Pacific Ethanol, Inc.
Form 10-Q
May 11, 2015

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended **March 31, 2015**

o **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: **000-21467**

(Exact name of registrant as specified in its charter)

Delaware	**41-2170618**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
400 Capitol Mall, Suite 2060, Sacramento, California	**95814**
(Address of principal executive offices)	(zip code)

(916) 403-2123
(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 o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes x No o

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

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

As of May 11, 2015, there were 24,658,394 shares of Pacific Ethanol, Inc. common stock, $0.001 par value per share, outstanding.

PART I
FINANCIAL INFORMATION

PART II

OTHER INFORMATION

PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

PACIFIC ETHANOL, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands)

	March 31, 2015 (unaudited)	December 31, 2014 *
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 42,274	$ 62,084
Accounts receivable, net (net of allowance for doubtful accounts of $6)	27,342	34,612
Inventories	17,840	18,550
Prepaid inventory	8,431	11,595
Other current assets	14,678	12,710
Total current assets	110,565	139,551
Property and equipment, net	160,179	155,302
Other Assets:		
Intangible assets, net	2,678	2,786
Other assets	1,803	1,863
Total other assets	4,481	4,649
Total Assets	$ 275,225	$ 299,502

* Amounts derived from the audited financial statements for the year ended December 31, 2014.

See accompanying notes to consolidated financial statements.

PACIFIC ETHANOL, INC.
CONSOLIDATED BALANCE SHEETS (CONTINUED)
(in thousands, except par value and shares)

	March 31, 2015 (unaudited)	December 31, 2014 *
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable – trade	$ 14,823	$ 13,122
Accrued liabilities	4,230	6,203
Current portion – capital leases	2,986	4,077
Other current liabilities	800	2,045
Total current liabilities	22,839	25,447
Long-term debt, net of current portion	17,003	34,533
Capital leases, net of current portion	1,883	2,055
Warrant liabilities at fair value	2,120	1,986
Deferred tax liabilities	17,040	17,040
Other liabilities	443	459
Total Liabilities	61,328	81,520
Commitments and Contingencies (Notes 5 and 7)		
Stockholders' Equity:		
Pacific Ethanol, Inc. Stockholders' Equity:		
Preferred stock, $0.001 par value; 10,000,000 shares authorized; Series A: 1,684,375 shares authorized; no shares issued and outstanding as of March 31, 2015 and December 31, 2014; Series B: 1,580,790 shares authorized; 926,942 shares issued and outstanding as of March 31, 2015 and December 31, 2014; liquidation preference of $18,075 as of March 31, 2015	1	1
Common stock, $0.001 par value; 300,000,000 shares authorized; 24,715,029 and 24,499,534 shares issued and outstanding as of March 31, 2015 and December 31, 2014, respectively	25	25
Additional paid-in capital	726,549	725,813
Accumulated deficit	(517,024)	(512,332)
Total Pacific Ethanol, Inc. Stockholders' Equity	209,551	213,507
Noncontrolling interest	4,346	4,475
Total Stockholders' Equity	213,897	217,982
Total Liabilities and Stockholders' Equity	$ 275,225	$ 299,502

* Amounts derived from the audited financial statements for the year ended December 31, 2014.

See accompanying notes to consolidated financial statements.

PACIFIC ETHANOL, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited, in thousands, except per share data)

	Three Months Ended March 31,	
	2015	2014
Net sales	$206,176	$254,543
Cost of goods sold	207,163	215,998
Gross profit (loss)	(987)	38,545
Selling, general and administrative expenses	4,905	3,670
Income (loss) from operations	(5,892)	34,875
Fair value adjustments	(173)	(35,844)
Interest expense, net	(1,015)	(4,351)
Other expense, net	(129)	(227)
Loss before provision for income taxes	(7,209)	(5,547)
Provision (benefit) for income taxes	(2,700)	3,270
Consolidated net loss	(4,509)	(8,817)
Net (income) loss attributed to noncontrolling interests	129	(2,009)
Net loss attributed to Pacific Ethanol, Inc.	$(4,380)	$(10,826)
Preferred stock dividends	$(312)	$(312)
Net loss attributed to common stockholders	$(4,692)	$(11,138)
Net loss per share, basic and diluted	$(0.19)	$(0.69)
Weighted-average shares outstanding, basic and diluted	24,104	16,181

See accompanying notes to consolidated financial statements.

PACIFIC ETHANOL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited, in thousands)

	Three Months Ended March 31, 2015	2014
Operating Activities:		
Consolidated net loss	$(4,509)	$(8,817)
Adjustments to reconcile consolidated net loss to net cash provided by operating activities:		
Fair value adjustments	173	35,844
Depreciation and amortization of intangibles	3,409	3,173
Deferred income taxes	–	3,270
Amortization of debt discount	44	1,557
Non-cash compensation	506	367
Amortization of deferred financing fees	60	112
Inventory valuation	–	97
Loss (gain) on derivatives	189	(70)
Bad debt expense	–	(34)
Changes in operating assets and liabilities:		
Accounts receivable	7,270	(16,096)
Inventories	709	(5,008)
Prepaid expenses and other assets	(2,857)	82
Prepaid inventory	3,164	2,974
Accounts payable and accrued expenses	(832)	5,425
Net cash provided by operating activities	7,326	22,876
Investing Activities:		
Additions to property and equipment	(8,178)	(1,833)
Net cash used in investing activities	(8,178)	(1,833)
Financing Activities:		
Proceeds from exercise of warrants	191	12,130
Net proceeds from (payments on) Kinergy’s line of credit	(17,530)	4,065
Principal payments on Plant Owners’ borrowings	–	(19,378)
Principal payments on senior notes	–	(13,007)
Principal payments on capital leases	(1,307)	(1,096)
Principal payments on related party note	–	(750)
Preferred stock dividends paid	(312)	(312)
Net cash used in financing activities	(18,958)	(18,348)
Net increase (decrease) in cash and cash equivalents	(19,810)	2,695
Cash and cash equivalents at beginning of period	62,084	5,151
Cash and cash equivalents at end of period	$42,274	$7,846
Supplemental Information:		
Interest paid	$969	$2,712
Noncash financing and investing activities:		

Reclass of warrant liability to equity upon warrant exercises	$39	$11,377

See accompanying notes to consolidated financial statements.

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PACIFIC ETHANOL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. ORGANIZATION AND BASIS OF PRESENTATION.

Organization and Business – The consolidated financial statements include, for all periods presented, the accounts of Pacific Ethanol, Inc., a Delaware corporation (“Pacific Ethanol”), and its direct and indirect subsidiaries, including its wholly-owned subsidiaries, Kinergy Marketing LLC, an Oregon limited liability company (“Kinergy”), Pacific Ag. Products, LLC, a California limited liability company (“PAP”) and PE Op Co., a Delaware corporation (“PE Op Co.,”), which owns the Plant Owners (as defined below) (collectively, the “Company”).

The Company is the leading producer and marketer of low-carbon renewable fuels in the Western United States. The Company also sells ethanol co-products, including wet distillers grain (“WDG”), a nutritious animal feed, and corn oil. Serving integrated oil companies and gasoline marketers who blend ethanol into gasoline, the Company provides transportation, storage and delivery of ethanol through third-party service providers in the Western United States, primarily in California, Arizona, Nevada, Utah, Oregon, Colorado, Idaho and Washington. The Company had a 96% and a 91% ownership interest in PE Op Co., the owner of four ethanol production facilities, as of March 31, 2015 and 2014, respectively. The facilities are near their respective fuel and feed customers, offering significant timing, transportation cost and logistical advantages. The Company sells ethanol produced by the Pacific Ethanol Plants (as defined below) and unrelated third parties to gasoline refining and distribution companies, sells its WDG to dairy operators and animal feed distributors and sells its corn oil to poultry and biodiesel customers.

The Company manages the production and operation of four ethanol production facilities, namely, Pacific Ethanol Madera LLC, Pacific Ethanol Columbia, LLC, Pacific Ethanol Stockton LLC and Pacific Ethanol Magic Valley, LLC (collectively, the “Pacific Ethanol Plants”) and their holding company, Pacific Ethanol Holding Co. LLC (“PEHC,” and together with the Pacific Ethanol Plants, the “Plant Owners”). PEHC is a wholly-owned subsidiary of PE Op Co. These four facilities have an aggregate annual ethanol production capacity of up to 200 million gallons.

Accounts Receivable and Allowance for Doubtful Accounts – Trade accounts receivable are presented at face value, net of the allowance for doubtful accounts. The Company sells ethanol to gasoline refining and distribution companies, sells WDG to dairy operators and animal feed distributors and sells corn oil to poultry and biodiesel customers generally without requiring collateral.

The Company maintains an allowance for doubtful accounts for balances that appear to have specific collection issues. The collection process is based on the age of the invoice and requires attempted contacts with the customer at specified intervals. If, after a specified number of days, the Company has been unsuccessful in its collection efforts, a bad debt allowance is recorded for the balance in question. Delinquent accounts receivable are charged against the allowance for doubtful accounts once uncollectibility has been determined. The factors considered in reaching this determination are the apparent financial condition of the customer and the Company’s success in contacting and negotiating with the customer. If the financial condition of the Company’s customers were to deteriorate, resulting in an impairment of ability to make payments, additional allowances may be required.

Of the accounts receivable balance, approximately $21,450,000 and $28,427,000 at March 31, 2015 and December 31, 2014, respectively, were used as collateral under Kinergy’s operating line of credit. The allowance for doubtful accounts was $6,000 as of March 31, 2015 and December 31, 2014. The Company recorded a recovery for bad debts of $34,000 for the three months ended March 31, 2014. The Company does not have any off-balance sheet credit exposure related to its customers.

Recent Accounting Pronouncements – In May 2014, the Financial Accounting Standards Board ("FASB") issued new guidance on the recognition of revenue. The guidance states that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard was originally effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, but has been further deferred one year. The Company's adoption begins with the first fiscal quarter of fiscal year 2018. Early adoption is permitted. The Company is currently evaluating the impact of the adoption of this accounting standard update on its consolidated results of operations and financial position.

In April 2015, the FASB issued new guidance on presentation of debt issuance costs. Historically, entities have presented debt issuance costs as an asset. Under the new guidance, effective for fiscal years beginning after December 31, 2015, debt issuance costs will be reclassified as a deduction to the carrying amount of the related debt balance. The guidance does not change any of the Company's other debt recognition or disclosure. The Company will adopt the guidance beginning March 31, 2016.

Basis of Presentation–Interim Financial Statements – The accompanying unaudited consolidated financial statements and related notes have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Results for interim periods should not be considered indicative of results for a full year. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2014. The accounting policies used in preparing these consolidated financial statements are the same as those described in Note 1 to the consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2014. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair statement of the results for interim periods have been included. All significant intercompany accounts and transactions have been eliminated in consolidation.

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates are required as part of determining the fair value of warrants and conversion features, allowance for doubtful accounts, estimated lives of property and equipment and intangibles, long-lived asset impairments, valuation allowances on deferred income taxes and the potential outcome of future tax consequences of events recognized in the Company's financial statements or tax returns. Actual results and outcomes may materially differ from management's estimates and assumptions.

2. PACIFIC ETHANOL PLANTS.

Consolidation of PE Op Co. – The Company concluded that since PE Op Co.'s inception, through the point the Company became a 91% owner in December 2013, PE Op Co. was a variable interest entity because the other owners of PE Op Co., due to the Company's involvement through its contractual arrangements, at all times lacked the power to direct the activities that most significantly impacted its economic performance. Since December 2013, as a result of owning 91% of PE Op Co., the Company, with its significant majority position, has the ability to make most all decisions on its own, and has therefore determined that PE Op Co. is no longer considered a variable interest entity. The Company currently is a 96% owner and continues to consolidate PE Op Co.'s financial results, however, now under the voting rights model. Consequently, since the Company does not wholly-own PE Op Co., it must adjust its consolidated net income (loss) for the income (loss) attributed to PE Op Co.'s other owners. The remaining amount after this adjustment results in net income (loss) attributed to Pacific Ethanol, Inc.

Noncontrolling interest decreased from $4,475,000 at December 31, 2014 to $4,346,000 at March 31, 2015 due to net loss attributed to noncontrolling interest of $129,000 for the three months ended March 31, 2015.

The Company's acquisition of its ownership interest in PE Op Co. does not impact the Company's rights or obligations under any of its contractual arrangements. Further, creditors of PE Op Co. do not have recourse to Pacific Ethanol, Inc. Since its acquisition, the Company has not provided any additional support to PE Op Co. beyond the terms of its contractual arrangements.

3. INVENTORIES.

Inventories consisted primarily of bulk ethanol and unleaded fuel, and are valued at the lower-of-cost-or-market, with cost determined on a first-in, first-out basis. Inventory balances consisted of the following (in thousands):

	March 31, 2015	December 31, 2014
Finished goods	$11,668	$ 11,118
Raw materials	1,914	2,695
Work in progress	2,848	3,274
Other	1,410	1,463
Total	$17,840	$ 18,550

4. DERIVATIVES.

The business and activities of the Company expose it to a variety of market risks, including risks related to changes in commodity prices and interest rates. The Company monitors and manages these financial exposures as an integral part of its risk management program. This program recognizes the unpredictability of financial markets and seeks to reduce the potentially adverse effects that market volatility could have on operating results.

Commodity Risk – Cash Flow Hedges – The Company uses derivative instruments to protect cash flows from fluctuations caused by volatility in commodity prices for periods of up to twelve months in order to protect gross profit margins from potentially adverse effects of market and price volatility on ethanol sale and purchase commitments where the prices are set at a future date and/or if the contracts specify a floating or index-based price for ethanol. In addition, the Company hedges anticipated sales of ethanol to minimize its exposure to the potentially adverse effects of price volatility. These derivatives may be designated and documented as cash flow hedges and effectiveness is evaluated by assessing the probability of the anticipated transactions and regressing commodity futures prices against the Company's purchase and sales prices. Ineffectiveness, which is defined as the degree to which the derivative does not offset the underlying exposure, is recognized immediately in cost of goods sold. For the three months ended March 31, 2015 and 2014, the Company did not designate any of its derivatives as cash flow hedges.

Commodity Risk – Non-Designated Hedges – The Company uses derivative instruments to lock in prices for certain amounts of corn and ethanol by entering into forward contracts for those commodities. These derivatives are not designated for special hedge accounting treatment. The changes in fair value of these contracts are recorded on the balance sheet and recognized immediately in cost of goods sold. The Company recognized losses of $189,000 and gains of $70,000 as the change in the fair value of these contracts for the three months ended March 31, 2015 and 2014, respectively.

Non Designated Derivative Instruments – The classification and amounts of the Company's recognized gains (losses) for its derivatives not designated as hedging instruments are as follows (in thousands):

Type of Instrument	Statements of Operations Location	Realized Gains (Losses) Three Months Ended March 31, 2015	2014
Commodity contracts	Cost of goods sold	$(115)	$ 84

Type of Instrument	Statements of Operations Location	Unrealized Losses Three Months Ended March 31, 2015	2014
Commodity contracts	Cost of goods sold	$(74)	$(14)

5. DEBT.

Long-term borrowings are summarized as follows (in thousands):

	March 31, 2015	December 31, 2014
Kinergy operating line of credit	$–	$ 17,530
Plant Owners' third-party term debt	17,003	17,003
	17,003	34,533
Less short-term portion	–	–
Long-term debt	$17,003	$ 34,533

Kinergy Operating Line of Credit – As of March 31, 2014, Kinergy had no outstanding balance and an available borrowing base under the credit facility of $30,000,000.

