

PACIFIC BIOSCIENCES OF CALIFORNIA, INC.

Form 10-Q

November 04, 2016

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2016

Or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 001-34899

Pacific Biosciences of California, Inc.

(Exact name of registrant as specified in its charter)

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(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

1380 Willow Road

Menlo Park, CA 94025 94025  
(Address of principal executive offices) (Zip Code)

(650) 521-8000

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

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

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

Number of shares outstanding of the issuer's common stock as of October 31, 2016: 92,646,752

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## PACIFIC BIOSCIENCES OF CALIFORNIA, INC.

## Condensed Consolidated Balance Sheets

(Unaudited)

(in thousands except par value amounts)	September 30, 2016	December 31, 2015
Assets		
Current assets		
Cash and cash equivalents	\$ 22,794	\$ 33,629
Investments	64,539	48,641
Accounts receivable	11,761	5,245
Inventory	16,473	10,955
Prepaid expenses and other current assets	6,900	12,071
Total current assets	122,467	110,541
Property and equipment, net	14,003	8,548
Long-term restricted cash	4,500	4,500
Other long-term assets	9,665	7,518
Total assets	\$ 150,635	\$ 131,107
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	\$ 8,311	\$ 4,749
Accrued expenses	16,482	15,551
Deferred service revenue, current	6,436	6,815
Deferred contractual revenue, current	135	10,822
Other liabilities, current	742	241
Total current liabilities	32,106	38,178
Deferred service revenue, non-current	1,020	1,143
Deferred contractual revenue, non-current	1,212	1,312
Other liabilities, non-current	1,605	1,386
Notes payable	15,794	14,948
Financing derivative	218	600
Total liabilities	51,955	57,567
Commitments and contingencies		

Stockholders' equity		
Preferred Stock, \$0.001 par value:		
Authorized 50,000 shares; No shares issued or outstanding	—	—
Common Stock, \$0.001 par value:		
Authorized 1,000,000 shares; Issued and outstanding 92,605 shares at September 30, 2016 and 79,983 shares at December 31, 2015	93	80
Additional paid-in capital	867,078	786,636
Accumulated other comprehensive income (loss)	23	(7)
Accumulated deficit	(768,514)	(713,169)
Total stockholders' equity	98,680	73,540
Total liabilities and stockholders' equity	\$ 150,635	\$ 131,107
See accompanying notes to the condensed consolidated financial statements.		

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## PACIFIC BIOSCIENCES OF CALIFORNIA, INC.

## Condensed Consolidated Statements of Operations and Comprehensive Income (Loss)

(Unaudited)

(in thousands, except per share amounts)	Three-Month Periods Ended September 30,		Nine-Month Periods Ended September 30,	
	2016	2015	2016	2015
Revenue:				
Product revenue	\$ 18,050	\$ 7,570	\$ 44,016	\$ 27,703
Service and other revenue	3,472	2,751	10,188	8,010
Contractual revenue	3,596	3,596	10,788	20,788
Total revenue	25,118	13,917	64,992	56,501
Cost of revenue:				
Cost of product revenue	9,273	5,119	23,268	23,289
Cost of service and other revenue	3,207	2,247	8,938	6,228
Total cost of revenue	12,480	7,366	32,206	29,517
Gross profit	12,638	6,551	32,786	26,984
Operating expense:				
Research and development	17,479	16,162	51,362	45,688
Sales, general and administrative	11,894	10,818	34,794	32,411
Gain on lease amendments	—	(23,043)	—	(23,043)
Total operating expense	29,373	3,937	86,156	55,056
Operating income (loss)	(16,735)	2,614	(53,370)	(28,072)
Interest expense	(821)	(741)	(2,395)	(2,153)
Other income (expense), net	62	(52)	420	(62)
Net income (loss)	(17,494)	1,821	(55,345)	(30,287)
Other comprehensive loss:				
Unrealized gain (loss) on investments	(29)	(6)	30	(3)
Comprehensive income (loss)	\$ (17,523)	\$ 1,815	\$ (55,315)	\$ (30,290)
Net income (loss) per share:				
Basic	\$ (0.19)	\$ 0.02	\$ (0.63)	\$ (0.41)
Diluted	\$ (0.19)	\$ 0.02	\$ (0.63)	\$ (0.41)
Weighted average shares outstanding used in calculating net income (loss) per share				
Basic	92,110	75,205	87,969	74,699
Diluted	92,110	80,479	87,969	74,699

See accompanying notes to the condensed consolidated financial statements.

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## PACIFIC BIOSCIENCES OF CALIFORNIA, INC.

