PACIFIC BIOSCIENCES OF CALIFORNIA, INC.
Form 10-Q
August 03, 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 June 30, 2018

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)

Delaware (State or other jurisdiction of incorporation or organization)	16-1590339 (I.R.S. Employer Identification No.)
1305 O'Brien Drive	94025

Menlo Park, CA 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, a 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	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

Number of shares outstanding of the issuer's common stock as of July 31, 2018: 131,941,955

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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 per share amounts)	June 30, 2018	December 31, 2017
Assets		
Current assets		
Cash and cash equivalents	$ 23,058	$ 16,507
Investments	40,433	46,365
Accounts receivable	7,446	13,433
Inventory	23,440	23,065
Prepaid expenses and other current assets	2,035	2,249
Total current assets	96,412	101,619
Property and equipment, net	36,103	37,920
Long-term restricted cash	4,500	4,500
Other long-term assets	43	45
Total assets	$ 137,058	$ 144,084
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	$ 4,169	$ 9,093
Accrued expenses	10,935	12,618
Deferred service revenue, current	6,416	6,319
Other liabilities, current	744	605
Total current liabilities	22,264	28,635
Deferred service revenue, non-current	1,053	1,075
Deferred rent, non-current	14,106	14,453
Notes payable, non-current	14,121	13,635
Financing derivative	40	183
Total liabilities	51,584	57,981

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 131,888 and 116,277 shares at June 30, 2018 and December 31, 2017, respectively	132	116
Additional paid-in-capital	1,011,621	965,752
Accumulated other comprehensive loss	(16)	(32)
Accumulated deficit	(926,263)	(879,733)
Total stockholders’ equity	85,474	86,103
Total liabilities and stockholders’ equity	$ 137,058	$ 144,084

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 Loss

(Unaudited)

(in thousands, except per share amounts)	Three-Month Periods Ended June 30, 2018	Three-Month Periods Ended June 30, 2017	Six-Month Periods Ended June 30, 2018	Six-Month Periods Ended June 30, 2017
Revenue:				
Product revenue	$ 18,485	$ 16,548	$ 34,767	$ 37,842
Service and other revenue	3,093	3,525	6,173	7,146
Total revenue	21,578	20,073	40,940	44,988
Cost of revenue:				
Cost of product revenue	9,858	8,155	18,877	19,517
Cost of service and other revenue	2,858	3,917	5,905	8,533
Total cost of revenue	12,716	12,072	24,782	28,050
Gross profit	8,862	8,001	16,158	16,938
Operating expense:				
Research and development	15,664	16,883	31,975	33,854
Sales, general and administrative	14,943	15,505	29,877	30,770
Total operating expense	30,607	32,388	61,852	64,624
Operating loss	(21,745)	(24,387)	(45,694)	(47,686)
Interest expense	(598)	(826)	(1,179)	(1,664)
Other income (expense), net	(197)	(326)	154	(56)
Net loss	(22,540)	(25,539)	(46,719)	(49,406)
Other comprehensive loss:				
Unrealized income (loss) on investments	22	(13)	16	(21)
Comprehensive loss	$ (22,518)	$ (25,552)	$ (46,703)	$ (49,427)
Net loss per share:				
Basic and diluted net loss per share	$ (0.17)	$ (0.26)	$ (0.37)	$ (0.52)
Shares used in computing basic and diluted net loss per share	131,882	97,360	127,847	95,177

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)

	Six-Month Periods Ended June 30,	
(in thousands)	2018	2017
Cash flows from operating activities		
Net loss	$ (46,719)	$ (49,406)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation	3,611	4,839
Amortization of debt discount and financing costs	486	652
(Gain) Loss on derivative	(143)	485
Stock-based compensation	10,506	9,994
Other items	(194)	87
Changes in assets and liabilities		
Accounts receivable	5,987	1,896
Inventory	(560)	(2,240)
Prepaid expenses and other assets	337	6,368
Accounts payable	(4,765)	(1,944)
Accrued expenses	(1,683)	(2,266)
Deferred service revenue	75	(349)
Other liabilities	(208)	2,404
Net cash used in operating activities	(33,270)	(29,480)
Cash flows from investing activities		
Purchase of property and equipment	(1,700)	(6,116)
Disposal of property and equipment	—	12
Purchase of investments	(44,500)	(61,181)
Sales of investments	2,442	3,662
Maturities of investments	48,200	46,511
Net cash provided by (used in) investing activities	4,442	(17,112)
Cash flows from financing activities		
Proceeds from issuance of common stock from equity plans	2,517	6,231
Notes payable principal paying off	—	(4,500)
Proceeds from issuance of common stock from at-the-market equity offering, net of issuance costs	—	11,865
Proceeds from issuance of common stock from underwritten public equity offering, net of issuance costs	32,862	52,709
Net cash provided by financing activities	35,379	66,305

