

Pacific Ethanol, Inc.  
Form 10-Q  
November 06, 2015

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended **September 30, 2015**

**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**  
(State or other jurisdiction  
of incorporation or organization)

**41-2170618**  
(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  No

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  No

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

As of November 6, 2015, there were 38,978,689 shares of Pacific Ethanol, Inc. common stock, \$0.001 par value per share, and 3,540,132 shares of Pacific Ethanol, Inc. non-voting common stock, \$0.001 par value per share, outstanding.

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## PART I – FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS.

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

	September 30, 2015 (unaudited)	December 31, 2014 *
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 53,056	\$62,084
Accounts receivable, net	51,379	34,612
Inventories	48,238	18,550
Income tax receivable	14,097	–
Prepaid inventory	11,100	11,595
Other current assets	5,084	12,710
Total current assets	182,954	139,551
Property and equipment, net	472,632	155,302
Other Assets:		
Intangible assets, net	2,566	2,786
Other assets	9,882	1,863
Total other assets	12,448	4,649
Total Assets	\$ 668,034	\$ 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)

	September 30, 2015 (unaudited)	December 31, 2014 *
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Accounts payable – trade	\$41,447	\$13,122
Accrued liabilities	5,846	6,203
Current portion – capital leases	4,217	4,077
Current portion – long-term debt	17,003	–
Other current liabilities	7,120	2,045
Total current liabilities	75,633	25,447
Long-term debt, net of current portion	190,166	34,533
Capital leases, net of current portion	5,279	2,055
Warrant liabilities at fair value	501	1,986
Deferred tax liabilities	5,293	17,040
Other noncurrent liabilities	20,451	459
Total Liabilities	297,323	81,520
Commitments and Contingencies (Notes 6 and 8)		
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 September 30, 2015 and December 31, 2014;	1	1
Series B: 1,580,790 shares authorized; 926,942 shares issued and outstanding as of September 30, 2015 and December 31, 2014; liquidation preference of \$18,075 as of September 30, 2015		
Common stock, \$0.001 par value; 300,000,000 shares authorized; 38,985,661 and 24,499,534 shares issued and outstanding as of September 30, 2015 and December 31, 2014, respectively	39	25
Non-voting common stock, \$0.001 par value; 3,553,000 shares authorized; 3,540,132 and no shares issued and outstanding as of September 30, 2015 and December 31, 2014, respectively	4	–
Additional paid-in capital	901,978	725,813
Accumulated deficit	(531,311 )	(512,332)
Total Pacific Ethanol, Inc. Stockholders' Equity	370,711	213,507
Noncontrolling interests	–	4,475
Total Stockholders' Equity	370,711	217,982
Total Liabilities and Stockholders' Equity	\$ 668,034	\$ 299,502

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

See accompanying notes to consolidated financial statements.

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PACIFIC ETHANOL, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited, in thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Net sales	\$380,622	\$275,573	\$814,419	\$851,260
Cost of goods sold	388,002	257,587	816,532	761,153
Gross profit (loss)	(7,380 )	17,986	(2,113 )	90,107
Selling, general and administrative expenses	7,446	4,392	16,344	12,377
Income (loss) from operations	(14,826 )	13,594	(18,457 )	77,730
Fair value adjustments and warrant inducements	1,202	(4,378 )	1,413	(39,737 )
Interest expense, net	(5,167 )	(1,133 )	(7,187 )	(8,370 )
Loss on extinguishments of debt	—	—	—	(2,363 )
Other income (expense), net	203	(172 )	16	(734 )
Income (loss) before provision for income taxes	(18,588 )	7,911	(24,215 )	26,526
Provision (benefit) for income taxes	(3,925 )	3,163	(6,095 )	13,629
Consolidated net income (loss)	(14,663 )	4,748	(18,120 )	12,897
Net (income) loss attributed to noncontrolling interests	—	(723 )	87	(4,126 )
Net income (loss) attributed to Pacific Ethanol	\$(14,663 )	\$4,025	\$(18,033 )	\$8,771
Preferred stock dividends	\$(319 )	\$(319 )	\$(946 )	\$(946 )
Income (loss) available to common stockholders	\$(14,982 )	\$3,706	\$(18,979 )	\$7,825
Net income (loss) per share, basic	\$(0.36 )	\$0.16	\$(0.63 )	\$0.40
Net income (loss) per share, diluted	\$(0.36 )	\$0.15	\$(0.63 )	\$0.35
Weighted-average shares outstanding, basic	41,861	22,986	30,170	19,713
Weighted-average shares outstanding, diluted	41,861	24,307	30,170	22,073

See accompanying notes to consolidated financial statements.



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

	Nine Months Ended September 30,	
	2015	2014
Operating Activities:		
Consolidated net income (loss)	\$(18,120 )	\$12,897
Adjustments to reconcile consolidated net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization of intangibles	15,103	9,775
Deferred income taxes	(120 )	191
Loss on extinguishments of debt	–	2,363
Fair value adjustments	(1,413 )	37,465
Amortization of debt discount	383	1,815
Amortization of deferred financing fees	178	1,139
Inventory valuation	–	722
Non-cash compensation	1,465	1,311
Derivative instruments	1,552	700
Bad debt expense (recoveries)	(357 )	(40 )
Changes in operating assets and liabilities, net of effects from acquisition of Aventine:		
Accounts receivable	(5,980 )	4,862
Inventories	(205 )	2,401
Other current assets	(1,399 )	962
Prepaid inventory	495	1,734
Accounts payable and accrued expenses	(9,020 )	(2,047 )
Net cash provided by (used in) operating activities	(17,438 )	76,250
Investing Activities:		
Net cash from Aventine acquisition	18,756	–
Additions to property and equipment	(17,680 )	(9,996 )
Purchase of cash collateralized letters of credit	(4,574 )	–
Purchases of PE Op Co. ownership	–	(6,000 )
Net cash used in investing activities	(3,498 )	(15,996 )
Financing Activities:		
Proceeds from equity offering	–	26,073
Proceeds from exercise of warrants	368	42,656
Principal payments on senior notes	–	(13,984)
Principal payment on related party note	–	(750 )
Parent purchases of Plant Owners' debt	–	(17,038)
Net proceeds from (payments on) Kinerger's line of credit	29,718	(5,570 )
Principal payments on Plant borrowings	(13,833 )	(35,378)
Payments on capital leases	(3,399 )	(3,772 )
Debt issuance costs	–	(440 )
Preferred stock dividends paid	(946 )	(946 )
Net cash provided by (used in) financing activities	11,908	(9,149 )

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Net increase (decrease) in cash and cash equivalents	(9,028 )	51,105
Cash and cash equivalents at beginning of period	62,084	5,151
Cash and cash equivalents at end of period	\$53,056	\$56,256
Supplemental Information:		
Interest paid	\$6,043	\$5,606
Income taxes paid	\$-	\$10,470
Noncash financing and investing activities:		
Reclass of warrant liability to equity upon warrant exercises	\$72	\$40,884
Reclass of noncontrolling interests to APIC upon acquisitions of ownership positions in PE Op Co.	\$560	\$80
Accrued payment for ownership positions in PE Op Co.	\$3,828	\$-
Assets acquired in acquisition of Aventine:		
Cash and cash equivalents	18,756	-
Accounts receivables	10,430	-
Inventories	29,483	-
Other current assets	10,480	-
Property and equipment	312,781	-
Net deferred tax assets	10,021	-
Other assets	750	-
Liabilities assumed in acquisition of Aventine:		
Accounts payable and accrued expenses	27,233	-
Term debt	142,744	-
Line of credit	13,721	-
Pension plan liabilities	8,518	-
Other noncurrent liabilities	25,913	-
Net assets acquired in acquisition of Aventine	\$174,572	\$-
Common stock issued in acquisition of Aventine	\$174,572	\$-
Preferred stock dividends paid in common stock	\$-	\$1,463

See accompanying notes to consolidated financial statements.

**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 (collectively, the “Company”), 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.”). The Company’s acquisition of Aventine Renewable Energy Holdings, Inc. (now, Pacific Ethanol Central, LLC, a Delaware limited liability company, “Aventine”) was consummated on July 1, 2015, and as a result, the Company’s consolidated financial statements include the results of Aventine only as of and for the three months ended September 30, 2015 and the same three month period within the nine months ended September 30, 2015.

The Company is a leading producer and marketer of low-carbon renewable fuels in the United States. The Company’s four ethanol plants in the Western United States (together with their respective holding companies, the “Pacific Ethanol West Plants”) are located in close proximity to both feed and ethanol customers and thus enjoy unique advantages in efficiency, logistics and product pricing. These plants produce among the lowest-carbon ethanol produced in the United States due to low energy use in production.

With the addition of four Midwestern ethanol plants in July 2015 as a result of the Company’s acquisition of Aventine, the Company now has a combined ethanol production capacity of 515 million gallons per year, markets, on an annualized basis, over 800 million gallons of ethanol and produces, on an annualized basis, over 1 million tons of co-products such as wet and dry distillers grains, wet and dry corn gluten feed, condensed distillers solubles, corn gluten meal, corn germ, distillers yeast and CO<sub>2</sub>. The Company’s four ethanol plants in the Midwest (together with their respective holding companies, the “Pacific Ethanol Central Plants”) are located in the heart of the Corn Belt, benefit from low-cost and abundant feedstock production and allow for access to many additional domestic markets; and the Company’s ability to load unit trains from these facilities in the Midwest allows for greater access to international markets.

*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 co-products to dairy operators, animal feed distributors and 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 \$35,541,000 and \$28,475,000 at September 30, 2015 and December 31, 2014, respectively, were used as collateral under Kinery's operating line of credit. The allowance for doubtful accounts was \$21,700 and \$6,000 as of September 30, 2015 and December 31, 2014, respectively. The Company recorded bad debt recoveries of \$360,000 and \$357,000 for the three and nine months ended September 30, 2015, respectively, and bad debt recoveries of \$6,000 and \$40,000 for the three and nine months ended September 30, 2014, respectively. The Company does not have any off-balance sheet credit exposure related to its customers.

Employment-related Benefits – Employment-related benefits associated with pensions and postretirement health care are expensed based on actuarial analysis. The recognition of expense is affected by estimates made by management, such as discount rates used to value certain liabilities, investment rates of return on plan assets, increases in future wage amounts and future health care costs. Discount rates are determined based on a spot yield curve that includes bonds with maturities that match expected benefit payments under the plan.

Provision for Income Taxes – For the three and nine months ended September 30, 2015, the Company recognized a tax benefit for losses incurred to the extent they are able to be carried back to prior taxable years, however, losses from the Pacific Ethanol Central Plants are not eligible to be carried back to prior taxable years and as such, were not recognized as an income tax benefit. In addition, for the three and nine months ended September 30, 2015, the Company recognized \$1.5 million in tax benefit related to adjustments to its tax asset valuation allowance from a prior period. This adjustment is considered to be immaterial. For the three and nine months ended September 30, 2014, expenses related to warrant fair value adjustments are not tax deductible and as such, those expenses were excluded from a tax benefit, resulting in a higher effective tax rate.

The resulting effective tax rates for the three months ended September 30, 2015 and 2014 were 21.1% and 40.0% of pre-tax income, respectively. The resulting effective tax rates for the nine months ended September 30, 2015 and 2014 were 25.2% and 51.4% of pre-tax income, respectively.

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. 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.

In July 2015, the FASB issued new guidance on simplifying the measurement of inventory. Under the new guidance, entities are required to measure most inventory at the lower of cost and net realizable value, thereby simplifying the current guidance under which an entity must measure inventory at the lower of cost or market. This guidance is effective prospectively for fiscal years beginning after December 15, 2016. Early adoption is permitted. The Company

has adopted the guidance with no material impact on its results of operations or financial condition.

