

Pacific Ethanol, Inc.  
Form 10-Q  
May 10, 2018

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 **March 31, 2018**

**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)

Edgar Filing: Pacific Ethanol, Inc. - Form 10-Q

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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth 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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 May 9, 2018, there were 43,810,043 shares of Pacific Ethanol, Inc. common stock, \$0.001 par value per share, and 896 shares of Pacific Ethanol, Inc. non-voting common stock, \$0.001 par value per share, outstanding.

PART I  
FINANCIAL INFORMATION

	<b>Page</b>
<u>ITEM 1. FINANCIAL STATEMENTS.</u>	
<u>Consolidated Balance Sheets as of March 31, 2018 (unaudited) and December 31, 2017</u>	1
<u>Consolidated Statements of Operations for the Three Months Ended March 31, 2018 and 2017 (unaudited)</u>	3
<u>Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2018 and 2017 (unaudited)</u>	4
<u>Notes to Consolidated Financial Statements (unaudited)</u>	5
<u>ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	16
<u>ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	27
<u>ITEM 4. CONTROLS AND PROCEDURES</u>	28
<b>PART II</b>	
<b>OTHER INFORMATION</b>	
<u>ITEM 1. LEGAL PROCEEDINGS</u>	30
<u>ITEM 1A. RISK FACTORS</u>	30
<u>ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	39
<u>ITEM 3. DEFAULTS UPON SENIOR SECURITIES</u>	40
<u>ITEM 4. MINE SAFETY DISCLOSURES</u>	40
<u>ITEM 5. OTHER INFORMATION</u>	40
<u>ITEM 6. EXHIBITS</u>	42
<u>SIGNATURES</u>	43



## PART I - FINANCIAL INFORMATION

## ITEM 1.

## FINANCIAL STATEMENTS.

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

<u>ASSETS</u>	March 31, 2018 (unaudited)	December 31, 2017 *
Current Assets:		
Cash and cash equivalents	\$ 57,380	\$49,489
Accounts receivable, net (net of allowance for doubtful accounts of \$66 and \$19, respectively)	74,217	80,344
Inventories	70,262	61,550
Prepaid inventory	3,609	3,281
Derivative instruments	2,981	998
Other current assets	6,082	7,584
Total current assets	214,531	203,246
Property and equipment, net	502,545	508,352
Other Assets:		
Intangible assets, net	2,678	2,678
Other assets	4,725	6,020
Total other assets	7,403	8,698
Total Assets	\$ 724,479	\$ 720,296

\* Amounts derived from the audited financial statements for the year ended December 31, 2017.

See accompanying notes to consolidated financial statements.



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

	March 31, 2018 (unaudited)	December 31, 2017 *
<b><u>LIABILITIES AND STOCKHOLDERS' EQUITY</u></b>		
Current Liabilities:		
Accounts payable – trade	\$ 44,671	\$ 39,738
Accrued liabilities	24,255	21,673
Current portion – capital leases	380	592
Current portion – long-term debt	16,500	20,000
Derivative instruments	3,094	2,307
Other current liabilities	6,955	6,396
Total current liabilities	95,855	90,706
Long-term debt, net of current portion	228,625	221,091
Capital leases, net of current portion	112	123
Other liabilities	25,261	24,676
Total Liabilities	349,853	336,596
Commitments and Contingencies (Note 6)		
Stockholders' Equity:		
Pacific Ethanol, Inc. Stockholders' Equity:		
Preferred stock, \$0.001 par value; 10,000 shares authorized; Series A: 1,684 shares authorized; no shares issued and outstanding as of March 31, 2018 and December 31, 2017; Series B: 1,581 shares authorized; 927 shares issued and outstanding as of March 31, 2018 and December 31, 2017; liquidation preference of \$18,075 as of March 31, 2018	1	1
Common stock, \$0.001 par value; 300,000 shares authorized; 43,954 and 43,985 shares issued and outstanding as of March 31, 2018 and December 31, 2017, respectively	44	44
Non-voting common stock, \$0.001 par value; 3,553 shares authorized; 1 share issued and outstanding as of March 31, 2018 and December 31, 2017	—	—
Additional paid-in capital	927,825	927,090
Accumulated other comprehensive loss	(2,234 )	(2,234 )
Accumulated deficit	(576,615 )	(568,462)
Total Pacific Ethanol, Inc. Stockholders' Equity	349,021	356,439
Noncontrolling interests	25,605	27,261
Total Stockholders' Equity	374,626	383,700
Total Liabilities and Stockholders' Equity	\$ 724,479	\$ 720,296

\* Amounts derived from the audited financial statements for the year ended December 31, 2017.

See accompanying notes to consolidated financial statements.

-2-



PACIFIC ETHANOL, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited, in thousands, except per share data)

	Three Months Ended March 31,	
	2018	2017
Net sales	\$400,027	\$386,340
Cost of goods sold	396,665	392,113
Gross profit (loss)	3,362	(5,773 )
Selling, general and administrative expenses	9,315	5,450
Loss from operations	(5,953 )	(11,223 )
Fair value adjustments	—	455
Interest expense	(4,505 )	(2,637 )
Other income (expense), net	398	(80 )
Loss before benefit for income taxes	(10,060 )	(13,485 )
Benefit for income taxes	563	—
Consolidated net loss	(9,497 )	(13,485 )
Net loss attributed to noncontrolling interests	1,656	849
Net loss attributed to Pacific Ethanol, Inc.	\$(7,841 )	\$(12,636 )
Preferred stock dividends	\$(312 )	\$(312 )
Net loss available to common stockholders	\$(8,153 )	\$(12,948 )
Net loss per share, basic and diluted	\$(0.19 )	\$(0.31 )
Weighted-average shares outstanding, basic and diluted	42,912	42,375

See accompanying notes to consolidated financial statements.

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

	Three Months Ended March 31,	
	2018	2017
Operating Activities:		
Consolidated net loss	\$(9,497 )	\$(13,485)
Adjustments to reconcile consolidated net loss to net cash provided by operating activities:		
Depreciation and amortization of intangibles	10,164	9,110
Deferred income taxes	(563 )	—
Inventory valuation adjustment	—	2,086
Amortization of debt discount	178	136
Non-cash compensation	736	1,221
Amortization of deferred financing fees	465	91
Loss (gain) on derivatives	462	(216 )
Fair value adjustments	—	(455 )
Bad debt expense	47	7
Changes in operating assets and liabilities:		
Accounts receivable	6,080	22,250
Inventories	(8,712 )	(61 )
Prepaid expenses and other assets	1,370	(2,412 )
Prepaid inventory	(328 )	2,033
Accounts payable and accrued liabilities	8,508	(8,213 )
Net cash provided by operating activities	8,910	12,092
Investing Activities:		
Additions to property and equipment	(4,357 )	(4,111 )
Net cash used in investing activities	(4,357 )	(4,111 )
Financing Activities:		
Net proceeds (payments) on Kinerger's line of credit	8,722	(1,358 )
Proceeds from assessment financing	331	—
Principal payments on borrowings	(5,000 )	(1,000 )
Principal payments on capital leases	(403 )	(190 )
Proceeds from exercise of warrants	—	37
Debt issuance costs	—	(14 )
Preferred stock dividends paid	(312 )	(312 )
Net cash provided by (used in) financing activities	3,338	(2,837 )
Net increase in cash and cash equivalents	7,891	5,144
Cash and cash equivalents at beginning of period	49,489	68,590
Cash and cash equivalents at end of period	\$57,380	\$73,734
Supplemental Information:		
Interest paid	\$3,593	\$2,403

Income taxes received	\$168	\$3
-----------------------	-------	-----

See accompanying notes to consolidated financial statements.

-4-

**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 subsidiaries, Kinergy Marketing LLC, an Oregon limited liability company (“Kinergy”), Pacific Ag. Products, LLC, a California limited liability company (“PAP”), PE Op Co., a Delaware corporation (“PE Op Co.”) and all nine of the Company’s ethanol production facilities.

The Company’s acquisition of Illinois Corn Processing, LLC (“ICP”) was consummated on July 3, 2017, and as a result, the Company’s accompanying consolidated financial statements include the results of ICP only as of December 31, 2017 and for the three months ended March 31, 2018.

The Company is a leading producer and marketer of low-carbon renewable fuels in the United States. The Company has a combined production capacity of 605 million gallons per year, markets, on an annualized basis, nearly 1.0 billion gallons of ethanol and specialty alcohols, and produces, on an annualized basis, over 3.0 million tons of co-products on a dry matter basis, such as wet and dry distillers grains, wet and dry corn gluten feed, condensed distillers solubles, corn gluten meal, corn germ, dried yeast and CO<sub>2</sub>.

The Company owns and operates nine production facilities, four in the Western states of California, Oregon and Idaho, and five in the Midwestern states of Illinois and Nebraska.

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.

The Company’s five 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. In addition, the Company’s ability to load unit trains from these facilities in the Midwest allows for greater access to international markets.

As of March 31, 2018, all nine facilities were operating. As market conditions change, the Company may increase, decrease or idle production at one or more operational facilities or resume operations at any idled facility.

*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, 2017. 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, 2017, with the exception of revenue recognition, as discussed further below. 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.

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 distillers grains and other feed co-products to dairy operators and animal feedlots and sells corn oil to poultry and biodiesel customers generally without requiring collateral.

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

Of the accounts receivable balance, approximately \$60,487,000 and \$64,501,000 at March 31, 2018 and December 31, 2017, respectively, were used as collateral under Kenergy's operating line of credit. The allowance for doubtful accounts was \$66,000 and \$19,000 as of March 31, 2018 and December 31, 2017, respectively. The Company recorded a bad debt expense of \$47,000 and \$7,000 for the three months ended March 31, 2018 and 2017, respectively. The Company does not have any off-balance sheet credit exposure related to its customers.