Net increase in cash and cash equivalents and restricted cash	6,551	19,713
Cash and cash equivalents and restricted cash at beginning of period	21,007	21,265
Cash and cash equivalents and restricted cash at end of period	$ 27,558	$ 40,978
Cash and cash equivalents at end of period	23,058	36,478
Restricted cash at end of period	4,500	4,500
Cash and cash equivalents and restricted cash at end of period	$ 27,558	$ 40,978
Supplemental disclosure of non-cash investing and financing activities		
Inventory transferred to property and equipment	$ 492	$ 608
Changes in unpaid property and equipment	$ 159	$ 3,323
Property and equipment paid by landlord	$ —	$ 12,600
Changes in deposits for property and equipment paid in prior period	$ —	$ 9,694
Property and equipment returned to landlord	$ —	$ 1,854

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

We design, develop and manufacture 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 the ability to simultaneously detect epigenetic changes. PacBio® sequencing systems, including consumables and software, provide a simple and fast end-to-end workflow for SMRT sequencing.

Our most advanced products offered today include the Sequel instrument and the Sequel SMRT Cell 1M, which together are capable of sequencing up to approximately one million DNA molecules simultaneously. We are continuously developing new products including what we refer to as the SMRT Cell 8M, which is designed to have up to eight times as much throughput capability as the current Sequel SMRT Cell 1M. We anticipate starting beta testing of the SMRT Cell 8M in early 2019 and launching this new product more broadly some months thereafter.

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

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Consolidation

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, 2017 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, 2017. The results of operations for the three- and six- month periods ended June 30, 2018 are not necessarily indicative of the results to be expected for the entire year or any future periods.

The consolidated financial statements include the accounts of Pacific Biosciences and our wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated. Translation adjustments resulting from translating foreign subsidiaries’ results of operations and assets and liabilities into U.S. dollars are immaterial for all periods presented.

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 expected renewal period for service contracts, the useful lives assigned to long-lived assets, and the computation of provisions for income taxes. Actual results could differ materially from these estimates.

Fair Value of Financial Instruments

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.

The fair value hierarchy established under U.S. GAAP requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The three levels of inputs that may be used to measure fair value are as follows:

- Level 1: quoted prices in active markets for identical assets or liabilities;
- Level 2: inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in markets that are

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not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

· Level 3: unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

We consider an active market as one in which transactions for the asset or liability occurs with sufficient frequency and volume to provide pricing information on an ongoing basis. Conversely, we view an inactive market as one in which there are few transactions for the asset or liability, the prices are not current, or price quotations vary substantially either over time or among market makers. Where appropriate, our non-performance risk, or that of our counterparty, is considered in determining the fair values of liabilities and assets, respectively.

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.

Assets and liabilities measured at fair value are classified in their entirety based on the lowest level input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the entire fair value measurement requires management to make judgments and consider factors specific to the asset or liability.

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 that were measured on a recurring basis as of June 30, 2018 and December 31, 2017 respectively (in thousands):

	June 30, 2018				December 31, 2017			
(in thousands)	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets								
Cash and cash equivalents:								
Cash and money market funds	$ 16,438	$ —	$ —	$ 16,438	$ 14,858	$ —	$ —	$ 14,858
Commercial paper	—	6,620	—	6,620	—	1,649	—	1,649
Total cash and cash equivalents	16,438	6,620	—	23,058	14,858	1,649	—	16,507
Investments:								
Commercial paper	—	22,062	—	22,062	—	20,394	—	20,394
Corporate debt securities	—	4,369	—	4,369	—	9,034	—	9,034
US government & agency securities	—	14,002	—	14,002	—	16,937	—	16,937
Total investments	—	40,433	—	40,433	—	46,365	—	46,365
Long-term restricted cash:								

Cash	4,500	—	—	4,500	4,500	—	—	4,500
Total assets measured at fair value	$ 20,938	$ 47,053	$ —	$ 67,991	$ 19,358	$ 48,014	$ —	$ 67,372
Liabilities								
Financing derivative	$ —	$ —	$ 40	$ 40	$ —	$ —	$ 183	$ 183
Total liabilities measured at fair value	$ —	$ —	$ 40	$ 40	$ —	$ —	$ 183	$ 183

The estimated fair value of the Financing Derivative liability was determined using Level 3 inputs, or significant unobservable inputs.