In September 2015, the FASB issued new guidance on simplifying the accounting for measurement-period adjustments. Under the new guidance, an acquirer must recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The guidance also requires acquirers to present separately on the face of the statement of operations or disclose in the notes, the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. The guidance is effective for fiscal years beginning after December 31, 2015, applied prospectively. Early adoption is permitted. The Company will consider early adoption in future periods related to its current measurement period for its acquisition of Aventine.

*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 assets acquired and liabilities assumed from the acquisition of Aventine, warrants and conversion features, pension and postretirement benefit plan obligations, 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 WEST PLANTS.

As of September 30, 2015, the Company owned 100% of its four Pacific Ethanol West Plants located in the Western United States through its holding company, PE Op Co., namely, Pacific Ethanol Madera LLC, Pacific Ethanol Columbia, LLC, Pacific Ethanol Stockton LLC and Pacific Ethanol Magic Valley, LLC, and their holding company, Pacific Ethanol Holding Co. LLC (together with the Pacific Ethanol West Plants, the “Plant Owners”).

Prior to December 2013, PE Op Co. was consolidated as a variable interest entity because the Company, through its contractual arrangements with PE Op Co., had the power to direct the activities that most significantly impacted PE Op Co.’s economic performance. Since December 2013, as a result of owning 91% of PE Op Co., the Company continued to consolidate PE Op Co.’s financial results under the voting rights model.

In May 2015, the Company purchased the remaining 4% ownership interest in PE Op Co. that it did not own, giving it 100% ownership of PE Op Co.





For the prior periods in which the Company did not wholly-own PE Op Co., it adjusted its consolidated net income (loss) for the income (loss) attributed to PE Op Co.'s other owners. The remaining amount after this adjustment resulted in net income (loss) attributed to Pacific Ethanol.

Noncontrolling interest decreased from \$4,475,000 at December 31, 2014 to \$0 at September 30, 2015 due to the Company's purchase of the remaining 4% ownership interest in PE Op Co. for \$3,828,000, resulting in a reduction of noncontrolling interest of \$4,388,000, and loss attributed to noncontrolling interest of \$87,000 for the nine months ended September 30, 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. ACQUISITION OF AVENTINE.

On December 30, 2014, the Company entered into a definitive merger agreement with Aventine, a Midwest ethanol producer, under which the Company agreed to acquire Aventine through a stock-for-stock merger. The merger agreement was amended effective March 31, 2015 to address certain conditions to closing and other matters. The acquisition closed on July 1, 2015 and the Company issued an aggregate of 17.8 million shares of common stock and non-voting common stock for 100% of the outstanding shares of common stock of Aventine. The common stock and non-voting common stock issued as consideration had an aggregate fair value of \$174.6 million, based on the closing market price of the Company's common stock on the acquisition date.

The Company believes the Aventine acquisition will result in a number of synergies and strategic advantages. The Company believes the acquisition will spread commodity and basis price risks across diverse markets and products, assisting in its efforts to optimize margin management; improve its hedging opportunities with a greater correlation to the liquid physical and paper markets in Chicago; and increase its flexibility and alternatives in feedstock procurement for its Midwestern and Western production facilities. The acquisition also expands the Company's marketing reach into new markets and extends its mix of co-products. The Company believes the acquisition will enable it to have deeper market insight and engagement in major ethanol and feed markets outside the Western United States, thereby improving pricing opportunities; allows the Company to establish access to markets in 48 states for ethanol sales and access many markets with ethanol and co-product sales reaching domestic and international customers; and enable it to use its more diverse mix of co-products to generate strong co-product returns. In addition, the acquisition also increases the Company's combined annual ethanol production capacity to 515 million gallons per year and annualized ethanol marketing volume to over 800 million gallons, including Aventine's historical volumes.

The Company has recognized the following allocation of the purchase price at fair values. The following fair value allocation for all assets and liabilities is provisional and incomplete as the Company is in the process of completing its valuation of the assets acquired and liabilities assumed, most significantly its valuation of property and equipment, deferred taxes and environmental remediation. The fair values of property and equipment and deferred taxes are based on the Company's draft valuations, and represent its best estimates at the time of the filing of this report. The Company expects to conclude its valuations during the fourth quarter of 2015. The Company has included in the following allocation its estimated fair values for certain operating lease agreements and open commitments. The fair-value determination of long-term debt is based on the interest rate environment at the acquisition date.

Based upon these fair value estimates, the purchase price consideration allocation is as follows (in thousands):

Cash and cash equivalents	\$18,756
Accounts receivable	10,430
Inventory	29,483
Other current assets	10,480
Total current assets	69,149
Property and equipment	312,781
Net deferred tax assets	10,021
Other assets	750
Total assets acquired	\$392,701
Accounts payable and accrued liabilities	\$27,233
Long-term debt - revolvers	13,721
Long-term debt - term debt	142,744
Pension plan liabilities	8,518
Other non-current liabilities	25,913
Total liabilities assumed	\$218,129
Net assets acquired	\$174,572
Estimated goodwill	\$-
Total purchase price	\$174,572

The contractual amount due on the accounts receivable acquired was \$10.8 million, of which \$0.4 million is expected to be uncollectible. Any changes to the initial estimates of the fair value of the acquired assets and assumed liabilities will be recorded as adjustments to those assets and liabilities and residual amounts will be allocated to goodwill if the net assets acquired are less than the purchase price. If the net assets acquired exceed the purchase price, the residual amount will result in a bargain purchase gain. As discussed in Note 9, the Company recognized \$3.7 million, included in other noncurrent liabilities above, as a litigation contingency related to certain legal cases for amounts that were probable and estimable as of the acquisition date. Subsequent to the acquisition date, the Company paid approximately \$0.4 million of this amount.

The following table presents unaudited pro forma financial information assuming the acquisition occurred on January 1, 2014 (in thousands, except per share).

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Net sales – pro forma	\$380,622	\$429,373	\$1,107,919	\$1,267,853
Cost of goods sold – pro forma	\$379,302	\$400,260	\$1,102,278	\$1,137,410
Selling, general and administrative expenses – pro forma	\$7,346	\$8,892	\$29,144	\$24,568
Net income (loss) – pro forma	\$(6,182)	\$(117)	\$(34,226)	\$4,400
Diluted net income (loss) per share – pro forma	\$(0.15)	\$(0.00)	\$(0.71)	\$0.11

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Diluted weighted-average shares – pro forma	41,861	42,062	47,945	39,828
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The effects of the initial step-up of inventories and open contracts in the aggregate of \$8.7 million recorded during the three months ended September 30, 2015 were excluded in the above amounts, and instead recorded for the nine months ended September 30, 2014, as if the acquisition had occurred on January 1, 2014. For the three months ended September 30, 2015, Aventine contributed \$143.6 million in net revenues and \$16.6 million in pre-tax loss. For the three and nine months ended September 30, 2015, the Company recorded approximately \$0.1 million and \$1.4 million, respectively, in costs associated with the Aventine acquisition. These costs are reflected in selling, general and administrative expenses on the Company's consolidated statements of operations, but were excluded from the amounts above.

#### 4. INVENTORIES.

Inventories consisted primarily of bulk ethanol, corn, co-products 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):

	September 30, 2015	December 31, 2014
Finished goods	\$ 31,554	\$ 11,118
Raw materials	8,213	2,695
Work in progress	7,055	3,274
Other	1,416	1,463
Total	\$ 48,238	\$ 18,550

#### 5. 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 and nine months ended September 30, 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 exchange-traded 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 classification and amounts of the Company's derivatives not designated as hedging instruments are as follows (in thousands):

As of September 30, 2015				
Type of Instrument	Assets		Liabilities	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Commodity contracts	Other current assets	\$1,012	Other current liabilities	\$2,026
		\$1,012		\$2,026

As of December 31, 2014				
Type of Instrument	Assets		Liabilities	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Commodity contracts	Other current assets	\$1,586	Other current liabilities	\$1,149
		\$1,586		\$1,149

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 Three Months Ended September 30,	
		2015	2014
Commodity contracts	Cost of goods sold	\$(251)	\$(1,619)
		\$(251)	\$(1,619)

  

Type of Instrument	Statements of Operations Location	Unrealized Gains (Losses) Three Months Ended September 30,	
		2015	2014

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Commodity contracts	Cost of goods sold				
					\$(824) \$402
					\$(824) \$402

Type of Instrument	Statements of Operations Location		Realized Gains Nine Months Ended September 30,	
			2015	2014
Commodity contracts	Cost of goods sold		\$(101)	\$(1,070)
			\$(101)	\$(1,070)

Type of Instrument	Statements of Operations Location		Unrealized Gains (Losses) Three Months Ended September 30,	
			2015	2014
Commodity contracts	Cost of goods sold		\$(1,451)	\$370
			\$(1,451)	\$370



## 6. DEBT.

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

	September 30, 2015	December 31, 2014
Kinergy operating line of credit	\$ 47,137	\$ 17,530
Term debt	162,622	17,003
	209,759	34,533
Less unamortized discount	(2,590 )	–
Less short-term portion	(17,003 )	–
Long-term debt	\$ 190,166	\$ 34,533

*Kinergy Operating Line of Credit* – As of September 30, 2015, Kinergy had an outstanding balance of \$47,137,000 and an available borrowing base under the credit facility of \$4,576,000.

Effective, July 1, 2015, Kinergy amended its line of credit to:

- Extend the term and maturity date of the credit facility from December 31, 2016 to December 31, 2020;
- Increase the maximum credit under the credit facility from \$30,000,000 to \$75,000,000, with an “accordion” feature to further increase the maximum credit under the credit facility to up to \$100,000,000 in minimum increments of \$5,000,000 each, upon Kinergy’s request, but subject to the consent of the agent and the lenders in their sole discretion.
- Increase the inventory loan limit under the credit facility from \$12,500,000 to \$40,000,000 and increase the letter of credit limit under the credit facility from \$5,000,000 to \$20,000,000;
- Reduce the applicable margin to 1.75% to 2.75% depending on the quarterly average amounts available for borrowing and reduce the unused line fee under the credit facility to an annual rate equal to 0.25% to 0.375% depending on the average daily principal balance during the immediately preceding month; and
- Delete the financial covenant concerning Kinergy’s earnings before interest, taxes, depreciation and amortization (“EBITDA”) but retained financial covenants concerning its fixed-charge coverage ratios.

*Pacific Ethanol West Plants’ Term Debt and Operating Lines of Credit* – As of September 30, 2015, the Pacific Ethanol West Plants’ term debt had an outstanding balance of \$17,003,000. As of September 30, 2015, the Pacific Ethanol West Plants had no outstanding balances on their revolving credit facilities, with an aggregate of \$19,473,000 of borrowing availability. The outstanding balance matures in June 2016 and has been classified as current.

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 Pacific Ethanol West Plants. The creditors under the term loans and revolving credit facilities for the Pacific Ethanol West Plants do not have recourse to Pacific Ethanol, Inc. or any of its other direct or indirect subsidiaries.

*Pacific Ethanol Central Plants' Term Debt* – As of September 30, 2015, the Pacific Ethanol Central Plants' term debt had an outstanding balance of \$145,619,000. On July 1, 2015, upon effectiveness of the Aventine acquisition, Aventine became a wholly-owned subsidiary of the Company and, on a consolidated basis, the combined company became obligated with respect to the Pacific Ethanol Central Plants' term loan and revolving credit facilities. The creditors under the term loan for the Pacific Ethanol Central Plants have recourse solely against the Pacific Ethanol Central Plants and their subsidiaries but not against Pacific Ethanol, Inc. or its other direct or indirect subsidiaries. In connection with the Company's allocation of purchase price, the debt was recorded at \$142,744,000, net of a discount of \$2,875,000.

The term loan facility matures on September 24, 2017. The term loan facility is secured through a first-priority lien on substantially all of the Pacific Ethanol Central Plants' assets and contains customary financial covenants, including the requirement that Aventine maintain a cash balance of at least \$2.0 million. Interest on the term loan facility accrues and may be paid in cash at a rate of 10.5% per annum or may be paid in-kind at a rate of 15.0% per annum by adding such interest to the outstanding principal balance. If the Company were to elect to pay interest in-kind, the interest would be capitalized at the end of each quarter. The Company paid interest in cash for the three months ended September 30, 2015.