Benefit for Income Taxes – The Company recognized a tax benefit of \$563,000 for the three months ended March 31, 2018 due to the Company's reduction of its deferred tax asset valuation allowance due to the taxable losses incurred during the period. Under the Tax Cuts and Jobs Act enacted on December 22, 2017, losses incurred after 2017 can be carried forward indefinitely. The Company does not expect additional tax benefits to be recognized during 2018 due to this provision. The Company recognized no tax benefit for the three months ended March 31, 2017 due to the uncertainty of using its tax losses to offset future taxable income. To the extent the Company believes it can utilize its tax losses, the Company will adjust its benefit for income taxes accordingly in future periods.

Comprehensive Loss – The Company's accumulated other comprehensive loss relates to the Company's pension plans. For the three months ended March 31, 2018 and 2017, the Company's consolidated loss and comprehensive loss were substantially the same.

Noncontrolling Interests – For the three months ended March 31, 2018 and 2017, the changes to noncontrolling interests represented the net loss attributed to noncontrolling interests, with no other adjustment for the periods.

Financial Instruments – The carrying values of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities are reasonable estimates of their fair values because of the short maturity of these items. The

Company believes the carrying value of its long-term debt approximates fair value because the interest rates on these instruments are variable, and are considered Level 2 fair value measurements.

-6-

*Recent Accounting Pronouncements* – In February 2016, the Financial Accounting Standards Board (“FASB”) issued new guidance on accounting for leases. Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted cash flow basis; and (2) a “right of use” asset, which is an asset that represents the lessee’s right to use the specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged, with some minor exceptions. Lessees will no longer be provided with a source of off-balance sheet financing for other than short-term leases. The standard is effective for public companies for annual reporting periods beginning after December 15, 2018, including interim periods within those fiscal years. The Company expects that upon adoption of this accounting standard, right of use assets and lease obligations will be recognized in its consolidated balance sheets in amounts that will be material.

In May 2014, the FASB issued new guidance on the recognition of revenue (“ASC 606”). ASC 606 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 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. In March and April 2016, the FASB issued further revenue recognition guidance amending principal vs. agent considerations regarding whether 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 and services.

The provisions of ASC 606 include a five-step process by which an entity will determine revenue recognition, depicting the transfer of goods or services to customers in amounts reflecting the payment to which an entity expects to be entitled in exchange for those goods or services. ASC 606 requires the Company to apply the following steps: (1) identify the contract with the customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when, or as, the Company satisfies the performance obligation.

Effective January 1, 2018, the Company adopted ASC 606 using the modified retrospective method for all of its contracts. Following the adoption of ASC 606, the Company will continue to recognize revenue at a point-in-time when control of goods transfers to the customer. This is consistent with the Company’s previous revenue recognition accounting policy under which the Company recognized revenue when title and risk of loss pass to the customer and collectability is reasonably assured. In addition, ASU 606 did not impact the Company’s presentation of revenue on a gross or net basis.

The Company recognizes revenue primarily from sales of ethanol and its related co-products.

The Company has nine ethanol production facilities from which it produces and sells ethanol to its customers through Kinergy. Kinergy enters into sales contracts with ethanol customers under exclusive intercompany ethanol sales agreements with each of the Company’s nine ethanol plants. Kinergy also acts as a principal when it purchases third



party ethanol which it resells to its customers. Finally, Kinergy has exclusive sales agreements with other third-party owned ethanol plants under which it sells their ethanol production for a fee plus the costs to deliver the ethanol to Kinergy's customers. These sales are referred to as third-party agent sales. Revenue from these third-party agent sales is recorded on a net basis, with Kinergy recognizing its predetermined fees and any associated delivery costs.

The Company has nine ethanol production facilities from which it produces and sells co-products to its customers through PAP. PAP enters into sales contracts with co-product customers under exclusive intercompany co-product sales agreements with each of the Company's nine ethanol plants.

-7-

The Company recognizes revenue from sales of ethanol and co-products at the point in time when the customer obtains control of such products, which typically occurs upon delivery depending on the terms of the underlying contracts. In some instances, the Company enters into contracts with customers that contain multiple performance obligations to deliver volumes of ethanol or co-products over a contractual period of less than 12 months. The Company allocates the transaction price to each performance obligation identified in the contract based on relative standalone selling prices and recognizes the related revenue as control of each individual product is transferred to the customer in satisfaction of the corresponding performance obligations.

When the Company is the agent, the supplier controls the products before they are transferred to the customer because the supplier is primarily responsible for fulfilling the promise to provide the product, has inventory risk before the product has been transferred to a customer and has discretion in establishing the price for the product. When the Company is the principal, the Company controls the products before they are transferred to the customer because the Company is primarily responsible for fulfilling the promise to provide the products, has inventory risk before the product has been transferred to a customer and has discretion in establishing the price for the product.

The Company accounts for shipping and handling costs relating to contracts with customers as costs to fulfill its promise to transfer its products. Accordingly, the costs are classified as a component of cost of goods.

The Company recognized revenue by type of contracts for periods as follows (in thousands):

	Three Months Ended March 31,	
	2018	2017
Net Sales - acting as a principal		
Production Ethanol	\$219,609	\$184,203
Production Co-Products	74,550	58,872
Marketing third-party ethanol sales	105,432	142,881
Net Sales - acting as an agent		
Marketing agent ethanol sales	436	384
Consolidated net sales	\$400,027	\$386,340

*Estimates and Assumptions* – The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles 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 allowance for doubtful accounts, net realizable value of inventory, estimated lives of property and equipment, 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, and the valuation of assets acquired and liabilities assumed as a result of business combinations. Actual results

and outcomes may materially differ from management's estimates and assumptions.

2.

SEGMENTS.

The Company reports its financial and operating performance in two segments: (1) ethanol production, which includes the production and sale of ethanol, specialty alcohols and co-products, with all of the Company's production facilities aggregated, and (2) marketing and distribution, which includes marketing and merchant trading for Company-produced ethanol, specialty alcohols and co-products and third-party ethanol.

-8-

The following tables set forth certain financial data for the Company's operating segments (in thousands):

	Three Months Ended March 31,	
	2018	2017
Net Sales:		
Production:		
Net sales to external customers	\$294,159	\$243,075
Intersegment net sales	474	310
Total production segment net sales	294,633	243,385
Marketing and distribution:		
Net sales to external customers	105,868	143,265
Intersegment net sales	2,226	1,837
Total marketing and distribution segment net sales	108,094	145,102
Net sales including intersegment activity	402,727	388,487
Intersegment eliminations	(2,700 )	(2,147 )
Net sales, as reported	\$400,027	\$386,340
<b><u>Cost of goods sold:</u></b>		
Production	\$297,478	\$250,587
Marketing and distribution	100,932	143,676
Intersegment eliminations	(1,745 )	(2,150 )
Cost of goods sold, as reported	\$396,665	\$392,113
<b><u>Income (loss) before benefit for income taxes:</u></b>		
Production	\$(12,445 )	\$(12,315 )
Marketing and distribution	5,750	150
Corporate activities	(3,365 )	(1,320 )
	\$(10,060 )	\$(13,485 )
Depreciation and amortization:		
Production	\$9,932	\$8,847
Corporate activities	232	263
	\$10,164	\$9,110
Interest expense:		
Production	\$2,024	\$1,092
Marketing and distribution	363	308
Corporate activities	2,118	1,237
	\$4,505	\$2,637

The following table sets forth the Company's total assets by operating segment (in thousands):

	March 31, 2018	December 31, 2017
Total assets:		
Production	\$ 567,889	\$ 583,696
Marketing and distribution	152,073	127,242
Corporate assets	4,517	9,358
	\$ 724,479	\$ 720,296

### 3. INVENTORIES.

Inventories consisted primarily of bulk ethanol, specialty alcohols, corn, co-products, low-carbon and Renewable Identification Number ("RIN") credits and unleaded fuel, and are valued at the lower-of-cost-or-net realizable value, with cost determined on a first-in, first-out basis. Inventory is net of a \$2.7 million valuation adjustment as of December 31, 2017. Inventory balances consisted of the following (in thousands):

	March 31, 2018	December 31, 2017
Finished goods	\$ 43,641	\$ 35,652
Work in progress	8,991	8,807
Raw materials	7,276	7,601
Low-carbon and RIN credits	8,708	7,952
Other	1,646	1,538
Total	\$ 70,262	\$ 61,550

### 4. DERIVATIVES.

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

Commodity Risk – Cash Flow Hedges – The Company uses derivative instruments to protect cash flows from fluctuations caused by volatility in commodity prices for periods of up to twelve months in order to protect gross profit margins from potentially adverse effects of market and price volatility on ethanol sale and purchase commitments where the prices are set at a future date and/or if the contracts specify a floating or index-based price for ethanol. In addition, the Company hedges anticipated sales of ethanol to minimize its exposure to the potentially adverse effects of price volatility. These derivatives may be designated and documented as cash flow hedges and effectiveness is evaluated by assessing the probability of the anticipated transactions and regressing commodity

futures prices against the Company's purchase and sales prices. Ineffectiveness, which is defined as the degree to which the derivative does not offset the underlying exposure, is recognized immediately in cost of goods sold. For the three months ended March 31, 2018 and 2017, 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 Company recognized losses of \$462,000 and gains of \$216,000 as the changes in the fair values of these contracts for the three months ended March 31, 2018 and 2017, respectively.

