

**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, 2020**

**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)

1305 O'Brien Drive  
Menlo Park, CA  
(Address of principal executive offices)

16-1590339  
(I.R.S. Employer  
Identification No.)

94025  
(Zip Code)

(650) 521-8000  
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, par value \$0.001 per share	PACB	The NASDAQ Stock Market LLC

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 T No o

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes T No o

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	T	Accelerated Filer	O
Non-accelerated Filer	o	Smaller Reporting Company	O
Emerging Growth Company	o		

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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 October 31, 2020: 180,212,604.

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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)	September 30, 2020	December 31, 2019
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 69,028	\$ 29,627
Investments	139,522	19,472
Accounts receivable	11,806	15,266
Inventory	15,940	13,312
Prepaid expenses and other current assets	3,212	3,369
Total current assets	239,508	81,046
Property and equipment, net	26,568	30,070
Operating lease right-of-use assets, net	30,700	32,827
Long-term restricted cash	3,500	4,000
Other long-term assets	42	42
Total assets	\$ 300,318	\$ 147,985
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities		
Accounts payable	\$ 5,406	\$ 8,368
Accrued expenses	15,079	13,242
Deferred revenue, current	6,982	7,610
Operating lease liabilities, current	4,217	3,837
Notes payable, current	—	15,871
Deferred gain from Reverse Termination Fee	98,000	—
Other liabilities, current	584	225
Total current liabilities	130,268	49,153
Deferred revenue, non-current	1,761	1,951
Operating lease liabilities, non-current	38,793	41,964
Total liabilities	170,822	93,068
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 179,937 shares and 153,119 shares at September 30, 2020 and December 31, 2019, respectively	180	153
Additional paid-in capital	1,241,002	1,120,999
Accumulated other comprehensive income	118	5
Accumulated deficit	(1,111,804)	(1,066,240)
Total stockholders' equity	129,496	54,917
Total liabilities and stockholders' equity	\$ 300,318	\$ 147,985

See accompanying notes to the condensed consolidated financial statements.

**PACIFIC BIOSCIENCES OF CALIFORNIA, INC.**

**Condensed Consolidated Statements of Operations and Comprehensive Loss  
(Unaudited)**

<u>(in thousands, except per share amounts)</u>	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	2020	2019	2020	2019
Revenue:				
Product revenue	\$ 15,749	\$ 18,484	\$ 41,798	\$ 53,191
Service and other revenue	3,333	3,431	9,959	9,770
Total revenue	19,082	21,915	51,757	62,961
Cost of revenue:				
Cost of product revenue	9,228	12,188	22,874	32,786
Cost of service and other revenue	2,790	2,813	7,718	8,531
Total cost of revenue	12,018	15,001	30,592	41,317
Gross profit	7,064	6,914	21,165	21,644
Operating expense:				
Research and development	16,467	14,962	46,727	45,357
Sales, general and administrative	14,772	20,066	54,846	58,915
Total operating expense	31,239	35,028	101,573	104,272
Operating loss	(24,175)	(28,114)	(80,408)	(82,628)
Gain from Continuation Advances	—	—	34,000	—
Interest expense	—	(664)	(267)	(1,933)
Other income (expense), net	467	(345)	1,143	518
Net loss	(23,708)	(29,123)	(45,532)	(84,043)
Other comprehensive income (loss):				
Unrealized income (loss) on investments	(125)	(6)	113	47
Comprehensive loss	\$ (23,833)	\$ (29,129)	\$ (45,419)	\$ (83,996)
Net loss per share:				
Basic and diluted net loss per share	\$ (0.14)	\$ (0.19)	\$ (0.29)	\$ (0.55)
Shares used in computing basic and diluted net loss per share	166,862	152,983	158,195	152,351

See accompanying notes to the condensed consolidated financial statements.