On July 1, 2015, the Company repaid in full \$14.5 million, including approximately \$0.7 million in termination fees, representing all amounts owed under Aventine's revolving credit facility.

At September 30, 2015, there were approximately \$320.9 million of net assets of the Company's subsidiaries that were not available to be transferred to the parent company in the form of dividends, loans or advances due to restrictions contained in the credit facilities of these subsidiaries.

## 7. PENSION AND RETIREMENT BENEFIT PLANS

The Company, through its acquisition of Aventine, has assumed a defined benefit pension plan (the "Pension Plan") and a health care and life insurance plan (the "Postretirement Plan").

The Pension Plan is noncontributory, and covers unionized employees at the Company's Pekin, Illinois facility, who fulfill minimum age and service requirements. Benefits are based on a prescribed formula based upon the employee's years of service. The Pension Plan, part of a collective bargaining agreement, covers only Union employees hired after November 1, 2010. The Company uses a December 31 measurement date for its Pension Plan. The Company's funding policy is to make the minimum annual contributions that are required by applicable regulations. As of September 30, 2015, the Pension Plan's accumulated projected benefit obligation was \$18.0 million, with a fair value of plan assets of \$13.2 million. The underfunded amount of \$4.8 million is recorded on the Company's consolidated balance sheet in other noncurrent liabilities. For the three months ended September 30, 2015, the Pension Plan's net periodic expense was \$24,000, comprised of \$169,000 in interest cost and \$106,000 in service cost, partially offset by a \$251,000 expected return on plan assets. The Company expects approximately \$0.5 million to be paid out of the Pension Plan for the remainder of 2015.

The Postretirement Plan provides postretirement medical benefits and life insurance to certain "grandfathered" unionized employees. Employees hired after December 31, 2000 are not eligible to participate in the Postretirement Plan. The Postretirement Plan is contributory, with contributions required at the same rate as active employees. Benefit eligibility under the plan reduces at age 65 from a defined benefit to a defined collar cap based upon years of

service. As of September 30, 2015, the Postretirement Plan's accumulated projected benefit obligation was \$3.7 million and is recorded on the Company's consolidated balance sheet in other noncurrent liabilities. The Company's funding policy is to make the minimum annual contributions that are required by applicable regulations. For the three months ended September 30, 2015, the Postretirement Plan's net periodic expense was \$49,000, comprised of \$33,000 of interest cost and \$16,000 of service cost. The Company expects approximately \$0.1 million to be paid out of the Postretirement Plan for the remainder of 2015.

#### 8. COMMON STOCK AND WARRANTS.

Warrant Exercises – There were no warrants exercised during the three months ended September 30, 2015. During the nine months ended September 30, 2015, certain holders exercised warrants and received an aggregate of 42,000 shares of the Company's common stock upon payment of an aggregate of \$368,000 in cash. During the three months ended September 30, 2015, approximately 432,000 warrants expired unexercised. As of September 30, 2015, there were warrants outstanding to purchase 349,000 shares of the Company's common stock at an average exercise price of \$7.02 per share.

During the three and nine months ended September 30, 2014, certain holders exercised warrants and received an aggregate of 3,095,000 and 5,942,000 shares of the Company's common stock upon payment of an aggregate of \$24,417,000 and \$42,575,000 in cash, respectively. During the three and nine months ended September 30, 2014, the Company paid an aggregate of \$1,471,000 and \$2,271,000, respectively, in cash to certain warrant holders as an inducement to exercise their warrants and recorded an expense of \$1,471,000 and \$2,271,000, respectively. During the nine months ended September 30, 2014, certain warrant holders exercised warrants on a cashless basis and received 291,000 shares of the Company's common stock.

Grants of Stock – In August 2015, the Company granted an aggregate of 5,000 shares of restricted stock to certain of the Company's eligible employees that vest in equal amounts on each of April 1, 2016, 2017 and 2018, which had a grant date fair value of \$7.03 per share. In July 2015, the Company granted an aggregate of 67,000 shares of restricted stock to certain of the Company's eligible employees that vest in equal amounts on each of April 1, 2016, 2017 and 2018, which had a grant date fair value of \$9.83 per share. In June 2015, the Company granted an aggregate of approximately 41,000 shares of restricted stock to non-employee members of the Company's Board of Directors that vest on the earlier of (i) the date of the Company's 2016 annual meeting of stockholders, or (ii) July 1, 2016, which had a grant date fair value of \$10.87 per share. In March 2015, the Company granted an aggregate of 194,000 shares of restricted stock to the Company's executive officers and other eligible employees that vest in equal amounts on each of April 1, 2016, 2017 and 2018, which had a grant date fair value of \$10.20 per share. As of September 30, 2015, there was \$4.4 million of total unrecognized costs related to nonvested restricted stock. That cost is expected to be recognized over a weighted-average period of 2.5 years.

## 9. COMMITMENTS AND CONTINGENCIES.

Sales Commitments – At September 30, 2015, the Company had sales contracts with its major customers to sell certain quantities of ethanol and co-products. The Company had fixed-price sales contracts to sell \$6,593,000 of ethanol and indexed-price contracts to sell 176,108,000 gallons of ethanol. At September 30, 2015, the Company had fixed-price sales contracts to sell \$18,778,000 of co-products and indexed-price sales contracts to sell 13,000 tons of co-products. These sales contracts are scheduled to be completed throughout 2015.

Purchase Commitments – At September 30, 2015, the Company had fixed-price purchase contracts with its suppliers to purchase \$7,749,000 of ethanol, \$10,625,000 of corn and indexed-price contracts to purchase 23,892,000 gallons of ethanol. These contracts are scheduled to be satisfied throughout the remainder of 2015.

Litigation – 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.

Pacific Ethanol, Inc., through a subsidiary acquired in its acquisition of Aventine, became involved in a pending lawsuit with Western Sugar Cooperative ("Western Sugar") that pre-dated the Aventine acquisition.

On February 27, 2015, Western Sugar filed a complaint in the United States District Court for the District of Colorado (Case No. 1:15-cv-00415) naming Aventine Renewable Energy, Inc. (“ARE, Inc.”), one of Aventine’s subsidiaries, as defendant. Western Sugar amended its complaint on April 21, 2015. ARE, Inc. purchased surplus sugar through a United States Department of Agriculture program. Western Sugar was one of the entities that warehoused this sugar for ARE, Inc. The suit alleges that ARE, Inc. breached its contract with Western Sugar by failing to pay certain penalty rates for the storage of its sugar or alternatively failing to pay a premium rate for storage. Western Sugar alleges that the penalty rates apply because ARE, Inc. failed to take timely delivery or otherwise cause timely shipment of the sugar. Western Sugar claims “expectation damages” in the amount of approximately \$8.6 million. ARE, Inc. filed answers to Western Sugar’s complaint and amended complaint generally denying Western Sugar’s allegations and asserting various defenses. The case is currently in its discovery phase.

The Company, through subsidiaries acquired in its acquisition of Aventine, became involved in various pending lawsuits with Aurora Cooperative Elevator Company (“Aurora Coop”) that pre-dated the Aventine acquisition.

On July 26, 2015, the Company settled all outstanding litigation with Aurora Coop. The Company and Aurora Coop agreed to dismiss all lawsuits with prejudice with no admission of fault or liability by the parties, and to release the alleged option held by Aurora Coop to repurchase the land upon which the Company’s 110 million gallon ethanol production facility in Aurora, Nebraska is located (the “Aurora West Facility”). In addition, the parties agreed to terminate the grain supply, marketing and various other agreements between them or their subsidiaries. Under the terms of the settlement, the Company and Aurora Coop will each bear its own costs and fees associated with the lawsuits and the settlement. The Company and Aurora Coop agreed to continue to work together to amend or replace certain real property easements currently in place to ensure continued mutual access by both parties to a system of rails, rail switches, roads, electrical improvements, and utilities already constructed near the Aurora West Facility.

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 was conducted last month on that single issue as well as whether GS Cleantech's behavior during prosecution of the patents renders this an exceptional case. The Company is awaiting the court's decision. If the Defendants, including Pacific Ethanol, Inc., PE Stockton and PE Magic Valley, succeed in proving inequitable conduct, and that GS Cleantech's behavior makes this an "exceptional case" such a finding 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 June 30, 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.

The Company has evaluated the above cases as well as other pending cases. The Company currently has recognized \$3.3 million as a litigation contingency liability with respect to these cases for amounts that are probable and estimable.

#### 10. 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 September 30, 2015 were as follows:

Original Issuance	Exercise Price	Volatility	Risk Free Interest Rate	Term (years)	Market Discount	Warrants Outstanding	Fair Value
07/3/2012	\$ 6.09	50.0%	0.64%	1.76	25.3%	211,000	\$355,000
12/13/2011	\$ 8.43	46.7%	0.33%	1.21	20.0%	138,000	146,000
							\$501,000

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.

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 September 30, 2015 (in thousands):

	Level 1	Level 2	Level 3	Total
Assets:				
Commodity contracts <sup>(1)</sup>	\$1,012	\$ -	\$-	\$1,012
Total Assets	\$1,012	\$ -	\$-	\$1,012
Liabilities:				
Warrants <sup>(2)</sup>	\$-	\$ -	\$501	\$501
Commodity contracts <sup>(3)</sup>	2,026	-	-	2,026
Total Liabilities	\$2,026	\$ -	\$501	\$2,527

(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 <sup>(1)</sup>	\$1,586	\$ -	\$-	\$1,586
Total Assets	\$1,586	\$ -	\$-	\$1,586
Liabilities:				
Warrants <sup>(2)</sup>	\$-	\$ -	\$1,986	\$1,986
Commodity contracts <sup>(3)</sup>	1,149	-	-	1,149
Total Liabilities	\$1,149	\$ -	\$1,986	\$3,135

(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	(72 )
Expiration of warrants	(527 )
Adjustments to fair value for the period	(886 )
Balance, September 30, 2015	\$501

## 11. EARNINGS PER SHARE.

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

	Three Months Ended September 30, 2015		
	Income Numerator	Shares Denominator	Per-Share Amount
Net loss attributed to Pacific Ethanol	\$(14,663)		
Less: Preferred stock dividends	(319 )		
Basic and diluted loss per share:			
Loss available to common stockholders	\$(14,982)	41,861	\$ (0.36 )

	Three Months Ended September 30, 2014		
	Income Numerator	Shares Denominator	Per-Share Amount
Net income attributed to Pacific Ethanol	\$4,025		
Less: Preferred stock dividends	(319 )		
Basic income per share:			
Income available to common stockholders	\$3,706	22,986	\$ 0.16
Add: Warrants	–	1,321	
Diluted income per share:			
Income available to common stockholders	\$3,706	24,307	\$ 0.15

	Nine Months Ended September 30, 2015		
	Loss Numerator	Shares Denominator	Per-Share Amount
Net loss attributed to Pacific Ethanol	\$(18,033)		
Less: Preferred stock dividends	(946 )		
Basic and diluted loss per share:			
Loss available to common stockholders	\$(18,979)	30,170	\$ (0.63 )

	Nine Months Ended September 30, 2014		
	Income Numerator	Shares Denominator	Per-Share Amount
Net income attributed to Pacific Ethanol	\$8,771		
Less: Preferred stock dividends	(946 )		
Basic income per share:			
Income available to common stockholders	\$7,825	19,713	\$ 0.40
Add: Warrants	–	2,360	
Diluted income per share:			
Income available to common stockholders	\$7,825	22,073	\$ 0.35

There were an aggregate of 897,000 and 786,000 potentially dilutive weighted-average shares from the Company's warrants and shares of Series B Cumulative Convertible Preferred Stock outstanding for the three and nine months ended September 30, 2015, respectively. These convertible securities were not considered in calculating diluted net income (loss) per share for the three and nine months ended September 30, 2015, as their effect would have been anti-dilutive.