-10-

Non Designated Derivative Instruments – The classification and amounts of the Company’s derivatives not designated as hedging instruments, and related cash collateral balances, are as follows (in thousands):

As of March 31, 2018				
Assets			Liabilities	
Type of Instrument	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Cash collateral balance	Other current assets	\$2,141		
Commodity contracts	Derivative instruments	\$2,981	Derivative instruments	\$3,094

As of December 31, 2017				
Assets			Liabilities	
Type of Instrument	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Cash collateral balance	Other current assets	\$3,813		
Commodity contracts	Derivative instruments	\$998	Derivative instruments	\$2,307

The classification and amounts of the Company’s recognized gains (losses) for its derivatives not designated as hedging instruments are as follows (in thousands):

		Realized Losses	
		Three Months Ended March 31,	
Type of Instrument	Statements of Operations Location	2018	2017
Commodity contracts	Cost of goods sold	\$ (1,658 )	\$ (2,344 )

		Unrealized Gains	
		Three Months Ended March 31,	
Type of Instrument	Statements of Operations Location	2018	2017
Commodity contracts	Cost of goods sold	\$ 1,196	\$ 2,560

5.

DEBT.

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

	March 31, 2018	December 31, 2017
Kinergy line of credit	\$58,199	\$49,477
Pekin term loan	50,000	53,500
Pekin revolving loan	32,000	32,000
ICP term loan	21,000	22,500
ICP revolving loan	18,000	18,000
Parent notes payable	68,948	68,948
	248,147	244,425
Less unamortized debt discount	(1,231 )	(1,409 )
Less unamortized debt financing costs	(1,791 )	(1,925 )
Less short-term portion	(16,500 )	(20,000 )
Long-term debt	\$228,625	\$221,091

*Kinergy Operating Line of Credit* – As of March 31, 2018, Kinergy had additional borrowing availability under its credit facility of \$19,680,000.

*Pekin Term Loan* – On March 30, 2018, Pacific Ethanol Pekin, LLC (“PE Pekin”), one of the Company’s subsidiaries, amended its term loan facility by reducing the amount of working capital it is required to maintain to not less than \$13.0 million from March 31, 2018 through November 30, 2018 and not less than \$16.0 million from December 1, 2018 and continuing at all times thereafter. In addition, a principal payment in the amount of \$3.5 million due for May 2018 was deferred until the maturity date of the term loan. As of the filing of this report, the Company believes PE Pekin is in compliance with its working capital requirement.

*Pacific Aurora Line of Credit* – On March 30, 2018, Pacific Aurora, LLC, a majority owned subsidiary of the Company, terminated its revolving credit facility, which was unused during the three months ended March 31, 2018. As a result, the Company fully amortized its deferred financing fees of \$0.3 million during the three months ended March 31, 2018.

At March 31, 2018, there were approximately \$204.3 million of net assets at the Company’s subsidiaries that were not available to be transferred to Pacific Ethanol, Inc. in the form of dividends, loans or advances due to restrictions contained in the credit facilities of the Company’s subsidiaries.



6. COMMITMENTS AND CONTINGENCIES.

Sales Commitments – At March 31, 2018, the Company had entered into sales contracts with its major customers to sell certain quantities of ethanol and co-products. The Company had open ethanol indexed-price contracts for 326,559,000 gallons of ethanol as of March 31, 2018 and open fixed-price ethanol sales contracts totaling \$74,369,000 as of March 31, 2018. The Company had open fixed-price co-product sales contracts totaling \$37,674,000 and open indexed-price co-product sales contracts for 518,000 tons as of March 31, 2018. These sales contracts are scheduled to be completed throughout 2018.

-12-

Purchase Commitments – At March 31, 2018, the Company had indexed-price purchase contracts to purchase 17,295,000 gallons of ethanol and fixed-price purchase contracts to purchase \$7,241,000 of ethanol from its suppliers. The Company had fixed-price purchase contracts to purchase \$33,641,000 of corn from its suppliers as of March 31, 2018. These purchase commitments are scheduled to be satisfied throughout 2018.

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

The Company assumed certain legal matters which were ongoing at July 1, 2015, the date of the Company’s acquisition of Aventine Renewable Energy Holdings, Inc. (“PE Central”). Among them were lawsuits between Aventine Renewable Energy, Inc. (now known as Pacific Ethanol Pekin, LLC) and Glacial Lakes Energy, Aberdeen Energy and Redfield Energy, together, the “Defendants,” in which PE Pekin sought damages for breach of termination agreements that wound down ethanol marketing arrangements between PE Pekin and each of the Defendants. In February and March 2017, the Company and the Defendants entered into settlement agreements and the Defendants paid in cash to the Company \$3.9 million in final resolution of these matters. The Company did not assign any value to the claims against the Defendants in its accounting for the PE Central acquisition as of July 1, 2015. The Company recorded a gain, net of legal fees, of \$3.6 million upon receipt of the cash settlement and recognized the gain as a reduction to selling, general and administrative expenses in the consolidated statements of operations for the three months ended March 31, 2017.

7.

PENSION PLANS.

The Company sponsors a defined benefit pension plan (the “Retirement Plan”) and a health care and life insurance plan (the “Postretirement Plan”). The Company assumed the Retirement Plan and the Postretirement Plan as part of its acquisition of PE Central on July 1, 2015. The Pension Plan is noncontributory, and covers only “grandfathered” 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 Retirement Plan, which is part of a collective bargaining agreement, covers only union employees hired prior to November 1, 2010.

The Company uses a December 31 measurement date for its Retirement Plan. The Company’s funding policy is to make the minimum annual contribution required by applicable regulations. As of December 31, 2017, the Retirement Plan’s accumulated projected benefit obligation was \$19.7 million, with a fair value of plan assets of \$14.0 million. The underfunded amount of \$5.7 million is recorded on the Company’s consolidated balance sheet in other liabilities. For the three months ended March 31, 2018, the Retirement Plan’s net periodic expense was \$76,000, comprised of

Edgar Filing: Pacific Ethanol, Inc. - Form 10-Q

\$174,000 in interest cost and \$106,000 in service cost, partially offset by \$204,000 of expected return on plan assets. For the three months ended March 31, 2017, the Retirement Plan's net periodic expense was \$117,000, comprised of \$188,000 in interest cost and \$98,000 in service cost, partially offset by \$169,000 of expected return on plan assets.

-13-

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 dollar cap based upon years of service. As of December 31, 2017, the Postretirement Plan’s accumulated projected benefit obligation was \$5.6 million and is recorded on the Company’s consolidated balance sheet in other liabilities. The Company’s funding policy is to make the minimum annual contribution required by applicable regulations. For the three months ended March 31, 2018, the Postretirement Plan’s net periodic expense was \$81,000, comprised of \$46,000 of interest cost, \$2,000 of service cost and \$33,000 of amortization expense. For the three months ended March 31, 2017, the Postretirement Plan’s net periodic expense was \$104,000, comprised of \$50,000 of interest cost, \$21,000 of service cost and \$33,000 of amortization expense.

## 8. FAIR VALUE MEASUREMENTS.

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

Level 1 – Observable inputs – unadjusted quoted prices in active markets for identical assets and liabilities;

Level 2 – Observable inputs other than quoted prices included in Level 1 that are observable for the asset or liability through corroboration with market data; and

Level 3 – Unobservable inputs – includes amounts derived from valuation models where one or more significant inputs are unobservable. For fair value measurements using significant unobservable inputs, a description of the inputs and the information used to develop the inputs is required along with a reconciliation of Level 3 values from the prior reporting period.

Pooled separate accounts – Pooled separate accounts invest primarily in domestic and international stocks, commercial paper or single mutual funds. The net asset value is used as a practical expedient to determine fair value for these accounts. Each pooled separate account provides for redemptions by the Retirement Plan at reported net asset values per share, with little to no advance notice requirement, therefore these funds are classified within Level 2 of the valuation hierarchy.

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 recurring fair value measurements by level at March 31, 2018 (in thousands):

Edgar Filing: Pacific Ethanol, Inc. - Form 10-Q

	Fair Value	Level 1	Level 2	Level 3
Assets:				
Derivative instruments(1)	\$2,981	\$2,981	\$ —	\$ —
	\$2,981	\$2,981	\$ —	\$ —
Liabilities:				
Derivative instruments(6)	\$(3,094)	\$(3,094)	\$ —	\$ —
	\$(3,094)	\$(3,094)	\$ —	\$ —

The following table summarizes recurring fair value measurements by level at December 31, 2017 (in thousands):

	Fair Value	Level 1	Level 2	Level 3	Benefit Plan Percentage Allocation	
<b>Assets:</b>						
Derivative financial instruments(1)	\$998	\$998	\$—	\$ —		
Defined benefit plan assets (pooled separate accounts):						
Large U.S. Equity(2)	3,748	—	3,748	—	27	%
Small/Mid U.S. Equity(3)	2,018	—	2,018	—	14	%
International Equity(4)	2,528	—	2,528	—	18	%
Fixed Income(5)	5,664	—	5,664	—	41	%
	\$14,956	\$998	\$13,958	\$ —		
<b>Liabilities:</b>						
Derivative financial instruments(6)	\$(2,307)	\$(2,307)	\$—	\$ —		

(1) Included in derivative instruments in the consolidated balance sheets.

This category includes investments in funds comprised of equity securities of large U.S. companies. The funds are (2) valued using the net asset value method in which an average of the market prices for the underlying investments is used to value the fund.

This category includes investments in funds comprised of equity securities of small- and medium-sized U.S. (3) companies. The funds are valued using the net asset value method in which an average of the market prices for the underlying investments is used to value the fund.