Plant Owners' Term Debt and Operating Lines of Credit – As of March 31, 2015, the Plant Owners' term debt had an outstanding balance of $17,003,000. As of March 31, 2015, the Plant Owners had no outstanding balances on their revolving credit facilities, with an aggregate of $34,473,000 of availability.

6. COMMON STOCK AND WARRANTS.

Warrant Exercises – During the three months ended March 31, 2015 and 2014, certain holders exercised warrants and received an aggregate of 22,000 and 1,888,000 shares of the Company's common stock upon payment of an aggregate of $191,000 and $12,130,000 in cash, respectively.

7. COMMITMENTS AND CONTINGENCIES.

Sales Commitments – At March 31, 2015, the Company had entered into sales contracts with its major customers to sell certain quantities of ethanol, WDG, corn oil and syrup. The Company had open ethanol indexed-price contracts for 154,350,000 gallons of ethanol as of March 31, 2015. The Company had open fixed-price WDG and syrup sales contracts valued at $1,159,000, open corn oil sales contracts valued at $992,000 and open indexed-price sales contracts for 62,000 tons of WDG and syrup as of March 31, 2015. These sales contracts are scheduled to be completed throughout 2015.

Purchase Commitments – At March 31, 2015, the Company had fixed-price purchase contracts with its suppliers to purchase $6,413,000 of ethanol and indexed-price contracts to purchase 30,802,000 gallons of ethanol. These contracts are scheduled to be satisfied throughout the remainder of 2015.

Litigation – General – The Company is subject to various claims and contingencies in the ordinary course of its business, including those related to litigation, business transactions, employee-related matters, and others. When the Company is aware of a claim or potential claim, it assesses the likelihood of any loss or exposure. If it is probable that a loss will result and the amount of the loss can be reasonably estimated, the Company will record a liability for the loss. If the loss is not probable or the amount of the loss cannot be reasonably estimated, the Company discloses the claim if the likelihood of a potential loss is reasonably possible and the amount involved could be material. While there can be no assurances, the Company does not expect that any of its pending legal proceedings will have a material financial impact on the Company's operating results.

On May 24, 2013, GS CleanTech Corporation ("GS CleanTech"), filed a suit in the United States District Court for the Eastern District of California, Sacramento Division (Case No.: 2:13-CV-01042-JAM-AC), naming Pacific Ethanol, Inc. as a defendant. On August 29, 2013, the case was transferred to the United States District Court for the Southern District of Indiana and made part of the pre-existing multi-district litigation involving GS CleanTech and multiple defendants. The suit alleged infringement of a patent assigned to GS CleanTech by virtue of certain corn oil separation technology in use at one or more of the ethanol production facilities in which the Company has an interest, including Pacific Ethanol Stockton LLC ("PE Stockton"), located in Stockton, California. The complaint sought preliminary and permanent injunctions against the Company, prohibiting future infringement on the patent owned by GS CleanTech and damages in an unspecified amount adequate to compensate GS CleanTech for the alleged patent infringement, but in any event no less than a reasonable royalty for the use made of the inventions of the patent, plus attorneys' fees. The Company answered the complaint, counterclaimed that the patent claims at issue, as well as the claims in several related patents, are invalid and unenforceable and that the Company is not infringing. Pacific Ethanol, Inc. does not itself use any corn oil separation technology and may seek a dismissal on those grounds.

On March 17 and March 18, 2014, GS CleanTech filed suit naming as defendants two Company subsidiaries: PE Stockton and Pacific Ethanol Magic Valley, LLC ("PE Magic Valley"). The claims were similar to those filed against Pacific Ethanol, Inc. in May 2013. These two cases were transferred to the multi-district litigation division in United States District Court for the Southern District of Indiana, where the case against Pacific Ethanol, Inc. was pending. Although PE Stockton and PE Magic Valley do separate and market corn oil, Pacific Ethanol, Inc., PE Stockton and PE Magic Valley strongly disagree that either of the subsidiaries use corn oil separation technology that infringes the patent owned by GS CleanTech. In a January 16, 2015 decision, the District Court for the Southern District of Indiana ruled in favor of a stipulated motion for partial summary judgment for Pacific Ethanol, Inc., PE Stockton and PE Magic Valley finding that all of the GS Cleantech patents in the suit were invalid and, therefore, not infringed. GS Cleantech has said it will appeal this decision when the remaining claim in the suit has been decided. The only remaining claim alleges that GS Cleantech inequitably conducted itself before the United States Patent Office when obtaining the patents at issue. A trial in the District Court for the Southern District of Indiana on that single issue is expected later in 2015. If the Defendants, including Pacific Ethanol, Inc., PE Stockton and PE Magic Valley, succeed in proving inequitable conduct, then the Court will be asked to determine whether GS Cleantech's behavior makes this an "exceptional case". A finding that this is an exceptional case would allow the Court to award to Pacific Ethanol, Inc., PE Stockton and PE Magic Valley the attorneys' fees expended to date for defense in this case. It is unknown whether GS Cleantech would appeal such a ruling. The Company did not record a provision for these matters as of March 31, 2015 as Company management intends to vigorously defend these allegations and believes a material adverse ruling against Pacific Ethanol, Inc., PE Stockton and/or PE Magic Valley is not probable. The Company believes that any liability Pacific Ethanol, Inc., PE Stockton and/or PE Magic Valley may incur would not have a material adverse effect on the Company's financial condition or its results of operations.

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8. FAIR VALUE MEASUREMENTS.

The fair value hierarchy prioritizes the inputs used in valuation techniques into three levels, as follows:

- Level 1 – Observable inputs – unadjusted quoted prices in active markets for identical assets and liabilities;
- Level 2 – Observable inputs other than quoted prices included in Level 1 that are observable for the asset or liability through corroboration with market data; and
- Level 3 – Unobservable inputs – includes amounts derived from valuation models where one or more significant inputs are unobservable. For fair value measurements using significant unobservable inputs, a description of the inputs and the information used to develop the inputs is required along with a reconciliation of Level 3 values from the prior reporting period.

The Company recorded its warrants issued from 2010 through 2013 at fair value and designated them as Level 3 on their issuance dates.

Warrants – Except for the warrants issued September 26, 2012, the Company's warrants were valued using a Monte Carlo Binomial Lattice-Based valuation methodology, adjusted for marketability restrictions. The warrants issued September 26, 2012, due to no anti-dilution protection features, were valued using the Black-Scholes Valuation Model.

Significant assumptions used and related fair values for the warrants as of March 31, 2015 were as follows:

Original Issuance	Exercise Price	Volatility	Risk Free Interest Rate	Term (years)	Market Discount	Warrants Outstanding	Fair Value
09/26/2012	$8.85	54.6%	0.20%	0.49	32.0%	452,000	$815,000
07/3/2012	$6.09	53.9%	0.56%	2.26	30.6%	211,000	855,000
12/13/2011	$8.43	54.8%	0.56%	1.71	27.3%	138,000	450,000
							$2,120,000

Significant assumptions used and related fair values for the warrants as of December 31, 2014 were as follows:

Original Issuance	Exercise Price	Volatility	Risk Free Interest Rate	Term (years)	Market Discount	Warrants Outstanding	Fair Value
09/26/2012	$8.85	51.0%	0.19%	0.74	37.0%	473,000	$748,000
07/3/2012	$6.09	56.1%	0.89%	2.51	32.8%	211,000	811,000
12/13/2011	$8.43	54.3%	0.67%	1.95	28.7%	138,000	427,000

$1,986,000

The estimated fair value of the warrants is affected by the above underlying inputs. Observable inputs include the values of exercise price, stock price, term and risk-free interest rate. As separate inputs, an increase (decrease) in either the term or risk free interest rate will result in an increase (decrease) in the estimated fair value of the warrant.

Unobservable inputs include volatility and market discount. An increase (decrease) in volatility will result in an increase (decrease) in the estimated warrant value and an increase (decrease) in the market discount will result in a decrease (increase) in the estimated warrant fair value.

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The volatility utilized was a blended average of the Company’s historical volatility and implied volatilities derived from a selected peer group. The implied volatility component has remained relatively constant over time given that implied volatility is a forward-looking assumption based on observable trades in public option markets. Should the Company’s historical volatility increase (decrease) on a go-forward basis, the resulting value of the warrants would increase (decrease).

The market discount, or a discount for lack of marketability, is quantified using a Black-Scholes option pricing model, with a primary model input of assumed holding period restriction. As the assumed holding period increases (decreases), the market discount increases (decreases), conversely impacting the value of the warrant fair value.

Other Derivative Instruments – The Company’s other derivative instruments consist of commodity positions. The fair values of the commodity positions are based on quoted prices on the commodity exchanges and are designated as Level 1 inputs.

The following table summarizes fair value measurements by level at March 31, 2015 (in thousands):

	Level 1	Level 2	Level 3	Total
Assets:				
Commodity contracts(1)	$812	$ –	$–	$812
Total Assets	$812	$ –	$–	$812
Liabilities:				
Warrants(2)	$–	$ –	$2,120	$2,120
Commodity contracts(3)	449	–	–	449
Total Liabilities	$449	$ –	$2,120	$2,569

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(1) Included in other current assets in the consolidated balance sheets.

(2) Included in warrant liabilities at fair value in the consolidated balance sheets.

(3) Included in accrued liabilities in the consolidated balance sheets.

The following table summarizes fair value measurements by level at December 31, 2014 (in thousands):

	Level 1	Level 2	Level 3	Total
Assets:				
Commodity contracts(1)	$1,586	$ –	$–	$1,586
Total Assets	$1,586	$ –	$–	$1,586
Liabilities:				
Warrants(2)	$–	$ –	$1,986	$1,986
Commodity contracts(3)	1,149	–	–	1,149
Total Liabilities	$1,149	$ –	$1,986	$3,135

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(1) Included in other current assets in the consolidated balance sheets.

(2) Included in warrant liabilities at fair value in the consolidated balance sheets.

(3) Included in accrued liabilities in the consolidated balance sheets.

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For fair value measurements using significant unobservable inputs (Level 3), a description of the inputs and the information used to develop the inputs is required along with a reconciliation of Level 3 values from the prior reporting period. The changes in the Company's fair value of its Level 3 inputs with respect to its warrants were as follows (in thousands):

Balance, December 31, 2014	$1,986
Exercises of warrants	(39)
Adjustments to fair value for the period	173
Balance, March 31, 2015	$2,120

9. EARNINGS PER SHARE.

The following tables compute basic and diluted earnings per share (in thousands, except per share data):

	Three Months Ended March 31, 2015		
	Loss Numerator	Shares Denominator	Per-Share Amount
Net loss attributed to Pacific Ethanol, Inc.	$(4,380)		
Less: Preferred stock dividends	(312)		
Basic and diluted loss per share:			
Net loss attributed to common stockholders	$(4,692)	24,104	$ (0.19)

	Three Months Ended March 31, 2014		
	Loss Numerator	Shares Denominator	Per-Share Amount
Net loss attributed to Pacific Ethanol, Inc.	$(10,826)		
Less: Preferred stock dividends	(312)		
Basic and diluted loss per share:			
Net loss attributed to common stockholders	$(11,138)	16,181	$ (0.69)

There were an aggregate of 1,080,000 and 2,301,000 potentially dilutive weighted-average shares from convertible securities outstanding as of March 31, 2015 and 2014, respectively. These convertible securities were not considered in calculating diluted net loss per share for the three months ended March 31, 2015 and 2014, as their effect would have been anti-dilutive.

10. MERGER AGREEMENT WITH AVENTINE.

On December 30, 2014, the Company entered into a definitive merger agreement with Aventine Renewable Energy Holdings, Inc. ("Aventine"), a Midwest ethanol producer, under which the Company plans to acquire Aventine through a merger. Effective March 31, 2015, the Company entered into an amendment to the definitive merger agreement with Aventine to address certain conditions to closing and other matters. The merger agreement provides that, upon the terms and subject to the conditions set forth in the merger agreement, a wholly-owned subsidiary of the Company will merge with and into Aventine, with Aventine surviving as a wholly-owned subsidiary of the Company. Subject to the terms and conditions of the merger agreement which was approved by the Company’s and Aventine’s boards of directors, if the merger is completed, each outstanding share of Aventine common stock will be converted into the right to receive 1.25 shares of the Company’s common stock, and the Company will issue approximately 17.75 million shares of its common stock. The merger is expected to result in the Company’s stockholders holding approximately 58% of the combined company.

The merger transaction, which is intended to be structured as a tax-free exchange of shares, is expected to close during the second quarter of 2015, and is subject to closing conditions, including obtaining certain regulatory approvals and approvals from the stockholders of both companies.

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

The following discussion and analysis should be read in conjunction with our consolidated financial statements and notes to consolidated financial statements included elsewhere in this report. This report and our consolidated financial statements and notes to consolidated financial statements contain forward-looking statements, which generally include the plans and objectives of management for future operations, including plans and objectives relating to our future economic performance and our current beliefs regarding revenues we might generate and profits we might earn if we are successful in implementing our business and growth strategies. The forward-looking statements and associated risks may include, relate to or be qualified by other important factors, including:

- fluctuations in the market price of ethanol and its co-products;
- fluctuations in the costs of key production input commodities such as corn and natural gas;
- the projected growth or contraction in the ethanol and co-product markets in which we operate;
- our strategies for expanding, maintaining or contracting our presence in these markets;
- our ability to successfully manage and operate third party ethanol production facilities;
- anticipated trends in our financial condition and results of operations; and
- our ability to distinguish ourselves from our current and future competitors.

You are cautioned not to place undue reliance on any forward-looking statements, which speak only as of the date of this report, or in the case of a document incorporated by reference, as of the date of that document. We do not undertake to update, revise or correct any forward-looking statements, except as required by law.

Any of the factors described immediately above, or referenced from time to time in our filings with the Securities and Exchange Commission or in the "Risk Factors" section below could cause our financial results, including our net income or loss or growth in net income or loss to differ materially from prior results, which in turn could, among other things, cause the price of our common stock to fluctuate substantially.

Overview

We are the leading producer and marketer of low-carbon renewable fuels in the Western United States.

We have extensive customer relationships throughout the Western United States. Our ethanol customers are integrated oil companies and gasoline marketers who blend ethanol into gasoline. These customers collectively require ethanol volumes in excess of the supply produced in the Western United States. We arrange for transportation, storage and delivery of ethanol purchased by our customers through our agreements with third-party service providers in the Western United States, as well as in the Midwest from a variety of sources. In 2014, we obtained approximately 42%

of our ethanol supplies from Midwest producers to supplement ethanol produced in the Western United States, including by the Pacific Ethanol Plants. We also market ethanol co-products, including WDG and corn oil for the Pacific Ethanol Plants. Our WDG customers are dairies and feedlots located near the Pacific Ethanol Plants. Our corn oil is sold to poultry and biodiesel customers. We do not market co-products from other ethanol producers.

We market all the ethanol we sell through Kinergy. We hold a 96% ownership interest in PE Op Co., the owner of each of the plant holding companies, or the Plant Owners, that collectively own the Pacific Ethanol Plants. We operate and maintain the Pacific Ethanol Plants under the terms of an asset management agreement with the Plant Owners, and supply all goods and materials necessary to operate and maintain each Pacific Ethanol Plant.

