Seres Therapeutics, Inc.
Form 10-Q
November 10, 2016

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, 2016

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: 001-37465

Seres Therapeutics, Inc.

(Exact name of registrant as specified in its charter)

Delaware	27-4326290
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

200 Sidney Street - 4th Floor

Cambridge, MA 02139
(Address of principal executive offices) (Zip Code)

(617) 945-9626

(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.

Large accelerated filer Accelerated filer

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

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

As of November 7, 2016 there were 40,355,753 shares of Common Stock, $0.001 par value per share, outstanding.

Seres Therapeutics, Inc.

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FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements other than statements of historical facts contained in this Quarterly Report, including statements regarding our future results of operations and financial position, business strategy, prospective products, product approvals, research and development costs, timing and likelihood of success, plans and objectives of management for future operations and future results of anticipated products, are forward-looking statements. These statements involve known and unknown risks, uncertainties and other important factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements.

In some cases, you can identify forward-looking statements by terms such as “may,” “will,” “should,” “expect,” “plan,” “anticipate,” “could,” “intend,” “target,” “project,” “contemplate,” “believe,” “estimate,” “predict,” “potential” or “continue” o of these terms or other similar expressions. The forward-looking statements in this Quarterly Report are only predictions. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our business, financial condition and results of operations. These forward-looking statements speak only as of the date of this Quarterly Report and are subject to a number of important factors that could cause actual results to differ materially from those in the forward-looking statements, including the factors described under the sections in this Quarterly Report titled “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” as well as the following:

- our status as a clinical-stage company and our expectation to incur losses in the future;
- our future capital needs and our need to raise additional funds;
- our ability to build a pipeline of product candidates and develop and commercialize drugs;
- our unproven approach to therapeutic intervention;
- our ability to enroll patients in clinical trials, timely and successfully complete those trials and receive necessary regulatory approvals;
- our ability to establish our own manufacturing facilities and to receive or manufacture sufficient quantities of our product candidates;
- our ability to protect and enforce our intellectual property rights;
- federal, state, and foreign regulatory requirements, including FDA regulation of our product candidates;
- our ability to obtain and retain key executives and attract and retain qualified personnel; and
- our ability to successfully manage our growth.

Moreover, we operate in an evolving environment. New risk factors and uncertainties may emerge from time to time, and it is not possible for management to predict all risk factors and uncertainties.

You should read this Quarterly Report and the documents that we reference in this Quarterly Report completely and with the understanding that our actual future results may be materially different from what we expect. We qualify all of our forward-looking statements by these cautionary statements. Except as required by applicable law, we do not plan to publicly update or revise any forward-looking statements contained herein, whether as a result of any new information, future events, changed circumstances or otherwise.

Part I – Financial Information

SERES THERAPEUTICS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited, in thousands, except share and per share data)

	September 30, 2016	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$55,611	$73,933
Investments	147,768	131,149
Prepaid expenses and other current assets	5,055	2,528
Total current assets	208,434	207,610
Property and equipment, net	34,560	7,751
Long-term investments	53,098	—
Restricted cash	1,422	1,539
Total assets	$297,514	$216,900
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$4,228	$5,397
Accrued expenses and other current liabilities	15,623	5,523
Deferred revenue - related party	12,027	—
Total current liabilities	31,878	10,920
Lease incentive obligation, net of current portion	10,740	586
Deferred rent	1,381	—
Deferred revenue, net of current portion - related party	99,518	—
Total liabilities	143,517	11,506
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.001 par value; 10,000,000 shares authorized at September 30, 2016 and December 31, 2015; no shares issued and outstanding at September 30, 2016 and December 31, 2015	—	—
Common stock, $0.001 par value; 200,000,000 shares authorized at September 30, 2016 and December 31, 2015; 40,355,753 and 39,082,017 shares issued and outstanding at September 30, 2016 and December 31, 2015, respectively	40	39
Additional paid-in capital	302,939	287,937
Accumulated other comprehensive income	(67)	30
Accumulated deficit	(148,915)	(82,612)
Total stockholders' equity	153,997	205,394
Total liabilities and stockholders' equity	$297,514	$216,900