This category includes investments in funds comprised of equity securities of foreign companies including (4) emerging markets. The funds are valued using the net asset value method in which an average of the market prices for the underlying investments is used to value the fund.

This category includes investments in funds comprised of U.S. and foreign investment-grade fixed income (5) securities, high-yield fixed income securities that are rated below investment-grade, U.S. treasury securities, mortgage-backed securities, and other asset-backed securities. The funds are valued using the net asset value method in which an average of the market prices for the underlying investments is used to value the fund.

(6) Included in derivative instruments in the consolidated balance sheets.

Edgar Filing: Pacific Ethanol, Inc. - Form 10-Q

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

	Three Months Ended March 31, 2018		
	Loss Numerator	Shares Denominator	Per-Share Amount
Net loss attributed to Pacific Ethanol, Inc.	\$(7,841)		
Less: Preferred stock dividends	(312)		
Basic and diluted loss per share:			
Net loss available to common stockholders	\$(8,153)	42,912	\$ (0.19)

  

	Three Months Ended March 31, 2017		
	Loss Numerator	Shares Denominator	Per-Share Amount
Net loss attributed to Pacific Ethanol, Inc.	\$(12,636)		
Less: Preferred stock dividends	(312)		
Basic and diluted loss per share:			
Net loss available to common stockholders	\$(12,948)	42,375	\$(0.31)

There were an aggregate of 912,000 and 784,000 potentially dilutive weighted-average shares from convertible securities outstanding as of March 31, 2018 and 2017, respectively. These convertible securities were not considered in calculating diluted net loss per share for the three months ended March 31, 2018 and 2017, 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.

### **Overview**



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

We operate nine strategically-located production facilities. Four of our plants are in the Western states of California, Oregon and Idaho, and five of our plants are located in the Midwestern states of Illinois and Nebraska. We are the sixth largest producer of ethanol in the United States based on annualized volumes. Our plants have a combined production capacity of 605 million gallons per year. We market all the ethanol, specialty alcohols and co-products produced at our plants as well as ethanol produced by third parties. On an annualized basis, we market nearly 1.0 billion gallons of ethanol and over 3.0 million tons of co-products on a dry matter basis. Our business consists of two operating segments: a production segment and a marketing segment.

-16-

Our mission is to advance our position and significantly increase our market share as a leading producer and marketer of low-carbon renewable fuels and high-quality alcohol products in the United States. We intend to accomplish this goal in part by expanding our ethanol production capacity and distribution infrastructure, accretive acquisitions, lowering the carbon intensity of our ethanol, extending our marketing business into new regional and international markets, and implementing new technologies to promote higher production yields and greater efficiencies.

*Production Segment*

We produce ethanol, specialty alcohols and co-products at our production facilities described below. Our plants located on the West Coast are near their respective fuel and feed customers, offering significant timing, transportation cost and logistical advantages. Our plants located in the Midwest are in the heart of the Corn Belt, benefit from low-cost and abundant feedstock production and allow for access to many additional domestic markets. In addition, our ability to load unit trains from our plants located in the Midwest, and barges from our Pekin, Illinois plants, allows for greater access to international markets.

We wholly-own all of our plants located on the West Coast and the three plants in Pekin, Illinois. We own approximately 74% of the two plants in Aurora, Nebraska as well as the grain elevator adjacent to those properties and related grain handling assets, including the outer rail loop, and the real property on which they are located, through Pacific Aurora, LLC, or Pacific Aurora, an entity owned approximately 26% by Aurora Cooperative Elevator Company.

<b>Facility Name</b>	<b>Facility Location</b>	<b>Estimated Annual Capacity (gallons)</b>
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
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
Pekin ICP	Pekin, IL	90,000,000

We produce ethanol co-products at our production facilities such as wet distillers grains, or WDG, dried distillers grains with solubles, or DDGS, wet and dry corn gluten feed, condensed distillers solubles, corn gluten meal, corn germ, corn oil, dried yeast and CO<sub>2</sub>.

*Marketing Segment*

We market ethanol, specialty alcohols and co-products produced by our facilities and market ethanol produced by third parties. We have extensive customer relationships throughout the Western and Midwestern United States. Our ethanol customers are integrated oil companies and gasoline marketers who blend ethanol into gasoline. Our customers depend on us to provide a reliable supply of ethanol, and manage the logistics and timing of delivery with very little effort on their part. Our customers collectively require ethanol volumes in excess of the supplies we produce at our production facilities. We secure additional ethanol supplies from third-party plants in California and other third-party suppliers in the Midwest where a majority of ethanol producers are located. 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 market our distillers grains and other feed co-products to 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.

See “Note 2 – Segments” to our Notes to Consolidated Financial Statements included elsewhere in this report for financial information about our business segments.

## Outlook

Our results for the first quarter reflect slightly improved production margins on both a quarterly year-over-year and sequential basis. While production margins improved over both the first and fourth quarters of 2017, predominantly from sales of higher margin products and better California carbon credit values, they remained compressed due to elevated ethanol inventory levels which reached an historic high in early March 2018. The industry’s high inventory levels negatively impacted ethanol sales prices, compressing production margins despite a decline in our average delivered cost of corn. Our results also reflect increased production gallons sold in the first quarter predominately from increased volumes from our recently acquired ICP facility.

Since early March, industry fundamentals have further improved as inventory levels have declined 9% and are now at approximately 5% below inventory levels at this time last year. Year-to-date, ethanol production rates across the industry are running only 1% higher than last year. Production margins, while still quite volatile, have improved thus far in the second quarter. Gasoline demand is approximately 3% higher year-over-year as we approach the high-demand summer driving season. In addition, the industry exported 522 million gallons of ethanol in the first quarter, reflecting strong annualized export growth.

We believe that part of the industry’s recent margin volatility arose from escalating trade positioning between the U.S. and China, which resulted in additional tariffs placed on U.S. ethanol shipped to China in early April, halting for now new export business to China. China had previously returned in the earlier part of the first quarter as a significant buyer of U.S.-sourced ethanol, supporting its announced 10% blending requirement by 2020.

We are optimistic that the improved ethanol supply and demand balances will result in continued margin improvement as we enter peak demand season, and we believe that overall long-term market fundamentals remain strong. Ethanol’s compelling blending economics, octane value and carbon-reducing benefits will drive higher blend rates in both the U.S. and international markets. We are actively working with the industry as a whole to achieve Reid vapor pressure (RVP) parity for higher ethanol blends. The Trump administration supports removing the arbitrary restrictions on E15 blending in many markets during the summer months, which will encourage increases in year-round E15 blending. We believe the Environmental Protection Agency, or EPA, has legal authority to remove these restrictions and

anticipate the EPA's initiation of rulemaking to this end in the near future.

International demand for ethanol set records in 2017 and is on pace to exceed those records in 2018. We believe that U.S. ethanol exports may reach 1.6 billion to 1.8 billion gallons in 2018. More countries are importing ethanol from the U.S. as it represents a low-cost source of high-octane and low-carbon transportation fuel. Japan recently announced its intention to allow U.S. ethanol to meet up to 44% of a total estimated annual demand of 217 million gallons of ethanol used to make ethyl tert-butyl ether, or ETBE, an oxygenate gasoline additive, or the equivalent of approximately 100 million gallons of U.S.-sourced ethanol annually.

Carbon values in our California and Oregon markets are increasing, resulting in continued and growing premiums for our lower-carbon ethanol. In California, prices exceed \$150 per metric ton of carbon. Over the past year, California carbon prices have risen steadily to more than double where they were in 2017. Earlier this year, the California Air Resources Board announced changes to extend and increase carbon reduction requirements imposed on refiners through 2030, requiring them to reduce carbon levels to 20% below 2010 levels. Carbon values in Oregon have also improved, reaching over \$60 per metric ton of carbon for our lower-carbon ethanol produced at our Oregon facility.

We continue to focus on implementing initiatives and investing in our assets to reduce our costs, improve our yields and carbon scores, and build our long-term value. We are engaged in several plant-level capital projects with near-term paybacks designed to increase output of high-value co-products such as corn oil, corn gluten meal and yeast. We are also working with our ingredient suppliers to reduce costs and increase ethanol yields.

Our acquisition of ICP in July provided product diversification, bringing us high-quality alcohol products, which help support stronger margins and reduce our exposure to commodity price fluctuations in the fuel ethanol market. Our integration of ICP is progressing well and we are on track to achieve our goal of \$4.5 million in annualized cost synergies in 2018.

Our 3.5 megawatt cogeneration system at our Stockton plant has not yet achieved full commercial operation. The system converts process waste gas and natural gas into electricity and steam, reducing energy costs by up to \$4.0 million per year and lowering carbon and nitrogen oxide emissions. The two natural gas fired cogeneration units have performed intermittently since February and remain under the manufacturer's care. The manufacturer is working diligently to achieve completion.

The installation of our 5 megawatt solar photovoltaic power system is progressing at our Madera facility. We anticipate full electricity production from the system starting in the third quarter of 2018. We expect the system to reduce our utility costs by over \$1.0 million annually and lower our carbon score.

Airgas has begun construction of a liquid CO<sub>2</sub> production plant adjacent to our Stockton facility. We expect to commence production and begin generating revenues from this arrangement in the fourth quarter of 2018.

We continue to produce commercial levels of cellulosic ethanol and generate D3 RINs at our Stockton plant. However, we have paused production of cellulosic ethanol at our Madera and Magic Valley plants due to delays in EPA approval of our cellulosic ethanol pathways for those plants. We anticipate resolution of any underlying issues soon.