**PACIFIC BIOSCIENCES OF CALIFORNIA, INC.**  
**Condensed Consolidated Statements of Stockholders' Equity**  
**(Unaudited)**

(in thousands)	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders' Equity
<b><i>For the three months ended September 30, 2020</i></b>						
<b>Balance at June 30, 2020</b>	154,318	\$ 154	\$ 1,129,091	\$ 243	\$ (1,088,096)	\$ 41,392
Net loss	—	—	—	—	(23,708)	(23,708)
Other comprehensive loss	—	—	—	(125)	—	(125)
Issuance of common stock in conjunction with equity plans	3,274	3	13,344	—	—	13,347
Issuance of common stock from Underwritten Public Equity Offering, net of issuance costs	22,345	23	93,575	—	—	93,598
Stock-based compensation expense	—	—	4,992	—	—	4,992
<b>Balance at September 30, 2020</b>	<u>179,937</u>	<u>\$ 180</u>	<u>\$ 1,241,002</u>	<u>\$ 118</u>	<u>\$ (1,111,804)</u>	<u>\$ 129,496</u>
<b><i>For the three months ended September 30, 2019</i></b>						
<b>Balance at June 30, 2019</b>	152,959	\$ 153	\$ 1,112,610	\$ 17	\$ (1,037,026)	\$ 75,754
Net loss	—	—	—	—	(29,123)	(29,123)
Other comprehensive loss	—	—	—	(6)	—	(6)
Issuance of common stock in conjunction with equity plans	72	—	327	—	—	327
Stock-based compensation expense	—	—	4,062	—	—	4,062
<b>Balance at September 30, 2019</b>	<u>153,031</u>	<u>\$ 153</u>	<u>\$ 1,116,999</u>	<u>\$ 11</u>	<u>\$ (1,066,149)</u>	<u>\$ 51,014</u>
<b><i>For the nine months ended September 30, 2020</i></b>						
<b>Balance at December 31, 2019</b>	153,119	\$ 153	\$ 1,120,999	\$ 5	\$ (1,066,240)	\$ 54,917
Net loss	—	—	—	—	(45,532)	(45,532)
Other comprehensive income	—	—	—	113	—	113
Adoption effect of Topic 326	—	—	—	—	(32)	(32)
Issuance of common stock from Underwritten Public Equity Offering, net of issuance costs	22,345	23	93,575	—	—	93,598
Issuance of common stock in conjunction with equity plans	4,473	4	14,170	—	—	14,174
Stock-based compensation expense	—	—	12,258	—	—	12,258
<b>Balance at September 30, 2020</b>	<u>179,937</u>	<u>\$ 180</u>	<u>\$ 1,241,002</u>	<u>\$ 118</u>	<u>\$ (1,111,804)</u>	<u>\$ 129,496</u>
<b><i>For the nine months ended September 30, 2019</i></b>						
<b>Balance at December 31, 2018</b>	150,244	\$ 150	\$ 1,096,053	\$ (36)	\$ (982,106)	\$ 114,061
Net loss	—	—	—	—	(84,043)	(84,043)
Other comprehensive income	—	—	—	47	—	47
Issuance of common stock in conjunction with equity plans	2,787	3	8,414	—	—	8,417
Stock-based compensation expense	—	—	12,532	—	—	12,532
<b>Balance at September 30, 2019</b>	<u>153,031</u>	<u>\$ 153</u>	<u>\$ 1,116,999</u>	<u>\$ 11</u>	<u>\$ (1,066,149)</u>	<u>\$ 51,014</u>