## Condensed Consolidated Statements of Cash Flows

(Unaudited)

(in thousands)	Nine-Month Periods Ended September 30,	
	2016	2015
Cash flows from operating activities		
Net loss	\$ (55,345)	\$ (30,287)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation	2,822	2,694
Amortization of debt discount and financing costs	846	699
Stock-based compensation	14,726	9,813
Non-cash portion of gain on lease amendments	—	(3,043)
Other items	(270)	21
Changes in assets and liabilities		
Accounts receivable	(6,516)	(758)
Inventory	(7,079)	(1,990)
Prepaid expenses and other assets	3,024	(15,410)
Accounts payable	2,402	364
Accrued expenses	931	1,523
Deferred service revenue	(502)	303
Deferred contractual revenue	(10,787)	(10,788)
Other liabilities	720	(316)
Net cash used in operating activities	(55,028)	(47,175)
Cash flows from investing activities		
Purchase of property and equipment	(5,556)	(2,131)
Disposal of property and equipment	10	12
Purchase of investments	(82,028)	(43,715)
Sales of investments	19,830	8,317
Maturities of investments	46,208	68,553
Net cash provided by (used in) investing activities	(21,536)	31,036
Cash flows from financing activities		
Proceeds from issuance of common stock from equity plans	7,529	5,465
Proceeds from issuance of common stock from at-the-market equity offering, net of issuance costs	58,200	1,433
Net cash provided by financing activities	65,729	6,898
Net decrease in cash and cash equivalents	(10,835)	(9,241)
Cash and cash equivalents at beginning of period	33,629	36,449

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Cash and cash equivalents at end of period	\$ 22,794	\$ 27,208
Supplemental disclosure of non-cash investing and financing activities		
Purchase of property and equipment through accounts payable	\$ 1,160	\$ (125)
Instruments that were transferred from inventory to property and equipment	\$ 1,561	\$ 1,704

See accompanying notes to the condensed consolidated financial statements.

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PACIFIC BIOSCIENCES OF CALIFORNIA, INC.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

NOTE 1. OVERVIEW

Pacific Biosciences of California, Inc. (the “Company,” “we,” “us,” or “our”) designs, develops and manufactures sequencing systems to help scientists resolve genetically complex problems. Based on our novel Single Molecule, Real-Time (SMRT®) Sequencing technology, our products enable: de novo genome assembly to finish genomes in order to more fully identify, annotate and decipher genomic structures; full-length transcript analysis to improve annotations in reference genomes, characterize alternatively spliced isoforms in important gene families, and find novel genes; targeted sequencing to more comprehensively characterize genetic variations; and real-time kinetic information for epigenome characterization. Our technology provides high accuracy, ultra-long reads, uniform coverage, and is the only DNA sequencing technology that provides the ability to simultaneously detect epigenetic changes.

PacBio® sequencing systems, including consumables and software, provide a simple, fast, end-to-end workflow for SMRT Sequencing.

In September 2015, we announced that we had launched a new nucleic acid sequencing platform, the PacBio Sequel™ System, which will provide higher throughput, more scalability, a reduced footprint and lower sequencing project costs compared to the PacBio® RS II System, while maintaining the existing benefits of our SMRT Sequencing Technology.

The names “Pacific Biosciences,” “PacBio,” “SMRT,” “SMRTbell,” “Sequel” and our logo are our trademarks.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

In the opinion of management, our accompanying unaudited Condensed Consolidated Financial Statements (“Financial Statements”) have been prepared on a consistent basis with our December 31, 2015 audited Consolidated Financial Statements and include all adjustments, consisting of only normal recurring adjustments, necessary to fairly state the information set forth herein. The Financial Statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (“SEC”) and, as permitted by such rules and regulations, omit certain information and footnote disclosures necessary to present the statements in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”). These Financial Statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2015. The results of operations for the nine-month period ended September 30, 2016 are not necessarily indicative of the results to be expected for the entire year or any future periods.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes to the financial statements. Our estimates include, but are not limited to, the valuation of inventory, revenue valuation, the valuation of a financing derivative and long-term notes, the valuation and recognition of share-based compensation, the delivery period for collaboration agreements, the useful lives assigned to long-lived assets, and the computation provisions for income taxes. Actual results could differ materially from these estimates.