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

SERES THERAPEUTICS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(unaudited, in thousands, except share and per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenue:				
Collaboration revenue - related party	$13,015	$—	$18,730	$—
Total revenue	13,015	—	18,730	—
Operating expenses:				
Research and development expenses	24,143	9,850	61,733	24,195
General and administrative expenses	7,967	4,711	24,163	10,873
Total operating expenses	32,110	14,561	85,896	35,068
Loss from operations	(19,095)	(14,561)	(67,166)	(35,068)
Other income (expense):				
Interest income	719	172	1,483	372
Interest expense	(312)	(231)	(620)	(443)
Revaluation of preferred stock warrant liability	—	$—	—	(7)
Total other income (expense), net	407	(59)	863	(78)
Net loss	$(18,688)	$(14,620)	$(66,303)	$(35,146)
Net loss per share attributable to common stockholders, basic and diluted	$(0.46)	$(0.38)	$(1.67)	$(1.92)
Weighted average common shares outstanding, basic and diluted	40,235,623	38,980,839	39,676,085	18,292,002
Other comprehensive income:				
Unrealized gain/(loss) on investments, net of tax of $0	$(150)	$(33)	$(97)	$(10)
Total other comprehensive income	(150)	(33)	(97)	(10)
Comprehensive loss	$(18,838)	$(14,653)	$(66,400)	$(35,156)

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

SERES THERAPEUTICS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited, in thousands)

	Nine Months Ended September 30,	
	2016	2015
Cash flows from operating activities:		
Net loss	$(66,303)	$(35,146)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation expense	12,865	6,907
Depreciation and amortization expense	2,511	394
Loss from revaluation of preferred stock warrant liability	—	7
Non-cash interest expense	2	269
Accretion of discount on investments	(317)	—
Changes in operating assets and liabilities:		
Prepaid expenses and other current assets	(2,527)	(2,962)
Deferred revenue	111,545	—
Accounts payable	84	532
Accrued expenses and other liabilities	6,866	724
Net cash provided by (used in) operating activities	64,726	(29,275)
Cash flows from investing activities:		
Purchases of property and equipment	(15,805)	(3,126)
Purchases of investments	(245,728)	(197,100)
Sales and maturities of investments	176,230	47,295
Changes in restricted cash	117	—
Net cash used in investing activities	(85,186)	(152,931)
Cash flows from financing activities:		
Proceeds from issuance of convertible preferred stock, net of issuance costs	—	(24)
Proceeds from exercise of stock options and common stock warrants	2,138	260
Proceeds from issuances of common stock upon completion of initial public offering	—	143,015
Repayment of notes payable	—	(2,600)
Payments of initial public offering costs	—	(2,928)
Net cash provided by financing activities	2,138	137,723
Net decrease in cash and cash equivalents	(18,322)	(44,483)
Cash and cash equivalents at beginning of period	73,933	114,185
Cash and cash equivalents at end of period	$55,611	$69,702
Supplemental disclosure of cash flow information:		
Cash paid for interest	$109	$162
Supplemental disclosure of non-cash investing and financing activities:		
Conversion of convertible preferred stock into common stock upon listing of the Company's common stock on the NASDAQ	$—	$136,053
Property and equipment purchases included in accounts payable and accrued expenses	$4,484	$648

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

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SERES THERAPEUTICS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except share and per share data)

(Unaudited)