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;
- 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.

### **Recent Development**

On July 1, 2015, we consummated our acquisition of Aventine Renewable Energy Holdings, Inc., now known as Pacific Ethanol Central, LLC, or Aventine, under the terms of an Agreement and Plan of Merger dated as of December 30, 2014 by and among Pacific Ethanol, Inc., AVR Merger Sub, Inc., one of our wholly-owned subsidiaries, and Aventine. Under the terms of the acquisition, Aventine became one of our wholly-owned subsidiaries.

In connection with the acquisition, each issued and outstanding share of Aventine common stock as of July 1, 2015, the effective date of the acquisition, was automatically cancelled and converted into the right to receive consideration



equal to (i) 1.25 shares of our non-voting common stock, plus cash in lieu of fractional shares, for each issued and outstanding share of Aventine's common stock, (ii) 1.25 shares of our voting common stock plus cash in lieu of fractional shares, for each issued and outstanding share of Aventine's common stock, or (iii) a combination of non-voting common stock and voting common stock at the ratios provided above, in each case at the election or deemed election of each Aventine stockholder.

We issued approximately 14.2 million shares of our voting common stock and approximately 3.6 million shares of our non-voting common stock to the Aventine stockholders in connection with the acquisition.

We believe the Aventine acquisition will result in a number of synergies and strategic advantages. We believe the acquisition will spread commodity and basis price risks across diverse markets and products, assisting in our efforts to optimize margin management; improve our hedging opportunities with a greater correlation to the liquid physical and paper markets in Chicago; and increase our flexibility and alternatives in feedstock procurement for our Midwest and Western production facilities. The acquisition also expands our marketing reach into new markets and extends our mix of co-products. We believe the acquisition will enable us to have deeper market insight and engagement in major ethanol and feed markets outside the Western United States, thereby improving pricing opportunities; allow us to establish access to markets in 48 states for ethanol sales and access many markets with ethanol and co-product sales reaching domestic and international customers; and enable us to use our more diverse mix of co-products to generate strong co-product returns. In addition, the acquisition also increases our combined ethanol production capacity to 515 million gallons per year and our annualized ethanol marketing volume to over 800 million gallons, including Aventine's historical volumes.

## Overview

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

We own and operate eight strategically-located ethanol production facilities, four in the Western states of California, Oregon and Idaho, and four in the Midwestern states of Illinois and Nebraska. Our ethanol plants have a combined ethanol production capacity of 515 million gallons per year. We are the sixth largest producer of ethanol in the United States based on annualized volumes, including Aventine's historical volumes.

We have extensive customer relationships throughout the United States and market and distribute ethanol and co-products domestically and internationally. Our ethanol customers are integrated oil companies and gasoline marketers who blend ethanol into gasoline.

Our customers collectively require ethanol volumes in excess of the supplies we produce, and depend on us to provide a reliable supply of product, and manage the logistics and timing of delivery with very little effort on their side. We secure ethanol supplies from a variety of sources, including our eight ethanol production facilities, other plants in California for which we market ethanol, and other suppliers in the Midwest, where a majority of ethanol manufacturers are located. In 2014, we obtained approximately 42% of our ethanol supplies from Midwest producers to supplement ethanol produced by our plants 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.

We also produce and market, on an annualized basis, over 1.0 million tons of ethanol co-products such as wet and dry distillers grains, wet and dry corn gluten feed, condensed distillers solubles, corn gluten meal, corn germ, corn oil, distillers yeast and CO<sub>2</sub>. Customers for our distillers grains and other feed co-products include dairies and feedlots, in many cases located near our ethanol plants. These customers use our feed co-products for livestock as a substitute for corn and other sources of starch and protein. We sell our corn oil to poultry and biodiesel customers. We do not market co-products from other ethanol producers.

Our subsidiary, Kinergy Marketing LLC, or Kinergy, markets all the ethanol produced at our ethanol plants as well as for third parties, with an annualized marketing volume of over 800 million gallons of ethanol, including Aventine's historical volumes.

Our ethanol plants are comprised of the eight production facilities described immediately below. The Pacific Ethanol West facilities are near their respective fuel and feed customers, offering significant timing, transportation cost and logistical advantages. The Pacific Ethanol Central facilities are located in the heart of the Corn Belt, benefit from low-cost and abundant feedstock production and allow for access to many additional domestic markets; and our ability to load unit trains from these facilities in the Midwest allows for greater access to international markets.

	<b>Facility Name</b>	<b>Facility Location</b>	<b>Estimated Annual Capacity (gallons)</b>
<i>Pacific Ethanol West</i>	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
<i>Pacific Ethanol Central</i>	Aurora West	Aurora, NE	110,000,000
	Aurora East	Aurora, NE	45,000,000
	Pekin Wet	Pekin, IL	100,000,000
	Pekin Dry	Pekin, IL	60,000,000

Our mission is to be the leading producer and marketer of low-carbon renewable fuels in the United States. We intend to accomplish this goal in part by expanding our relationships with our current customers and establishing relationships with new customers. As we develop new customer relationships, we will seek new suppliers, including through the acquisition of additional production facilities.

### **Current Initiatives and Outlook**

We experienced a compressed margin environment in the third quarter and throughout most of the first nine months 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, remained low in 2015 compared to 2014 due to lower ethanol prices predominantly caused by higher industry-wide inventory levels. As 2015 has progressed, ethanol demand has increased and inventory levels have moderated. The ethanol stock-to-use ratio is now at its lowest level in a year, which is contributing to improved production margins in the fourth quarter of 2015. A better supply and demand balance now exists in part due to higher overall demand for gasoline as low oil prices have led to higher consumption of transportation fuels. In addition, exports continue to grow as global markets react to the economic, environmental and octane benefits of ethanol.

We remain confident in the long-term demand for renewable fuels and our ability to execute and create value. 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.

We expect our acquisition of Aventine to result in significant synergies in multiple areas of our business. Our goal is to achieve at least \$12.0 million annualized in synergistic benefits. We believe our larger, more diversified platform yields significant benefits, including enhanced purchasing power, increased revenues, new product sales and an overall strengthened position as a low-cost producer and marketer of ethanol and high-value co-products.

On July 26, 2015, we settled all outstanding litigation with Aurora Cooperative Elevator Company, or Aurora Coop. Pacific Ethanol and Aurora Coop agreed to dismiss all lawsuits with prejudice with no admission of fault or liability by the parties, and to release the alleged option held by Aurora Coop to repurchase the land upon which Pacific Ethanol's 110 million gallon ethanol production facility in Aurora, Nebraska is located. See "Legal Proceedings".

In July, we began producing and selling corn oil at our Boardman, Oregon facility which completes our two-year initiative to add this high-value co-product. We now produce and sell corn oil at all of our dry mill ethanol plants, further diversifying our revenue and providing immediate incremental operating income. Production and sale of corn oil adds approximately \$0.05 per gallon of incremental operating income.

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. Currently, we receive a \$0.04 to \$0.07 per gallon premium over Midwest ethanol on each California production gallon sold into the California market. We expect this premium to increase as the compliance curve steepens beginning in 2016.

We have undertaken a number of plant improvement initiatives. We are working on cogeneration technology at our Stockton, California plant, and are examining the feasibility of implementing the technology at our Madera, California facility. We are commercially producing cellulosic ethanol at our Stockton plant and we are working with our technology provider and the U.S. Environmental Protection Agency to qualify this ethanol for special premiums over conventional ethanol.

Our goals for the remainder of 2015 include further integrating and optimizing our Pacific Ethanol Central plants to maximize the synergies from our acquisition of Aventine; continuing to reinvest in our ethanol production business through initiatives focused on further improving operating efficiencies and yields, diversifying our feedstock, creating new revenue streams and furthering our advanced biofuels initiatives; and leveraging our state-of-the-art, strategically-located ethanol plants to expand market share, 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; pension and postretirement benefit plan obligations; impairment of long-lived and intangible assets; and allowance for doubtful accounts. These significant accounting principles, other than with respect to our pension and postretirement benefit plan obligations, 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. In addition, the accounting for our acquisition of assets acquired and liabilities assumed in the acquisition of Aventine involves significant estimates of their fair values.

*Pension and Postretirement Benefit Plan Obligations*

Liabilities associated with pension and postretirement benefit plans are primarily based on actuarial analysis. The recognition of obligations and associated expense are affected by estimates made by management, such as discount rates, investment rates of return on plan assets, increases in future wage amounts and future health care costs. Discount rates are determined based on a spot yield curve that includes bonds with maturities that match expected benefit payments under the plan.

## Results of Operations

Our acquisition of Aventine was consummated on July 1, 2015, and as a result, our results of operations include Aventine's results of operations only as of and for the three months ended September 30, 2015 and the same three month period within the nine months ended September 30, 2015. The three and nine months ended September 30, 2014 exclude Aventine's results of operations for those periods.

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			Nine Months Ended								
	September 30		Percentage	September 30		Percentage						
	2015	2014	Variance	2015	2014	Variance						
West production gallons sold (in millions)	47.0	46.8	2.2	%	139.1	133.1	6.7	%				
Central production gallons sold (in millions)	62.6	–	NM		62.6	–	NM					
Third party gallons sold (in millions)	102.0	86.9	8.8	%	286.3	245.5	16.2	%				
Total gallons sold (in millions)	211.6	133.7	33.3	%	488.0	378.6	28.9	%				
Average sales price per gallon	\$1.67	\$2.32	(28.0	)%	\$1.69	\$2.59	(34.7	)%				
Corn cost per bushel – CBOT equivalent	\$3.83	\$3.88	1.3	%	\$3.81	\$4.40	(13.4	)%				
Average basis <sup>(1)</sup>	\$0.37	\$1.27	(70.9	)%	\$0.62	\$1.22	(49.2	)%				
Delivered cost of corn	\$4.20	\$5.15	(18.4	)%	\$4.43	\$5.62	(21.2	)%				
Co-product revenues as % of delivered cost of corn <sup>(2)</sup>	38.0	%	30.8	%	23.4	%	35.8	%	33.9	%	5.6	%



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Average CBOT ethanol price per gallon	\$1.51	\$2.02	(25.2	)%	\$1.53	\$2.16	(29.2	)%
Average CBOT corn price per bushel	\$3.83	\$3.60	6.4	%	\$3.78	\$4.31	(12.3	)%

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- (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.

The disparity between our average ethanol sales price per gallon and the Chicago Board of Trade, or 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.

**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):

	<b>Three Months Ended September 30,</b>		<b>Variance in</b>		<b>Nine Months Ended September 30,</b>		<b>Variance in</b>		
	<b>2015</b>	<b>2014</b>	<b>Dollars</b>	<b>Percent</b>	<b>2015</b>	<b>2014</b>	<b>Dollars</b>	<b>Percent</b>	
Net sales	\$ 380,622	\$ 275,573	\$ 105,049	38.1 %	\$ 814,419	\$ 851,260	\$(36,841)	(4.3 %)	
Cost of goods sold	388,002	257,587	130,415	50.6 %	816,532	761,153	55,379	7.3 %	
Gross profit	\$(7,380 )	\$ 17,986	\$(25,366 )	NM	\$(2,113 )	\$ 90,107	\$(92,220)	NM	
Percentage of net sales	(1.9)%	6.5%			(0.3)%	10.6%			

**Net Sales**

The increase in our net sales for the three months ended September 30, 2015 as compared to the same period in 2014 was primarily due to increased gallons sold from new volumes from our Pacific Ethanol Central Plants resulting from our acquisition of Aventine, partially offset by our lower average sales price. The decrease in our net sales for the nine months ended September 30, 2015 as compared to 2014 was primarily due to our lower average sales price, partially offset by an increase in gallons sold due to new volumes from our Pacific Ethanol Central plants resulting from our acquisition of Aventine.