Our capital expenditures for the first quarter of 2018 totaled \$4.4 million and were primarily related to plant improvement initiatives. We expect our 2018 capital expenditures to approximate our 2017 expenditure level, although we may adjust this amount based on industry economics and our financial performance.

We plan to drive growth by leveraging our diverse base of production and marketing assets to advance our position and significantly increase market share as a leading producer and marketer of low-carbon renewable fuels and high-quality alcohol products in the United States. The foundations of this strategy are our strategically located bio-refineries, which enable us to serve multiple markets; the diversity of our production, geography, technology, feedstocks and logistics, which helps us mitigate exposure to commodity price risks within fuel markets; and our focus on evaluating and investing in plant improvement and other initiatives to increase production and operating efficiencies and yields.

### **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; impairment of long-lived assets; valuation of allowance for deferred taxes; derivative instruments; accounting for business combinations; and allowance for doubtful accounts. These significant accounting principles are more fully described in “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies” in our Annual Report on Form 10-K for the year ended December 31, 2017.

### **Results of Operations**

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

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

	Three Months Ended		Percentage	
	March 31, 2018	March 31, 2017	Change	
Production gallons sold (in millions)	140.8	115.0	22.4	%
Third party gallons sold (in millions)	91.9	111.2	(17.4)	)%
Total gallons sold (in millions)	232.7	226.2	2.9	%
Total gallons produced (in millions)	142.1	117.9	20.5	%
Production capacity utilization	94 %	92 %	2.2	%
Average sales price per gallon	\$1.57	\$1.62	(3.1)	)%
Corn cost per bushel—CBOT equivalent	\$3.57	\$3.64	(1.9)	)%
Average basis <sup>(1)</sup>	0.27	0.29	(6.9)	)%
Delivered cost of corn	\$3.84	\$3.93	(2.3)	)%
Total co-product tons sold (in thousands)	798.0	685.5	16.4	%
Co-product revenues as % of delivered cost of corn <sup>(2)</sup>	37.1 %	34.9 %	6.3	%
Average CBOT ethanol price per gallon	\$1.42	\$1.52	(6.6)	)%
Average CBOT corn price per bushel	\$3.66	\$3.64	0.5	%

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

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

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

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

	<b>Three Months Ended</b>		<b>Change in</b>		
	<b>March 31, 2018</b>	<b>2017</b>	<b>Dollars</b>	<b>Percent</b>	
Net sales	\$400,027	\$386,340	\$13,687	3.5	%
Cost of goods sold	396,665	392,113	4,552	1.2	%
Gross profit (loss)	\$3,362	\$(5,773 )	\$9,135	NM	
Percentage of net sales	0.8	% (1.5 )%			

***Net Sales***

The increase in our net sales for the three months ended March 31, 2018 as compared to the same period in 2017 was due to an increase in our total ethanol gallons sold, partially offset by a decrease in our average ethanol sales price per gallon.

We increased our production gallons sold and our volume of co-products sold for the three months ended March 31, 2018 as compared to the same period in 2017. These increases are primarily due to higher capacity utilization at our plants and increased volumes attributed to our recently acquired ICP facility. We increased capacity utilization at our plants to 94% for the three months ended March 31, 2018 compared to 92% for the same period in 2017 in anticipation of improved market conditions. Our third-party gallons sold declined over the same period as we deliberately focused our third-party ethanol sales in regions where we have a stronger presence around our own production assets.

On a consolidated basis, our average sales price per gallon decreased 3.1% to \$1.57 for the three months ended March 31, 2018 compared to our average sales price per gallon of \$1.62 for the same period in 2017. The average Chicago Board of Trade, or CBOT, ethanol price per gallon, decreased 6.6% to \$1.42 for the three months ended March 31, 2018 compared to an average CBOT sales price per gallon of \$1.52 for the same period in 2017.

***Production Segment***



Net sales of ethanol from our production segment increased by \$35.4 million, or 19%, to \$219.6 million for the three months ended March 31, 2018 as compared to \$184.2 million for the same period in 2017. Our total volume of production ethanol gallons sold increased by 25.8 million gallons, or 22%, to 140.8 million gallons for the three months ended March 31, 2018 as compared to 115.0 million gallons for the same period in 2017. Our production segment's average sales price per gallon decreased 3% to \$1.56 for the three months ended March 31, 2018 compared to our production segment's average sales price per gallon of \$1.60 for the same period in 2017. At our production segment's average sales price per gallon of \$1.56 for the three months ended March 31, 2018, we generated \$40.2 million in additional net sales from our production segment from the 25.8 million additional gallons of produced ethanol sold in the three months ended March 31, 2018 as compared to the same period in 2017. The decrease of \$0.04 in our production segment's average sales price per gallon for the three months ended March 31, 2018 as compared to the same period in 2017 decreased our net sales of ethanol from our production segment by \$4.8 million.

Net sales of co-products increased \$15.7 million, or 27%, to \$74.6 million for the three months ended March 31, 2018 as compared to \$58.9 million for the same period in 2017. Our total volume of co-products sold increased by 112.5 thousand tons, or 16%, to 798.0 thousand tons for the three months ended March 31, 2018 from 685.5 thousand tons from the same period in 2017 and our average sales price per ton increased to \$93.42 per ton for the three months ended March 31, 2018 from \$85.88 per ton for the same period in 2017. At our average sales price per ton of \$93.42 for the three months ended March 31, 2018, we generated \$10.5 million in additional net sales from the additional 112.5 thousand tons of co-products sold in the three months ended March 31, 2018 as compared to the same period in 2017. The increase in our average sales price per ton of \$7.54 per ton, or 9%, for the three months ended March 31, 2018 as compared to the same period in 2017 increased net sales from our production segment by \$5.2 million.

### *Marketing Segment*

Net sales of ethanol from our marketing segment decreased by \$37.4 million, or 26%, to \$105.9 million for the three months ended March 31, 2018 as compared to \$143.3 million for the same period in 2017. Our total volume of ethanol gallons sold by our marketing segment increased by 6.5 million gallons, or 3%, to 232.7 million gallons for the three months ended March 31, 2018 as compared to 226.2 million gallons for the same period in 2017. As noted above, our additional production gallons sold accounted for 25.8 million gallons of this increase and was offset by 19.3 million fewer third party gallons sold.

Our marketing segment's average sales price per gallon decreased 4% to \$1.60 for the three months ended March 31, 2018 compared to our marketing segment's average sales price per gallon of \$1.66 for the same period in 2017.

The increase in production gallons sold by our marketing segment contributed insignificantly to net sales generated by our marketing segment, resulting in an additional \$0.2 million in net sales, which were eliminated upon consolidation.

At our marketing segment's average sales price per gallon of \$1.60 for the three months ended March 31, 2018, we generated \$31.0 million less net sales from our marketing segment from the 19.3 million gallons in third-party ethanol sold in the three months ended March 31, 2018 as compared to the same period in 2017. Further, the decline of \$0.06 in our marketing segment's average sales price per gallon for the three months ended March 31, 2018 as compared to the same period in 2017 reduced our net sales from third-party ethanol sold by our marketing segment by \$6.4 million.

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

Our consolidated gross profit (loss) improved to gross profit of \$3.4 million for the three months ended March 31, 2018 as compared to a gross loss of \$5.8 million for the same period in 2017, representing a gross profit margin of

0.8% for the three months ended March 31, 2018 as compared to a negative gross margin of 1.5% for the same period in 2017. Our consolidated gross profit improved primarily due to sales of higher margin products and better California carbon credit values.

-20-

*Production Segment*

Our production segment's gross loss from external sales improved by \$3.4 million to a gross loss of \$3.8 million for the three months ended March 31, 2018 as compared to a gross loss of \$7.2 million for the same period in 2017. Of this increase, \$4.1 million was attributable to improved margins, partially offset by \$0.7 million in additional gross loss from increased production volumes at negative production margins for the three months ended March 31, 2018 as compared to the same period in 2017.

Gross profit generated by our production segment was negatively impacted by \$2.6 million in higher than expected repairs and maintenance expense at our Pekin, Illinois wet mill facility. We have experienced larger than anticipated expenses since the second half of 2015 related initially to the repair, and then replacement, of two package boilers that failed shortly prior to our acquisition of our Midwest assets in 2015. These expenses for the first quarter of 2018 related to the installation and start-up of two new boilers. We anticipate that our results for the second quarter of 2018 will include final costs associated with these boilers of approximately \$2.0 million. We have largely resolved these boiler issues, which totaled \$11.0 million in 2017, and look forward to eliminating our wet mill boiler expenses going forward.

*Marketing Segment*

Our marketing segment's gross profit improved by \$5.8 million to \$7.2 million for the three months ended March 31, 2018 as compared to \$1.4 million for the same period in 2017. Of this increase, \$8.3 million is attributable to our improved margins per gallon for the three months ended March 31, 2018 as compared to the same period in 2017, partially offset by \$2.5 million in lower gross profit attributable to the 19.3 million gallon decrease in third-party marketing volumes for the three months ended March 31, 2018 as compared to the same period in 2017.

*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):

Change in

**Three Months  
Ended**

	<b>March 31,</b>		Dollars	Percent
	2018	2017		
Selling, general and administrative expenses	\$9,315	\$5,450	\$3,865	70.9 %
Percentage of net sales	2.3 %	1.4 %		

Our SG&A expenses increased for the three months ended March 31, 2018 as compared to the same period in 2017. The \$3.9 million period over period increase in SG&A expenses is primarily due to \$3.6 million in one-time gains associated with legal matters resolved in the prior year that reduced our SG&A expenses from \$9.1 million to \$5.5 million in the prior year period. In addition, our SG&A expenses for the period included expenses related to the operation of our recently-acquired ICP facility that were not present in the prior year period as the acquisition had not yet occurred. We anticipate SG&A expenses will total approximately \$34.0 million for all of 2018.