1. Nature of the Business and Basis of Presentation

Seres Therapeutics, Inc. (the "Company") was incorporated under the laws of the State of Delaware in October 2010 under the name Newco LS21, Inc. In October 2011, the Company changed its name to Seres Health, Inc., and in May 2015, the Company changed its name to Seres Therapeutics, Inc. The Company is a microbiome therapeutics platform company developing a novel class of biological drugs, which are designed to restore health by repairing the function of a dysbiotic microbiome. The Company's lead product candidate, SER-109, is intended to prevent further recurrences of Clostridium difficile infection ("CDI"), a debilitating infection of the colon, and, if approved by the FDA, could be a first-in-field drug. Using its microbiome therapeutics platform, the Company is developing additional product candidates to treat diseases where the microbiome is implicated, including SER-262, a synthetic product candidate, to prevent an initial recurrence of primary CDI, SER-287 to treat inflammatory bowel disease, including ulcerative colitis, SER-301, a synthetic ulcerative colitis product candidate, and SER-155, a synthetic product candidate, to improve clinical outcomes following allogeneic hematopoietic stem cell transplantation (allo-HSCT) due to infections and graft-versus-host disease. The Company is also using its microbiome therapeutics platform to conduct research on metabolic diseases, such as non-alcoholic steatohepatitis (NASH); inflammatory diseases, such as Crohn's disease; rare liver disorders such as primary sclerosing cholangitis (PSC); and immuno-oncology treatments.

The Company is subject to risks common to companies in the biotechnology industry including, but not limited to, new technological innovations, protection of proprietary technology, dependence on key personnel, compliance with government regulations and the need to obtain additional financing. Product candidates currently under development will require significant additional research and development efforts, including extensive pre-clinical and clinical testing and regulatory approval, prior to commercialization. These efforts require significant amounts of additional capital, adequate personnel infrastructure and extensive compliance-reporting capabilities.

The Company's product candidates are in development. There can be no assurance that the Company's research and development will be successfully completed, that adequate protection for the Company's intellectual property will be obtained, that any products developed will obtain necessary government regulatory approval or that any approved products will be commercially viable. Even if the Company's product development efforts are successful, it is uncertain when, if ever, the Company will generate significant revenue from product sales. The Company operates in an environment of rapid change in technology and substantial competition from pharmaceutical and biotechnology companies. In addition, the Company is dependent upon the services of its employees and consultants.

Unaudited Interim Financial Information

The accompanying unaudited consolidated financial statements as of September 30, 2016 and for the three and nine months ended September 30, 2016 and 2015 have been prepared by the Company, pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") for interim financial statements. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted pursuant to such rules and regulations. However, the Company believes that the disclosures are adequate to make the

information presented not misleading. These consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and the notes thereto for the year ended December 31, 2015 included in the Company's annual report on Form 10-K for the fiscal year ended December 31, 2015, which was filed with the U.S. Securities and Exchange Commission on March 14, 2016.

The unaudited interim financial statements have been prepared on the same basis as the audited consolidated financial statements. The condensed consolidated balance sheet at December 31, 2015 was derived from audited annual financial statements, but does not contain all of the footnote disclosures from the annual financial statements. In the opinion of management, the accompanying unaudited interim consolidated financial statements contain all adjustments which are necessary for a fair statement of the Company's financial position as of September 30, 2016 and consolidated results of operations for the three and nine months ended September 30, 2016 and its cash flows for the nine months ended September 30, 2016 and 2015. Such adjustments are of a normal and recurring nature. The results of operations for the three and nine months ended September 30, 2016 are not necessarily indicative of the results of operations that may be expected for the year ending December 31, 2016.

2.Summary of Significant Accounting Policies

The significant accounting policies and estimates used in preparation of the condensed consolidated financial statements are described in the Company's audited financial statements as of and for the year ended December 31, 2015, and the notes thereto, which are included in the Company's Annual Report on Form 10-K. During the three and nine months ended September 30, 2016, the Company recorded revenue in connection with its collaboration agreement. See Note 9, "Collaboration Revenue," for additional information.