**Three Months ended September 30, 2015**

Net sales of ethanol increased by \$65.7 million, or 26%, to \$315.6 million for the three months ended September 30, 2015 as compared to \$249.9 million for the three months ended September 30, 2014. Our total volume of ethanol gallons sold increased by 77.9 million gallons, or 33%, to 211.6 million gallons for the three months ended September 30, 2015 as compared to 133.7 million gallons for the same period in 2014. Total gallons sold as a producer or merchant increased 62.8 million gallons and 16.2 million gallons, respectively, for the three months ended September 30, 2015 as compared to the same period in 2014. At our average sales price per gallon of \$1.67 for the three months ended September 30, 2015, we generated \$134.8 million in additional net sales from the 79.0 million additional gallons of ethanol sold as a producer or merchant for the period as compared to the same period in 2014. In addition, we sold 1.1 million fewer gallons as an agent during the period. The 1.1 million fewer gallons of ethanol sold as an agent had an immaterial impact on our net sales for the three months ended September 30, 2015. The decline of \$0.65, or 28%, in our average sales price per gallon for the three months ended September 30, 2015 as compared to the same

period in 2014 reduced our net sales by \$69.1 million.

Net sales of co-products increased by \$39.3 million, or 153%, to \$65.0 million for the three months ended September 30, 2015 as compared to \$25.7 million for the same period in 2014. Our total volume of co-products sold increased by 285,000 tons to 670,000 tons for the three months ended September 30, 2015 from 385,000 tons for the same period in 2014. Our average sales price per ton of co-products increased by \$28.68, or 45%, to \$93.02 for the three months ended September 30, 2015 as compared to \$64.34 per ton of co-product for the three months ended September 30, 2014. At our average sales price per ton of \$93.02 for the three months ended September 30, 2015, we generated \$11.0 million in additional net sales from the 285,000 additional tons of co-products sold in the third quarter of 2015 as compared to the same period in 2014. The increase of \$28.68 in our average sales price per ton for the three months ended September 30, 2015 as compared to the same period in 2014 increased our net sales by \$28.3 million.

We increased both production and third party gallons sold, as well as our volume of co-products sold, for the three months ended September 30, 2015 as compared to the same period in 2014 primarily due to new volumes from our Pacific Ethanol Central plants resulting from our acquisition of Aventine.

Nine Months ended September 30, 2015

Net sales of ethanol declined by \$65.5 million, or 9%, to \$698.8 million for the nine months ended September 30, 2015 as compared to \$764.3 million for the nine months ended September 30, 2014. Our total volume of ethanol gallons sold increased by 109.4 million gallons, or 29%, to 488.0 million gallons for the nine months ended September 30, 2015 as compared to 378.6 million gallons for the same period in 2014. Total gallons sold as a producer or merchant increased 68.6 million gallons and 47.1 million gallons, respectively, for the nine months ended September 30, 2015 as compared to the same period in 2014. At our average sales price per gallon of \$1.69 for the nine months ended September 30, 2015, we generated \$197.1 million in additional net sales from the 115.7 million additional gallons of ethanol sold as a producer or merchant for the period as compared to the same period in 2014. In addition, we sold 6.3 million fewer gallons as an agent during the period. The 6.3 million fewer gallons of ethanol sold as an agent had an immaterial impact on our net sales for the nine months ended September 30, 2015. The decline of \$0.90, or 35%, in our average sales price per gallon for the nine months ended September 30, 2015 as compared to the same period in 2014 reduced our net sales by \$262.6 million.

Net sales of co-products increased \$28.6 million, or 33%, to \$115.6 million for the nine months ended September 30, 2015 as compared to \$87.0 million for the same period in 2014. Our total volume of co-products sold increased by 297,300 tons to 1,398,100 tons for the nine months ended September 30, 2015 from 1,100,800 tons for the same period in 2014. Our average sales price per ton of co-products increased by \$2.39, or 3%, to \$79.84 for the nine months ended September 30, 2015 as compared to \$77.45 per ton of co-product for the nine months ended September 30, 2014. At our average sales price per ton of \$79.84 for the nine months ended September 30, 2015, we generated \$26.0 million in additional net sales from the 297,300 additional tons of co-products sold in the first nine months of 2015 as compared to the same period in 2014. The increase of \$2.39 in our average sales price per ton for the nine months ended September 30, 2015 as compared to the same period in 2014 increased our net sales by \$2.6 million.

We increased both production and third party gallons sold, as well as our volume of co-products sold, for the nine months ended September 30, 2015 as compared to the same period in 2014 primarily due to new volumes from our Pacific Ethanol Central plants resulting from our acquisition of Aventine as well as a result of the restart of production at our Madera plant in the second quarter of 2014.

*Cost of Goods Sold and Gross Profit (Loss)*

Three Months ended September 30, 2015

Our gross profit declined to a gross loss of \$7.4 million for the three months ended September 30, 2015 from a gross profit of \$18.0 million for the same period in 2014. Our gross margin declined to negative 1.9% for the three months

ended September 30, 2015 from a gross margin of 6.5% for the same period in 2014. Our gross profit and gross margin declined primarily due to significantly lower crush and commodity margins realized at our plants, predominantly related to lower ethanol sales prices relative to corn costs caused by industry-wide excess ethanol supply relative to demand. In addition, we realized approximately \$8.7 million in purchase accounting adjustments in our costs of goods sold for the three months ended September 30, 2015 related to our acquisition of Aventine.

Of the \$25.4 million decline in gross profit for the three months ended September 30, 2015 as compared to the same period in 2014, gross loss of \$28.6 million related to our total production gallons sold and gross profit of \$3.2 million related to our merchant sales. Our production gallons sold increased by 62.8 million gallons in the three months ended September 30, 2015 as compared to the same period in 2014. Of the \$28.6 million in gross loss resulting from our total production gallons sold, \$21.8 million is attributable to our lower gross margins in the third quarter of 2015 and \$6.8 million is attributable to the 62.8 million gallon increase in production gallons sold in the third quarter of 2015 as compared to the same period in 2014. Of the \$3.2 million in higher gross profit resulting from our merchant sales, \$2.2 million is attributable to our higher gross margins for these sales in the third quarter of 2015 and \$1.0 million is attributable to the 16.2 million gallon increase in merchant gallons sold in the third quarter of 2015 as compared to the same period in 2014.

Nine Months ended September 30, 2015

Our gross profit declined to a gross loss of \$2.1 million for the nine months ended September 30, 2015 from a gross profit of \$90.1 million for the same period in 2014. Our gross margin declined to negative 0.3% for the nine months ended September 30, 2015 from a gross margin of 10.6% for the same period in 2014. Our gross profit and gross margin declined primarily due to significantly lower crush and commodity margins realized at our plants, predominantly related to lower ethanol sales prices relative to corn costs caused by industry-wide excess ethanol supply relative to demand. In addition, we realized approximately \$8.7 million in purchase accounting adjustments in our costs of goods sold for the nine months ended September 30, 2015 related to our acquisition of Aventine.

Of the \$92.2 million decline in gross profit for the nine months ended September 30, 2015 as compared to the same period in 2014, gross loss of \$93.5 million related to our total production gallons sold and gross profit of \$1.3 million related to our merchant sales. Our production gallons sold increased by 68.6 million gallons in the nine months ended September 30, 2015 as compared to the same period in 2014. Of the \$93.5 million in lower gross profit resulting from our total production gallons sold, \$90.3 million is attributable to our lower gross margins in the first nine months of 2015 and \$3.2 million is attributable to the 68.6 million gallon increase in production gallons sold in the first nine months of 2015 as compared to the same period in 2014. Of the \$1.3 million in higher gross profit resulting from our merchant sales, \$1.7 million is attributable to the 47.1 million gallon increase in merchant gallons sold in the first nine months of 2015 as compared to the same period in 2014, partially offset by \$0.4 million in lower gross profit related to our lower gross margins for these sales in the first nine months of 2015 as compared to the same period in 2014.

***Selling, General and Administrative Expenses***

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

	<b>Three Months Ended</b>		<b>Variance in</b>		<b>Nine Months Ended</b>		<b>Variance in</b>	
	<b>September 30, 2015</b>	<b>2014</b>	<b>Dollars</b>	<b>Percent</b>	<b>September 30, 2015</b>	<b>2014</b>	<b>Dollars</b>	<b>Percent</b>
Selling, general and administrative expenses	\$7,446	\$4,392	\$3,054	69.5%	\$16,344	\$12,377	\$3,967	32.1%
<i>Percentage of net sales</i>	2.0%	1.6%			2.0%	1.5%		

Our SG&A expenses increased \$3.1 million to \$7.5 million for the three months ended September 30, 2015 as compared to \$4.4 million for the same period in 2014, and increased as a percentage of net sales for the three months ended September 30, 2015 as compared to the same period in 2014. The increase in SG&A expenses is primarily due

to additional SG&A expenses of \$3.0 million associated with our new Pacific Ethanol Central operations resulting from our acquisition of Aventine.

Our SG&A expenses increased \$4.0 million to \$16.4 million for the nine months ended September 30, 2015 as compared to \$12.4 million for the same period in 2014. The increase in SG&A expenses is due to additional SG&A expenses of \$3.0 million associated with our new Pacific Ethanol Central operations resulting from our acquisition of Aventine and an increase in professional fees of \$1.0 million due to costs largely associated with our acquisition of Aventine, which were partially offset by a reduction in compensation costs of \$0.5 million due to a decline in incentive compensation compared to the prior year.

At current operating levels, including our Pacific Ethanol Central operations, we are targeting our SG&A expenses at approximately \$7.0 million for the fourth quarter of 2015.

### *Fair Value Adjustments and Warrant Inducements*

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

	<b>Three Months Ended September 30,</b>		<b>Variance in</b>		<b>Nine Months Ended September 30,</b>		<b>Variance in</b>	
	<b>2015</b>	<b>2014</b>	<b>Dollars</b>	<b>Percent</b>	<b>2015</b>	<b>2014</b>	<b>Dollars</b>	<b>Percent</b>
Fair value adjustments and warrant inducements	\$ 1,202	\$(4,378)	\$5,580	NM	\$ 1,413	\$(39,737)	\$41,150	NM
<i>Percentage of net sales</i>	0.3%	(1.6)%			0.2%	(4.7)%		

We issued 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 fair value adjustments and warrant inducements, we recorded income of \$1.2 million and expense of \$4.4 million for the three months ended September 30, 2015 and 2014, respectively, and we recorded income of \$1.4 million and expense of \$39.7 million for the nine months ended September 30, 2015 and 2014, respectively.

These changes in fair value are primarily due to the volatility in the market price of our common stock from period to period. The substantial change in fair value for the nine months ended September 30, 2014 occurred because the exercise prices of our warrants were, as of September 30, 2014, well below the market price of our common stock. At December 31, 2013, the market price of our common stock was \$5.09 per share and our outstanding warrants had a weighted-average exercise price of \$7.27 per share. At September 30, 2014, the market price of our common stock had increased to \$13.96 per share, and our outstanding warrants were in-the-money and had significant intrinsic value.



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.

We paid an aggregate of \$1.5 million and \$2.3 million in cash to certain warrant holders as an inducement to exercise their warrants and recorded an equivalent expense for the three and nine months ended September 30, 2014, respectively.

