneficial conversion feature, valued at $824 was classified as an equity instrument and recorded as a discount to the carrying value of the related debt. The warrants, valued at approximately $1,260, were recorded as a warrant liability and recorded as a discount to the carrying value related to debt.

During the period from inception through December 31, 2013, the Company issued 9,202,215 shares of common stock to note holders for the conversion of Convertible Notes with a principal balance totaling $4,530 and accrued interest totaling $485.

The Company issued warrants, valued at approximately $32,743, in connection with the Reverse Merger and the Private Placement during 2012. The warrants were recognized as a derivative liability.

During the period from inception through December 31, 2013, the Company purchased equipment valued at $34 through a capital lease.

During the nine months ended December 31, 2013, the Company issued 75,000 warrants to purchase shares of its common stock for consulting services. The warrants were valued at approximately $404. During the period from inception through December 31, 2013, the Company issued 725,000 warrants to purchase shares of its common stock for consulting services. The warrants were valued at approximately $1,294.

During the period from inception through December 31, 2013, the warrant liability was reduced by $57,712 as a result of warrant exercises and $2,653 for warrants reclassified as equity instruments.

The accompanying notes are an integral part of these condensed consolidated financial statements.

Organovo Holdings, Inc.

(A development stage company)

Notes to Unaudited Condensed Consolidated Financial Statements

1. Change in Fiscal Year End

On March 31, 2013, the Board of Directors of the Company (the Board) approved a change in the Company s fiscal year end from December 31st to March 31st. As a result of this change, the Company filed a Transition Report on Form 10-KT for the three-month transition period ended March 31, 2013. References to any of the Company s fiscal years mean the fiscal year ending March 31st of that calendar year.

2. Description of Business and Summary of Significant Accounting Policies

Nature of operations and basis of presentation

References in these notes to the unaudited condensed consolidated financial statements to Organovo Holdings, Inc., Organovo Holdings, we, us, our, the Company and our Company refer to Organovo Holdings, Inc. and consolidated subsidiary Organovo, Inc. The Company is developing and commercializing functional three-dimensional (3D) human tissues that can be employed in drug discovery and development, biological research, and as therapeutic implants for the treatment of damaged or degenerating tissues and organs.

As of December 31, 2013, the Company has devoted substantially all of its efforts to product development, raising capital and building infrastructure. The Company has not realized significant revenues from its planned principal operations. Accordingly, the Company is considered to be in the development stage.

The accompanying interim condensed consolidated financial statements have been prepared by the Company, without audit, in accordance with the instructions to Form 10-Q and, therefore, do not necessarily include all information and footnotes necessary for a fair statement of its financial position, results of operations, stockholders equity (deficit) and cash flows in accordance with generally accepted accounting principles (GAAP). The balance sheet at March 31, 2013 is derived from the audited balance sheet at that date.

In the opinion of management, the unaudited financial information for the interim periods presented reflects all adjustments, which are only normal and recurring, necessary for a fair statement of the Company s financial position, results of operations, stockholders equity (deficit) and cash flows. These financial statements should be read in conjunction with the financial statements included in the Company s Transition Report filed on Form 10-KT for the transition period ended March 31, 2013 filed with the Securities and Exchange Commission (the SEC) on May 24, 2013. Operating results for interim periods are not necessarily indicative of operating results for the Company s fiscal year ending March 31, 2014.

Reverse merger transaction

On February 8, 2012, Organovo, Inc., a privately held Delaware corporation, merged with and into Organovo Acquisition Corp., a wholly-owned subsidiary of Organovo Holdings, Inc., a publicly traded Delaware corporation, with Organovo, Inc. surviving the merger as a wholly-owned subsidiary of the Company (the Merger). As a result of the Merger, the Company acquired the business of Organovo, Inc., and will continue the existing business operations of Organovo, Inc.

Simultaneously with the Merger, on February 8, 2012 (the closing date), all of the issued and outstanding shares of Organovo, Inc. s common stock converted, on a 1 for 1 basis, into shares of the Company s common stock, par value \$0.001 per share. Also, on the closing date, all of the issued and outstanding options to purchase shares of Organovo, Inc. s common stock and other outstanding warrants to purchase Organovo, Inc. s common stock, and all of the issued and outstanding bridge warrants to purchase shares of Organovo, Inc. s common stock, converted on a 1 for 1 basis, into options, warrants and new bridge warrants to purchase shares of the Company s common stock.