Use of Estimates

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, equity, revenue and expenses, and related disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant estimates and assumptions reflected in these consolidated financial statements include, but are not limited to, revenue recognition, the accrual of research and development expenses and the valuation of stock-based awards. Estimates are periodically reviewed in light of changes in circumstances, facts and experience. Actual results could differ from the Company's estimates.

Fair Value Measurements

Certain assets and liabilities are carried at fair value under GAAP. Fair value 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. Financial assets and liabilities carried at fair value are to be classified and disclosed in one of the following three levels of the fair value hierarchy, of which the first two are considered observable and the last is considered unobservable:

- Level 1—Quoted prices in active markets for identical assets or liabilities.
- Level 2—Observable inputs (other than Level 1 quoted prices), such as quoted prices in active markets for similar assets or liabilities, quoted prices in markets that are not active for identical or similar assets or liabilities, or other inputs that are observable or can be corroborated by observable market data.
- Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to determining the fair value of the assets or liabilities, including pricing models, discounted cash flow methodologies and similar techniques.

The Company's cash equivalents and investments are carried at fair value, determined according to the fair value hierarchy described above. The Company's investments in certificates of deposit are carried at amortized cost, which approximates fair value. Certain cash equivalents or investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy. The carrying values of the Company's accounts payable and accrued expenses approximate their fair value due to the short-term nature of these liabilities.

The following table presents information about the Company's assets as of September 30, 2016 and December 31, 2015 that are measured at fair value on a recurring basis and indicate the level of the fair value hierarchy utilized to determine such fair values (note there were no liabilities measured at fair value on a recurring basis in either of the periods presented):

	Fair Value Measurements as of September 30, 2016 Using:

	Level 1	Level 2	Level 3	Not Subject to Leveling [1]	Total
Assets:					
Cash Equivalents	$—	$8,318	$ —	$ 1,119	$9,437
Repurchase Agreements	—	8,500	—	—	8,500
Investments:					
Commercial Paper	$—	$29,739	$ —	$ —	$29,739
Certificates of Deposit	—	12,799	—	—	12,799
Corporate Bonds	—	88,762	—	—	88,762
Government Securities	—	51,537	—	—	51,537
Treasury Bonds	—	18,029	—	—	18,029
	$—	$217,684	$ —	$ 1,119	$218,803

[1] Certain cash equivalents and investments that are valued using the net asset value per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy.

	Fair Value Measurements as of December 31, 2015 Using:				
	Level 1	Level 2	Level 3	Not Subject to Leveling [1]	Total
Assets:					
Cash Equivalents	$—	$11,952	$ —	$ 11,173	$23,125
Repurchase Agreements	—	20,000	—	—	20,000
Investments:					
Commercial Paper	$—	$64,820	$ —	$ —	$64,820
Corporate Bonds	—	46,490	—	—	46,490
Government Securities	—	15,819	—	—	15,819
Treasury Bonds	—	4,020	—	—	4,020
	$—	$163,101	$ —	$ 11,173	$174,274

[1] Certain cash equivalents and investments that are valued using the net asset value per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy.

As of September 30, 2016, the Company's cash equivalents, which were invested in money market funds, corporate bonds, and repurchase agreements with original maturities of less than 90 days from the date of purchase, were valued based on Level 2 inputs. Repurchase agreements are agreements with banks to repurchase notes that are collateralized by U.S. government securities.

As of December 31, 2015, the Company's cash equivalents consisted of money market funds, corporate bonds, commercial paper, government securities and repurchase agreements with original maturities of less than 90 days from the date of purchase and were valued based on Level 2 inputs. Repurchase agreements are agreements with banks to repurchase notes that are collateralized by U.S. government securities.

The fair value of the Company's investments, which consisted of commercial paper, certificates of deposit, corporate bonds, government securities and treasury bonds as of September 30, 2016 and December 31, 2015 were determined using Level 2 inputs. During the three and nine months ended September 30, 2016 there were no transfers between Level 1, Level 2 and Level 3.