See accompanying notes to the condensed consolidated financial statements

**PACIFIC BIOSCIENCES OF CALIFORNIA, INC.**  
**Condensed Consolidated Statements of Cash Flows**  
**(Unaudited)**

(in thousands)	Nine Months Ended September 30.	
	2020	2019
<b>Cash flows from operating activities</b>		
Net loss	\$ (45,532)	\$ (84,043)
Adjustments to reconcile net loss to net cash used in operating activities		
Gain from Continuation Advances	(34,000)	—
Depreciation	4,827	5,483
Amortization of operating lease right-of-use assets	2,127	1,954
Amortization of debt discount and financing costs	129	887
Gain on derivative	—	(16)
Stock-based compensation	12,258	12,532
Amortization (accretion) from investment premium (discount)	(141)	(821)
Loss on disposition of equipment	—	144
Changes in assets and liabilities		
Accounts receivable	3,428	(1,371)
Inventory	(2,988)	2,255
Prepaid expenses and other assets	216	238
Accounts payable	(2,955)	1,454
Accrued expenses	1,646	4,914
Deferred revenue	(818)	387
Operating lease liabilities	(2,791)	(2,537)
Other liabilities	360	(1,592)
Deferred gain from Reverse Termination Fee	98,000	—
Net cash provided by (used in) operating activities	33,766	(60,132)
<b>Cash flows from investing activities</b>		
Purchase of property and equipment	(972)	(2,695)
Purchase of investments	(234,555)	(42,710)
Sales of investments	—	1,500
Maturities of investments	114,700	109,360
Net cash provided by (used in) investing activities	(120,827)	65,455
<b>Cash flows from financing activities</b>		
Continuation Advances	34,000	—
Notes payable principal payoff	(16,000)	—
Proceeds from issuance of common stock from underwritten public equity offering, net of issuance costs	93,788	—
Proceeds from issuance of common stock from equity plans	14,174	8,417
Net cash provided by financing activities	125,962	8,417
Net increase in cash and cash equivalents and restricted cash	38,901	13,740
Cash and cash equivalents and restricted cash at beginning of period	33,627	23,344
Cash and cash equivalents and restricted cash at end of period	\$ 72,528	\$ 37,084
Cash and cash equivalents at end of period	69,028	33,084
Restricted cash at end of period	3,500	4,000
Cash and cash equivalents and restricted cash at end of period	\$ 72,528	\$ 37,084
<b>Supplemental disclosure of non-cash operating activities</b>		
Inventory transferred to property and equipment	\$ 541	\$ 1,784
Inventory transferred from property and equipment	\$ 181	\$ 1,228

See accompanying notes to the condensed consolidated financial statements.

**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 current products include the Sequel II instrument and SMRT Cell 8M, which together are capable of sequencing up to approximately eight million DNA molecules simultaneously, and the previous generation Sequel instrument and Sequel SMRT Cell 1M, which together are capable of sequencing up to approximately one million DNA molecules simultaneously. In October 2020, we launched the Sequel IIe System, which has increased computational capacity, and is designed to enable customers to generate PacBio HiFi reads more efficiently.

Our customers and our scientific collaborators have published numerous peer-reviewed articles in journals including Nature, Science, Cell, PNAS and The New England Journal of Medicine highlighting the power and applications of SMRT sequencing in projects such as finishing genomes, structural variation discovery, isoform transcriptome characterization, rare mutation discovery and the identification of chemical modifications of DNA related to virulence and pathogenicity. Our research and development efforts are focused on developing new products and further improving our existing products including continuing chemistry and sample preparation improvements to increase throughput and expand our supported applications. By providing access to genetic information that was previously inaccessible, we enable scientists to confidently increase their understanding of biological systems.

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

**NOTE 2 TERMINATION OF MERGER WITH ILLUMINA**

On November 1, 2018, we entered into an Agreement and Plan of Merger (as amended, the “Merger Agreement”) with Illumina, Inc. (“Illumina”) and FC Ops Corp., a wholly owned subsidiary of Illumina (“Merger Subsidiary”). On January 2, 2020, we, Illumina and Merger Subsidiary, entered into an agreement to terminate the Merger Agreement (the “Termination Agreement”). As part of the Termination Agreement, Illumina paid us a \$98.0 million termination fee (the “Reverse Termination Fee”), from which we paid our financial advisor associated fees of \$6.0 million in April 2020. In addition, Illumina paid us cash payments (“Continuation Advances”) of \$18.0 million during the fourth quarter of 2019 and \$34.0 million during the first quarter of 2020.