Our ethanol customers rely on us to provide a reliable supply of product, and manage the logistics and timing of delivery with very little effort on their side. In meeting the needs of our customers, we secure supply from a variety of sources, including the Pacific Ethanol Plants, other plants in California for which we market, and suppliers in the Midwest, where a majority of ethanol manufacturers are located.

The Pacific Ethanol Plants are comprised of the four facilities described immediately below and have an aggregate annual production capacity of up to 200 million gallons. The facilities are near their respective fuel and feed customers, offering significant timing, transportation cost and logistical advantages.

Facility Name	**Facility Location**	**Estimated Annual Capacity (gallons)**
Magic Valley	Burley, ID	60,000,000
Columbia	Boardman, OR	40,000,000
Stockton	Stockton, CA	60,000,000
Madera	Madera, CA	40,000,000

We intend to advance our position as the leading producer and marketer of low-carbon renewable fuels in the Western United States, in part by expanding our relationships with our current customers and establishing new relationships with customers outside that region. As we develop new customer relationships, we will seek new suppliers including through the acquisition of additional production facilities. We have entered into a definitive merger agreement with Aventine Renewable Energy Holdings, Inc., or Aventine, as discussed below, which we expect will add 315 million gallons of annual capacity to our existing portfolio of ethanol production assets, as well as additional supplies of co-products.

Recent Development

Proposed Merger with Aventine

On December 30, 2014, we entered into a definitive merger agreement with Aventine, a Midwest ethanol producer, under which we plan to acquire Aventine through a merger. Effective March 31, 2015, we entered into an amendment to the definitive merger agreement with Aventine to address certain conditions to closing and other matters. The merger agreement provides that, upon the terms and subject to the conditions set forth in the merger agreement, one of our wholly-owned subsidiaries will merge with and into Aventine, with Aventine surviving as one of our wholly-owned subsidiaries. Subject to the terms and conditions of the merger agreement, which was approved by our board of directors and the board of directors of Aventine, if the merger is completed, each outstanding share of Aventine common stock will be converted into the right to receive 1.25 shares of our common stock, and we will issue approximately 17.75 million shares of our common stock to the former stockholders of Aventine. The merger is expected to result in our stockholders holding approximately 58% of the combined company.

The merger transaction, which is intended to be structured as a tax-free exchange of shares, is expected to close during the second quarter of 2015, and is subject to closing conditions, including obtaining certain regulatory approvals and approvals from the stockholders of both companies.

We expect to incur significant expenses in connection with the merger. While we have assumed that a certain level of expenses will be incurred, there are many factors that could affect the total amount or the timing of the merger expenses, and many of the expenses that will be incurred are, by their nature, difficult to estimate. These expenses could result in the combined company taking significant charges against earnings following the completion of the merger. The ultimate amount and timing of such charges are uncertain at the present time. We incurred $1.7 million in professional and other fees associated with the proposed merger through March 31, 2015.

Current Initiatives and Outlook

The ethanol industry experienced negative margins during the first quarter of 2015. Overall crush and commodity margins, which reflect ethanol and co-product sales prices relative to production inputs such as corn and natural gas, declined due to the drop in ethanol prices and an industry-wide increase in inventories as well as volatility in the energy markets. As a result, we along with others in the industry, reduced production rates in the first quarter of 2015 to better balance supply and demand. Thus far during the second quarter of 2015, margins have improved and are now positive. We have increased production levels in the second quarter and expect to maintain these production levels for the balance of 2015 assuming the improved supply and demand balance is sustained.

Part of the decline in margins is attributable to seasonality, with lower demand in the winter months, driven by lower overall demand for gasoline. We expect a better supply and demand balance during the summer and fall months, due to higher overall demand for gasoline during the driving season. We remain confident in the long-term demand for renewable fuels and our ability to execute and create value. Even with the recent drop in fuel prices, ethanol continues to trade at a significant discount to the wholesale price of gasoline. We believe this underscores the value of ethanol as a high-octane, cleaner-burning and cheapest available liquid transportation fuel.

Net exports of ethanol continue to be a positive factor for the industry. According to the Renewable Fuels Association, United States exports of ethanol rose 35% to approximately 836 million gallons in 2014 as compared to approximately 617 million gallons in 2013. We expect United States exports of ethanol to further increase in 2015, as Brazil migrates to 27% blend levels, strong demand from Canada persists and Asia and other parts of the world continue to draw exports from the United States. In addition, demand from China for dried distillers grains with solubles remains strong which supports WDG prices.

From 2010 through 2013, we issued in various financing transactions warrants to purchase shares of our common stock. The warrants were initially recorded at their fair values, which are adjusted quarterly, generally resulting in non-cash expenses or income if the market price of our common stock increases or decreases, respectively, during the period. These fair value adjustments will continue in future periods until all of our warrants are exercised or expire. These adjustments will generally reduce our net income or increase our net loss if the market price of our common stock increases from the prior quarter through the date of a warrant’s exercise, if exercised during the quarter, or if our common stock increases on a quarter over quarter basis for warrants outstanding at the end of a quarter. Conversely, the adjustments will generally increase our net income or reduce our net loss if the market price of our common stock declines in these scenarios. Since January 1, 2014, we have processed warrant exercises for approximately 6.7 million shares of our common stock, currently at approximately 0.8 million warrants outstanding. We expect that these warrant exercises will reduce our GAAP earnings volatility in future quarters as the amount of warrants marked to fair value has declined significantly.

We began producing and selling corn oil at our Magic Valley and Stockton facilities in 2013, allowing us to diversify our revenue and providing immediate incremental operating income. We are currently producing corn oil in meaningful amounts at these facilities. In May 2015, we began producing and selling corn oil at our Madera facility and plan to complete the implementation of corn oil production technology at our remaining Pacific Ethanol Plant by the end of the second quarter of 2015. Production and sale of corn oil adds approximately $0.05 per gallon of incremental gross profit.

We continue to focus on increasing operating efficiencies and improving yields at the Pacific Ethanol Plants. To this end, we installed yield-enhancing fine grind technologies at our Stockton and Magic Valley facilities, allowing us to increase yields by increasing available starch for conversion. These technologies also may allow us to produce cellulosic corn ethanol. We will evaluate when and to what extent these technologies should be implemented at the remaining two Pacific Ethanol Plants. We are also seeking to optimize chemical additive blends to improve yields. Based on expected production margins, each 1% improvement in production yields results in approximately $3.0 million in additional annual gross profit when operating at our full production capacity of 200 million gallons.

We have approved a capital expenditure budget to invest up to $30.0 million in the Pacific Ethanol Plants over the next year to further improve efficiencies, diversify feedstock, implement our advanced biofuels initiatives and implement cogeneration technologies to displace purchased electricity by converting waste gas from ethanol production and natural gas into electricity and steam. Our goal with these investments is to achieve a $0.05 to $0.06 per gallon improvement in annual operating earnings, which would equal approximately $10 million to $12 million in additional annual operating earnings at expected production margins when operating at our full production capacity.

The regulatory environment continues to support the long-term demand for renewable fuels. California's Low-Carbon Fuel Standard requires refiners to reduce the carbon intensity of their fuels by 10% between 2011 and 2020, which we believe is an aggressive requirement that will necessitate a significant amount of low-carbon fuel to displace gasoline in the California fuel supply. In 2014, we entered into an arrangement to sell CO_2 generated from our Columbia plant through a liquefaction and dry ice processing facility under construction adjacent to our plant. We expect to commence CO_2 sales by the end of the second quarter of 2015.

We recently were awarded a $3.0 million matching grant from the California Energy Commission to develop a sorghum feedstock program collaboratively with Chromatin, Inc., California State University, Fresno's Center for Irrigation Technology, and the Kearney Agricultural Research and Extension Center. This undertaking also includes the California In-State Sorghum Program to support a lasting expansion in California's ability to produce low-carbon ethanol from in-state feedstock that meets both the renewable fuel and greenhouse gas reduction goals stipulated under the national RFS and California's Low-Carbon Fuel Standard.

We continue to pursue production of advanced biofuels at the Pacific Ethanol Plants. To this end, we are in the project development phase with Sweetwater Energy to acquire cellulosic industrial sugars. We expect this project will take at least two years. We are also working with Cellunators™ technology to enable the release of cellulosic sugars from corn kernel fibers which, when released through an appropriate enzyme for commercial production, will allow us to produce cellulosic ethanol for up to 2.0% of our overall production at a plant that uses the technology. We are also running a pilot program for anaerobic digestion at our Stockton facility to substitute biogas for natural gas for the production of advanced biofuels. In addition, our Magic Valley plant is well situated to add new facilities enabling ethanol production from wheat straw and we are evaluating the feasibility of a cellulosic project of this nature at this facility. Finally, we are analyzing various co-generation configurations, particularly at our California plants where energy prices are high and we receive a low-carbon premium for the ethanol we produce and sell into the California market.

Our goals for 2015 include completing our proposed merger with Aventine and efficiently integrating our two companies, and continuing to reinvest in our ethanol production business through initiatives focused on further improving operating efficiencies and yields at the Pacific Ethanol Plants, diversifying our feedstock, creating new revenue streams and furthering our advanced biofuels initiatives, all of which are directed at expanding our share of the renewable fuels market and delivering long-term profitable growth.

Critical Accounting Policies

The preparation of our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America, requires us to make judgments and estimates that may have a significant impact upon the portrayal of our financial condition and results of operations. We believe that of our significant accounting policies, the following require estimates and assumptions that require complex, subjective judgments by management that can materially impact the portrayal of our financial condition and results of operations: revenue recognition; warrants and conversion features carried at fair value; impairment of long-lived and intangible assets; and allowance for doubtful accounts. These significant accounting principles are more fully described in "Management's Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies" in our Annual Report on Form 10-K for the year ended December 31, 2014.

Results of Operations

The following selected financial information should be read in conjunction with our consolidated financial statements and notes to our consolidated financial statements included elsewhere in this report, and the other sections of "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained in this report.

Certain performance metrics that we believe are important indicators of our results of operations include:

	Three Months Ended March 31, 2015	2014	Percentage Change
Production gallons sold (in millions)	44.6	39.8	12.1%
Third party gallons sold (in millions)	91.1	73.0	24.8%
Total gallons sold (in millions)	135.7	112.8	20.3%
Average sales price per gallon	$1.65	$2.70	(38.9%)
Corn cost per bushel—CBOT equivalent	$3.88	$4.48	(13.4%)
Average basis[1]	0.93	1.28	(27.3%)
Delivered cost of corn	$4.81	$5.76	(16.5%)
Co-product revenues as % of delivered cost of corn[2]	33.8 %	34.6 %	(2.3%)
Average CBOT ethanol price per gallon	$1.50	$2.20	(31.8%)
Average CBOT corn price per bushel	$3.85	$4.52	(14.8%)

(1) Corn basis represents the difference between the immediate cash price of delivered corn and the future price of corn for Chicago delivery.

(2) Co-product revenues as a percentage of delivered cost of corn shows our yield based on sales of co-products, including WDG and corn oil, generated from ethanol we produced.

Net Sales, Cost of Goods Sold and Gross Profit (Loss)

The following table presents our net sales, cost of goods sold and gross profit (loss) in dollars and gross profit (loss) as a percentage of net sales (in thousands, except percentages):

	Three Months Ended March 31,		**Change in**	
	2015	**2014**	**Dollars**	**Percent**
Net sales	$206,176	$254,543	$(48,367)	(19.0%)
Cost of goods sold	207,163	215,998	(8,835)	(4.1%)
Gross profit (loss)	$(987)	$38,545	$(39,532)	NM
Percentage of net sales	0.5%	15.1%		

Net Sales

The decrease in our net sales for the three months ended March 31, 2015 as compared to the same period in 2014 was due to a decrease in our average sales price per gallon, partially offset by an increase in our total gallons sold.

Net sales of ethanol declined by $45.1 million, or 20%, to $179.0 million for the three months ended March 31, 2015 as compared to $224.1 million for the three months ended March 31, 2014. Our total volume of ethanol gallons sold increased by 22.9 million gallons, or 20%, to 135.7 million gallons for the three months ended March 31, 2015 as compared to 112.8 million gallons for the same period in 2014. All of the additional 22.9 million gallons of ethanol sold in the first quarter of 2015 were attributable to our sales as a producer or a merchant. At our average sales price per gallon of $1.65 for the three months ended March 31, 2015, we generated $42.0 million in additional net sales from the 22.9 million gallons of ethanol sold as a producer or merchant for the period as compared to the same period in 2014. In addition, we sold 2.6 million fewer gallons as an agent during the period. The 2.6 million fewer gallons of ethanol sold as an agent had an immaterial impact on our net sales for the three months ended March 31, 2015. The decline of $1.05, or 39%, in our average sales price per gallon for the three months ended March 31, 2015 as compared to the same period in 2014 reduced our net sales by $87.1 million.

Net sales of co-products declined by $2.1 million, or 8%, to $25.5 million for the three months ended March 31, 2015 as compared to $27.6 million for the same period in 2014. Our total volume of WDG sold increased by 13,400 tons to 355,300 tons for the three months ended March 31, 2015 from 341,900 tons for the same period in 2014. At our average sales price per ton of $69.46 for the three months ended March 31, 2015, we generated $0.9 million in additional net sales from the 13,400 additional tons of WDG sold in the first quarter of 2015 as compared to the same period in 2014. However, the decline of $9.12, or 12%, in our average sales price per ton for the three months ended March 31, 2015 as compared to the same period in 2014 fully offset the increase in our net sales resulting from higher sales volumes, reducing our net sales by $3.0 million. Although net sales of our other co-products increased for the three months ended March 31, 2015 as compared to the same period in 2014, we believe the overall changes in sales volumes and prices of those co-products were immaterial to our net sales for the three months ended March 31, 2015.

We increased both production and third party gallons sold, and our volume of co-products sold, for the three months ended March 31, 2015 as compared to the same period in 2014. The increases in our production gallons and third party gallons sold are primarily due to increased production rates at the Pacific Ethanol Plants and third party supplier plants, respectively, including, in the case of the Pacific Ethanol Plants, as a result of the restart of production at our Madera plant in the second quarter of 2014. The increase in our volume of co-products sold is due to increased production at the Pacific Ethanol Plants, including as a result of the restart of production at our Madera plant. Excluding the impact on our production levels due to the restart of production at our Madera plant, we and our third party suppliers decreased production rates in the first quarter of 2015 as compared to the same period in 2014 due to low industry-wide crush margins resulting from lower ethanol sales prices due to excess ethanol inventories relative to demand, which more than offset the benefit of lower corn costs.

Our average sales price per gallon decreased 39% to $1.65 for the three months ended March 31, 2015 compared to our average sales price per gallon of $2.70 for the same period in 2014. The average Chicago Board of Trade, or CBOT, ethanol price per gallon, however, declined 32% to $1.50 for the three months ended March 31, 2015 compared to an average CBOT sales price per gallon of $2.20 for the same period in 2014.

This disparity between our average ethanol sales price per gallon and the CBOT average reflects both the additional basis costs for West Coast delivery of ethanol as well as the premiums we receive by selling lower-carbon intensity ethanol in the Western United States. Ethanol prices in the Western United States were also higher than ethanol prices in the Midwest in the first quarter of 2014 due to weather conditions and ongoing rail logistics challenges which constrained the flow of ethanol and co-products from the Midwest to the markets in which we operate.