Revenue recognition

The Company currently generates its revenue through collaboration and license arrangements with strategic partners for the development and commercialization of product candidates.

The Company recognizes revenue in accordance with FASB ASC Topic 605, Revenue Recognition ("ASC 605"). Accordingly, revenue is recognized for each unit of accounting when all of the following criteria are met:

- Persuasive evidence of an arrangement exists

- Delivery has occurred or services have been rendered
- The seller's price to the buyer is fixed or determinable
- Collectability is reasonably assured

Amounts received prior to satisfying the revenue recognition criteria are recorded as deferred revenue in the Company's consolidated balance sheets. Amounts expected to be recognized as revenue within the 12 months following the balance sheet date are classified as deferred revenue, current portion. Amounts not expected to be recognized as revenue within the 12 months following the balance sheet date are classified as long-term deferred revenue.

Collaboration revenue

In January 2016 the Company entered into a Collaboration and License Agreement (the "License Agreement") with Nestec Ltd. ("NHS"), an affiliate of Nestlé Health Science US Holdings, Inc. In connection with the License Agreement, the Company received an upfront, non-refundable payment of $120,000. Other non-refundable payments to the Company under this arrangement may include: (i) payments for research and development services, (ii) payments for the supply of clinical product, (iii) payments for the supply of commercial product, (iv) payments based on the achievement of certain development, regulatory, commercial, and sales-based milestones and (v) royalties on product sales.

The Company evaluates multiple-element arrangements based on the guidance in FASB ASC Topic 605-25, Revenue Recognition-Multiple-Element Arrangements ("ASC 605-25"). Pursuant to this guidance, the Company identifies the deliverables included in the

arrangement and determines: (1) whether the individual deliverables have value to the customer on a standalone basis and represent separate units of accounting or whether they must be accounted for as a combined unit of accounting; and (2) if the arrangement includes a general right of return relative to the delivered item. This evaluation requires management to make judgments about the individual deliverables and whether such deliverables are separable from the other aspects of the contractual relationship. Deliverables are considered separate units of accounting provided that: (i) the delivered item(s) has value to the customer on a standalone basis and (ii) if the arrangement includes a general right of return relative to the delivered item(s), delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the Company. In assessing whether an item has standalone value, the Company considers factors such as the research, manufacturing and commercialization capabilities of the collaboration partner, the retention of any key rights by the Company, and the availability of the associated expertise in the general marketplace. In addition, the Company considers whether the collaboration partner can use the other deliverable(s) for their intended purpose without the receipt of the remaining element(s), whether the value of the deliverable is dependent on the undelivered item(s) and whether there are other vendors that can provide the undelivered element(s).

In situations where the Company has identified multiple units of accounting, the arrangement consideration that is fixed or determinable is allocated among the separate units of accounting using the relative selling price method. The Company determines the selling price of a unit of accounting following the hierarchy of evidence prescribed by ASC 605-25. Accordingly, the Company determines the estimated selling price for units of accounting within each arrangement using vendor-specific objective evidence (“VSOE”) of selling price, if available, third-party evidence (“TPE”) of selling price if VSOE is not available, or best estimate of selling price (“BESP”) if neither VSOE nor TPE is available.

Then, the applicable revenue recognition criteria in ASC 605-25 are applied to each of the separate units of accounting to determine the appropriate period and pattern of recognition. The Company recognizes arrangement consideration allocated to each unit of accounting when all of the revenue recognition criteria in ASC 605-25 are satisfied for that particular unit of accounting. The Company will recognize as revenue, upon delivery, arrangement consideration attributed to licenses that have standalone value from the other deliverables to be provided in an arrangement. For licenses that do not have standalone value from the other deliverables to be provided in an arrangement over the Company’s estimated performance period as the arrangement would be accounted for as a single unit of accounting.