***Interest Expense***

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

	<b>Three Months Ended</b>		Change in	
	<b>March 31,</b>		Dollars	Percent
	2018	2017		
Interest expense	\$4,505	\$2,637	\$1,868	70.8 %
Percentage of net sales	1.1 %	0.7 %		

Interest expense increased \$1.9 million to \$4.5 million for the three months ended March 31, 2018 from \$2.6 million for the same period in 2017. The increase in interest expense is primarily due to additional borrowings related to our recent acquisition of ICP, higher interest rates on our senior notes which increased in accordance with their terms and accelerated amortization of deferred financing costs associated with our termination of Pacific Aurora's line of credit.

***Net Loss Available to Common Stockholders***

The following table presents our net loss available to common stockholders in dollars and as a percentage of net sales (in thousands, except percentages):

	<b>Three Months Ended</b>		Change in	
	<b>March 31, 2018</b>	<b>2017</b>	Dollars	Percent
Net loss available to Common Stockholders	\$8,153	\$12,948	\$(4,795)	(37.0 )%
Percentage of net sales	2.0 %	3.4 %		

The decrease in net loss available to common stockholders was primarily due to our increased gross profit, as discussed above, for the three months ended March 31, 2018 as compared to the same period in 2017.

**Liquidity and Capital Resources**

During the three months ended March 31, 2018, we funded our operations primarily from cash on hand, cash generated from our operations and advances from our revolving credit facilities. These funds were also used to make capital expenditures, capital lease payments and principal payments on term debt.

Our current available capital resources consist of cash on hand and amounts available for borrowing under our 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 our operations and tax refunds collected.

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***

Edgar Filing: Pacific Ethanol, Inc. - Form 10-Q

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

	March 31, 2018	December 31, 2017	Change	
Cash and cash equivalents	\$ 57,380	\$ 49,489	15.9	%
Current assets	\$ 214,531	\$ 203,246	5.6	%
Property and equipment, net	\$ 502,545	\$ 508,352	(1.1)	)%
Current liabilities	\$ 95,855	\$ 90,706	5.7	%
Long-term debt, net of current portion	\$ 228,625	\$ 221,091	3.4	%
Working capital	\$ 118,676	\$ 112,540	5.5	%
Working capital ratio	2.24	2.24		<del>%</del>

-22-

*Restricted Net Assets*

At March 31, 2018, we had approximately \$204.3 million of net assets at our subsidiaries that were not available to be transferred to Pacific Ethanol, Inc. in the form of dividends, loans or advances due to restrictions contained in the credit facilities of our subsidiaries.

*Changes in Working Capital and Cash Flows*

Working capital increased to \$118.7 million at March 31, 2018 from \$112.5 million at December 31, 2017 as a result of an increase of \$11.3 million in current assets, partially offset by an increase of \$5.1 million in current liabilities.

Current assets increased primarily due to increases of \$7.9 million in cash and cash equivalents, \$8.7 million in inventories and \$2.0 million in derivative instruments, partially offset by a decrease in accounts receivable of \$6.1 million and \$1.5 million in other current assets. Our cash and cash equivalents increased by \$7.9 million at March 31, 2018 as compared to December 31, 2017 due to \$8.9 million of cash provided by our operations and \$3.3 million of cash provided by our financing activities, partially offset by \$4.4 million of cash used in our investing activities.

Our current liabilities increased primarily due to increases of \$7.5 million in accounts payable and accrued liabilities and \$0.8 million in derivative instruments, partially offset by a decrease of \$3.5 million in the current portion of our long-term debt in accordance with our amended amortization schedule associated with our Pekin term debt.

*Cash provided by our Operating Activities*

Cash provided by our operating activities declined by \$3.2 million for the three months ended March 31, 2018, as compared to the same period in 2017. We generated \$8.9 million of cash from our operating activities during the period. Specific factors that contributed to the decrease in cash provided by our operating activities include:

- a decrease related to accounts receivable of \$16.2 million primarily due to the timing of collections; and
- a decrease related to inventories and prepaid inventory of \$11.0 million due to the timing of purchases.

These amounts were partially offset by:



an improvement in consolidated net loss of \$4.0 million;

an increase related to accounts payable and accrued liabilities of \$16.7 million due to the timing of payments and higher sales volumes; and

an increase related to prepaid expenses and other assets of \$3.8 million.

*Cash used in our Investing Activities*

Cash used in our investing activities increased by \$0.2 million for the three months ended March 31, 2018 as compared to the same period in 2017. The increase in cash used in our investing activities is primarily due to higher spending on capital projects associated with our plant improvement initiatives.

*Cash provided by our Financing Activities*

Cash provided by our financing activities increased by \$6.2 million for the three months ended March 31, 2018 as compared to the same period in 2017. The increase in cash provided by our financing activities is primarily due to \$10.1 million in increased net borrowings under Kinergy's line of credit, partially offset by \$4.0 million in increased principal payments on our term debt.

***Kinergy Operating Line of Credit***

Kinergy maintains an operating line of credit for an aggregate amount of up to \$100.0 million. The credit facility matures on August 2, 2022. 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 1.50% to 2.00%. 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 of Pacific Ag. Products, LLC, or PAP, as additional collateral. Payments that may be made by PAP to Pacific Ethanol as reimbursement for management and other services provided by Pacific Ethanol to PAP are limited under the terms of the credit facility to \$0.5 million per fiscal quarter. PAP, one of our indirect wholly-owned subsidiaries, markets our co-products and also provides raw material procurement services to our subsidiaries.

For all monthly periods in which excess borrowing 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 certain additional indebtedness (other than specific intercompany indebtedness). 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. Kinergy and PAP believe they are in compliance with this covenant. The following table summarizes Kinergy’s financial covenants and actual results for the periods presented (dollars in thousands):

	Three Months Ended March 31, 2018		Years Ended December 31, 2017	
	2018	2017	2017	2016
Fixed-Charge Coverage Ratio Requirement	2.00	2.00	2.00	2.00
Actual	7.72	6.80	2.79	7.88
Excess	5.72	4.80	0.79	5.88

Pacific Ethanol has guaranteed all of Kinergy’s obligations under the credit facility. As of March 31, 2018, Kinergy had an outstanding balance of \$58.2 million with additional borrowing availability under the credit facility of \$19.7 million.

***Pekin Credit Facilities***

On December 15, 2016, our wholly-owned subsidiary, Pacific Ethanol Pekin, LLC, or Pekin, entered into term and revolving credit facilities. Pekin borrowed \$64.0 million under a term loan facility that matures on August 20, 2021 and \$32.0 million under a revolving credit facility that matures on February 1, 2022. The Pekin credit facilities are secured by a first-priority security interest in all of Pekin's assets. Interest initially accrued under the Pekin credit facilities at an annual rate equal to the 30-day LIBOR plus 3.75%, payable monthly. Pekin is required to make quarterly principal payments in the amount of \$3.5 million on the term loan beginning on May 20, 2017 and a principal payment of \$8.0 million at maturity on August 20, 2021. Pekin is required to pay monthly in arrears a fee on any unused portion of the revolving credit facility at a rate of 0.75% per annum. Prepayment of these facilities is subject to a prepayment penalty. Under the initial terms of the credit facilities, Pekin was required to maintain not less than \$20.0 million in working capital and an annual debt service coverage ratio of not less than 1.25 to 1.0.

On August 7, 2017, Pekin amended its term and revolving credit facilities by agreeing to increase the interest rate under the facilities by 25 basis points to an annual rate equal to the 30-day LIBOR plus 4.00%. Pekin and its lender also agreed that Pekin is required to maintain working capital of not less than \$17.5 million from August 31, 2017 through December 31, 2017 and working capital of not less than \$20.0 million from January 1, 2018 and continuing at all times thereafter. In addition, the required debt service coverage ratio was reduced to 0.15 to 1.00 for the fiscal year ended December 31, 2017. Pekin's actual debt service coverage ratio was 0.17 to 1.00 for the fiscal year ended December 31, 2017, 0.02 in excess of the required 0.15 to 1.00. For the month ended January 31, 2018, Pekin was not in compliance with its working capital requirement due to larger than anticipated repair and maintenance related expenses to replace faulty equipment. Pekin has received a waiver from its lender for this noncompliance. Further, the lender decreased Pekin's working capital covenant requirement to \$13.0 million for the month ended February 28, 2018, excluding from the calculation a \$3.5 million principal payment previously due in May 2018.

On March 30, 2018, Pekin further amended its term loan facility by reducing the amount of working capital it is required to maintain to not less than \$13.0 million from March 31, 2018 through November 30, 2018 and not less than \$16.0 million from December 1, 2018 and continuing at all times thereafter. In addition, a principal payment in the amount of \$3.5 million due for May 2018 was deferred until the maturity date of the term loan. As of the filing of this report, we believe Pekin is in compliance with its working capital requirement.