***Interest Expense, net***

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

	<b>Three Months Ended September 30,</b>		<b>Variance in</b>		<b>Nine Months Ended September 30,</b>		<b>Variance in</b>	
	<b>2015</b>	<b>2014</b>	<b>Dollars</b>	<b>Percent</b>	<b>2015</b>	<b>2014</b>	<b>Dollars</b>	<b>Percent</b>
Interest expense, net	\$5,167	\$1,133	\$4,034	356.0%	\$7,187	\$8,370	\$(1,183)	(14.1)%
<i>Percentage of net sales</i>	1.4%	0.4%			0.9%	1.0%		

Interest expense, net increased \$4.0 million to \$5.2 million for the three months ended September 30, 2015 from \$1.1 million for the same period in 2014. The increase in interest expense, net is primarily related to our increased term debt outstanding due to Aventine's \$145.6 million in term debt. Interest expense, net declined by \$1.2 million to \$7.2 million for the nine months ended September 30, 2015 from \$8.4 million for the same period in 2014. The decrease in interest expense, net is primarily due to decreased average debt balances, partially offset by accelerations of debt discount and deferred financing fees of an aggregate of \$2.5 million for the nine months ended September 30, 2014, due to the early retirement of the indebtedness associated with our Pacific Ethanol West plants and our senior unsecured notes.

***Loss on Extinguishments of Debt***

The following table presents our loss on extinguishments of debt in dollars and as a percentage of net sales (in thousands, except percentages):

	<b>Three Months Ended September 30,</b>		<b>Variance in</b>		<b>Nine Months Ended September 30,</b>		<b>Variance in</b>	
	<b>2015</b>	<b>2014</b>	<b>Dollars</b>	<b>Percent</b>	<b>2015</b>	<b>2014</b>	<b>Dollars</b>	<b>Percent</b>
Loss on extinguishments of debt	\$ -	\$ -	\$ -	-	\$ -	\$2,363	\$(2,363)	(100)%
<i>Percentage of net sales</i>	-%	-%			-%	0.3%		

For the nine months ended September 30, 2014, we extinguished certain PE Op Co. debt by paying \$2.4 million in cash in excess of the amount of the debt, and as such, recorded a loss on extinguishments of debt. We retired a total of \$64.8 million in debt in the nine months ended September 30, 2014, eliminating all parent level debt and reducing our consolidated third-party debt at the plant level to \$17.0 million as of September 30, 2014.

**Other Income (Expense), net**

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

	<b>Three Months Ended September 30,</b>		<b>Variance in</b>		<b>Nine Months Ended September 30,</b>		<b>Variance in</b>	
	<b>2015</b>	<b>2014</b>	<b>Dollars</b>	<b>Percent</b>	<b>2015</b>	<b>2014</b>	<b>Dollars</b>	<b>Percent</b>
Other income (expense), net	\$203	\$(172)	\$375	NM	\$16	\$(734)	\$750	NM
<i>Percentage of net sales</i>	0.1%	(0.1)%			0.0%	(0.1)%		

Other income (expense), net increased by \$0.4 million to income of \$0.2 million for the three months ended September 30, 2015 from an expense of \$0.2 million for the same period in 2014. Other income (expense), net increased by \$0.8 million to income of \$0.1 million for the nine months ended September 30, 2015 from an expense of \$0.7 million for the same period in 2014. These increases in other income (expense), net are primarily due to a payment received from a one-time settlement of a claim.

**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):

	<b>Three Months Ended September 30,</b>		<b>Variance in</b>		<b>Nine Months Ended September 30,</b>		<b>Variance in</b>	
	<b>2015</b>	<b>2014</b>	<b>Dollars</b>	<b>Percent</b>	<b>2015</b>	<b>2014</b>	<b>Dollars</b>	<b>Percent</b>
Provision (benefit) for income taxes	\$(3,925)	\$3,163	\$(7,088)	NM	\$(6,095)	\$13,629	\$(19,724)	NM
<i>Percentage of net sales</i>	(1.0)%	1.1%			(0.7)%	1.6%		

For the three and nine months ended September 30, 2015, we recorded a benefit for income taxes of \$2.4 million and \$4.6 million, respectively, at an estimated effective tax rate. In addition, for the three and nine months ended September 30, 2015, we recognized \$1.5 million in tax benefit related to adjustments to our tax asset valuation allowance from a prior period. For the three and nine months ended September 30, 2014, we generated income subject

to income tax, partially as a result of the non-tax deductible nature of our fair value adjustments for the period. As a result, we recorded a gross provision for income taxes of \$13.6 million for the nine months ended September 30, 2014.

***Net (Income) Loss Attributed to Noncontrolling Interests***

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

	<b>Three Months Ended September 30, 2015</b>		<b>Variance in</b>		<b>Nine Months Ended September 30, 2015</b>		<b>Variance in</b>	
	<b>2015</b>	<b>2014</b>	<b>Dollars</b>	<b>Percent</b>	<b>2015</b>	<b>2014</b>	<b>Dollars</b>	<b>Percent</b>
Net (income) loss attributed to noncontrolling interests	\$-	\$(723)	\$723	100.0 %	\$87	\$(4,126)	\$4,213	NM
<i>Percentage of net sales</i>	-%	(0.3)%			0.0%	(0.5)%		

Net (income) loss attributed to noncontrolling interests relates to our consolidated treatment of PE Op Co., which indirectly owns our plants located in the Western United States. For the three and nine months ended September 30, 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 portions of the three and nine months ended September 30, 2015 and 2014, respectively, we reduced our consolidated net income (loss) for the noncontrolling interests, which were the ownership interests that we did not own. The decreases in net income attributed to noncontrolling interests for the periods are primarily due to lower operating income from lower commodity margins, much of which was generated at the plant level. Going forward, given our 100% ownership of PE Op Co., no amounts will be recorded for noncontrolling interests.

***Net Income (Loss) Attributed to Pacific Ethanol***

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

	<b>Three Months Ended</b>		<b>Variance in</b>		<b>Nine Months Ended</b>		<b>Variance in</b>	
	<b>September 30, 2015</b>	<b>2014</b>	<b>Dollars</b>	<b>Percent</b>	<b>September 30, 2015</b>	<b>2014</b>	<b>Dollars</b>	<b>Percent</b>
Net income (loss) attributed to Pacific Ethanol	\$(14,663)	\$4,025	\$(18,688)	NM	\$(18,033)	\$8,771	\$(26,804)	NM
<i>Percentage of net sales</i>	(3.9)%	1.5%			(2.2)%	1.0%		

Net income attributed to Pacific Ethanol decreased substantially during the three and nine months ended September 30, 2015 as compared to the same periods in 2014, primarily due to significantly lower crush and commodity margins in 2015 resulting predominantly from lower ethanol sales prices.

***Preferred Stock Dividends and Income (Loss) Available to Common Stockholders***

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

**Variance in**

**Variance in**

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	<b>Three Months Ended September 30,</b>				<b>Nine Months Ended September 30,</b>			
	<b>2015</b>	<b>2014</b>	<b>Dollars</b>	<b>Percent</b>	<b>2015</b>	<b>2014</b>	<b>Dollars</b>	<b>Percent</b>
Preferred stock dividends	\$319	\$319	\$—	—%	\$946	\$946	\$—	—%
Percentage of net sales	0.1%	0.1%			0.1%	0.1%		
Income (loss) available to common stockholders	\$(14,982)	\$3,706	\$(18,688)	NM	\$(18,979)	\$7,825	\$(26,804)	NM
Percentage of net sales	(3.9)%	1.3%			(2.3)%	0.9%		

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 paid cash dividends on our Series B Preferred Stock in the aggregate amount of \$0.3 million for the three months ended September 30, 2015 and 2014, and \$0.9 million for the nine months ended September 30, 2015 and 2014.

## Liquidity and Capital Resources

During the nine months ended September 30, 2015, we funded our operations primarily from cash on hand, including cash held by Aventine as of the closing of our acquisition of Aventine, and advances from Kinergy's revolving credit facility. These funds were also used to make capital expenditures, payoff Aventine's revolving credit facility, make payments on our capital leases and pay dividends in respect of our Series B Preferred Stock.

Our current available capital resources consist of cash on hand and amounts available for borrowing under Kinergy's credit facility and our Pacific Ethanol West plants' credit facilities. We expect that our future available capital resources will consist primarily of our remaining cash balances, amounts available for borrowing, if any, under our credit facilities, cash generated from operations and proceeds from warrant exercises.

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 capital 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. The information below as of September 30, 2015 includes amounts consolidated from our acquisition of Aventine. The information below as of July 1, 2015 is the corresponding Aventine amounts outstanding as of July 1, 2015, the effective date of the acquisition (dollars in thousands).

	<b>Pacific Ethanol, Inc.</b>		<b>Aventine</b>
	<b>September</b>	<b>December</b>	<b>July 1,</b>
	<b>30, 2015</b>	<b>31, 2014</b>	<b>2015</b>
Cash and cash equivalents	\$53,056	\$62,084	\$18,756
Current assets	\$182,954	\$139,551	\$69,149
Property and equipment, net	\$472,632	\$155,302	\$312,781
Current liabilities	\$75,633	\$25,447	\$27,233
Notes payable, noncurrent portion	\$190,166	\$34,533	\$156,465
Working capital	\$107,321	\$114,104	\$41,916
Working capital ratio	2.42	5.48	2.54



*Change in Working Capital and Cash Flows*

Working capital decreased to \$107.3 million at September 30, 2015 from \$114.1 million at December 31, 2014 as a result of an increase of \$50.2 million in current liabilities, partially offset by an increase of \$43.4 million in current assets.

Current assets increased primarily due to an increase of \$16.8 million in accounts receivable and \$29.7 million in inventory related to our new Pacific Ethanol Central operations, an increase of \$14.1 million in income tax receivables resulting from losses generated in 2015, partially offset by a decrease in cash and cash equivalents of \$9.0 million predominantly due to \$17.4 million in cash used in our operations, \$11.9 million in cash provided by our financing activities, as discussed below, and \$3.5 million of cash used in our investing activities, also as discussed below. Current liabilities increased primarily due to an increase in accounts payable and accrued liabilities of \$28.0 million resulting from our new Pacific Ethanol Central operations and \$17.0 million in current portion of long-term debt related to the term loans associated with our Pacific Ethanol West plants that mature in June 2016.

Cash provided by our operating activities declined by \$93.7 million, to net cash used in our operating activities of \$17.4 million, primarily due to lower earnings predominantly from lower crush margins resulting from lower ethanol prices. Adjustments to reconcile net loss for the nine months ended September 30, 2015 to net cash used in our operating activities include depreciation and amortization of \$15.1 million, an increase in accounts receivable of \$6.0 million predominantly due to higher sales volumes and a decrease in accounts payable and accrued liabilities of \$9.0 million due to timing of payments.

Cash used in our investing activities declined by \$12.5 million in the first nine months of 2015 as compared to the same period in 2014 predominantly as a result of net cash of \$18.8 million acquired in connection with our acquisition of Aventine upon closing the transaction, partially offset by \$7.7 million in additional expenditures for the period for additions to property and equipment associated with our plant improvement initiatives and purchases of temporary cash collateralized letters of credit in the amount of \$4.6 million related to our new Pacific Ethanol Central operations. In addition, we used \$6.0 million in the first nine months of 2014 to acquire the remaining 4% ownership interest in PE Op Co., the owner of the Pacific Ethanol West plants. This expenditure did not recur in the same period in 2015.

Cash provided by our financing activities of \$11.9 million in the first nine months of 2015 resulted from proceeds from Kinergy's revolving line of credit of \$29.7 million, proceeds from exercises of our warrants in the aggregate amount of \$0.4 million, which were partially offset by principal and other payments on Aventine's revolving line of credit of \$13.8 million, payments on capital leases of \$3.4 million and preferred stock dividends of \$0.9 million.

### ***Kinergy Operating Line of Credit***

Kinergy maintains an operating line of credit for an aggregate amount of up to \$75.0 million. The credit facility expires on December 31, 2020. 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 1.75% to 2.75%. The credit facility's monthly unused line fee is 0.25% to 0.375% of the amount by which the maximum credit under the facility exceeds the average daily principal balance during the immediately preceding month. 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 \$1.5 million per fiscal quarter.

The credit facility also includes the accounts receivable and any inventory of Pacific Ag. Products, LLC, or PAP, one of our indirect wholly-owned subsidiaries, as additional collateral.