The Company recognizes arrangement consideration allocated to each unit of accounting when all of the revenue recognition criteria in ASC 605-25 are satisfied for that particular unit of accounting. The Company will recognize as revenue arrangement consideration attributed to licenses that have standalone value from the other deliverables to be provided in an arrangement upon delivery. The Company will recognize as revenue arrangement consideration attributed to licenses that do not have standalone value from the other deliverables to be provided in an arrangement over the Company’s estimated performance period as the arrangement would be accounted for as a single unit of accounting.

If there is no discernible pattern of performance and/or objectively measurable performance measures do not exist, then the Company recognizes revenue under the arrangement for the single unit of accounting on a straight-line basis over the period the Company is expected to complete its performance obligations. Alternatively, if the pattern of performance in which the service is provided to the customer can be determined and objectively measurable performance measures exist, then the Company recognizes revenue under the arrangement using the proportional performance method. Revenue recognized is limited to the lesser of the cumulative amount of payments received or the cumulative amount of revenue earned, as determined using the straight-line method or proportional performance method, as applicable.

At the inception of an arrangement that includes milestone payments, the Company evaluates whether each milestone is substantive and at risk to both parties on the basis of the contingent nature of the milestone. This evaluation includes an assessment of whether: (i) the consideration is commensurate with either the Company’s performance to achieve the

milestone or the enhancement of the value of the delivered item(s) as a result of a specific outcome resulting from the Company's performance to achieve the milestone, (ii) the consideration relates solely to past performance and (iii) the consideration is reasonable relative to all of the deliverables and payment terms within the arrangement. The Company evaluates factors such as the scientific, clinical, regulatory, commercial and other risks that must be overcome to achieve the respective milestone and the level of effort and investment required to achieve the respective milestone in making this assessment. There is considerable judgment involved in determining whether a milestone satisfies all of the criteria required to conclude that a milestone is substantive. The Company recognizes revenue associated with substantive milestones in accordance with FASB ASC Topic 605-28, Revenue Recognition-Milestone Method upon successful accomplishment of each milestone, assuming all other revenue recognition criteria are met. Milestones that are not considered substantive would be recognized as revenue over the remaining period of performance, assuming all other revenue recognition criteria are met.

The Company will recognize royalty revenue in the period of sale of the related product(s), based on the underlying contract terms, provided that the reported sales are reliably measurable and the Company has no remaining performance obligations, assuming all other revenue recognition criteria are met.

Refer to footnote 9 for further information related to the Company's collaboration and license agreement with Nestec, Ltd.

Net Loss per Share

Basic net loss per share is computed using the weighted average number of common shares outstanding during the period. Diluted net loss per share is computed using the sum of the weighted average number of common shares outstanding during the period and, if dilutive, the weighted average number of potential shares of common stock, including the assumed exercise of stock options and warrants and unvested restricted stock. The Company applied the two-class method to calculate its basic and diluted net loss per share attributable to common stockholders for the three and nine months ended September 30, 2015, as its convertible preferred stock and common stock are participating securities. The two-class method is an earnings allocation formula that treats a participating security as having rights to earnings that otherwise would have been available to common stockholders. However, the two-class method does not impact the net loss per share of common stock as the Company was in a net loss position for the three and nine months ended September 30, 2015 and preferred stockholders do not participate in losses.

The Company's restricted stock awards granted by the Company entitle the holder of such awards to dividends declared or paid by the board of directors, regardless of whether such awards are unvested, as if such shares were outstanding common shares at the time of the dividend. However, the unvested restricted stock awards are not entitled to share in the residual net assets (deficit) of the Company. Accordingly, in periods in which the Company reports a net loss attributable to common stockholders, diluted net loss per share attributable to common stockholders is the same as basic net loss per share attributable to common stockholders, since dilutive common shares are not assumed to have been issued if their effect is anti-dilutive.