### ***ICP Credit Facilities***

On September 15, 2017, ICP entered into term and revolving credit facilities. ICP borrowed \$24.0 million under a term loan facility that matures on September 20, 2021 and \$18.0 million under a revolving credit facility that matures on September 1, 2022. The ICP credit facilities are secured by a first-priority security interest in all of ICP's assets. Interest accrues under the ICP credit facilities at an annual rate equal to the 30-day LIBOR plus 3.75%, payable monthly. ICP is required to make quarterly consecutive principal payments in the amount of \$1.5 million. ICP is required to pay monthly in arrears a fee on any unused portion of the revolving credit facility at a rate of 0.75% per annum. Prepayment of these facilities is subject to a prepayment penalty. Under the terms of the credit facilities, ICP is required to maintain not less than \$8.0 million in working capital and an annual debt service coverage ratio of not less than 1.5 to 1.0, beginning for the year ended December 31, 2018.

### ***Pacific Ethanol, Inc. Notes Payable***

On December 12, 2016, we entered into a Note Purchase Agreement with five accredited investors. On December 15, 2016, under the terms of the Note Purchase Agreement, we sold \$55.0 million in aggregate principal amount of our senior secured notes to the investors in a private offering for aggregate gross proceeds of 97% of the principal amount of the notes sold. On June 26, 2017, we entered into a second Note Purchase Agreement with five accredited investors. On June 30, 2017, under the terms of the second Note Purchase Agreement, we sold an additional \$13.9 million in aggregate principal amount of our senior secured notes to the investors in a private offering for aggregate gross proceeds of 97% of the principal amount of the notes sold, for a total of \$68.9 million in aggregate principal

amount of senior secured notes.

-25-

The notes mature on December 15, 2019. Interest on the notes accrues at an annual rate equal to (i) the greater of 1% and the three-month LIBOR, plus 7.0% from the closing through December 14, 2017, (ii) the greater of 1% and three-month LIBOR, plus 9% between December 15, 2017 and December 14, 2018, and (iii) the greater of 1% and three-month LIBOR plus 11% between December 15, 2018 and the maturity date. The interest rate increases by an additional 2% per annum above the interest rate otherwise applicable upon the occurrence and during the continuance of an event of default until cured. Interest is payable in cash in arrears on the 15th calendar day of each March, June, September and December. We are required to pay all outstanding principal and any accrued and unpaid interest on the notes on the maturity date. We may, at our option, prepay the outstanding principal amount of the notes at any time without premium or penalty. Pacific Ethanol, Inc. issued the notes, which are secured by a first-priority security interest in the equity interest held by Pacific Ethanol, Inc. in its wholly-owned subsidiary, PE Op. Co., which indirectly owns our plants located on the West Coast.

### ***Pacific Aurora Credit Facility***

On December 15, 2016, Pacific Aurora entered into a revolving credit facility for up to \$30.0 million with a maturity date of February 1, 2022. The credit facility was secured by a first-priority security interest in all of Pacific Aurora's assets. Borrowing availability under the credit facility automatically declined by \$2.5 million on the first day of each June and December beginning on June 1, 2017 through and including December 1, 2020. Interest accrued under the Pacific Aurora credit facility at an annual rate equal to the 30-day LIBOR plus 4.0%, payable monthly. Pacific Aurora was required to pay monthly in arrears a fee on any unused portion of the credit facility at a rate of 0.75% per annum. Prepayment of the credit facility was subject to a prepayment penalty. Under the terms of the credit facility, Pacific Aurora was required to maintain not less than \$22.5 million in working capital through June 30, 2017, not less than \$24.0 million in working capital after June 30, 2017 and an annual debt service coverage ratio of not less than 1.50 to 1.00.

On September 1, 2017, Pacific Aurora and its lender agreed that Pacific Aurora was required to maintain working capital of not less than \$18.0 million from September 30, 2017 through February 28, 2018 and working capital of not less than \$20.0 million from March 1, 2018 and continuing at all times thereafter. In addition, the required debt service coverage ratio was reduced to 0.00 to 1.00 for the fiscal year ending December 31, 2017 and 1.50 to 1.00 for the fiscal year ending December 31, 2018.

At December 31, 2017, Pacific Aurora was not in compliance with its working capital and debt service coverage ratio requirements. We did not utilize the credit facility in 2017 and had no plans to draw on the facility, having addressed the liquidity and capital needs of Pacific Aurora through other means. On March 30, 2018, Pacific Aurora terminated this credit facility.

### **Contractual Obligations**

There have been no material changes in the three months ended March 31, 2018 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 2017.

#### Effects of Inflation

The impact of inflation was not significant to our financial condition or results of operations for the three months ended March 31, 2018 and 2017.

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, specialty alcohols and co-products. Our business is sensitive to changes in the prices 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-price arrangements, we are exposed to risk of an increase 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. Additionally, 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 the 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 exchanged-traded contracts are recorded on the balance sheet and recognized immediately in cost of goods sold. We recognized losses of \$0.5 million and gains of \$0.2 million related to settled non-designated hedges as the change in the fair values of these contracts for the three months ended March 31, 2018 and 2017, respectively.

-27-

At March 31, 2018, 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 March 31, 2018, which may differ materially from actual results, are as follows (in millions):

Commodity	Three Months	Unit of Measure	Approximate Adverse Change to Pre-Tax Income
	Ended March 31, 2018		
	<b>Volume</b>		
Ethanol	232.7	Gallons	\$ 22.1
Corn	50.0	Bushels	\$ 17.9

#### *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 March 31, 2018, all of our long-term debt of \$248.1 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 three months ended March 31, 2018 would be negatively impacted by approximately \$0.6 million.

#### ITEM 4.

#### CONTROLS AND PROCEDURES.

##### Evaluation of Disclosure Controls and Procedures

We conducted an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by the company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission’s rules and forms. Disclosure controls and procedures also include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded as of March 31, 2018 that our disclosure controls and

procedures were effective at a reasonable assurance level.

#### Changes in Internal Control over Financial Reporting

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

-28-

*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.

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 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 three months ended March 31, 2018 and 2017, we incurred consolidated net losses of approximately \$9.5 million and \$13.5 million, respectively. For the years ended December 31, 2017 and 2015, we incurred consolidated net losses of approximately \$38.1 million and \$18.9 million, respectively. For the year ended December 31, 2015, we incurred negative operating cash flows of \$28.0 million. We may incur losses and negative operating cash flow in the future. We expect to rely on cash on hand, cash, if any, generated from our operations, borrowing availability under our lines of credit and proceeds from future financing activities, if any, 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.

-30-

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 other ethanol co-products at some or all of our plants.

***Increased ethanol production or higher inventory levels 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. 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 a record 16.2 billion gallons in 2017. In addition, if ethanol production margins improve, we anticipate that owners of ethanol production facilities will increase production levels, thereby resulting in more abundant ethanol supplies and inventories. Any increase in the supply of ethanol may not be commensurate with increases in the demand for 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 \$1.26 to \$1.67 per gallon during 2017 and \$1.31 to \$1.75 per gallon during 2016. 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 production or distribution 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 and specialty alcohols also requires a significant and uninterrupted supply of other raw materials and energy, primarily water, electricity and natural gas. 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. During 2014, poor weather caused disruptions in rail transportation, which slowed the delivery of ethanol by rail, the principle manner by which ethanol from our plants located in the Midwest is transported to market. Disruptions in production or distribution 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 could delay transport of our products to market, and may require us to halt production at one or more plants, any of 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 and financial condition.***

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. In addition, our open contract

positions may require cash deposits to cover margin calls, negatively impacting our liquidity. As a result, our results of operations and financial condition may be adversely affected by our hedging activities and 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, specialty alcohols and 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 could 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. 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.

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

Our business following recent acquisitions is larger than the individual businesses of Pacific Ethanol and the acquired companies prior to the acquisitions. Our future success depends, in part, upon our ability to manage our expanded business, which may pose continued 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 plant indebtedness exposes us to many risks that could negatively impact our business, our business prospects, our liquidity and our cash flows and results of operations.***

Our plants located in the Midwest have significant indebtedness. Unlike traditional term debt, the terms of our plant loans require amortizing payments of principal over the lives of the loans and our borrowing availability under our plant credit facilities periodically and automatically declines through the maturity dates of those facilities. Our plant indebtedness 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 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;

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; and/or

limit our ability to procure additional financing for working capital or other purposes.

Our term loans and credit facilities also require compliance with numerous financial and other covenants. In addition, our plant indebtedness bears interest at variable rates. An increase in prevailing interest rates would likewise increase our debt service obligations and could materially and adversely affect our cash flows and results of operations.

Our ability to generate sufficient cash to make all principal and interest payments when due depends on our business performance, which is subject to a variety of factors beyond our control, including the supply of and demand for ethanol and co-products, ethanol and co-product prices, the cost of key production inputs, and many other factors incident to the ethanol production and marketing industry. We cannot provide any assurance that we will be able to timely satisfy such obligations. Our failure to timely satisfy our debt obligations could have a material adverse effect on our business, business prospects, liquidity, cash flows and results of operations.

***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 Kinery's credit facility to help finance its operations. Kinery must satisfy monthly financial covenants under its credit facility, including fixed-charge coverage ratio covenants. Kinery 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 Kinery's credit facility, or a significant reduction in Kinery's borrowing capacity under the facility, would result in Kinery'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 EPA has implemented the RFS pursuant to the Energy Policy Act of 2005 and the Energy Independence and Security Act of 2007. The 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 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 price of ethanol relative to the price of gasoline, the relative octane value of ethanol, constraints in the ability of vehicles to use higher ethanol blends, the RFS, and other applicable environmental requirements. Any significant increase in production capacity above the RFS minimum requirements may have an adverse impact on ethanol prices.