Immediately following the consummation of the Merger: (i) the former security holders of Organovo, Inc. common stock had an approximate 75% voting interest in the Company and the Company stockholders retained an approximate 25% voting interest, (ii) the former executive management team of Organovo, Inc. remained as the only continuing executive management team for the Company, and (iii) the Company s ongoing operations consist solely of the ongoing operations of Organovo, Inc. Based primarily on these factors, the Merger was accounted for as a reverse merger and a recapitalization in accordance with GAAP. As a result, these financial statements reflect the historical results of Organovo, Inc. prior to the Merger, and the combined results of the Company following the Merger. The par value of Organovo, Inc. common stock immediately prior to the Merger was \$0.0001 per share. The par value subsequent to the Merger is \$0.001 per share, and therefore the historical results of Organovo, Inc. prior to the Merger have been retroactively adjusted to affect the change in par value.

In connection with three separate closings of a private placement transaction completed in connection with the Merger (the Private Placement), the Company received gross proceeds of approximately $5.0 million, $1.8 million and $6.9 million on closings on February 8, 2012, February 29, 2012 and March 16, 2012, respectively. In 2011, the Company received $1.5 million from the purchase of 6% convertible notes which were automatically converted into 1,500,000 shares of common stock, plus 25,387 shares for accrued interest of $25,387 on the principal, on February 8, 2012.

The cash transaction costs related to the Merger were approximately $2.1 million.

Before the Merger, Organovo Holdings Board of Directors and stockholders adopted the 2012 Equity Incentive Plan (the 2012 Plan). In addition, Organovo Holdings assumed and adopted Organovo, Inc. s 2008 Equity Incentive Plan.

NYSE:MKT Listing

On July 9, 2013, the Company announced that its common stock had been approved to list on the NYSE:MKT. Shares began trading on the New York Stock Exchange on July 11, 2013 under the symbol ONVO . Prior to that time, the Company s shares were quoted on the OTC QX.

Liquidity

As of December 31, 2013, the Company had an accumulated deficit of approximately $85.7 million. The Company also had negative cash flows from operations of approximately $10.2 million during the nine months ended December 31, 2013.

In August of 2013, the Company raised net proceeds of approximately $43.4 million through the sale of 10,350,000 shares of its common stock in a public offering (see Note 4).

In addition, in November 2013, the Company entered into an equity distribution agreement with an investment banking firm. Under the terms of the distribution agreement, the Company may offer and sell up to 4,000,000 shares of its common stock, from time to time, through the investment bank in at the market offerings, as defined by the SEC, and pursuant to the Company s effective shelf registration statement previously filed with the SEC. As of the three months ended December 31, 2013, the Company had not sold any shares under the distribution agreement.

Through December 31, 2013, the Company has financed its operations primarily through the sale of convertible notes, the private placement of equity securities, the public offering of common stock, and through revenue derived from grants or collaborative research agreements. Based on its current operating plan and available cash resources, the Company has sufficient resources to fund its business for at least the next twelve months.

The Company cannot predict with certainty when, if ever, it will require additional capital to further fund the product development and commercialization of its human tissues that can be employed in drug discovery and development, biological research, and as therapeutic implants for the treatment of damaged or degenerating tissues and organs. The Company intends to cover its future operating expenses through cash on hand, and from revenue derived from grants and collaborative research agreements. However, the Company cannot provide assurance that it will not require additional funding in the future. In addition, the Company cannot be sure that additional financing will be available if and when needed, or that, if available, financing will be obtained on terms favorable to the Company and its stockholders. Having insufficient funds may require the Company to delay, scale back, or eliminate some or all of its development programs or relinquish rights to its technology on less favorable terms than it would otherwise choose. Failure to obtain adequate financing could eventually adversely affect the Company s ability to operate as a going concern.

Use of estimates

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates. Significant estimates used in preparing the condensed consolidated financial statements include those assumed in computing the valuation of warrants, revenue recognized under the proportional performance model, the valuation of stock-based compensation expense, and the valuation allowance on deferred tax assets.