The following potential common shares, presented based on amounts outstanding at each period end, were excluded from the calculation of diluted net loss per share attributable to common stockholders for the periods indicated because including them would have had an anti-dilutive effect:

	Three and Nine Months Ended	
	September 30,	
	2016	2015
Stock options to purchase common stock	5,165,729	4,842,496
Unvested restricted common stock	—	625
	5,165,729	4,843,121

Recently Issued Accounting Standards

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which supersedes all existing revenue recognition requirements, including most industry-specific guidance. The new standard requires a company to recognize revenue when it transfers goods or services to customers in an amount that reflects the consideration that the company expects to receive for those goods or services. In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which delayed the effective date of the new standard from January 1, 2017 to January 1, 2018. The FASB also agreed to allow entities to choose to adopt the standard as of the original effective date. In March 2016, the FASB issued ASU

2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations, which clarifies the implementation guidance on principal versus agent considerations. In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, which clarifies how a company identifies promised goods or services and clarifies whether an entity's promise to grant a license provides a customer with either a right to use the entity's intellectual property (which is satisfied at a point in time) or a right to access the entity's intellectual property (which is satisfied over time). In May 2016, the FASB issued ASU No. 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients related to disclosures of remaining performance obligations, as well as other amendments to guidance on collectibility, non-cash consideration and the presentation of sales and other similar taxes collected from customers. We are currently evaluating the method of adoption and the potential impact that Topic 606 may have on our financial position and results of operations.

In May 2015, the FASB issued ASU 2015-07, Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent). The new standard removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. The new standard became effective for us on January 1, 2016. Refer to the Fair Value Measurements significant accounting policy for the impact of this change.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract (i.e. lessees and lessors). The new standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase by the lessee. This classification will determine whether lease expense is recognized based on an effective interest method or on a straight line basis over the term of the lease, respectively. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for similar to existing guidance for operating leases today. ASC 842 supersedes the previous leases standard, ASC 840 Leases. The standard is effective on January 1, 2019, with early adoption permitted. The Company is in the process of evaluating the impact of this new guidance.

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, which amends the accounting for employee share-based payment transactions to require recognition of the tax effects resulting from the settlement of stock-based awards as income tax expense or benefit in the income statement in the reporting period in which they occur. In addition, the ASU requires that all tax-related cash flows resulting from share-based payments, including the excess tax benefits related to the settlement of stock-based awards, be classified as cash flows from operating activities in the statement of cash flows. The ASU also requires that cash paid by directly withholding shares for tax withholding purposes be classified as a financing activity in the statement of cash flows. In addition, the ASU also allows companies to make an accounting policy election to either estimate the number of awards that are expected to vest, consistent with current U.S. GAAP, or account for forfeitures when they occur. The new standard is effective for annual reporting periods beginning after December 15, 2016 with early adoption permitted. The Company is in the process of evaluating the impact of this new guidance.

In August 2016, the FASB issued ASU No. 2016-15, Classification of Certain Cash Receipts and Cash Payments. The new standard addresses specific cash flow issues with the objective of reducing existing diversity in practice. The new standard will be effective for the Company on January 1, 2018. The Company is in the process of evaluating the impact of this new guidance.

Reclassifications

Certain amounts reported in the prior year financial statements have been reclassified for comparative purposes to conform with the presentation in the current year condensed consolidated financial statements.

3. Investments

As of September 30, 2016 and December 31, 2015, the fair value of available-for-sale investments by type of security was as follows:

	September 30, 2016			
	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Investments:				
Commercial Paper	$29,709	$ 30	$ —	$29,739
Certificates of Deposit	12,799	—	—	12,799
Corporate Bonds	88,856	3	(97)	88,762
Government Securities	51,546	7	(16)	51,537
Treasury Bonds	18,021	8	—	18,029
	$200,931	$ 48	$ (113)	$200,866

	December 31, 2015			
	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Investments:				
Commercial Paper	$64,733	$ 87	$ —	$64,820
Corporate Bonds	46,538	—	(48)	46,490
Government Securities	15,823			