However, pursuant to the Termination Agreement, in the event that, on or prior to September 30, 2020, we entered into a definitive agreement providing for, or consummated, a Change of Control Transaction (as defined in the Termination Agreement) (“Change of Control Transaction”), then we may have been required to repay the Reverse Termination Fee (without interest) to Illumina in connection with the consummation of such Change of Control Transaction. No such definitive agreement was entered into nor was a Change of Control Transaction consummated as of September 30, 2020. Please refer to “Note 5. Balance Sheet Components” for the accounting treatment of the Reverse Termination Fee.

In addition, up to the full \$52.0 million of Continuation Advances paid to us are repayable without interest to Illumina if, within two years of March 31, 2020, we enter into, or consummate a Change of Control Transaction or raise at least \$100 million in a single equity or debt financing (that may have multiple closings), with the amount repayable dependent on the amount raised by us. Please refer to “Note 3. Summary of Significant Accounting Policies” for the accounting treatment of the Continuation Advances.



### NOTE 3. 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, 2019 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, 2019. The results of operations for the three and nine months ended September 30, 2020 are not necessarily indicative of the results to be expected for the entire year or any future periods.

The condensed consolidated financial statements include the accounts of Pacific Biosciences and our wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated.

#### ***COVID-19***

We are subject to risks and uncertainties as a result of the novel coronavirus pandemic (COVID-19). The extent of the impact of the COVID-19 pandemic on our business is highly uncertain as responses to the pandemic can change quickly and information is rapidly evolving. We considered the impact of COVID-19 on the assumptions and estimates used to determine the results reported and asset valuations as of September 30, 2020.

#### ***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, the determination of stand-alone selling prices for revenue recognition, the valuation of a financing derivative and long-term notes, the probability of repaying the Continuation Advances and Reverse Termination Fee to Illumina, the valuation and recognition of share-based compensation, the expected renewal period for service contracts to derive the amortization period for capitalized commissions, the useful lives assigned to long-lived assets, the computation of provisions for income taxes and the determination of the internal borrowing rate used in calculating the operating lease right-of-use assets and operating lease liabilities. 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 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. 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 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 September 30, 2020 and December 31, 2019 respectively:

(in thousands)	September 30, 2020				December 31, 2019			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
<b>Assets</b>								
<u>Cash and cash equivalents:</u>								
Cash and money market funds	\$ 41,784	\$ —	\$ —	\$ 41,784	\$ 18,644	\$ —	\$ —	\$ 18,644
Commercial paper	—	24,244	—	24,244	—	10,983	—	10,983
U.S. Treasury security	—	3,000	—	3,000	—	—	—	—
Total cash and cash equivalents	41,784	27,244	—	69,028	18,644	10,983	—	29,627
<u>Investments:</u>								
Commercial paper	—	105,380	—	105,380	—	16,971	—	16,971
Corporate debt securities	—	21,195	—	21,195	—	2,501	—	2,501
U.S. government & agency securities	—	10,097	—	10,097	—	—	—	—
U.S. Treasury security	—	2,850	—	2,850	—	—	—	—
Total investments	—	139,522	—	139,522	—	19,472	—	19,472
<u>Long-term restricted cash:</u>								
Cash	3,500	—	—	3,500	4,000	—	—	4,000
Total assets measured at fair value	\$ 45,284	\$ 166,766	\$ —	\$ 212,050	\$ 22,644	\$ 30,455	\$ —	\$ 53,099
<b>Liabilities</b>								
Financing Derivative	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Continuation Advances	—	—	—	—	—	—	—	—
Total liabilities measured at fair value	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —

#### Estimated fair value of the Financing Derivative liability

The estimated fair value of the Financing Derivative liability (as defined in the “Notes payable, current” section in “Note 5. Balance Sheet Components”) was determined using Level 3 inputs, or significant unobservable inputs. Changes to the estimated fair value of the Financing Derivative are recorded in “Other income, net” in the consolidated statements of operations and comprehensive loss.