Cost of Goods Sold and Gross Profit (Loss)

Our gross profit declined significantly to a gross loss of $1.0 million for the three months ended March 31, 2015 from a gross profit of $38.5 million for the same period in 2014. Our gross margin also declined significantly to negative 0.5% for the three months ended March 31, 2015 from a gross margin of 15.1% for the same period in 2014. Our gross profit and gross margin decreased primarily due to significantly lower crush and commodity margins realized at the Pacific Ethanol Plants, predominantly related to lower ethanol sales prices relative to corn costs and industry-wide excess ethanol supply relative to demand.

Of the $39.5 million decline in gross profit for the three months ended March 31, 2015 as compared to the same period in 2014, $28.8 million resulted from our total production gallons sold and $10.7 million related to our merchant sales. Our production gallons sold increased by 4.8 million gallons in the three months ended March 31, 2015 as compared to the same period in 2014. Of the $28.8 million in lower gross profit resulting from our total production gallons sold, $28.3 million is attributable to our lower gross margins in the first quarter of 2015 and $0.5 million is attributable to the 4.8 million gallon increase in production gallons sold in the first quarter of 2015 as compared to the same period in 2014. Of the $10.7 million in lower gross profit resulting from our merchant sales, $11.7 million is attributable to our lower gross margins in the first quarter of 2015, which was partially offset by higher gross profits of $1.0 million attributable to the 20.7 million gallon increase in merchant gallons sold in the first quarter of 2015 as compared to the same period in 2014.

Selling, General and Administrative Expenses

The following table presents our selling, general and administrative expenses, or SG&A, in dollars and as a percentage of net sales (in thousands, except percentages):

	Three Months Ended March 31,		Change in	
	2015	2014	Dollars	Percent
Selling, general and administrative expenses	$4,905	$3,670	$1,235	33.7%
Percentage of net sales	2.4%	1.4%		

Our SG&A increased in both absolute dollars and as a percentage of net sales for the three months ended March 31, 2015 as compared to the same period in 2014. The $1.2 million period over period increase in SG&A is primarily due to an increase in professional fees of $1.0 million due to costs associated with our pending merger transaction with Aventine.

Fair Value Adjustments

The following table presents our fair value adjustments in dollars and as a percentage of net sales (in thousands, except percentages):

	Three Months Ended March 31,		Change in	
	2015	2014	Dollars	Percent
Fair value adjustments	$173	$35,844	$(35,671)	(99.5%)
Percentage of net sales	0.1%	14.1%		

We issued certain warrants in various financing transactions from 2010 through 2013. These warrants were initially recorded at fair value and are adjusted quarterly. As a result of quarterly adjustments to their fair values, we recorded an expense of $0.2 million and $35.8 million for the three months ended March 31, 2015 and 2014, respectively. The fair value adjustments for the three months ended March 31, 2014 related to a substantial increase in the market price of our common stock from December 31, 2013 to March 31, 2014 and because the exercise prices of these warrants were, as of March 31, 2014, well below the market price of our common stock. The decline in fair value adjustments for the first quarter of 2015 was also due in part to fewer warrants outstanding in the quarter as compared to the same period in 2014.

These fair value adjustments will continue in future periods until all of our warrants are exercised or expire. These adjustments will generally reduce our net income or increase our net loss if the market price of our common stock increases from the prior quarter through the date of a warrant's exercise, if exercised during the quarter, or if our common stock increases on a quarter over quarter basis for warrants outstanding at the end of a quarter. Conversely, the adjustments will generally increase our net income or reduce our net loss if the market price of our common stock declines on a quarter over quarter basis.

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Interest Expense, net

The following table presents our interest expense, net in dollars and as a percentage of net sales (in thousands, except percentages):

	Three Months Ended March 31,		**Change in**	
	2015	**2014**	**Dollars**	**Percent**
Interest expense, net	$1,015	$4,351	$(3,336)	(76.7%)
Percentage of net sales	0.5%	1.7%		

Interest expense, net decreased $3.3 million to $1.0 million for the three months ended March 31, 2015 from $4.3 million for the same period in 2014. The decrease in interest expense, net is primarily due to significantly reduced average debt balances.

Provision (Benefit) for Income Taxes

The following table presents our provision (benefit) for income taxes in dollars and as a percentage of net sales (in thousands, except percentages):

	Three Months Ended March 31,		**Change in**	
	2015	**2014**	**Dollars**	**Percent**
Provision (benefit) for income taxes	$(2,700)	$3,270	$(5,970)	NM
Percentage of net sales	*1.3%*	*1.3%*		

For the three months ended March 31, 2015, we recorded a net loss for the period on both a book and tax basis, and recorded a benefit associated with the loss at an estimated tax rate. For the three months ended March 31, 2014, although we incurred a net loss for the period on a book basis, we generated income subject to income tax as a result of the nontax-deductible nature of our fair value adjustments. We applied our net operating loss carryforwards to our potential taxable income and as a result, we recorded a deferred provision for income taxes of $11.3 million, eliminating any need for a current tax provision or liability. Further, we reversed $8.0 million of our valuation allowance against our net tax assets, resulting in an income tax benefit.

Net (Income) Loss Attributed to Noncontrolling Interest

The following table presents the portion of our net (income) loss attributed to noncontrolling interest in dollars and as a percentage of net sales (in thousands, except percentages):

	Three Months Ended March 31,		**Change in**	
	2015	**2014**	**Dollars**	**Percent**
Net (income) loss attributed to noncontrolling interest	$129	$(2,009)	$(2,138)	NM
Percentage of net sales	*0.1%*	*0.8%*		

Net (income) loss attributed to noncontrolling interest relates to our consolidated treatment of PE Op Co., of which we are a 96% owner. For the three months ended March 31, 2015 and 2014, we consolidated the entire income statement of PE Op Co. However, because we owned less than 100% of PE Op Co. for these periods, we reduced our consolidated net income (loss) for the noncontrolling interest, which was the ownership interest that we did not own.

Net Loss Attributed to Pacific Ethanol, Inc.

The following table presents our net loss attributed to Pacific Ethanol, Inc. in dollars and as a percentage of net sales (in thousands, except percentages):

	Three Months Ended March 31,		**Change in**	
	2015	**2014**	**Dollars**	**Percent**
Net loss attributed to Pacific Ethanol, Inc.	$4,380	$10,826	$(6,446)	(59.5%)
Percentage of net sales	2.1%	4.3%		

The decrease in net loss attributed to Pacific Ethanol, Inc. was primarily due to our substantial fair value adjustments during the first quarter of 2014 which did not recur in the first quarter of 2015, and which offset the impact of our increased ownership interest in PE Op Co. For the three months ended March 31, 2015, our increased ownership interest in PE Op Co. resulted in higher operating losses due to lower overall gross margins.

Preferred Stock Dividends and Net Loss Attributed to Common Stockholders

The following table presents our preferred stock dividends for our Series B Cumulative Convertible Preferred Stock, or Series B Preferred Stock, in dollars and as a percentage of net sales, and our net loss attributed to common stockholders in dollars and as a percentage of net sales (in thousands, except percentages):

	Three Months Ended March 31,		**Change in**	
	2015	**2014**	**Dollars**	**Percent**
Preferred stock dividends	$312	$312	$–	–
Percentage of net sales	0.2%	0.1%		
Net loss attributed to common stockholders	$4,692	$11,138	$(6,446)	(57.9%)
Percentage of net sales	2.3%	4.4%		

Shares of our Series B Preferred Stock are entitled to quarterly cumulative dividends payable in arrears in an amount equal to 7% per annum of the purchase price per share of the Series B Preferred Stock. We accrued and paid cash dividends on our Series B Preferred Stock in the aggregate amount of $0.3 million for the three months ended March

31, 2015 and 2014.

Liquidity and Capital Resources

During the three months ended March 31, 2015, we funded our operations primarily from cash flow from operations, cash on hand and proceeds from warrant exercises. These funds were used to fund our operations, make capital expenditures and make payments on Kinergy’s revolving credit facility.

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Our current available capital resources consist of cash on hand and amounts available for borrowing under Kinergy's credit facility. In addition, the Plant Owners have credit facilities for use in the operations of the Pacific Ethanol Plants. We expect that our future available capital resources will consist primarily of our remaining cash balances, amounts available for borrowing, if any, under Kinergy's credit facility, cash generated from Kinergy's ethanol marketing business, fees paid under our asset management agreement relating to our operation of the Pacific Ethanol Plants, proceeds from warrant exercises and dividends, if any, in respect of our ownership interest in PE Op Co.

We believe that current and future available capital resources, revenues generated from operations, and other existing sources of liquidity, including our credit facilities, will be adequate to meet our anticipated working capital and capital expenditure requirements for at least the next twelve months.

Quantitative Quarter-End Liquidity Status

We believe that the following amounts provide insight into our liquidity and capital resources. The following selected financial information should be read in conjunction with our consolidated financial statements and notes to consolidated financial statements included elsewhere in this report, and the other sections of "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained in this report (dollars in thousands):

	March 31, 2015	**December 31, 2014**	**Change**
Cash and cash equivalents	$42,274	$62,084	(31.9%)
Current assets	$110,565	$139,551	(20.8%)
Current liabilities	$22,839	$25,447	(10.2%)
Notes payable	$17,003	$34,533	(50.8%)
Working capital	$87,726	$114,104	(23.1%)
Working capital ratio	4.84	5.48	(11.7%)

Change in Working Capital and Cash Flows

Working capital decreased to $87.7 million at March 31, 2015 from $114.1 million at December 31, 2014 as a result of a decrease in current assets of $29.0 million, which was partially offset by a decrease in current liabilities of $2.6 million.

Current assets decreased primarily due to a decrease in cash and cash equivalents of $19.8 million predominantly due to capital expenditures and payments on Kinergy's revolving line of credit, a decrease in accounts receivable of $7.3

million primarily due to lower ethanol prices, a decrease in inventories of $0.7 million, a decrease in prepaid inventory of $3.2 million due to lower ethanol prices and an increase in other current assets of $2.0 million. Current liabilities decreased primarily due to a decrease in accrued liabilities of $2.0 million resulting from the timing of payments during the quarter, a decrease in the current portion of capital leases of $1.1 million due to capital lease payments made during the quarter, and a decrease in other current liabilities of $1.2 million due to a reduction in derivative liabilities, which were partially offset by an increase in trade accounts payable of $1.7 million resulting from the timing of payments during the quarter.

Cash provided by our operating activities declined by $15.6 million primarily due to depreciation and amortization of $3.4 million, a decrease in accounts receivable of $7.3 million predominantly due to lower ethanol prices and a decrease in prepaid inventory of $3.2 million also due to lower ethanol prices, which were partially offset by our consolidated net loss of $4.5 million, an increase in prepaid expenses and other assets of $2.9 million resulting from increased tax benefit for the quarter and a decrease in accounts payable of $0.8 million due to the timing of payments during the quarter.

We used an additional $6.3 million in cash in our investing activities in the first quarter of 2015 as compared to the same period in 2014 for additions to property and equipment associated with our plant improvement initiatives.

Cash used in our financing activities of $19.0 million in the first quarter of 2015 was nearly unchanged compared to the same period in 2014 and resulted from payments on Kinergy's revolving line of credit of $17.5 million, principal payments on capital leases of $1.3 million and preferred stock dividends of $0.3 million, which were partially offset by the proceeds from exercises of our warrants in the aggregate amount of $0.2 million.

Kinergy Operating Line of Credit

Kinergy maintains an operating line of credit for an aggregate amount of up to $30.0 million. The credit facility expires on December 31, 2016. Interest accrues under the credit facility at a rate equal to (i) the three-month London Interbank Offered Rate ("LIBOR"), plus (ii) a specified applicable margin ranging from 2.00% to 3.00%. The credit facility's monthly unused line fee is 0.50% of the amount by which the maximum credit under the facility exceeds the average daily principal balance. Payments that may be made by Kinergy to Pacific Ethanol as reimbursement for management and other services provided by Pacific Ethanol to Kinergy are limited under the terms of the credit facility to $1.1 million per fiscal quarter in 2015.

The credit facility also includes the accounts receivable of Pacific Ag. Products, LLC, or PAP, one of our indirect wholly-owned subsidiaries, as additional collateral. Payments that may be made by PAP to Pacific Ethanol as reimbursement for management and other services provided by Pacific Ethanol to PAP are limited under the terms of the credit facility to the extent that quarterly payments would result in PAP recording less than $0.1 million of net income in the quarter.

Kinergy and PAP are collectively required to generate aggregate earnings before interest, taxes, depreciation and amortization, or EBITDA, of $0.5 million, measured at the end of each calendar month, for each three calendar month period and EBITDA of $1.3 million, measured at the end of each calendar month, for each six calendar month period. Further, for all monthly periods, Kinergy and PAP must collectively maintain a fixed-charge coverage ratio (calculated as a twelve-month rolling EBITDA divided by the sum of interest expense, capital expenditures, principal payments of indebtedness, indebtedness from capital leases and taxes paid during such twelve-month rolling period) of at least 2.0 and are prohibited from incurring any additional indebtedness (other than specific intercompany indebtedness) or making any capital expenditures in excess of $0.1 million absent the lender's prior consent. Kinergy and PAP's obligations under the credit facility are secured by a first-priority security interest in all of their assets in favor of the lender.

The following table summarizes Kinergy's financial covenants and actual results for the periods presented (dollars in thousands):

	Three Months Ended March 31,		Years Ended December 31,	
	2015	2014	2014	2013
EBITDA Requirement – Three Months	$500	$500	$500	$450
Actual	$(344)	$8,216	$2,129	$3,252
Excess (Deficit)	$(844)	$7,716	$1,629	$2,802
EBITDA Requirement – Six Months	$1,300	$1,300	$1,300	$1,100
Actual	$1,785	$11,468	$3,347	$4,131
Excess	$485	$10,168	$2,047	$3,031
Fixed Charge Coverage Ratio Requirement	2.00	2.00	2.00	2.00
Actual	11.06	13.56	17.66	8.64
Excess	9.06	11.56	15.66	6.64

In December 2014, the terms of the above covenants were changed such that if the monthly average unused availability is in excess of $10.0 million and Kinergy maintains at least $6.0 million in excess availability during the quarter, that month's EBITDA and fixed-charge coverage ratio covenants are not required to be met. During the three months ended March 31, 2015, Kinergy maintained these levels of unused and excess availability and as such, was not required to meet the EBITDA and fixed-charge coverage ratio covenants.

Pacific Ethanol has guaranteed all of Kinergy's obligations under the credit facility. As of March 31, 2015, Kinergy had an available borrowing base under the credit facility of $30.0 million and no outstanding balance.

Plant Owners' Term Debt and Operating Lines of Credit

The Plant Owners' debt as of March 31, 2015 consisted of a $32.5 million tranche A-1 term loan and a $26.3 million tranche A-2 term loan. Pacific Ethanol, Inc. holds $41.8 million of these term loans, which are eliminated in consolidation. The term debt requires monthly interest payments at a floating rate equal to the three-month LIBOR or the Prime Rate of interest, at the Plant Owners' election, plus 10.0%. The revolving credit facilities require monthly interest payments at a floating rate equal to the three-month LIBOR or the Prime Rate of interest, at the Plant Owners' election, plus 10.0% and 5.5% for the $19.5 million and $15.0 million facilities, respectively. At March 31, 2015, the average interest rate was approximately 11.0%. Repayments of principal are based on available free cash flow of the Plant Owners, until maturity, when all principal amounts are due.

As of March 31, 2015, the Plant Owners had no outstanding principal balances on their revolving credit facilities and an aggregate borrowing availability of $34.5 million.