For all monthly periods in which excess availability falls below a specified level, Kinergy and PAP must collectively maintain a fixed-charge coverage ratio (calculated as a twelve-month rolling earnings before interest, taxes, depreciation and amortization (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's 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 Kinery's financial covenants and actual results for the periods presented (dollars in thousands):

	Three Months		Years Ended	
	Ended		December	
	September 30,		31,	
	2015	2014	2014	2013
Fixed-Charge Coverage Ratio Requirement	2.00	2.00	2.00	2.00
Actual	12.24	18.60	17.66	8.64
Excess	10.24	16.60	15.66	6.64

Pacific Ethanol has guaranteed all of Kinery's obligations under the credit facility. As of September 30, 2015, Kinery had an outstanding balance of \$47.1 million and an available borrowing base of \$4.6 million under the credit facility.

#### ***Pacific Ethanol West Term Debt and Operating Line of Credit***

Our indebtedness associated with our Pacific Ethanol West plants as of September 30, 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 our 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 our election, plus 10.0%. At September 30, 2015, the average interest rate was approximately 13.25%. Repayments of principal are based on available free cash flow of the Pacific Ethanol West plants, until maturity, when all principal amounts are due.

As of September 30, 2015, we had no outstanding principal balances on our revolving credit facility for the Pacific Ethanol West plants and an aggregate borrowing availability of \$19.5 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 Pacific Ethanol West plants. The creditors under the term loans and revolving credit facilities for the Pacific Ethanol West plants do not have recourse to Pacific Ethanol, Inc.

#### ***Pacific Ethanol Central Term Debt***

On July 1, 2015, upon effectiveness of the Aventine acquisition, Aventine became one of our wholly-owned subsidiaries and, on a consolidated basis, the combined company became obligated with respect to Aventine's term loan and revolving credit facilities. Aventine's creditors under Aventine's term loan and revolving credit facilities have recourse solely against Aventine and its subsidiaries and not against Pacific Ethanol, Inc. or its other direct or indirect subsidiaries. As of July 1, 2015, Aventine's revolving line of credit had an outstanding balance of approximately \$13.8 million. On July 1, 2015, we repaid, on behalf of Aventine, approximately \$14.5 million, including approximately \$0.7 million in termination fees, representing all amounts owed under the revolving line of credit.

As of September 30, 2015, Pacific Ethanol Central's term loan facility had an outstanding balance of approximately \$145.6 million. Interest on the term loan facility accrues and may be paid in cash at a rate of 10.5% per annum or may be paid in-kind at a rate of 15.0% per annum by adding such interest to the outstanding principal balance. If we elect to pay interest in-kind, the interest is capitalized at the end of each quarter. The term loan facility matures on September 24, 2017. The term loan facility is secured through a first-priority lien on substantially all of Aventine's assets and contains customary financial covenants, including the requirement that Aventine maintain a cash balance of at least \$2.0 million.

## Contractual Obligations

As a result of our acquisition of Aventine, there have been material changes 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. The following table outlines the additional payments due under our significant contractual obligations related to Aventine (in thousands):

	<b>Q4 2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>Thereafter</b>	<b>Total</b>
Debt principal	\$–	\$–	\$145,619	\$–	\$–	\$–	\$145,619
Debt interest	3,822	15,290	11,468	–	–	–	30,580
Operating leases	4,431	12,616	8,497	5,158	3,341	215	34,258
Capital leases	886	3,545	2,659	–	–	–	7,090
Grain purchase obligations	10,625	–	–	–	–	–	10,625
Total commitments	\$19,764	\$31,451	\$168,243	\$5,158	\$3,341	\$ 215	\$228,172

The above table outlines our obligations as of September 30, 2015 and does not reflect the changes in our obligations that occurred after that date.

## Effects of Inflation

The impact of inflation was not significant to our financial condition or results of operations for the three and nine months ended September 30, 2015 and 2014.

## 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. 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.

In July 2015, the FASB issued new guidance on simplifying the measurement of inventory. Under the new guidance, entities are required to measure most inventory at the lower of cost and net realizable value, thereby simplifying the current guidance under which an entity must measure inventory at the lower of cost or market. This guidance is effective prospectively for fiscal years beginning after December 15, 2016. Early adoption is permitted. We have adopted the guidance with no material impact on our results of operations or financial condition.

In September 2015, the FASB issued new guidance on simplifying the accounting for measurement-period adjustments. Under the new guidance, an acquirer must recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The guidance also requires acquirers to present separately on the face of the statement of operations or disclose in the notes, the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. The guidance is effective for fiscal years beginning after December 31, 2015, applied prospectively. Early adoption is permitted. We will consider early adoption in future periods related to our current measurement period for our acquisition of Aventine.

### 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 ethanol co-products. 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 on a fixed price or an indexed price tied 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.

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 utilized.

Ethanol co-products are sensitive to various demand factors such as numbers of livestock on feed, prices for feed alternatives, and supply factors, primarily production of ethanol co-products 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 Mercantile 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 \$1.5 million and gains of \$0.4 million related to settled non-designated hedges as the change in the fair values of these contracts for the nine months ended September 30, 2015 and 2014, respectively.

At September 30, 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. The results of this analysis as of September 30, 2015, which may differ materially from actual results, are as follows (in millions):

Commodity	Nine Months Ended September 30, 2015	Unit of Measure	Approximate Adverse Change to Pre-Tax Income
	Volume		
Ethanol	488.0	Gallons	\$ 34.4
Corn	72.0	Bushels	\$ 31.5

#### *Interest Rate Risk*

We are exposed to market risk from changes in interest rates. Exposure to interest rate risk results primarily from our indebtedness that bears interest at variable rates. At September 30, 2015, all of our long-term debt of \$192.8 million was variable-rate in nature. Based on a 100 basis point (1.00%) increase in the interest rate on our long-term debt, pre-tax income for the nine months ended September 30, 2015 would be negatively impacted by approximately \$1.9 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 September 30, 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.

We have evaluated pending cases and have recognized \$3.3 million as a litigation contingency with respect to these cases for amounts that are probable and estimable.

#### *Western Sugar Cooperative*

Pacific Ethanol, Inc., through a subsidiary acquired in its acquisition of Aventine, became involved in a pending lawsuit with Western Sugar Cooperative (“Western Sugar”) that pre-dated the Aventine acquisition.

On February 27, 2015, Western Sugar filed a complaint in the United States District Court for the District of Colorado (Case No. 1:15-cv-00415) naming Aventine Renewable Energy, Inc. (“ARE, Inc.”), one of Aventine’s subsidiaries, as defendant. Western Sugar amended its complaint on April 21, 2015. ARE, Inc. purchased surplus sugar through a United States Department of Agriculture program. Western Sugar was one of the entities that warehoused this sugar for ARE, Inc. The suit alleges that ARE, Inc. breached its contract with Western Sugar by failing to pay certain penalty rates for the storage of its sugar or alternatively failing to pay a premium rate for storage. Western Sugar alleges that the penalty rates apply because ARE, Inc. failed to take timely delivery or otherwise cause timely shipment of the sugar. Western Sugar claims “expectation damages” in the amount of approximately \$8.6 million. ARE, Inc. filed answers to Western Sugar’s complaint and amended complaint generally denying Western Sugar’s allegations and asserting various defenses. The case is currently in its discovery phase. We are evaluating Western Sugar’s claims and may accrue a litigation reserve for this matter.

#### *Aurora Cooperative Elevator Company*

Pacific Ethanol, Inc., through subsidiaries acquired in its acquisition of Aventine, became involved in various pending lawsuits with Aurora Coop that pre-dated the Aventine acquisition.

On July 26, 2015, we settled all outstanding litigation with Aurora Coop. Pacific Ethanol and Aurora Coop agreed to dismiss all lawsuits with prejudice with no admission of fault or liability by the parties, and to release the alleged option held by Aurora Coop to repurchase the land upon which Pacific Ethanol's 110 million gallon ethanol production facility in Aurora, Nebraska is located (the "Aurora West Facility"). In addition, the parties agreed to terminate the grain supply, marketing and various other agreements between them or their subsidiaries. Under the terms of the settlement, Pacific Ethanol and Aurora Coop will each bear its own costs and fees associated with the lawsuits and the settlement. Pacific Ethanol and Aurora Coop agreed to continue to work together to amend or replace certain real property easements currently in place to ensure continued mutual access by both parties to a system of rails, rail switches, roads, electrical improvements, and utilities already constructed near the Aurora West Facility.

Below is a description of the settled litigation matters involving Aurora Coop.

On May 29, 2012, Aventine filed suit against Aurora Coop seeking declaratory relief. The suit alleged Aurora Coop had improperly threatened to invoke a purported option to acquire the land upon which the Aurora West Facility is located. On June 21, 2012, Aurora Coop filed claims against Aventine which were removed to the United States District Court for the District of Nebraska (Case No. 4:12-cv-0230), naming Aventine and Aventine Renewable Energy – Aurora West, LLC ("AWLLC"), one of Aventine's subsidiaries, as defendants. The suit alleged that Aventine failed to complete construction and operate the Aurora West Facility by a contractual deadline, thereby allowing Aurora Coop to exercise an option to repurchase 74 acres of land upon which 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. Aurora Coop asserted 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 that date. Aurora Coop also sought a judicial order imposing a constructive trust and requiring Aventine to account for and pay to Aurora Coop the greater of the profits which Aventine received or may have received in the exercise of reasonable care in the operation of the Aurora West Facility after July 1, 2012 to compensate Aurora Coop for damages it allegedly suffered as a result of Aventine's purported delay in conveying title to the Aurora West Facility and the land upon which it is located. Aventine answered the suit, arguing that the contract only required Aventine to diligently pursue construction, that construction was complete, and that there was no contractual ethanol production requirement. On July 26, 2015, we settled this matter with Aurora Coop, as described above.

On February 4, 2014, Aurora Coop filed suit in the United States District Court for the District of Nebraska (Case No. 4:14-cv-3032), naming Aventine and AWLLC as defendants. The suit was for declaratory judgment concerning Aurora Coop's rights as to certain disputed rail access matters. Aventine counterclaimed seeking damages for denial of rail access, including access over rail equipment for which it shared the costs of construction. On July 26, 2015, we settled this matter with Aurora Coop, as described above.

On November 8, 2013, Nebraska Energy, L.L.C. ("NELLC"), one of Aventine's subsidiaries, filed suit in the United States District Court for the District of Nebraska (Case No. 4:13-cv-03190), naming Aurora Coop as defendant. NELLC and Aurora Coop entered into a grain supply agreement that required NELLC to purchase all grain from Aurora Coop under an actual cost-plus fixed-fee price formula. The suit alleged breach of contract for failure to permit an audit of transactions between the parties and an unspecified amount of damages resulting from Aurora Coop's failure to properly charge NELLC under the price formula. Aurora Coop counterclaimed for breach of certain grain supply and marketing agreements between the parties. On July 26, 2015, we settled this matter with Aurora Coop, as described above.

On September 20, 2012, Aurora Coop filed suit in the United States District Court for the District of Nebraska (Case No. 4:12-cv-03200), naming Aventine, ARE, Inc. and AWLLC as defendants. The suit alleged that Aurora Coop acquired grain on the Aventine parties' behalf for which the Aventine parties had not paid and of which none of the Aventine parties had accepted delivery. The suit sought approximately \$1,800,000 in damages. The Aventine parties denied that the grain belonged to any of them and counterclaimed for amounts Aurora Coop owed to Aventine, which Aurora Coop had set off against amounts allegedly owed by the Aventine parties. The dispute was referred to the National Grain and Feed Association (NGFA Case No. 2651) for arbitration in which the Aventine parties prevailed. Thereafter, Aurora Coop sought to recast its claims in the federal suit to include breach of contract damages and other remedies. On July 26, 2015, we settled this matter with Aurora Coop, as described above.