The estimated fair value of the Financing Derivative was determined by comparing the difference between the fair value of the Notes from the debt facility that we entered into during the first quarter of 2013 (the “Notes”) with and without the Financing Derivative by calculating the respective present values from future cash flows using a 6.5% discount rate at December 31, 2019. The estimated fair value of the Financing Derivative as of December 31, 2019 was \$0.

In February 2020, upon maturity of the Notes, the Financing Derivative was extinguished. Refer to the “Notes payable, current” section in “Note 5. Balance Sheet Components” for a detailed description and valuation approach.

#### Estimated fair value of the Continuation Advances liability

In accordance with the terms of the Merger Agreement, we received Continuation Advances of \$18.0 million and \$34.0 million from Illumina during the fourth quarter of 2019 and the first quarter of 2020, respectively.

We determined that the Continuation Advances, which are subject to repayment under certain circumstances as discussed below, constitute a financial liability.

The fair value option was elected for the financial liability because management believes that among all measurement methods allowed by Accounting Standards Codification, or ASC, 825, *Financial Instruments*, the fair value option would most fairly represent the value of such a financial liability. Management applied the income approach to estimate the fair value of this financial liability. The estimated fair value of the liability related to the Continuation Advances was determined using Level 3 inputs, or significant unobservable inputs. Management estimated that there would be no future cash outflows associated with this financial instrument because the probabilities of either of the following events occurring and requiring repayment to Illumina were evaluated as being remote as of September 30, 2020 and December 31, 2019:

- we enter into a Change of Control Transaction within two years following March 31, 2020; or
- we raise \$100 million or more in a single equity or debt financing (that may have multiple closings) within two years following March 31, 2020.

As a result, the estimated fair value of the liability associated with the contingent repayment of the Continuation Advances received in the first quarter of 2020 was assessed to be zero as of March 31, 2020, June 30, 2020 and September 30, 2020, respectively, with a resulting non-operating gain of \$34.0 million recorded as “Gain from Continuation Advances from Illumina” for the quarter ended March 31, 2020. We recorded a similar gain of \$18.0 million in 2019 for the Continuation Advances received during the fourth quarter of 2019.

For the quarter ended September 30, 2020, 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.

### **Net Loss per Share**

The following outstanding common stock options, restricted stock units (“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.

(in thousands)	Nine Months Ended September 30,	
	2020	2019
Options to purchase common stock	19,921	23,048
RSUs with time-based vesting	5,971	1,094
RSUs with performance-based vesting	94	138

### **Concentration and Other Risks**

For the three and nine months ended September 30, 2020, Gene Company Limited accounted for approximately 18% and 14%, respectively, of our total revenue during the period with no other customer exceeding 10% during those periods. For the three and nine months ended September 30, 2019, Gene Company Limited accounted for approximately 14% and 18% of our total revenue, respectively, with no other customer exceeding 10% during those periods. Gene Company Limited is our primary distributor in China.

### **Recent Accounting Pronouncements**

#### *Recently Adopted Accounting Standards*

In June 2016, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update, or ASU, 2016-13 *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* (“Topic 326”), which replaces existing incurred loss impairment guidance and establishes a single allowance framework for financial assets carried at amortized cost. We adopted Topic 326 on January 1, 2020, using a modified retrospective transition method, which requires a cumulative-effect adjustment to the opening balance of retained earnings/accumulated deficit to be recognized on the date of adoption with prior periods not restated. The cumulative-effect adjustment recorded on January 1, 2020, is shown below (in thousands):

Balance Sheets	<u>Balance at December 31, 2019</u>	<u>Adjustments Due to Topic 326</u>	<u>Balance at January 1, 2020</u>
<b>Assets</b>			
Accounts receivable	\$ 15,266	\$ (32)	\$ 15,234
<b>Liabilities and Stockholders' Equity</b>			
Accumulated deficit	(1,066,240)	(32)	(1,066,272)

The adoption of Topic 326 did not have a material impact on our financial statements and our bad debt expense was immaterial as of September 30, 2020. Please see the description of our “Credit Losses” accounting policy in the “Significant Accounting Policies” section below.