All of the term loans and revolving credit facilities represent permanent financing and are secured by a perfected, first-priority security interest in all of the assets, including inventories and all rights, title and interest in all tangible and intangible assets, of the Plant Owners. The Plant Owners' creditors do not have recourse to Pacific Ethanol, Inc.

Contractual Obligations

There have been no material changes in the three months ended March 31, 2015, to the amounts presented in the table under the "Contractual Obligations" section in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operation" of our Annual Report on Form 10-K for 2014.

Effects of Inflation

The impact of inflation was not significant to our financial condition or results of operations for the three months ended March 31, 2015 and 2014.

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Impact of New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board, or FASB, issued new guidance on the recognition of revenue. The guidance states that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard was originally effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, but has been further deferred one year. Our adoption begins with the first fiscal quarter of fiscal year 2018. Early adoption is permitted. We are currently evaluating the impact of the adoption of this accounting standard update on our consolidated results of operations and financial position.

In April 2015, the FASB issued new guidance on presentation of debt issuance costs. Historically, entities have presented debt issuance costs as an asset. Under the new guidance, effective for fiscal years beginning after December 31, 2015, debt issuance costs will be reclassified as a deduction to the carrying amount of the related debt balance. The guidance does not change any of our other debt recognition or disclosure. We will adopt the guidance beginning March 31, 2016.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

We are exposed to various market risks, including changes in commodity prices and interest rates as discussed below. Market risk is the potential loss arising from adverse changes in market rates and prices. In the ordinary course of business, we may enter into various types of transactions involving financial instruments to manage and reduce the impact of changes in commodity prices and interest rates. We do not expect to have any exposure to foreign currency risk as we conduct all of our transactions in U.S. dollars.

Commodity Risk

We produce ethanol and its co-products, WDG and corn oil and therefore, our business is sensitive to changes in the prices of each of ethanol and corn. In the ordinary course of business, we may enter into various types of transactions involving financial instruments to manage and reduce the impact of changes in ethanol and corn prices. We do not enter into derivatives or other financial instruments for trading or speculative purposes.

We are subject to market risk with respect to ethanol pricing. Ethanol prices are sensitive to global and domestic ethanol supply, crude-oil supply and demand; crude-oil refining capacity; carbon intensity; government regulation;

and consumer demand for alternative fuels. Our ethanol sales are priced using contracts that are either based upon a fixed price or an indexed price to a specific market, such as CBOT or the Oil Price Information Service. Under these fixed-priced arrangements, we are exposed to risk of a decrease in the market price of ethanol between the time the price is fixed and the time the ethanol is sold at a lower price.

We satisfy our physical corn needs, the principal raw material used to produce ethanol and ethanol co-products, based on supply-guaranteed contracts with our vendors. Generally, we determine the purchase price of our corn at the time we begin to grind that day's needs. Sometimes, we may also enter into contracts with our vendors to fix a portion of the purchase price of our corn requirements. As such, we are also subject to market risk with respect to the price of corn. The price of corn is subject to wide fluctuations due to unpredictable factors such as weather conditions, farmer planting decisions, governmental policies with respect to agriculture and international trade and global supply and demand. Under the fixed-price arrangements, we assume the risk of a decrease in the market price of corn between the time this price is fixed and the time the corn is consumed.

WDG and corn oil are sensitive to various demand factors such as numbers of livestock on feed, prices for feed alternatives and supply factors, primarily production by ethanol plants and other sources.

As noted above, we may attempt to reduce the market risk associated with fluctuations in the price of ethanol or corn by employing a variety of risk management and hedging strategies. Strategies include the use of derivative financial instruments such as futures and options executed on the CBOT and/or the New York Merchantile Exchange, as well as the daily management of physical corn.

These derivatives are not designated for special hedge accounting treatment, and as such, the changes in the fair values of these contracts are recorded on the balance sheet and recognized immediately in cost of goods sold. We recognized losses of $0.1 million and gains of less than $0.1 million related to settled non-designated hedges as the change in the fair values of these contracts for the three months ended March 31, 2015 and 2014, respectively.

At March 31, 2015, we prepared a sensitivity analysis to estimate our exposure to ethanol and corn. Market risk related to these factors was estimated as the potential change in pre-tax income resulting from a hypothetical 10% adverse change in the prices of our expected ethanol and corn volumes for a three-month period. The results of this analysis as of March 31, 2015, which may differ from actual results, are as follows (in millions):

Commodity	**Three Months Ended March 31, 2015 Volume**	**Unit of Measure**	**Approximate Adverse Change to Pre-Tax Income**
Ethanol	135.7	Gallons	$ 7.6
Corn	15.9	Bushels	$ 7.7

Interest Rate Risk

We are exposed to market risk from changes in interest rates. Exposure to interest rate risk results primarily from holding loans that bear variable interest rates. At March 31, 2015, all of our long-term debt of $17.0 million was variable-rate in nature. Based on a 100 basis point (1.00%) change in the interest rate on our long-term debt, our quarterly pre-tax income would be negatively impacted by approximately $0.1 million.

ITEM 4. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

We conducted an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. 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, or Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by the company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission’s rules and forms. Disclosure controls and procedures also 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, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded as of March 31, 2015 that our disclosure controls and procedures were effective at a reasonable assurance level.

Changes in Internal Control over Financial Reporting

There were no changes during the most recently completed fiscal quarter that have materially affected or are reasonably likely to materially affect, our internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act.

Inherent Limitations on the Effectiveness of Controls

Management does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent or detect 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 systems 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 a cost-effective control system, no evaluation of internal control over financial reporting can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, have been or will be 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. Controls can also 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 is based in part on 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. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

We are subject to legal proceedings, claims and litigation arising in the ordinary course of business. While the amounts claimed may be substantial, the ultimate liability cannot presently be determined because of considerable uncertainties that exist. Therefore, it is possible that the outcome of those legal proceedings, claims and litigation could adversely affect our quarterly or annual operating results or cash flows when resolved in a future period. However, based on facts currently available, management believes such matters will not adversely affect in any material respect our financial position, results of operations or cash flows.

On May 24, 2013, GS CleanTech Corporation, or GS CleanTech, filed a suit in the United States District Court for the Eastern District of California, Sacramento Division (Case No.: 2:13-CV-01042-JAM-AC), naming Pacific Ethanol, Inc. as a defendant. On August 29, 2013, the case was transferred to the United States District Court for the Southern District of Indiana and made part of the pre-existing multi-district litigation involving GS CleanTech and multiple defendants. The suit alleged infringement of a patent assigned to GS CleanTech by virtue of certain corn oil separation technology in use at one or more of the ethanol production facilities in which we have an interest, including Pacific Ethanol Stockton LLC, or PE Stockton, located in Stockton, California. The complaint sought preliminary and permanent injunctions against us, prohibiting future infringement on the patent owned by GS CleanTech and damages in an unspecified amount adequate to compensate GS CleanTech for the alleged patent infringement, but in any event no less than a reasonable royalty for the use made of the inventions of the patent, plus attorneys' fees. We answered the complaint, counterclaimed that the patent claims at issue, as well as the claims in several related patents, are invalid and unenforceable and that we are not infringing. Pacific Ethanol, Inc. does not itself use any corn oil separation technology and may seek a dismissal on those grounds.

On March 17 and March 18, 2014, GS CleanTech filed suit naming as defendants two of our subsidiaries: PE Stockton and Pacific Ethanol Magic Valley, LLC, or PE Magic Valley. The claims were similar to those filed against Pacific Ethanol, Inc. in May 2013. These two cases were transferred to the multi-district litigation division in United States District Court for the Southern District of Indiana, where the case against us was pending. Although PE Stockton and PE Magic Valley do separate and market corn oil, Pacific Ethanol, Inc., PE Stockton and PE Magic Valley strongly disagree that either of the subsidiaries use corn oil separation technology that infringes the patent owned by GS CleanTech. In a January 16, 2015 decision, the District Court for the Southern District of Indiana ruled in favor of a stipulated motion for partial summary judgment for Pacific Ethanol, Inc., PE Stockton and PE Magic Valley finding that all of the GS Cleantech patents in the suit were invalid and, therefore, not infringed. GS Cleantech has said it will appeal this decision when the remaining claim in the suit has been decided. The only remaining claim alleges that GS Cleantech inequitably conducted itself before the United States Patent Office when obtaining the patents at issue. A trial in the District Court for the Southern District of Indiana on that single issue is expected later in 2015. If the Defendants, including Pacific Ethanol, Inc., PE Stockton and PE Magic Valley, succeed in proving inequitable conduct, then the Court will be asked to determine whether GS Cleantech's behavior makes this an "exceptional case". A finding that this is an exceptional case would allow the Court to award to Pacific Ethanol, Inc., PE

Stockton and PE Magic Valley the attorneys' fees expended to date for defense in this case. It is unknown whether GS Cleantech would appeal such a ruling. We did not record a provision for these matters as of March 31, 2015 as we intend to vigorously defend these allegations and believe a material adverse ruling against Pacific Ethanol, Inc., PE Stockton and/or PE Magic Valley is not probable. We believe that any liability Pacific Ethanol, Inc., PE Stockton and/or PE Magic Valley may incur would not have a material adverse effect on our financial condition or our results of operations.

ITEM 1A. RISK FACTORS.

Before deciding to purchase, hold or sell our common stock, you should carefully consider the risks described below in addition to the other information contained in this report and in our other filings with the Securities and Exchange Commission, including our subsequent reports on Forms 10-Q and 8-K. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also affect our business. If any of these known or unknown risks or uncertainties actually occurs with material adverse effects on Pacific Ethanol, our business, financial condition, results of operations and/or liquidity could be seriously harmed. In that event, the market price for our common stock will likely decline, and you may lose all or part of your investment.

Risks Related to the Merger with Aventine

The pendency of the merger with Aventine could have an adverse effect on the price of our common stock, business, financial condition, results of operations or business prospects.

While we are not aware of any significant adverse effects to date, the pendency of the merger with Aventine could disrupt our business in the following ways, among others:

- our customers and other third-party business partners may seek to terminate and/or renegotiate their relationships with us as a result of the merger, whether pursuant to the terms of their existing agreements with us or otherwise;
- the attention of our management may be directed toward the completion of the merger and related matters and may be diverted from our day-to-day business operations, including from other opportunities that might otherwise be beneficial to us; and
- current and prospective employees may experience uncertainty regarding their future roles with the combined company, which might adversely affect our ability to retain, recruit and motivate key personnel.

Should they occur, any of these matters could adversely affect our stock price, or harm our financial condition, results of operations or business prospects.

Failure to complete the merger could adversely affect our stock price and future business and financial results.

Completion of the merger is subject to a number of conditions, including among other things, the receipt of approval of the Pacific Ethanol and Aventine stockholders. There is no assurance that the parties will receive the necessary approvals or satisfy the other conditions to the completion of the merger. Failure to complete the proposed merger will prevent us and Aventine from realizing the anticipated benefits of the merger. We will also remain liable for significant transaction costs, including legal, accounting and financial advisory fees, unless provided otherwise by the merger agreement. In addition, the market price of our common stock may reflect various market assumptions as to whether the merger will occur. Consequently, the failure to complete the merger could result in a significant change in the market price of our common stock.

Obtaining required approvals necessary to satisfy the conditions to the completion of the merger may delay or prevent completion of the merger.

To complete the merger, our stockholders must approve the issuance of shares of our common stock and non-voting common stock and the amendment of our Certificate of Incorporation and holders of at least 66-2/3% of our Series B Cumulative Redeemable Convertible Preferred Stock, or Series B Preferred Stock, must agree not to treat the merger as a liquidation, dissolution or winding up within the meaning of the Series B Certificate of Designations, each as contemplated by the merger agreement, and Aventine stockholders must adopt the merger agreement and approve the merger. In addition, the completion of the merger is conditioned upon the receipt of certain governmental authorizations, consents, orders or other approvals. On February 18, 2015, the Federal Trade Commission granted early termination of the waiting period under the Hart-Scott-Rodino Act. Pacific Ethanol and Aventine intend to pursue all required approvals in accordance with the merger agreement. No assurance can be given that the required approvals will be obtained and, even if all such approvals are obtained, no assurance can be given as to the terms, conditions and timing of the approvals or that they will satisfy the terms of the merger agreement.

Termination of the merger agreement could negatively impact us.

If the merger agreement is terminated, there may be various consequences. For example, our business may be impacted adversely by the failure to pursue other beneficial opportunities due to the focus of management on the merger, without realizing any of the anticipated benefits of completing the merger. Additionally, if the merger agreement is terminated, the market price of our common stock could decline to the extent that the current market prices reflect a market assumption that the merger will be completed. If the merger agreement is terminated under certain circumstances, we may be required to pay to Aventine a termination fee of $5,982,000 or an expense reimbursement amount of up to $1,994,000.

The market price of our common stock after the merger may be affected by factors different from those currently affecting our shares.

Upon completion of the merger, holders of Aventine common stock will become holders of our common stock and/or non-voting common stock. Our business differs in important respects from that of Aventine, and, accordingly, the results of operations of the combined company and the market price of our common stock after the completion of the merger may be affected by factors different from those currently affecting our operations.

The issuance of shares of our common stock to Aventine stockholders in the merger will substantially dilute the interest in Pacific Ethanol held by our stockholders prior to the merger.

If the merger is completed, it is estimated that we will issue up to an aggregate of approximately 17,755,300 shares of our common stock and non-voting common stock upon the closing of the merger, assuming no exercise or conversion of outstanding options and warrants. Based on the number of shares of Pacific Ethanol common stock and Aventine common stock issued and outstanding on the Pacific Ethanol and Aventine record dates, Aventine stockholders before the merger will own, in the aggregate, approximately 42% of the aggregate number of shares of our common stock and non-voting common stock issued and outstanding immediately after the merger. The issuance of shares of our common stock and/or non-voting common stock to Aventine stockholders in the merger will cause a 42% reduction in the relative percentage interest of our current stockholders in the earnings, voting rights, liquidation value and book and market value of Pacific Ethanol. It is expected that Pacific Ethanol stockholders before the merger will hold approximately 58% of the total Pacific Ethanol common stock and non-voting common stock issued and outstanding immediately following the completion of the merger. Thus, Pacific Ethanol's stockholders before the merger will experience dilution in the amount of 42% as a result of the merger.

Risks Related to the Combined Company if the Merger is Completed

The failure to integrate successfully the businesses of Pacific Ethanol and Aventine in the expected timeframe would adversely affect the combined company's future results following the completion of the merger.

The success of the merger will depend, in large part, on the ability of the combined company following the completion of the merger to realize the anticipated benefits from combining our business with the business of Aventine. To realize these anticipated benefits, the combined company must successfully integrate the businesses of Pacific Ethanol and Aventine. This integration will be complex and time-consuming.

The failure to integrate successfully and to manage successfully the challenges presented by the integration process may result in the combined company's failure to achieve some or all of the anticipated benefits of the merger.

Potential difficulties that may be encountered in the integration process include the following:

- lost sales and customers as a result of customers of either of the two companies deciding not to do business with the combined company;
- complexities associated with managing the larger, more complex, combined business;
- integrating personnel from the two companies;
- potential unknown liabilities and unforeseen expenses, delays or regulatory conditions associated with the merger; and
- performance shortfalls at one or both of the companies as a result of the diversion of management's attention caused by completing the merger and integrating the companies' operations.

The combined company's future results will suffer if the combined company does not effectively manage its expanded operations following the merger.