Legislation aimed at reducing or eliminating the renewable fuel use required by the RFS has been introduced in the United States Congress. On January 3, 2017, the Leave Ethanol Volumes at Existing Levels (LEVEL) Act (H.R. 119) was introduced in the House of Representatives. The bill would freeze renewable fuel blending requirements under the RFS at 7.5 billion gallons per year, prohibit the sale of gasoline containing more than 10% ethanol, and revoke the EPA's approval of E15 blends. On January 31, 2017, a bill (H.R. 777) was introduced in the House of Representatives that would require the EPA and National Academies of Sciences to conduct a study on "the implications of the use of mid-level ethanol blends". A mid-level ethanol blend is an ethanol-gasoline blend containing 10-20% ethanol by volume, including E15 and E20, which is intended to be used in any conventional gasoline-powered motor vehicle or nonroad vehicle or engine. Also on January 31, 2017, a bill (H.R. 776) was introduced in the House of Representatives that would limit the volume of cellulosic biofuel required under the RFS to what is commercially available. On March 2, 2017, a bill (H.R. 1315) was introduced in the House of Representatives that would cap the volume of ethanol in gasoline at 10%. On the same day, the RFS Elimination Act (H.R. 1314) was introduced, which would fully repeal the RFS. On March 8, 2018, the Growing Renewable Energy through Existing and New Environmentally Responsible (GREENER) Fuels Act (H.R. 5212 and S. 2519) was introduced in the House of Representatives and Senate. The GREENER Fuels Act would phase-out the mandated use of corn ethanol and limit the total volume of conventional biofuel contained in transportation fuel at 9.7%.

All of these bills were referred to a congressional committee or subcommittee, which will consider them before possibly sending any of them on to the House of Representatives as a whole. Our operations could be adversely impacted if any legislation is enacted that reduces or eliminates the RFS volume requirements or that reduces or eliminates corn ethanol as qualifying as a renewable fuel under the 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 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. Our results of operations, cash flows and financial condition could be adversely impacted if the EPA reduces the RFS requirements from the statutory levels specified in the 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.*

-35-



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, POET, LLC, Green Plains, Inc. and Valero Renewable Fuels Company, LLC, 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 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.

***Our ability to utilize net operating loss carryforwards and certain other tax attributes may be limited.***

Federal and state income tax laws impose restrictions on the utilization of net operating loss, or NOL, and tax credit carryforwards in the event that an “ownership change” occurs for tax purposes, as defined by Section 382 of the Internal Revenue Code, or 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, 2017, of our \$154.6 million of federal NOLs, we had \$94.9 million of federal NOLs that are limited in their annual use under 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.

***Our business is not diversified. 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.***

Our business is not diversified. Our sales are highly concentrated within the ethanol production and marketing industry. We expect to be substantially focused on the production and marketing of ethanol and its co-products for the

foreseeable future. An industry shift away from ethanol, or the emergence of new competing products, may significantly reduce the demand for ethanol. However, we may be unable to timely alter our business focus away from the production and marketing of ethanol to other renewable fuels or competing products. A downturn in the demand for ethanol would likely materially and adversely affect our sales and profitability.

*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, 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. 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 2017, 2016 and 2015, three customers accounted for an aggregate of approximately \$544 million, \$572 million and \$467 million in net sales, representing 33%, 35% and 39% 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 volume or dollar value of ethanol or co-products, 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.

***We incur significant expenses to maintain and upgrade our operating equipment and plants, and any interruption in the operation of our facilities may harm our operating performance.***

We regularly incur significant expenses to maintain and upgrade our equipment and facilities. The machines and equipment we use to produce our products are complex, have many parts and some are run on a continuous basis. We must perform routine maintenance on our equipment and will have to periodically replace a variety of parts such as motors, pumps, pipes and electrical parts. In addition, our facilities require periodic shutdowns to perform major maintenance and upgrades. These scheduled facility shutdowns result in decreased sales and increased costs in the periods in which a shutdown occurs and could result in unexpected operational issues in future periods as a result of changes to equipment and operational and mechanical processes made during the shutdown period.

***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 ramifications of these risks are greater in magnitude 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, loans or advances to us by the terms of their financing arrangements. At March 31, 2018, we had approximately \$204.3 million of net assets at our subsidiaries that were not available to be distributed in the form of dividends, distributions, loans or advances due to restrictions contained in their financing arrangements.

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

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

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

fluctuations in the market prices of ethanol and its co-products;

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;

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 ICP cannot be fully realized in a timely manner or at all;

regulatory developments or increased enforcement;

fluctuations in our quarterly or annual operating results;

additions or departures of key personnel;

our ability 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.

Demand for ethanol could 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 and annual 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.

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

Unregistered Sales of Equity Securities

None.

Use of Proceeds from Registered Securities

Not applicable.



Purchases of Equity Securities by the Issuer and Affiliated Purchasers

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.

At March 31, 2018, we had approximately \$204.3 million of net assets at our subsidiaries that were not available to be transferred to Pacific Ethanol, Inc. in the form of dividends, loans or advances due to restrictions contained in the credit facilities of our subsidiaries.

For each of the three months ended March 31, 2018 and 2017, we declared and paid in cash an aggregate of \$0.3 million in dividends on our Series B Cumulative Convertible Preferred Stock, or Series B Preferred Stock. We have never declared or paid cash dividends on our common stock and do not currently intend to pay cash dividends on our common stock in the foreseeable future. We currently anticipate that we will retain any earnings for use in the continued development of our business. The holders of our outstanding Series B Preferred Stock are entitled to dividends of 7% per annum, payable quarterly. Dividends in respect of our Series B Preferred Stock must be paid prior to the payment of any dividends in respect of our common stock.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES.

Not applicable.

ITEM 5. OTHER INFORMATION.

*2018 Short-Term Incentive Plan*

On February 9, 2018, the Compensation Committee of our Board of Directors adopted a Short-Term Incentive Plan for 2018, or the Plan, applicable to our executive officers. The following is a description of the Plan:

*Participants:* Our Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, General Counsel, Vice President of Commodities and Corporate Development and Vice President of Supply and Trading (“Executive Officers”), and other officer, director and manager-level personnel will be eligible to participate in the Plan.

*Aggregate Plan Pool:* The dollar amount of the aggregate Plan pool will be established by the Compensation Committee.

*Awards:* Awards under the Plan for Executive Officers will be determined by the Compensation Committee. Awards under the Plan for other officer, director and manager-level personnel will be determined by our executive committee, within the limits of the Plan pool approved by the Compensation Committee.

*Individual Targets:* The Plan payout targets for Executive Officers will be determined by the Compensation Committee. The Plan payout targets for other officer, director and manager-level personnel will be set as a percentage of a participant's base salary in accordance with compensation policies established by our executive committee or a participant's employment agreement.

*Award Components:* Awards under the Plan will be based on two elements: financial performance and individual performance. Our financial performance will be an element in all participants' awards. Each element will be assigned a weighting based upon a participant's role.

The financial performance element will be based on earnings before interest, taxes, depreciation and amortization, adjusted for certain non-cash and other adjustments, such as asset impairments, purchase accounting adjustments and fair value adjustments, established by the Compensation Committee ("Adjusted EBITDA"). An Adjusted EBITDA goal will be established for 2018 by the Compensation Committee. The financial performance element is non-discretionary and will be funded at a rate of 0% to 200% of the participant's targeted payout amount for the element based on the level of actual Adjusted EBITDA compared to the Adjusted EBITDA goal.

The individual performance element will be based on individual participant goals based on quantitative criteria and subjective elements established by each participant's supervisor, in consultation with our executive committee. The extent to which a participant will be deemed to have achieved his or her individual performance goals will be determined by our executive committee in consultation with the participant's supervisor; provided, however, that the extent to which a participant who is an Executive Officer will be deemed to have achieved his or her individual performance goals will be recommended by our Chief Executive Officer but ultimately determined by the Compensation Committee. The individual performance element is discretionary and will be funded at a rate of 0% to 100% of the participant's targeted payout amount for the element, but may exceed 100% of the participant's targeted payout amount through a reduction of amounts set aside for other participants in the Plan pool without, however, affecting the overall amount of the Plan pool.

In addition to incentive compensation payable under the Plan, the Compensation Committee retains the authority to grant special discretionary cash and/or equity awards.

ITEM 6.

EXHIBITS.

Exhibit Number	Description (**)
<u>10.1</u>	<u>Pacific Ethanol, Inc. 2018 Short-Term Incentive Plan Description (*)</u>
<u>10.2</u>	<u>2016 Stock Incentive Plan, as amended (*)</u>
<u>10.3</u>	<u>Amendment No. 3 to Credit Agreement dated as of March 30, 2018 by and between Pacific Ethanol Pekin, LLC, Compeer Financial, PCA and CoBank, ACB (***)</u>
<u>10.4</u>	<u>Second Amended and Restated Term Note dated March 30, 2018 by Pacific Ethanol Pekin, LLC in favor of Compeer Financial, PCA (***)</u>
<u>31.1</u>	<u>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 (*)</u>
<u>31.2</u>	<u>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 (*)</u>
<u>32.1</u>	<u>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 (*)</u>
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.

(\*\*) Certain of the agreements filed as exhibits contain representations and warranties made by the parties thereto. The assertions embodied in such representations and warranties are not necessarily assertions of fact, but a mechanism for the parties to allocate risk. Accordingly, investors should not rely on the representations and warranties as characterizations of the actual state of facts or for any other purpose at the time they were made or otherwise.

(\*\*\*)

Edgar Filing: Pacific Ethanol, Inc. - Form 10-Q

Previously filed as an exhibit to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on April 5, 2018.

-42-

SIGNATURES

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

**PACIFIC ETHANOL, INC.**

Dated: May 10, 2018 By: /S/ BRYON T. MCGREGOR  
Bryon T. McGregor  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

-43-