During the six-month period ended June 30, 2018, there were no transfers between Level 1, Level 2, or Level 3 assets or liabilities reported at fair value on a recurring basis and our valuation techniques did not change compared to the prior year.

Financial Assets and Liabilities Not Measured at Fair Value on a Recurring Basis

We determined the fair value of the Notes from the debt facility that we entered into during the first quarter of 2013 using Level 3 inputs, or significant unobservable inputs. The value of the Notes was determined by comparing the difference between the fair value of the Notes with and without the Financing Derivative by calculating the respective present values from future cash flows using 9.3% and 10.3% weighted average market yield at June 30, 2018 and December 31, 2017, respectively. Refer to “Note 5. Notes Payable” for additional details regarding the Notes. The estimated fair value and carrying value of the Notes are as follows (in thousands):

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

	June 30, 2018		December 31, 2017	
	Fair Value	Carrying Value	Fair Value	Carrying Value
Notes payable	$ 15,939	$ 14,121	$ 15,664	$ 13,635

Net Loss per Share

The following outstanding common stock options, restricted stock units, or "RSUs", with time-based vesting and RSUs with performance-based vesting were excluded from the computation of diluted net loss per share for the periods presented because including them would have had an anti-dilutive effect. See "Note 7. Stockholders' Equity" for detailed information on RSUs with time-based vesting and RSUs with performance-based vesting

	Six Months Ended June 30,	
(in thousands)	2018	2017
Options to purchase common stock	28,601	25,592
RSUs with time-based vesting	355	—
RSUs with performance-based vesting	652	—

Concentration and Other Risks

For the three- and six- month periods ended June 30, 2018, one of our customers, Gene Company Limited, accounted for approximately 33% and 31% of our total revenue, respectively. For the three- and six- month periods ended June 30, 2017, the same customer, Gene Company Limited, accounted for approximately 26% and 28% of our total revenue, respectively. Gene Company Limited is our distributor in China.

Going Concern

Cash, cash equivalents and investments, excluding restricted cash, at June 30, 2018 totaled $63.5 million, compared to $62.9 million at December 31, 2017. We believe that our existing cash, cash equivalents and investments will be sufficient to fund our projected operating requirements for at least twelve months from the filing of this Quarterly Report on Form 10-Q; however, we may need to raise additional capital in the future. Our view regarding sufficiency of cash and liquidity is primarily based on our operating plans and financial forecast for 2018, which includes various assumptions regarding demand for our products.

Factors that may affect our capital needs include, but are not limited to, slower than expected adoption of our products resulting in lower sales of our products and services; future acquisitions; our ability to obtain new collaboration, distribution and customer arrangements; the progress of our research and development programs; initiation or expansion of research programs and collaborations; litigation costs, including the costs involved in preparing, filing, prosecuting, defending and enforcing intellectual property rights; the purchase of patent licenses; and other factors.

To the extent we raise additional funds through the sale of equity or convertible debt securities, the issuance of such securities will result in dilution to our stockholders. There can be no assurance that such funds will be available on favorable terms, or at all, particularly in light of restrictions under our debt agreement. If adequate funds are not available, we may be required to obtain funds by entering into collaboration, licensing or debt agreements on unfavorable terms. If we are unable to raise funds on favorable terms, or at all, we may have to reduce our cash burn rate and may not be able to support our commercialization efforts, or to increase or maintain the level of our research and development activities. If we are unable to generate sufficient cash flows or to raise adequate funds to finance our forecasted expenditures, we may have to make significant changes to our operations, including delaying or reducing the scope of or eliminating some or all of our development programs. We also may have to reduce sales, marketing, engineering, customer support or other resources devoted to our existing or new products or cease operations. If our cash, cash equivalents and investments are insufficient to fund our projected operating requirements, and we are unable to raise capital, it would have a material adverse effect on our business, financial condition and results of operations.

Significant Accounting Policies

Except as noted below relating to our adoption of ASC 606, there have been no material changes to our significant accounting policies as discussed in our Annual Report on Form 10-K for the year ended December 31, 2017.

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Recent Accounting Pronouncements

Recently Issued Accounting Standards

In June 2018, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update, or ASU, 2018-07, Improvements to Nonemployee Share-Based Payment Accounting, to simplify the accounting for nonemployee share-based payment transactions by expanding the scope of Accounting Standards Codification, or ASC, Topic 718, Compensation - Stock Compensation, to include share-based payment transactions for acquiring goods and services from nonemployees. Under the new standard, most of the guidance on stock compensation payments to nonemployees would be aligned with the requirements for share-based payments granted to employees. This standard is effective for annual reporting periods beginning after December 15, 2018, including interim reporting periods within those annual reporting periods, with early adoption permitted. We expect to adopt this standard beginning in 2019. While we continue to assess the potential impact of this standard, we do not expect the adoption of this standard to have a material impact on our condensed consolidated financial statements.