Following the merger, the size of the combined company’s business will be significantly larger than the current businesses of Pacific Ethanol and Aventine. The combined company’s future success depends, in part, upon its ability to manage this expanded business, which will pose substantial challenges for the combined company’s management, including challenges related to the management and monitoring of new operations and associated increased costs and complexity. We cannot assure you that the combined company will be successful or that the combined company will realize the expected operating efficiencies, annual net operating synergies, revenue enhancements and other benefits currently anticipated to result from the merger.

Aventine is currently engaged in litigation regarding the Aurora Cooperative Elevator Company’s option to purchase the Aurora West Facility.

Among other legal claims, the Aurora Cooperative Elevator Company, or the Aurora Coop, has filed legal claims against Aventine asserting that it has the right, pursuant to an agreement between Aventine and the Aurora Coop, dated March 23, 2010, to exercise an option to acquire the 74 acres of land upon which Aventine’s Aurora, Nebraska 110 million gallon ethanol production facility, or the Aurora West Facility, is located, together with the Aurora West Facility and all related improvements, for a purchase price of $16,500 per acre (or $1,221,000 in the aggregate). The Aurora Coop asserts that its contractual right to exercise this option arose on July 1, 2012 due to Aventine’s alleged failure to complete construction of the Aurora West Facility as of such date. Aventine disputes the allegations and claims asserted by the Aurora Coop, and Aventine denies the validity and effectiveness of the Aurora Coop’s exercise of its option to purchase the land on which the Aurora West Facility is located. Aventine has asserted in its legal filings that it has satisfied its contractual obligations with respect to the completion of the plant as of the required date. Aventine has advised that it will continue to vigorously defend against any assertion that the Aurora Coop has any right to repurchase the land or any improvements on the land. The action is currently pending in the United States District Court, Nebraska. If Aventine is unsuccessful in defending this litigation, a number of outcomes may occur, including, without limitation, the conveyance of the land on which the Aurora West Facility is located (together with the Aurora West Facility and all related improvements) to the Aurora Coop for a purchase price that is substantially below the fair market value of the land and the facility, which Aventine believes would be an inequitable resolution of this claim, together with an unspecified amount of damages to the Aurora Coop related to the income the Aurora Coop alleges that it could have generated if the land had been conveyed as of an earlier date. An adverse outcome in Aventine’s defense of this litigation, could materially adversely affect the combined company’s business, financial condition, and results of operations.

Aventine is attempting to establish a rail connection in conjunction with the Burlington Northern Santa Fe Railroad Company.

Aventine has advised that it is using its commercially reasonable efforts to complete all necessary arrangements, including engineering, design and contracting with the Burlington Northern Santa Fe Railroad Company, or BNSF, as promptly as practicable, in order to establish a new connection through the rail facilities of Aventine’s affiliate, Nebraska Energy, L.L.C., or NELLC, to the inner rail loop track belonging to Aventine’s Aurora West Facility along with the associated “diamond switch” crossing the exterior track loop, or the Exterior Track Loop, along a path that lies entirely on land owned by NELLC or Aventine’s subsidiary, Aventine Renewable Energy – Aurora West, LLC, such that the Aurora West Facility will be able to ship ethanol by rail in unit trains and single cars. However, there are no guarantees that Aventine will be able to complete the rail connection on a certain schedule (or at all). If such connection is not obtained it could have an adverse effect on the combined company’s future results following the completion of the merger.

Aventine is currently engaged in litigation matters that may prevent the combined company from crossing the Exterior Track Loop and could require the combined company to purchase grain for the Aurora West Facility exclusively from the Aurora Coop.

Among other legal claims, the Aurora Coop has filed legal claims against Aventine alleging that Aventine (and two of its subsidiaries) is in breach of the parties’ grain and marketing and master development agreements, or the Aurora Coop Grain Agreements. Aventine denies that it is in breach of the Aurora Coop Grain Agreements and maintains in a counterclaim that the Aurora Coop has breached the parties’ grain supply agreement, or the Grain Supply Agreement, and the marketing agreement, or the Marketing Agreement. As a result, Aventine issued notice of termination of the Grain Supply Agreement and the Marketing Agreement. The Aurora Coop seeks a judicial order declaring that Aventine is in breach of the Aurora Coop Grain Agreements and further declaring that Aventine’s termination of the Grain Supply Agreement and Marketing Agreement is ineffective. If Aventine is unsuccessful in this matter, the Grain Supply Agreement will not be terminated and, as a result, the combined company could be required to purchase grain for the Aurora West Facility exclusively from the Aurora Coop at a price higher than it otherwise may be able to negotiate. The inability to purchase corn for the Aurora West Facility on market terms could have a material adverse impact on the financial condition or results of operations of the combined company. On the other hand, if Aventine is successful in this matter, the Grain Supply Agreement and Marketing Agreement may be terminated. The termination of the Grain Supply Agreement, however, may trigger a termination provision in the parties’ Double Track Loop Easement and Use Agreement, thus terminating an easement allowing Aventine the use of the Exterior Track Loop, or the Easement Agreement.

The Aurora Coop has also filed a suit against Aventine seeking a judicial declaration that Aventine’s right to use the Exterior Track Loop is terminated if the Grain Supply Agreement, which is the subject of the litigation referred to above, is terminated. As discussed above, Aventine has issued notice of termination of the Grain Supply Agreement. Aventine disputes the Aurora Coop’s assertion that its easement rights to use the Exterior Track Loop have been terminated or extinguished. The easement would allow Aventine to use the Exterior Track Loop and to access the

BNSF line by crossing the Exterior Track Loop, but Aventine's use of the easement is currently blocked pending the resolution of these matters. If, as a result of the above discussed matters, it is determined that the Grain Supply Agreement is terminated and that such termination triggers a termination of the Easement Agreement, the combined company will be prevented from using the Exterior Track Loop and accessing the BNSF line by crossing the Exterior Track Loop under the terms of the easement.

However, Aventine recently constructed a diamond switch on adjoining land owned by Aventine's affiliate, NELLC. This diamond switch allows Aventine to move rail cars between the Aurora West Facility and the BNSF line by crossing the Exterior Track Loop on land owned by NELLC and, therefore, obviates the need for the easement granted under the Easement Agreement. The Aurora Coop sought a temporary restraining order to block Aventine's construction and use of the diamond switch, which was denied by the Court, and the Aurora Coop is seeking to amend the above case to challenge Aventine's construction and use of the diamond switch. If the Aurora Coop is permitted to bring such a claim and if Aventine is unsuccessful in defending this matter and if the Easement Agreement is terminated as a result of the proceedings surrounding the Grain Supply Agreement (as discussed above), Aventine would not be able to use the diamond switch or the easement, and thus would be unable to use the railroad to transport its products between the Aurora West Facility and the BNSF line. If Aventine is unable to use railroad transportation to access the BNSF line from the Aurora West Facility, it would be forced to use other means of transportation, such as truck transport, which would not be as effective and cost efficient as railroad transportation. Aventine's inability to use railroad transportation could have a materially adverse impact on the financial condition or results of operations of the combined company. If, on the other hand, Aventine is successful in defending the action regarding the diamond switch but the Easement Agreement is terminated as a result of the proceedings surrounding the Grain Supply Agreement (as discussed above), the combined company's ability to cross or use a portion of the Exterior Track Loop may nonetheless be limited by the courts. For example, even if the combined company is able to transfer single rail cars across between the Aurora West Facility and the BNSF line, it may be unable to transfer unit trains (i.e., trains comprised of 100 or more rail cars). Any significant restrictions on the combined company's use of the diamond switch to cross the Exterior Track Loop could have a material adverse impact on the financial condition or results of operations of the combined company inasmuch as the combined company may not be able to capture the cost advantages and efficiencies of shipping products in the larger conveyance format.

An affiliate of Aventine is currently engaged in a dispute in connection with its storage of surplus beet sugar and amounts allegedly owed by such affiliate.

In 2013, Aventine Renewable Energy, Inc., a wholly owned affiliate of Aventine, or ARE, Inc., purchased surplus beet sugar through a U.S. Department of Agriculture program for Aventine's operations. The Western Sugar Cooperative, or Western Sugar, among other entities, warehoused this surplus sugar. ARE, Inc. paid for the warehousing of this sugar from inception of the relationship. Western Sugar, however, subsequently asserted that certain penalty rates for the storage of this product should have applied despite the lack of an agreement to such rates by ARE, Inc. Aventine and ARE, Inc. had been attempting to resolve the matter short of formal litigation. On February 27, 2015, Western Sugar filed an action in the United States District Court, District of Colorado, seeking payment of the penalty storage fees as "expectation damages," in the amount of approximately $8.6 million. Aventine considers these claims to be without merit and will aggressively defend against them. ARE, Inc. and Aventine's inability to successfully defend this matter could have a material adverse effect on the combined company's future results following the completion of the merger.

The loss of key personnel could have a material adverse effect on the combined company's business, financial condition or results of operations.

The success of the merger will depend in part on the combined company's ability to retain key Pacific Ethanol and Aventine employees who continue employment with the combined company after the merger is completed. It is possible that these employees might decide not to remain with the combined company after the merger is completed. If these key employees terminate their employment, the combined company's business activities might be adversely affected, management's attention might be diverted from integrating Pacific Ethanol and Aventine to recruiting suitable replacements and the combined company's business, financial condition or results of operations could be adversely affected. In addition, the combined company might not be able to locate suitable replacements for any such key employees who leave the combined company or offer employment to potential replacements on reasonable terms.

The success of the combined company will also depend on relationships with third parties and pre-existing customers of Pacific Ethanol and Aventine, which relationships may be affected by customer preferences or public attitudes about the merger. Any adverse changes in these relationships could adversely affect the combined company's business, financial condition or results of operations.

The combined company's success will depend on the ability to maintain and renew business relationships, including relationships with preexisting customers of both Pacific Ethanol and Aventine, and to establish new business relationships. There can be no assurance that the business of the combined company will be able to maintain preexisting customer contracts and other business relationships, or enter into or maintain new customer contracts and other business relationships, on acceptable terms, if at all. The failure to maintain important business relationships could have a material adverse effect on the business, financial condition or results of operations of the combined company.

The combined company will incur significant transaction and merger-related costs in connection with the merger.

Pacific Ethanol and Aventine expect to incur significant costs associated with completing the merger and combining the operations of the two companies. Although the exact amount of these costs is not yet known, Pacific Ethanol and Aventine estimate that these costs will be approximately $2.4 million in the aggregate. In addition, there may be unanticipated costs associated with the integration. Although Pacific Ethanol and Aventine expect that the elimination of duplicative costs and other efficiencies may offset incremental transaction and merger-related costs over time, these benefits may not be achieved in the near term or at all.

The combined company will record goodwill that could become impaired and adversely affect the combined company's operating results.

The merger will be accounted for as an acquisition by Pacific Ethanol in accordance with accounting principles generally accepted in the United States. Under the acquisition method of accounting, the assets and liabilities of Aventine will be recorded, as of completion, at their respective fair values and added to ours. The reported financial condition and results of operations of Pacific Ethanol issued after completion of the merger will reflect Aventine balances and results after completion of the merger, but will not be restated retroactively to reflect the historical financial position or results of operations of Aventine for periods prior to the merger. Following completion of the merger, the earnings of the combined company will reflect acquisition accounting adjustments.

Under the acquisition method of accounting, the total purchase price will be allocated to Aventine's tangible assets and liabilities and identifiable intangible assets based on their fair values as of the date of completion of the merger. The excess of the purchase price over those fair values will be recorded as goodwill. We expect that the merger will result in the creation of goodwill based upon the application of the acquisition method of accounting. To the extent the value of goodwill or intangibles becomes impaired, the combined company may be required to incur material charges relating to such impairment. Such a potential impairment charge could have a material impact on the combined company's operating results.

The combined company's ability to utilize net operating loss carryforwards and certain other tax attributes may be limited.

Federal and state income tax laws impose restrictions on the utilization of net operating loss, or NOL, and tax credit carryforwards in the event that an "ownership change" occurs for tax purposes, as defined by Section 382 of the Internal Revenue Code. In general, an ownership change occurs when stockholders owning 5% or more of a "loss corporation" (a corporation entitled to use NOL or other loss carryovers) have increased their ownership of stock in such corporation by more than 50 percentage points during any three-year period. The annual base limitation under Section 382 of the Code is calculated by multiplying the loss corporation's value at the time of the ownership change by the greater of the long-term tax-exempt rate determined by the Internal Revenue Service in the month of the ownership change or the two preceding months.

As of December 31, 2014, Pacific Ethanol and Aventine had $28.3 million and $63.5 million, respectively, of NOLs that are currently limited in their annual use. As a result of the merger, it is possible that either or both Pacific Ethanol and Aventine will be deemed to have undergone an "ownership change" for purposes of Section 382 of the Code. Accordingly, the combined company's ability to utilize Pacific Ethanol's and Aventine's net operating loss carryforwards may be substantially limited. These limitations could in turn result in increased future tax payments for the combined company, which could have a material adverse effect on the business, financial condition or results of operations of the combined company.

The combined company's indebtedness following the merger will be greater than Pacific Ethanol's existing indebtedness. Therefore, it may be more difficult for the combined company to pay or refinance its debts and the combined company may need to divert its cash flow from operations to debt service payments. The additional indebtedness could limit the combined company's ability to pursue other strategic opportunities and increase its vulnerability to adverse economic and industry conditions.

In connection with the merger, the combined company will also be responsible for Aventine's outstanding debt. Our total indebtedness as of December 31, 2014 was approximately $34.5 million. Our pro forma total consolidated indebtedness as of December 31, 2014, after giving effect to the merger, would have been approximately $192.2 million (all of which would be non-current). The combined company's debt service obligations with respect to this increased indebtedness could have an adverse impact on its earnings and cash flows, which after the merger would include the earnings and cash flows of Aventine, for as long as the indebtedness is outstanding.

The combined company's increased indebtedness could also have important consequences to holders of our common stock. For example, it could:

- make it more difficult for the combined company to pay or refinance its debts as they become due during adverse economic and industry conditions because any decrease in revenues could cause the combined company to not have sufficient cash flows from operations to make its scheduled debt payments;

- limit the combined company's flexibility to pursue other strategic opportunities or react to changes in its business and the industry in which it operates and, consequently, place the combined company at a competitive disadvantage to its competitors with less debt; or

- require a substantial portion of the combined company's cash flows from operations to be used for debt service payments, thereby reducing the availability of its cash flow to fund working capital, capital expenditures, acquisitions, dividend payments and other general corporate purposes.

Based upon current levels of operations, we expect the combined company to be able to generate sufficient cash on a consolidated basis to make all of the principal and interest payments when such payments are due under its existing credit facilities, indentures and other instruments governing their outstanding indebtedness, and the indebtedness of Aventine that may remain outstanding after the merger, but there can be no assurance that the combined company will be able to repay or refinance such borrowings and obligations.

The merger may not be accretive, and may be dilutive, to our earnings per share, which may negatively affect the market price of our common stock.

Although the merger is expected to be accretive to earnings per share, the merger may not be accretive, and may be dilutive, to our earnings per share. The expectation that the merger will be accretive is based on preliminary estimates that may materially change. All of the risk factors applicable to the ethanol industry and our business as a marketer and producer of ethanol are also be applicable to Aventine's business and will be applicable to the combined company after the merger. In addition, future events and conditions could decrease or delay any accretion, result in dilution or cause greater dilution than may be expected, including:

- adverse changes in market conditions;
- commodity prices for corn, ethanol, gasoline and crude oil;
- production levels;
- operating results;
- competitive conditions;

- laws and regulations affecting the ethanol business;
- capital expenditure obligations; and
- general economic conditions.