On September 11, 2014, AWLLC filed suit with the Nebraska Public Service Commission naming Aurora Coop as defendant. The suit was for declaratory judgment on and an unspecified amount of damages as to Aurora Coop's denial of rail access and AWLLC's costs related to the construction of various infrastructures to work around that denial of access. Aventine claimed that Aurora Coop's actions in locking out access violated public policy and state law. On July 26, 2015, we settled this matter with Aurora Coop, as described above.

#### 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 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 nine months ended September 30, 2015, we incurred consolidated net losses of approximately \$18.1 million and incurred negative operating cash flows of \$17.4 million. 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, distillers grains 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, distillers grains 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, distillers grains 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, distillers grains 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, distillers grains 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, distillers grains 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, distillers grains and other ethanol co-products could decline below the marginal cost of production, which may force us to suspend production of ethanol, distillers grains and ethanol co-products at some or all of our 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 Renewable Fuels Association, domestic ethanol production capacity increased from an annualized rate of 1.5 billion gallons per year in January 1999 to 14.5 billion gallons in 2014. In addition, if ethanol production margins improve, we anticipate that owners of idle ethanol production facilities, many of which may be 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. 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 our plants and other considerations related to production efficiencies, our 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 our plants 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 us to halt production at one or more plants which could have a material adverse effect on our business, results of operations and financial condition.

***We 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, we may enter into contracts to fix the price of a portion of our ethanol production or purchase a portion of our 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 our plants could negatively impact sales volumes and could cause us to incur substantial losses.***

Operations at our 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. Our insurance may not be adequate to fully cover the potential operational hazards described above or we may not be able to renew this insurance on commercially reasonable terms or at all.

Moreover, our 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.

***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.

***If we fail to integrate successfully the businesses of Pacific Ethanol and Aventine in the expected timeframe our results of operations will be adversely affected.***

The success of the Aventine acquisition will depend, in large part, on our ability to realize the anticipated benefits from combining the businesses of Pacific Ethanol and Aventine. To realize these anticipated benefits, we 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 our failure to achieve some or all of the anticipated benefits of the acquisition.

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

- complexities associated with managing the larger, more complex, combined business;
- integrating personnel;
- potential unknown liabilities and unforeseen expenses, delays or regulatory conditions associated with the acquisition; and
- performance shortfalls as a result of the diversion of management's attention caused by integrating Pacific Ethanol's and Aventine's operations.

***Our future results will suffer if we do not effectively manage our expanded operations.***

Our business following the Aventine acquisition is significantly larger than the individual businesses of Pacific Ethanol and Aventine prior to the acquisition. Our future success depends, in part, upon our ability to manage our expanded business, which will pose substantial challenges for our management, including challenges related to the management and monitoring of new operations and associated increased costs and complexity. We cannot assure you that we will be successful or that we will realize the expected operating efficiencies, annual net operating synergies, revenue enhancements and other benefits currently anticipated to result from the acquisition.

***Our level of indebtedness, including Aventine's indebtedness, may make it more difficult for us to pay or refinance our debts and we may need to divert our cash flow from operations to debt service payments. Our indebtedness could limit our ability to pursue other strategic opportunities and could increase our vulnerability to adverse economic and industry conditions.***

As a result of the Aventine acquisition, on a consolidated basis, we are responsible for Aventine's outstanding debt. Our total consolidated indebtedness immediately prior to the acquisition was approximately \$25.6 million. Our total consolidated indebtedness immediately after the acquisition was approximately \$171.2 million. Our debt service obligations with respect to this increased indebtedness could have an adverse impact on our earnings and cash flows for as long as the indebtedness is outstanding.

Our increased indebtedness could also have important consequences to holders of our common stock. For example, it could:

- make it more difficult to pay or refinance our debts as they become due during adverse economic and industry conditions because any decrease in revenues could cause us to not have sufficient cash flows from operations to make our scheduled debt payments;
- limit our flexibility to pursue other strategic opportunities or react to changes in our business and the industry in which we operate and, consequently, place us at a competitive disadvantage to our competitors who have less debt; or
- require a substantial portion of our cash flows from operations to be used for debt service payments, thereby reducing the availability of our cash flows to fund working capital, capital expenditures, acquisitions, dividend payments and other general corporate purposes.



***Our level of indebtedness, including Aventine's indebtedness, may make it more difficult for us to pay or refinance our debts and we may need to divert our cash flow from operations to debt service payments. Our indebtedness could limit our ability to pursue other strategic opportunities and could increase our vulnerability to adverse economic and industry conditions.***

As a result of the Aventine acquisition, on a consolidated basis, we are responsible for Aventine's outstanding debt. Our total consolidated indebtedness immediately prior to the acquisition was approximately \$25.6 million. Our total consolidated indebtedness immediately after the acquisition was approximately \$171.2 million. Our debt service obligations with respect to this increased indebtedness could have an adverse impact on our earnings and cash flows for as long as the indebtedness is outstanding.

Our increased indebtedness could also have important consequences to holders of our common stock. For example, it could:

- make it more difficult to pay or refinance our debts as they become due during adverse economic and industry conditions because any decrease in revenues could cause us to not have sufficient cash flows from operations to make our scheduled debt payments;
- limit our flexibility to pursue other strategic opportunities or react to changes in our business and the industry in which we operate and, consequently, place us at a competitive disadvantage to our competitors who have less debt; or
- require a substantial portion of our cash flows from operations to be used for debt service payments, thereby reducing the availability of our cash flows to fund working capital, capital expenditures, acquisitions, dividend payments and other general corporate purposes.

Based upon current levels of operations, we expect to generate sufficient cash on a consolidated basis to make all principal and interest payments when such payments become due under our existing credit facilities, indentures and other instruments governing our outstanding indebtedness, including Aventine's outstanding debt, but there can be no assurance that we will be able to repay or refinance such borrowings and obligations.

***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 fixed-charge coverage ratio covenants. 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 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 Environmental Protection Agency, or EPA, has implemented the national Renewable Fuel Standard, or 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 January 21, 2015, the *Leave Ethanol Volumes at Existing Levels (LEVEL) Act* (H.R. 434) was introduced in the House. The bill would amend the national RFS by decreasing the required volume of renewable fuels in 2015-2022 to 7.5 billion gallons per year. 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 January 6, 2015, a bill (H.R. 21) was introduced in the House of Representatives to, among other things, vacate any waivers issued under the Clean Air Act to allow the sale of mid-level ethanol blends for use in motor vehicles. A mid-level ethanol blend is an ethanol-gasoline blend containing 10-20% of ethanol by volume that is intended to be used in any conventional gasoline-powered motor vehicle or nonroad vehicle or engine. On February 26, 2015, the *Corn Ethanol Mandate Elimination Act of 2015* (S. 577) was introduced in the Senate. The bill would eliminate corn ethanol as qualifying as a renewable fuel under the national RFS. *The American Energy Renaissance Act of 2015* (S. 791 and H.R. 1487), which was introduced in the Senate on March 18, 2015 and the House on March 19, 2015, would phase out the national RFS over a five-year period. The *Renewable Fuel Standard Repeal Act* (S. 1584), which would fully repeal the national RFS, was introduced in the Senate on June 16, 2015. 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 any 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 Renewable Volume Obligations, or 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. In addition, the EPA announced that it would propose the RVO for 2015 and 2016 simultaneously in 2015. On May 29, 2015, the EPA published its proposed rule for RFS blending requirements for 2014-2016. Because 2014 has passed, the EPA proposes to base the 2014 blending requirement on the market's actual use of renewable fuel. For 2015, the EPA is proposing to reduce the portion of the national RFS mandate for which corn ethanol qualifies from the statutory level of 15.0 billion gallons to 13.4 billion gallons. For 2016, the EPA is proposing to reduce this portion of the national RFS from the statutory level of 15.0 billion gallons to 14.0 billion gallons. We believe that the EPA's decision to propose cuts to the Congressionally established volumes is based on the EPA's perception that the nation's refueling infrastructure is currently unable to distribute the statutorily-required volumes to consumers. The EPA held a public hearing on its proposal on June 25, 2015, and accepted written comments from the public through July 27, 2015. A final rule for the 2014-2016 national RFS requirements is expected to be published by the EPA no later than November 30, 2015. Our results of operations, cash flows and financial condition could be adversely impacted if the EPA finalizes RVO levels that are below the levels specified in the national RFS.

***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 our cost structures. Any increase in domestic or foreign competition could cause us to reduce our prices and take other steps to compete effectively, which could adversely affect our business, financial condition and results of operations.

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.

***Our success will 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 Aventine acquisition. Any adverse changes in these relationships could adversely affect our business, financial condition and results of operations.***

Our success will depend on our 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 we 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 our business, financial condition and results of operations.

***Our ability to utilize net operating loss carryforwards and certain other tax attributes may be limited as a result of the Aventine acquisition.***

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 Aventine acquisition, 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, our ability to utilize these NOL carryforwards may be substantially limited. These limitations could in turn result in increased future tax obligations, which could have a material adverse effect on our business, 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.

***We depend in part 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.***

We depend in part, 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 our 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 our 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 or retain key personnel, including as a result of the Aventine acquisition, our ability to operate effectively may be impaired, which could have a material adverse effect on our business, financial condition and results of operations.***

Our ability to operate our business and implement strategies depends, in part, on the efforts of our executive officers and other key personnel. 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. In addition, the success of the Aventine acquisition will depend in part on our ability to retain key personnel. It is possible that these personnel might decide not to remain with us now that the acquisition is completed. If these key personnel terminate their employment, our business activities might be adversely affected and management's attention might be diverted from integrating the businesses of Pacific Ethanol and Aventine to recruiting suitable replacement personnel. We may be unable to locate suitable replacements for any such key personnel or offer employment to potential replacement personnel on reasonable terms. If we are unable to attract or retain key personnel, our ability to operate effectively may be impaired, which could have a material adverse effect on our business, financial condition 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.

## **Risks Related to Ownership of our Common Stock**

***Resales of shares of our common stock issued upon closing the Aventine acquisition, or a perception that a substantial number of such shares 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 issued an aggregate of approximately 17.8 million shares of our common stock and non-voting common stock upon the closing the Aventine acquisition. 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 acquisition) by former Aventine stockholders, or the perception that these sales could occur, could have the effect of depressing the market price for shares of our common stock, causing the value of your investment to decline significantly.

***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;
- 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 acquisition of Aventine cannot be fully realized in a timely manner or at all, or that integrating the 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.

***The Aventine acquisition 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 Aventine acquisition is expected to be accretive to earnings per share, the acquisition may not be accretive, and may be dilutive, to our earnings per share. The expectation that the acquisition 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 applicable to Aventine's business. 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.

***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 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 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. We have issued common stock in respect of our derivative securities in the past and may do so in the future. If the prices at which our derivative securities are converted or exercised, 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 September 30, 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. Accumulated and unpaid 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.

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ITEM 6. EXHIBITS.

Exhibit Number	<u>Description</u>
3.1	Certificate of Incorporation (*)
3.2	Certificate of Designations, Powers, Preferences and Rights of the Series A Cumulative Redeemable Convertible Preferred Stock (*)
3.3	Certificate of Designations, Powers, Preferences and Rights of the Series B Cumulative Convertible Preferred Stock (*)
3.4	Certificate of Amendment to Certificate of Incorporation dated June 3, 2010 (*)
3.5	Certificate of Amendment to Certificate of Incorporation effective June 8, 2011 (*)
3.6	Certificate of Amendment to Certificate of Incorporation effective May 14, 2013 (*)
3.7	Certificate of Amendment to Certificate of Incorporation effective July 1, 2015 (*)
10.1	Amendment No. 3 to Amended and Restated Loan and Security Agreement dated July 1, 2015 by and among Kinergy Marketing LLC, Pacific Ag. Products, LLC and Wells Fargo Capital Finance, LLC (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) Previously filed as an exhibit to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on July 6, 2015.

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: November 6, 2015 By: /S/ BRYON T. MCGREGOR  
Bryon T. McGregor  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

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