In February 2018, the FASB issued ASU 2018-02, Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, that allows for an entity to elect to reclassify the income tax effects on items within accumulated other comprehensive income resulting from U.S. tax reform to retained earnings. The guidance is effective for fiscal years beginning after December 15, 2018 with early adoption permitted, including interim periods within those years. We are currently evaluating the impact of this standard on our Consolidated Financial Statements and whether we will make the allowed election.

In February 2016, the FASB issued ASU 2016-02, Leases. The guidance in ASU 2016-02 supersedes the lease recognition requirements in ASC Topic 840, Leases. ASU 2016-02 requires an entity to recognize assets and liabilities arising from a lease for both financing and operating leases, along with additional qualitative and quantitative disclosures. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, with early adoption permitted. We are currently evaluating the impact of the adoption of this standard on our consolidated financial statements. We expect to adopt this standard beginning in 2019. We do not expect that this standard will have a material impact on our operating results, but we do expect that upon adoption, it will have a material impact on our assets and liabilities. The primary effect of adoption will be the requirement to record right-of-use assets and corresponding lease obligations for current operating leases. We are currently quantifying the impact of adoption.

Recently Adopted Accounting Standards

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, which requires restricted cash to be presented with cash and cash equivalents on the statement of cash flows and disclosure of how the statement of cash flows reconciles to the balance sheet if restricted cash is shown separately from cash and cash equivalents on the balance sheet. ASU 2016-18 is effective for interim and annual periods beginning after December 15, 2017, with early adoption permitted. We adopted this standard effective January 1, 2018 using the retrospective transition method by restating our condensed consolidated statements of cash flows to include restricted cash of $4.5 million in the beginning and ending cash, cash equivalents, and restricted cash balances for all periods presented. As a result of adoption, net cash flows for the six months ended June 30, 2017 did not change as a result of including restricted cash with cash and cash equivalents when reconciling the beginning-of-period and end-of-period amounts presented on the statements of cash flows.

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” as modified by subsequently issued ASUs 2015-14, 2016-08, 2016-10, 2016-12 and 2016-20 (collectively ASC 606). ASC 606 superseded existing revenue recognition standards with a single model unless those contracts are within the scope of other standards, such as leases, insurance, collaboration arrangements and financial instruments. The revenue recognition principle in ASC 606 is that an entity recognizes revenue when its customer obtains control of promised goods or services, in an amount that reflects the consideration which the entity expects to receive in exchange for those goods or services. To determine revenue recognition for arrangements that an entity determines are within the scope of Topic 606, the entity performs the following five steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when (or as) the entity satisfies a performance obligation. On January 1, 2018, we adopted ASC 606 using the modified retrospective method with the cumulative effect of adoption recognized as an adjustment to our accumulated deficit on January 1, 2018. Prior period financial statements and disclosures have not been restated and continue to be reported under the accounting standards in effect for those periods. The adoption of ASC 606 did not have a material impact on our condensed consolidated financial position, results of operations, equity or cash flows as of the adoption date or for the three-and six- month periods ended June 30, 2018. In addition, the standard requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers.

Upon adopting ASC 606, the incremental direct costs of obtaining a contract are now deferred and amortized over the period of contract performance or a longer period if renewals are expected and the renewal commission is not commensurate with the

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initial commission. We classify deferred commissions as current and included it in “Prepaid expenses and other current assets” in our condensed consolidated balance sheets.

The cumulative effect of the changes made to our consolidated January 1, 2018 balance sheet for the adoption of ASC 606 was as follows (in thousands):

Balance Sheet	Balance at December 31, 2017	Adjustments Due to ASC 606	Balance at January 1, 2018
Assets			
Prepaid expenses and other current assets	$ 2,249	$ 189	$ 2,438
Liabilities and Stockholders' Equity			
Accumulated deficit	(879,733)	189	(879,544)

In accordance with ASC 606, the disclosure of the impact of adoption on our condensed consolidated statement of operations and comprehensive loss, condensed consolidated balance sheets, and condensed consolidated statements of cash flows for the three- and six- month periods ended June 30, 2018 was as follows (in thousands):

For the three-month period ended June 30, 2018