#### Fair Value of Financial Instruments

Assets and liabilities measured at fair value on a recurring basis

The following table sets forth the fair value of our financial assets and liabilities measured on a recurring basis as of September 30, 2016 and December 31, 2015, respectively:

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(in thousands)	September 30, 2016				December 31, 2015			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
<b>Assets</b>								
<b>Cash and cash equivalents:</b>								
Cash and money market funds	\$ 10,850	\$ —	\$ —	\$ 10,850	\$ 22,034	\$ —	\$ —	\$ 22,034
Commercial paper	—	11,944	—	11,944	—	8,595	—	8,595
US government & agency securities	—	—	—	—	—	3,000	—	3,000
<b>Total cash and cash equivalents</b>	<b>10,850</b>	<b>11,944</b>	<b>—</b>	<b>22,794</b>	<b>22,034</b>	<b>11,595</b>	<b>—</b>	<b>33,629</b>
<b>Investments:</b>								
Commercial paper	—	26,486	—	26,486	—	15,903	—	15,903
Corporate debt securities	—	11,977	—	11,977	—	1,265	—	1,265
US government & agency securities	—	24,465	—	24,465	—	28,136	—	28,136
Asset backed securities	—	1,611	—	1,611	—	3,337	—	3,337
<b>Total investments</b>	<b>—</b>	<b>64,539</b>	<b>—</b>	<b>64,539</b>	<b>—</b>	<b>48,641</b>	<b>—</b>	<b>48,641</b>
<b>Long-term restricted cash:</b>								
Cash	4,500	—	—	4,500	4,500	—	—	4,500
<b>Total assets measured at fair value</b>	<b>\$ 15,350</b>	<b>\$ 76,483</b>	<b>\$ —</b>	<b>\$ 91,833</b>	<b>\$ 26,534</b>	<b>\$ 60,236</b>	<b>\$ —</b>	<b>\$ 86,770</b>
<b>Liabilities</b>								
Financing derivative	\$ —	\$ —	\$ 218	\$ 218	\$ —	\$ —	\$ 600	\$ 600
<b>Total liabilities measured at fair value</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 218</b>	<b>\$ 218</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 600</b>	<b>\$ 600</b>

We classify our cash deposits and money market funds within Level 1 of the fair value hierarchy because they are valued using bank balances or quoted market prices. We classify our investments as Level 2 instruments based on market pricing and other observable inputs. We did not classify any of our investments within Level 3 of the fair value hierarchy.

During the nine-month periods ended September 30, 2016 and 2015, there were no impairments of our investments.

The estimated fair value of the Financing Derivative liability (as defined in Note 6 Notes Payable) was determined using Level 3 inputs, or significant unobservable inputs. Refer to Note 6 Notes Payable for a detailed description and valuation approach. Changes to the estimated fair value of the Financing Derivative are recorded in "Other income (expense), net" in the condensed consolidated statements of operations and comprehensive income (loss).

The following table provides the changes in the estimated fair value of the Financing Derivative during the nine-month period ended September 30, 2016 (in thousands):

Financing Derivative	Amount
Balance as of December 31, 2015	\$ 600
Gain on change in estimated fair value	(382)
Balance as of September 30, 2016	\$ 218

During the nine-month period ended September 30, 2016 there were no transfers between Level 1, Level 2, or Level 3 assets or liabilities reported at fair value on a recurring basis and the valuation techniques used did not change compared to our established practice.

Financial assets and liabilities not measured at fair value on a recurring basis

The carrying amount of our accounts receivable, prepaid expenses, other current assets, accounts payable, accrued expenses and other liabilities, current, approximate fair value due to their short maturities. The carrying value of our other liabilities, non-current, approximates fair value due to the time to maturity and prevailing market rates.

We determined the estimated fair value of the Notes (as defined in Note 6 Notes Payable) using Level 3 inputs, or significant unobservable inputs. The estimated fair value of the Notes was determined by comparing the difference between the estimated fair value of the Notes with and without the Financing Derivative by calculating the respective present values from future cash flows using a weighted average market yield of 11.4% and 13.5% at September 30, 2016 and December 31, 2015, respectively.

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The estimated fair value and carrying value of the Notes are as follows (in thousands):

	September 30, 2016		December 31, 2015	
	Fair Value	Carrying Value	Fair Value	Carrying Value
Notes payable	\$ 19,381	\$ 15,794	\$ 18,037	\$ 14,948

#### Net Income (loss) per Share

Basic net income (loss) per share and diluted net income (loss) per share are presented in conformity with ASC 260 Earnings per Share, for all periods presented. Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding during the period. Diluted net income (loss) per share is computed using the weighted average number of shares of common stock outstanding and potential shares assuming the dilutive effect of outstanding stock options, warrants and common stock issuable pursuant to our employee stock purchase plan, or ESPP, using the treasury stock method.

The following table presents the calculation of weighted average number of shares of common stock used in the computations of basic and diluted net income (loss) per share amounts presented in the accompanying condensed consolidated statements of operations and comprehensive income (loss) (in thousands, except per share amounts):

	Three-Month Periods Ended		Nine-Month Periods Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Net income (loss)	\$ (17,494)	\$ 1,821		