Financial instruments

For certain of the Company s financial instruments, including cash and cash equivalents, grants receivable, inventory, prepaid expenses and other current assets, accounts payable, accrued expenses, deferred revenue and capital lease obligations, the carrying amounts are generally considered to be representative of their respective fair values because of the short-term nature of those instruments.

Cash and cash equivalents

The Company considers all highly liquid investments with original maturities of 90 days or less to be cash equivalents.

Derivative financial instruments

The Company does not use derivative instruments to hedge exposures to cash flow, market or foreign currency.

The Company reviews the terms of convertible debt and equity instruments it issues to determine whether there are derivative instruments, including an embedded conversion option that is required to be bifurcated and accounted for separately as a derivative financial instrument. In circumstances where a host instrument contains more than one embedded derivative instrument, including a conversion option, that is required to be bifurcated, the bifurcated derivative instruments are accounted for as a single, compound derivative instrument. Also, in connection with the sale of convertible debt and equity instruments, the Company may issue freestanding warrants that may, depending on their terms, be accounted for as derivative instrument liabilities, rather than as equity.

Derivative instruments are initially recorded at fair value and are then revalued at each reporting date with changes in the fair value reported as non-operating income or expense. When the convertible debt or equity instruments contain embedded derivative instruments that are to be bifurcated and accounted for as liabilities, the total proceeds allocated to the convertible host instruments are first allocated to the fair value of all the bifurcated derivative instruments. The remaining proceeds, if any, are then allocated to the convertible instruments themselves, usually resulting in those instruments being recorded at a discount from their face value.

The discount from the face value of the convertible debt, together with the stated interest on the instrument, is amortized over the life of the instrument through periodic charges to interest expense, using the effective interest method.

Restricted cash

As of December 31, 2013 and March 31, 2013, the Company had approximately $78,800 and $88,300, respectively, of restricted cash deposited with a financial institution. The entire $78,800 as of December 31, 2013 and $38,300 of the balance as of March 31, 2013 is held in certificates of deposit to support a letter of credit agreement related to the facility lease entered into during 2012. In December 2013, the lease was amended to increase the rented area by 15,268 square feet, and as such, the Company was required to increase the amount held in certificates of deposit to support the increased letter of credit as required by the lease amendment. The additional $50,000 included in the March 31, 2013 balance represents funds held by a financial institution as a guarantee for the Company s commercial credit cards. These funds were released from restriction during the nine months ended December 31, 2013 as a result of the Company transferring its credit card program to a different financial institution.

Grant receivable

Grant receivable as of December 31, 2013 represents the amount due under a private research grant that began in October 2013. Grant receivable as of December 31, 2012 represents the amount due from the National Institutes of Health (NIH) under a research grant that concluded in April 2013. The Company considers the grants receivable to be fully collectible; and accordingly, no allowance for doubtful amounts has been established. If amounts become uncollectible, they are charged to operations.

Inventory

Inventories are stated at the lower of the cost or market (first-in, first-out). Inventory at December 31, 2013 and March 31, 2013 consisted of approximately $82,000 and $88,000 in raw materials, respectively.

The Company provides inventory allowances based on excess or obsolete inventories determined based on anticipated use in the final product. There was no obsolete inventory reserve as of December 31, 2013 or March 31, 2013.

Fixed assets and depreciation

Property and equipment are carried at cost. Expenditures that extend the life of the asset are capitalized and depreciated. Depreciation and amortization are provided using the straight-line method over the estimated useful lives of the related assets or, in the case of leasehold improvements, over the lesser of the useful life of the related asset or the lease term. The estimated useful lives of the fixed assets range between two and five years.

Impairment of long-lived assets

In accordance with authoritative guidance, the Company reviews its long-lived assets, including property and equipment and other assets, for impairment whenever events or changes in circumstances indicate that the carrying amounts of the assets may not be fully recoverable. To determine recoverability of its long-lived assets, the Company evaluates whether future undiscounted net cash flows will be less than the carrying amount of the assets and adjusts the carrying amount of its assets to fair value. Management has determined that no impairment of long-lived assets occurred in the period from inception through December 31, 2013.