Any dilution of, or decrease or delay of any accretion to, our earnings per share could cause the price of our common stock to decline.

Business issues currently faced by one company may be imputed to the operations of the other company or the combined company.

To the extent that either we or Aventine currently has or is perceived by customers to have operational challenges, those challenges may raise concerns by existing customers of the other company following the merger which may limit or impede our future ability to maintain relationships with those customers.

Resales of shares of our common stock to be issued upon closing of the merger, or a perception that a substantial number of such shares merger will be resold into the market, may cause the market price of our common stock and the value of your investment to decline significantly.

We currently estimate that we will issue up to an aggregate of approximately 17,755,300 shares of our common stock and non-voting common stock upon the closing of the merger, assuming no exercise or conversion of Aventine's outstanding options and warrants. A majority of the newly issued shares are subject to stockholders agreements entered into by us and certain stockholders of Aventine prohibiting the sale of our shares issued in connection with the merger for various periods of time. The issuance of these new shares of our common stock and non-voting common stock, and the sale of these new shares of common stock (including shares of common stock issuable upon conversion of shares of non-voting common stock issued in the merger) by current Aventine stockholders (i) after the merger, for those Aventine stockholders not subject to the stockholders agreements, or (ii) after applicable restrictive periods have passed for those Aventine stockholders subject to the stockholders agreements, or the perception that these sales could occur, could have the effect of depressing the market price for shares of our common stock. In addition, the issuance of shares of our common stock upon exercise of our outstanding options and warrants or upon conversion of our Series B Preferred Stock could also have the effect of depressing the market price for shares of our common stock.

Risks Related to our Business

We have incurred significant losses and negative operating cash flow in the past and we may incur losses and negative operating cash flow in the future, which may hamper our operations and impede us from expanding our business.

We have incurred significant losses and negative operating cash flow in the past. For the three months ended March 31, 2015 and 2014, we incurred consolidated net losses of approximately $4.5 million and $8.8 million, respectively. For 2013 and 2012, we incurred consolidated net losses of approximately $1.2 million and $43.4 million, respectively, and in 2012 incurred negative operating cash flow of $20.8 million. We may incur losses and negative operating cash flow in the future. We expect to rely on cash on hand and cash, if any, generated from our operations and from future financing activities to fund all of the cash requirements of our business. Continued losses and negative operating cash flow may hamper our operations and impede us from expanding our business.

Our results of operations and our ability to operate at a profit is largely dependent on managing the costs of corn and natural gas and the prices of ethanol, WDG and other ethanol co-products, all of which are subject to significant volatility and uncertainty.

Our results of operations are highly impacted by commodity prices, including the cost of corn and natural gas that we must purchase, and the prices of ethanol, WDG and other ethanol co-products that we sell. Prices and supplies are subject to and determined by market and other forces over which we have no control, such as weather, domestic and global demand, supply shortages, export prices and various governmental policies in the United States and around the world.

As a result of price volatility of corn, natural gas, ethanol, WDG and other ethanol co-products, our results of operations may fluctuate substantially. In addition, increases in corn or natural gas prices or decreases in ethanol, WDG or other ethanol co-product prices may make it unprofitable to operate. In fact, some of our marketing activities will likely be unprofitable in a market of generally declining ethanol prices due to the nature of our business. For example, to satisfy customer demands, we maintain certain quantities of ethanol inventory for subsequent resale. Moreover, we procure much of our inventory outside the context of a marketing arrangement and therefore must buy ethanol at a price established at the time of purchase and sell ethanol at an index price established later at the time of sale that is generally reflective of movements in the market price of ethanol. As a result, our margins for ethanol sold in these transactions generally decline and may turn negative as the market price of ethanol declines.

No assurance can be given that corn or natural gas can be purchased at, or near, current or any particular prices or that ethanol, WDG or other ethanol co-products will sell at, or near, current or any particular prices. Consequently, our results of operations and financial position may be adversely affected by increases in the price of corn or natural gas or decreases in the price of ethanol, WDG or other ethanol co-products.

Over the past several years, the spread between ethanol and corn prices has fluctuated significantly. Fluctuations are likely to continue to occur. A sustained narrow spread, whether as a result of sustained high or increased corn prices or sustained low or decreased ethanol prices, would adversely affect our results of operations and financial position. Further, combined revenues from sales of ethanol, WDG and other ethanol co-products could decline below the marginal cost of production, which may force us to suspend production of ethanol, WDG and ethanol co-products at some or all of the Pacific Ethanol Plants.

Increased ethanol production may cause a decline in ethanol prices or prevent ethanol prices from rising, and may have other negative effects, adversely impacting our results of operations, cash flows and financial condition.

We believe that the most significant factor influencing the price of ethanol has been the substantial increase in ethanol production in recent years. According to the RFA, domestic ethanol production capacity has increased from an annualized rate of 1.5 billion gallons per year in January 1999 to 14.5 billion gallons in 2014. In addition, due to significantly improved ethanol production margins, we anticipate that owners of idle ethanol production facilities, many of which were idled due to poor production margins, will restart operations, thereby resulting in more abundant ethanol supplies and inventories. Any increase in the demand for ethanol may not be commensurate with increases in the supply of ethanol, thus leading to lower ethanol prices. Also, demand for ethanol could be impaired due to a number of factors, including regulatory developments and reduced United States gasoline consumption. Reduced gasoline consumption has occurred in the past and could occur in the future as a result of increased gasoline or oil prices or other factors such as increased automobile fuel efficiency. Any of these outcomes could have a material adverse effect on our results of operations, cash flows and financial condition.

The market price of ethanol is volatile and subject to large fluctuations, which may cause our profitability or losses to fluctuate significantly.

The market price of ethanol is volatile and subject to large fluctuations. The market price of ethanol is dependent upon many factors, including the supply of ethanol and the price of gasoline, which is in turn dependent upon the price of petroleum which is highly volatile and difficult to forecast. For example, ethanol prices, as reported by the CBOT, ranged from $1.50 to $3.52 per gallon during 2014 and corn prices, as reported by the CBOT, ranged from $3.21 to $5.16 per bushel during 2014. Fluctuations in the market price of ethanol may cause our profitability or losses to fluctuate significantly.

Some of our marketing activities will likely be unprofitable in a market of generally declining ethanol prices due to the nature of our business.

Some of our marketing activities will likely be unprofitable in a market of generally declining ethanol prices due to the nature of our business. For example, to satisfy customer demands, we maintain certain quantities of ethanol inventory for subsequent resale. Moreover, we procure much of our inventory outside the context of a marketing arrangement and therefore must buy ethanol at a price established at the time of purchase and sell ethanol at an index price established later at the time of sale that is generally reflective of movements in the market price of ethanol. As a result, our margins for ethanol sold in these transactions generally decline and may turn negative as the market price of ethanol declines.

Disruptions in ethanol production infrastructure may adversely affect our business, results of operations and financial condition.

Our business depends on the continuing availability of rail, road, port, storage and distribution infrastructure. In particular, due to limited storage capacity at the Pacific Ethanol Plants and other considerations related to production efficiencies, the Pacific Ethanol Plants depend on just-in-time delivery of corn. The production of ethanol also requires a significant and uninterrupted supply of other raw materials and energy, primarily water, electricity and natural gas. The prices of electricity and natural gas have fluctuated significantly in the past and may fluctuate significantly in the future. Local water, electricity and gas utilities may not be able to reliably supply the water, electricity and natural gas that the Pacific Ethanol Plants will need or may not be able to supply those resources on acceptable terms. Any disruptions in the ethanol production infrastructure, whether caused by labor difficulties, earthquakes, storms, other natural disasters or human error or malfeasance or other reasons, could prevent timely deliveries of corn or other raw materials and energy and may require the Pacific Ethanol Plants to halt production which could have a material adverse effect on our business, results of operations and financial condition.

We and the Pacific Ethanol Plants may engage in hedging transactions and other risk mitigation strategies that could harm our results of operations.

In an attempt to partially offset the effects of volatility of ethanol prices and corn and natural gas costs, the Pacific Ethanol Plants may enter into contracts to fix the price of a portion of their ethanol production or purchase a portion of their corn or natural gas requirements on a forward basis. In addition, we may engage in other hedging transactions involving exchange-traded futures contracts for corn, natural gas and unleaded gasoline from time to time. The financial statement impact of these activities is dependent upon, among other things, the prices involved and our ability to sell sufficient products to use all of the corn and natural gas for which forward commitments have been made. Hedging arrangements also expose us to the risk of financial loss in situations where the other party to the hedging contract defaults on its contract or, in the case of exchange-traded contracts, where there is a change in the expected differential between the underlying price in the hedging agreement and the actual prices paid or received by us. As a result, our results of operations and financial condition may be adversely affected by fluctuations in the price of corn, natural gas, ethanol and unleaded gasoline.

Operational difficulties at the Pacific Ethanol Plants could negatively impact sales volumes and could cause us to incur substantial losses.

Operations at the Pacific Ethanol Plants are subject to labor disruptions, unscheduled downtimes and other operational hazards inherent in the ethanol production industry, including equipment failures, fires, explosions, abnormal pressures, blowouts, pipeline ruptures, transportation accidents and natural disasters. Some of these operational hazards may cause personal injury or loss of life, severe damage to or destruction of property and equipment or environmental damage, and may result in suspension of operations and the imposition of civil or criminal penalties. Insurance obtained by the Pacific Ethanol Plants may not be adequate to fully cover the potential operational hazards described above or the Pacific Ethanol Plants may not be able to renew this insurance on commercially reasonable terms or at all.

Moreover, the production facilities at the Pacific Ethanol Plants may not operate as planned or expected. All of these facilities are designed to operate at or above a specified production capacity. The operation of these facilities is and will be, however, subject to various uncertainties. As a result, these facilities may not produce ethanol and its co-products at expected levels. In the event any of these facilities do not run at their expected capacity levels, our business, results of operations and financial condition may be materially and adversely affected.

The United States ethanol industry is highly dependent upon certain federal and state legislation and regulation and any changes in legislation or regulation could have a material adverse effect on our results of operations, cash flows and financial condition.

The EPA has implemented the national RFS pursuant to the Energy Policy Act of 2005 and the Energy Independence and Security Act of 2007. The national RFS program sets annual quotas for the quantity of renewable fuels (such as ethanol) that must be blended into motor fuels consumed in the United States. The domestic market for ethanol is significantly impacted by federal mandates under the national RFS program for volumes of renewable fuels (such as ethanol) required to be blended with gasoline. Future demand for ethanol will be largely dependent upon incentives to blend ethanol into motor fuels, including the relative price of gasoline versus ethanol, the relative octane value of ethanol, constraints in the ability of vehicles to use higher ethanol blends, the national RFS, and other applicable environmental requirements. Any significant increase in production capacity above the national RFS minimum requirements may have an adverse impact on ethanol prices.

Legislation aimed at reducing or eliminating the renewable fuel use required by the national RFS has been introduced in the United States Congress. On February 4, 2015, the *RFS Elimination Act* (H.R. 703) was introduced in the House of Representatives. The bill would fully repeal the national RFS. Also introduced on February 4, 2015, was the *RFS Reform Act* (H.R. 704), which prohibits corn-based ethanol from meeting the national RFS requirements, caps the amount of ethanol that can be blended into conventional gasoline at 10%, and requires the EPA to set requirements for cellulosic biofuels at actual production levels. On February 3, 2015, a bill (H.R. 21) was introduced in the House of Representatives to vacate the waiver issued by EPA allowing the use of 15% ethanol blends in certain light-duty vehicles. On February 26, 2015, the Corn Ethanol Mandate Elimination Act of 2015 was introduced in the Senate. The bill would eliminate corn ethanol as qualifying as a renewable fuel under the national RFS. All of these bills were assigned to a congressional committee, which will consider them before possibly sending any of them on to the House of Representatives or the Senate as a whole. Our operations could be adversely impacted if the RFS Elimination Act, the RFS Reform Act, the Corn Ethanol Mandate Elimination Act or other legislation is enacted that reduces or eliminates the national RFS volume requirements or that reduces or eliminates corn ethanol as qualifying as a renewable fuel under the national RFS.

Under the provisions of the Clean Air Act, as amended by the Energy Independence and Security Act of 2007, the EPA has limited authority to waive or reduce the mandated national RFS requirements, which authority is subject to consultation with the Secretaries of Agriculture and Energy, and based on a determination that there is inadequate domestic renewable fuel supply or implementation of the applicable requirements would severely harm the economy or environment of a state, region or the United States. On November 15, 2013, the EPA released its Notice of Proposed Rulemaking for the national RFS for 2014. The EPA proposed to reduce the RVO for 2014 for key categories of biofuel covered by the national RFS below the 2014 volumes specified in 2007 by the Energy Independence and Security Act of 2007 and below the RVO for 2013. However, the EPA withdrew its proposal on December 9, 2014, and announced that it would not finalize the RVO for 2014 until 2015. The EPA has indicated that its previous 2014 draft proposal for a total of 15.2 billion gallons for all renewable fuels, including 13.0 billion gallons for conventional renewable fuels in 2014, will not be the final regulation and that it expects to issue the final RVO for 2014 in the second quarter of 2015. In addition, the EPA announced that it would propose the RVO for 2015 and 2016 simultaneously in 2015. Our operations could be adversely impacted if the EPA finalizes RVO levels that are below the levels specified in the national RFS.

Future demand for ethanol is uncertain and may be affected by changes to federal mandates, public perception, consumer acceptance and overall consumer demand for transportation fuel, any of which could negatively affect demand for ethanol and our results of operations.

Although many trade groups, academics and governmental agencies have supported ethanol as a fuel additive that promotes a cleaner environment, others have criticized ethanol production as consuming considerably more energy and emitting more greenhouse gases than other biofuels and potentially depleting water resources. Some studies have suggested that corn-based ethanol is less efficient than ethanol produced from other feedstock and that it negatively impacts consumers by causing increased prices for dairy, meat and other food generated from livestock that consume corn. Additionally, ethanol critics contend that corn supplies are redirected from international food markets to domestic fuel markets. If negative views of corn-based ethanol production gain acceptance, support for existing measures promoting use and domestic production of corn-based ethanol could decline, leading to reduction or repeal of federal mandates, which would adversely affect the demand for ethanol. These views could also negatively impact public perception of the ethanol industry and acceptance of ethanol as an alternative fuel.

There are limited markets for ethanol beyond those established by federal mandates. Discretionary blending and E85 blending are important secondary markets. Discretionary blending is often determined by the price of ethanol versus the price of gasoline. In periods when discretionary blending is financially unattractive, the demand for ethanol may be reduced. Also, the demand for ethanol is affected by the overall demand for transportation fuel, which peaked in 2007 and has declined steadily since then. Demand for transportation fuel is affected by the number of miles traveled by consumers and the fuel economy of vehicles. Market acceptance of E15 may partially offset the effects of decreases in transportation fuel demand. A reduction in the demand for ethanol and ethanol co-products may depress the value of our products, erode our margins and reduce our ability to generate revenue or to operate profitably. Consumer acceptance of E15 and E85 fuels is needed before ethanol can achieve any significant growth in market share relative to other transportation fuels.