Fair value measurement

Financial assets and liabilities are measured at fair value, which is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The following is a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The Company has issued warrants, of which some are classified as derivative liabilities as a result of the terms in the warrants that provide for down-round protection in the event of a dilutive issuance. The Company uses Level 3 inputs for its valuation methodology for the warrant derivative liabilities. The estimated fair values were determined using a Monte Carlo option pricing model based on various assumptions (see Note 3). The Company s derivative liabilities are adjusted to reflect estimated fair value at each period end, with any decrease or increase in the estimated fair value being recorded in other income or expense accordingly, as adjustments to the fair value of derivative liabilities. Various factors are considered in the pricing models the Company uses to value the warrants, including the Company s current stock price, the remaining life of the warrants, the volatility of the Company s stock price, and the risk-free interest rate. Future changes in these factors will have a significant impact on the computed fair value of the warrant liability. As such, the Company expects future changes in the fair value of the warrants to continue to vary significantly from quarter to quarter.

The estimated fair values of the liabilities measured on a recurring basis are as follows:

Fair Value Measurements at December 31 and March 31, 2013 (in thousands):

	Balance at December 31, 2013	**Quoted Prices in Active Markets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Other Unobservable Inputs (Level 3)**
Warrant liability	$ 1,006			$ 1,006

	Balance at March 31, 2013	**Quoted Prices in Active Markets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Other Unobservable Inputs (Level 3)**

Warrant liability	$	6,898	$	6,898

The following table presents the activity for liabilities measured at estimated fair value using unobservable inputs for 2012 through December 31, 2013:

Fair Value Measurements Using Significant Unobservable Inputs (Level 3)

	Warrant Derivative Liability ($000 s)
Balance at December 31, 2011	$ 1,267
Issuances	32,742
Adjustments to estimated fair value	9,931
Warrant liability removal due to settlements	(23,321)
Balance at December 31, 2012	$ 20,619
Issuances	
Adjustments to estimated fair value	12,034
Warrant liability removal due to settlements	(23,869)
Warrant liability reclassified to equity	(1,886)
Balance at March 31, 2013	$ 6,898
Issuances	
Adjustments to estimated fair value	5,397
Warrant liability removal due to settlements	(10,522)
Warrant liability reclassified to equity	(767)
Balance at December 31, 2013	$ 1,006

Research and development

Research and development expenses, including direct and allocated expenses, consist of independent research and development costs, as well as costs associated with sponsored research and development. Research and development costs are expensed as incurred.

Income taxes

Deferred income taxes are recognized for the tax consequences in future years for differences between the tax basis of assets and liabilities and their financial reporting amounts at each year end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. Income tax expense is the combination of the tax payable for the year and the change during the year in deferred tax assets and liabilities.

Revenue recognition

The Company s revenues are derived from collaborative research agreements, grants from the NIH, U.S. Treasury Department and private not-for-profit organizations, as well as the sale of Bioprinter related products and services, and license agreements.

The Company recognizes revenue when the following criteria have been met: (i) persuasive evidence of an arrangement exists; (ii) services have been rendered or product has been delivered; (iii) price to the customer is fixed and determinable; and (iv) collection of the underlying receivable is reasonably assured.

Billings to customers or payments received from customers are included in deferred revenue on the balance sheet until all revenue recognition criteria are met. As of December 31, 2013 and March 31, 2013, the Company had approximately \$20,000 and \$62,000, respectively, in deferred revenue related to its collaborative research programs.

Product Revenue

The Company recognizes product revenue at the time of shipment to the customer, provided all other revenue recognition criteria have been met. The Company recognizes product revenues upon shipment to distributors, provided that (i) the price is substantially fixed or determinable at the time of sale; (ii) the distributor s obligation to pay the Company is not contingent upon resale of the products; (iii) title and risk of loss passes to the distributor at the time of shipment; (iv) the distributor has economic substance apart from that provided by the Company; (v) the Company has no significant obligation to the distributor to bring about the resale of the products; and (vi) future returns can be reasonably estimated. For any sales that do not meet all of the above criteria, revenue is deferred until all such criteria have been met.

Research and Development Revenue Under Collaborative Agreements

The Company s collaboration revenue consists of license and collaboration agreements that contain multiple elements, including non-refundable up front fees, payments for reimbursement of third-party research costs, payments for ongoing research, paym