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The ethanol production and marketing industry is extremely competitive. Many of our significant competitors have greater production and financial resources and one or more of these competitors could use their greater resources to gain market share at our expense. In addition, a number of Kinergy's suppliers may circumvent the marketing services we provide, causing our sales and profitability to decline.

The ethanol production and marketing industry is extremely competitive. Many of our significant competitors in the ethanol production and marketing industry, including Archer Daniels Midland Company and Valero Energy Corporation, have substantially greater production and/or financial resources. As a result, our competitors may be able to compete more aggressively and sustain that competition over a longer period of time. Successful competition will require a continued high level of investment in marketing and customer service and support. Our limited resources relative to many significant competitors may cause us to fail to anticipate or respond adequately to new developments and other competitive pressures. This failure could reduce our competitiveness and cause a decline in market share, sales and profitability. Even if sufficient funds are available, we may not be able to make the modifications and improvements necessary to compete successfully.

We also face increasing competition from international suppliers. Currently, international suppliers produce ethanol primarily from sugar cane and have cost structures that are generally substantially lower than the cost structures of the Pacific Ethanol Plants. Any increase in domestic or foreign competition could cause the Pacific Ethanol Plants to reduce their prices and take other steps to compete effectively, which could adversely affect their and our results of operations and financial condition.

In addition, some of our suppliers are potential competitors and, especially if the price of ethanol reaches historically high levels, they may seek to capture additional profits by circumventing our marketing services in favor of selling directly to our customers. If one or more of our major suppliers, or numerous smaller suppliers, circumvent our marketing services, our sales and profitability may decline.

If Kinergy fails to satisfy its financial covenants under its credit facility, it may experience a loss or reduction of that facility, which would have a material adverse effect on our financial condition and results of operations.

We are substantially dependent on Kinergy's credit facility to help finance its operations. Kinergy must satisfy monthly financial covenants under its credit facility, including covenants regarding its earnings before interest, taxes, depreciation and amortization (EBITDA) and fixed-charge coverage ratios. Kinergy will be in default under its credit facility if it fails to satisfy any financial covenant. A default may result in the loss or reduction of the credit facility. The loss of Kinergy's credit facility, or a significant reduction in Kinergy's borrowing capacity under the facility, would result in Kinergy's inability to finance a significant portion of its business and would have a material adverse effect on our financial condition and results of operations.

The high concentration of our sales within the ethanol production and marketing industry could result in a significant reduction in sales and negatively affect our profitability if demand for ethanol declines.

We expect to be completely focused on the production and marketing of ethanol and its co-products for the foreseeable future. We may be unable to shift our business focus away from the production and marketing of ethanol to other renewable fuels or competing products. Accordingly, an industry shift away from ethanol or the emergence of new competing products may reduce the demand for ethanol. A downturn in the demand for ethanol would likely materially and adversely affect our sales and profitability.

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In addition to ethanol produced by the Pacific Ethanol Plants, we also depend on one third-party supplier for a significant portion of the ethanol we sell. If this supplier does not continue to supply us with ethanol in adequate amounts, we may be unable to satisfy the demands of our customers and our sales, profitability and relationships with our customers will be adversely affected.

In addition to the ethanol produced by the Pacific Ethanol Plants, we also depend, and expect to continue to depend for the foreseeable future, on one third-party supplier for a significant portion of the total amount of ethanol that we sell. During 2014, 2013 and 2012, one supplier provided in excess of 10% of the total volume of ethanol we sold, accounting for an aggregate of approximately $134.6 million, $145.2 million and $109.9 million in net sales, representing 12%, 16% and 13% of our net sales, respectively, for those periods. This third-party supplier is located in the Midwest. The delivery of ethanol from this supplier is therefore subject to delays resulting from inclement weather and other conditions. If this supplier is unable or declines for any reason to continue to supply us with ethanol in adequate amounts, we may be unable to replace that supplier and source other supplies of ethanol in a timely manner, or at all, to satisfy the demands of our customers. If this occurs, our sales, profitability and our relationships with our customers will be adversely affected.

We may be adversely affected by environmental, health and safety laws, regulations and liabilities.

We are subject to various federal, state and local environmental laws and regulations, including those relating to the discharge of materials into the air, water and ground, the generation, storage, handling, use, transportation and disposal of hazardous materials and wastes, and the health and safety of our employees. In addition, some of these laws and regulations require us to operate under permits that are subject to renewal or modification. These laws, regulations and permits can often require expensive pollution control equipment or operational changes to limit actual or potential impacts to the environment. A violation of these laws and regulations or permit conditions can result in substantial fines, natural resource damages, criminal sanctions, permit revocations and/or facility shutdowns. In addition, we have made, and expect to make, significant capital expenditures on an ongoing basis to comply with increasingly stringent environmental laws, regulations and permits.

We may be liable for the investigation and cleanup of environmental contamination at each of the Pacific Ethanol Plants and at off-site locations where we arrange for the disposal of hazardous substances or wastes. If these substances or wastes have been or are disposed of or released at sites that undergo investigation and/or remediation by regulatory agencies, we may be responsible under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, or other environmental laws for all or part of the costs of investigation and/or remediation, and for damages to natural resources. We may also be subject to related claims by private parties alleging property damage and personal injury due to exposure to hazardous or other materials at or from those properties. Some of these matters may require us to expend significant amounts for investigation, cleanup or other costs.

In addition, new laws, new interpretations of existing laws, increased governmental enforcement of environmental laws or other developments could require us to make significant additional expenditures. Continued government and public emphasis on environmental issues can be expected to result in increased future investments for environmental controls at the Pacific Ethanol Plants. Present and future environmental laws and regulations, and interpretations of those laws and regulations, applicable to our operations, more vigorous enforcement policies and discovery of currently unknown conditions may require substantial expenditures that could have a material adverse effect on our results of operations and financial condition.

The hazards and risks associated with producing and transporting our products (including fires, natural disasters, explosions and abnormal pressures and blowouts) may also result in personal injury claims or damage to property and third parties. As protection against operating hazards, we maintain insurance coverage against some, but not all, potential losses. However, we could sustain losses for uninsurable or uninsured risks, or in amounts in excess of existing insurance coverage. Events that result in significant personal injury or damage to our property or third parties or other losses that are not fully covered by insurance could have a material adverse effect on our results of operations and financial condition.

If we are unable to attract and retain key personnel, our ability to operate effectively may be impaired.

Our ability to operate our business and implement strategies depends, in part, on the efforts of our executive officers and other key employees. Our future success will depend on, among other factors, our ability to retain our current key personnel and attract and retain qualified future key personnel, particularly executive management. Failure to attract or retain key personnel could have a material adverse effect on our business and results of operations.

We depend on a small number of customers for the majority of our sales. A reduction in business from any of these customers could cause a significant decline in our overall sales and profitability.

The majority of our sales are generated from a small number of customers. During 2014, 2013 and 2012, four customers accounted for an aggregate of approximately $659 million, $521 million and $410 million in net sales, representing 59%, 58% and 51% of our net sales, respectively, for those periods. We expect that we will continue to depend for the foreseeable future upon a small number of customers for a significant portion of our sales. Our agreements with these customers generally do not require them to purchase any specified amount of ethanol or dollar amount of sales or to make any purchases whatsoever. Therefore, in any future period, our sales generated from these customers, individually or in the aggregate, may not equal or exceed historical levels. If sales to any of these customers cease or decline, we may be unable to replace these sales with sales to either existing or new customers in a timely manner, or at all. A cessation or reduction of sales to one or more of these customers could cause a significant decline in our overall sales and profitability.

Our lack of long-term ethanol orders and commitments by our customers could lead to a rapid decline in our sales and profitability.

We cannot rely on long-term ethanol orders or commitments by our customers for protection from the negative financial effects of a decline in the demand for ethanol or a decline in the demand for our marketing services. The limited certainty of ethanol orders can make it difficult for us to forecast our sales and allocate our resources in a manner consistent with our actual sales. Moreover, our expense levels are based in part on our expectations of future sales and, if our expectations regarding future sales are inaccurate, we may be unable to reduce costs in a timely manner to adjust for sales shortfalls. Furthermore, because we depend on a small number of customers for a significant portion of our sales, the magnitude of the ramifications of these risks is greater than if our sales were less concentrated. As a result of our lack of long-term ethanol orders and commitments, we may experience a rapid decline in our sales and profitability.

There are limitations on our ability to receive distributions from our subsidiaries.

We conduct most of our operations through subsidiaries and are dependent upon dividends or other intercompany transfers of funds from our subsidiaries to generate free cash flow. Moreover, some of our subsidiaries are limited in their ability to pay dividends or make distributions to us by the terms of their financing arrangements.

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Risks Related to Ownership of our Common Stock

Our stock price is highly volatile, which could result in substantial losses for investors purchasing shares of our common stock and in litigation against us.

The market price of our common stock has fluctuated significantly in the past and may continue to fluctuate significantly in the future. The market price of our common stock may continue to fluctuate in response to one or more of the following factors, many of which are beyond our control:

- fluctuations in the market prices of ethanol and its co-products, including WDG and corn oil;
- the cost of key inputs to the production of ethanol, including corn and natural gas;
- the volume and timing of the receipt of orders for ethanol from major customers;
- competitive pricing pressures;
- our ability to timely and cost-effectively produce, sell and deliver ethanol;
- the announcement, introduction and market acceptance of one or more alternatives to ethanol;
- losses resulting from adjustments to the fair values of our outstanding warrants to purchase our common stock;
- changes in market valuations of companies similar to us;
- stock market price and volume fluctuations generally;
- the possibility that the anticipated benefits from our pending acquisition of Aventine cannot be fully realized in a timely manner or at all, or that integrating future acquired operations will be more difficult, disruptive or costly than anticipated;
- regulatory developments or increased enforcement;
- fluctuations in our quarterly or annual operating results;
- additions or departures of key personnel;
- our inability to obtain any necessary financing;
- our financing activities and future sales of our common stock or other securities; and
- our ability to maintain contracts that are critical to our operations.

Furthermore, we believe that the economic conditions in California and other Western states, as well as the United States as a whole, could have a negative impact on our results of operations. Demand for ethanol could also be adversely affected by a slow-down in the overall demand for oxygenate and gasoline additive products. The levels of our ethanol production and purchases for resale will be based upon forecasted demand. Accordingly, any inaccuracy in forecasting anticipated revenues and expenses could adversely affect our business. The failure to receive anticipated orders or to complete delivery in any quarterly period could adversely affect our results of operations for that period. Quarterly results are not necessarily indicative of future performance for any particular period, and we may not experience revenue growth or profitability on a quarterly or an annual basis.

The price at which you purchase shares of our common stock may not be indicative of the price that will prevail in the trading market. You may be unable to sell your shares of common stock at or above your purchase price, which may result in substantial losses to you and which may include the complete loss of your investment. In the past, securities class action litigation has often been brought against a company following periods of high stock price volatility. We may be the target of similar litigation in the future. Securities litigation could result in substantial costs and divert management's attention and our resources away from our business.

Any of the risks described above could have a material adverse effect on our results of operations or the price of our common stock, or both.

We may incur significant non-cash expenses in future periods due to adjustments to the fair values of our outstanding warrants. These non-cash expenses may materially and adversely affect our reported net income or losses and cause our stock price to decline.

From 2010 through 2013, we issued in various financing transactions warrants to purchase shares of our common stock. The warrants were initially recorded at their fair values, which are adjusted quarterly, generally resulting in non-cash expenses or income if the market price of our common stock increases or decreases, respectively, during the period. For example, due to the substantial increase in the market price of our common stock in the first quarter of 2014 and because the exercise prices of these warrants were, as of March 31, 2014, well below the market price of our common stock, the fair values of the warrants and the related non-cash expenses were significantly higher in the first quarter of 2014 than in prior quarterly periods, which resulted in an unusually large non-cash expense for the quarter. These fair value adjustments will continue in future periods until all of our warrants are exercised or expire. We may incur additional significant non-cash expenses in future periods due to adjustments to the fair values of our outstanding warrants resulting from increases in the market price of our common stock during those periods. These non-cash expenses may materially and adversely affect our reported net income or losses and cause our stock price to decline.

The conversion or exercise of our outstanding derivative securities or the issuance of shares of our common stock in lieu of accrued and unpaid dividends on our Series B Preferred Stock could substantially dilute your investment, reduce your voting power, and, if the resulting shares of common stock are resold into the market, or if a perception exists that a substantial number of shares may be issued and then resold into the market, the market price of our common stock and the value of your investment could decline significantly.

Our Series B Preferred Stock, which is convertible into our common stock, and outstanding options to acquire our common stock issued to employees, directors and others, and warrants to purchase our common stock, allow the holders of these derivative securities an opportunity to profit from a rise in the market price of our common stock. In addition, we may elect to issue shares of our common stock in lieu of accrued and unpaid cash dividends on our Series B Preferred Stock. We have issued common stock in respect of our derivative securities and accrued and unpaid dividends on our Series B Preferred Stock in the past and may do so in the future. If the prices at which our derivative securities are converted or exercised, or at which shares of common stock in lieu of accrued and unpaid dividends on our Series B Preferred Stock are issued, are lower than the price at which you made your investment, immediate dilution of the value of your investment will occur. Our issuance of shares of common stock under these circumstances will also reduce your voting power. In addition, sales of a substantial number of shares of common stock resulting from any of these issuances, or even the perception that these sales could occur, could adversely affect the market price of our common stock. As a result, you could experience a significant decline in the value of your investment as a result of both the actual and potential issuance of shares of our common stock.

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

Unregistered Sales of Equity Securities

None.

Dividends

Our current and future debt financing arrangements may limit or prevent cash distributions from our subsidiaries to us, depending upon the achievement of specified financial and other operating conditions and our ability to properly service our debt, thereby limiting or preventing us from paying cash dividends.

For each of the three months ended March 31, 2015 and 2014, we declared and paid in cash an aggregate of $0.3 million in dividends on our Series B Preferred Stock. We have never declared or paid cash dividends on our common stock and do not currently intend to pay cash dividends on our common stock in the foreseeable future. We currently anticipate that we will retain any earnings for use in the continued development of our business. The holders of our outstanding Series B Preferred Stock are entitled to dividends of 7% per annum, payable quarterly. Dividends in respect of our Series B Preferred Stock must be paid prior to the payment of any dividends in respect of our common stock.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES.

Not applicable.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS.

Exhibit Number	Description
10.1	Amendment No. 1 to Agreement and Plan of Merger dated as of March 31, 2015 by and between Pacific Ethanol, Inc., AVR Merger Sub, Inc. and Aventine Renewable Energy Holdings, Inc. (1)
31.1	Certifications Required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (*)
31.2	Certifications Required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (*)
32.1	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (*)
101.INS	XBRL Instance Document (*)
101.SCH	XBRL Taxonomy Extension Schema (*)
101.CAL	XBRL Taxonomy Extension Calculation Linkbase (*)
101.DEF	XBRL Taxonomy Extension Definition Linkbase (*)
101.LAB	XBRL Taxonomy Extension Label Linkbase (*)
101.PRE	XBRL Taxonomy Extension Presentation Linkbase (*)

(*) Filed herewith.

(1)

Filed as an exhibit to the Registrant's current report on Form 8-K filed with the Securities and Exchange Commission on April 2, 2015.

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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.

	PACIFIC ETHANOL, INC.
Dated: May 11, 2015	By: /s/ BRYON T. MCGREGOR Bryon T. McGregor Chief Financial Officer (Principal Financial and Accounting Officer)

EXHIBITS FILED WITH THIS REPORT

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