### ***Significant Accounting Policies***

With the exception of the change for the accounting of credit losses as a result of the adoption of Topic 326, there have been no new or material changes to the significant accounting policies discussed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2019, that are of significance, or potential significance, to us.

#### *Credit Losses*

*Trade accounts receivable.* The allowance for doubtful accounts is based on our assessment of the collectability of customer accounts. We regularly review the allowance by considering factors such as the age of the accounts receivable balances, customer creditworthiness, customer industry, and current and forecasted economic conditions that may affect a customer’s ability to pay.

*Available-for-sale debt securities.* Our investment portfolio at any point in time contains investments in cash deposits, money market funds, commercial paper, corporate debt securities and US government and agency securities. We regularly review the securities in an unrealized loss position and evaluate the current expected credit loss by considering factors such as significance of loss, historical experience, market data, issuer-specific factors, and current economic conditions and concluded that an allowance for credit losses was not required as of September 30 2020.

Although we have historically not experienced significant credit losses, our exposure to credit losses may increase if our customers are adversely affected by changes in economic pressures or uncertainty associated with local or global economic recessions, disruption associated with the current COVID-19 pandemic, or other customer-specific factors.

### **NOTE 4. CASH, CASH EQUIVALENTS AND INVESTMENTS**

The following tables summarize our cash, cash equivalents and investments as of September 30, 2020 and December 31, 2019 (in thousands):

	As of September 30, 2020			
	Amortized Cost	Gross unrealized gains	Gross unrealized losses	Fair Value
<b>Cash and cash equivalents:</b>				
Cash and money market funds	\$ 41,784	\$ —	\$ —	\$ 41,784
Commercial paper	24,243	1	—	24,244
U.S. Treasury security	3,000	—	—	3,000
Total cash and cash equivalents	69,027	1	—	69,028
<b>Investments:</b>				
Commercial paper	105,377	12	(9)	105,380
Corporate debt securities	21,081	119	(5)	21,195
U.S. government & agency securities	10,097	1	(1)	10,097
U.S. Treasury security	2,850	—	—	2,850
Total investments	139,405	132	(15)	139,522
Total cash, cash equivalents and investments	\$ 208,432	\$ 133	\$ (15)	\$ 208,550
<b>Long-term restricted cash:</b>				
Cash	\$ 3,500	\$ —	\$ —	\$ 3,500

	As of December 31, 2019			
	Amortized Cost	Gross unrealized gains	Gross unrealized losses	Fair Value
<b>Cash and cash equivalents:</b>				
Cash and money market funds	\$ 18,644	\$ —	\$ —	\$ 18,644
Commercial paper	10,983	—	—	10,983
Total cash and cash equivalents	29,627	—	—	29,627
<b>Investments:</b>				
Commercial paper	16,971	1	(1)	16,971
Corporate debt securities	2,496	5	—	2,501
Total investments	19,467	6	(1)	19,472
Total cash, cash equivalents and investments	\$ 49,094	\$ 6	\$ (1)	\$ 49,099
<b>Long-term restricted cash:</b>				
Cash	\$ 4,000	\$ —	\$ —	\$ 4,000

The following table summarizes the contractual maturities of our cash equivalents and available-for-sale investments, excluding money market funds, as of September 30, 2020 (in thousands):

	Fair Value
Due in one year or less	\$ 152,858
Due after one year through 5 years	13,908
Total investments	\$ 166,766

Actual maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations without call or prepayment penalties.

## NOTE 5. BALANCE SHEET COMPONENTS

### Inventory

As of September 30, 2020 and December 31, 2019, our inventory consisted of the following components:

(in thousands)	September 30, 2020	December 31, 2019
Purchased materials	\$ 5,198	\$ 3,966
Work in process	5,439	4,594
Finished goods	5,303	4,752
Inventory	<u>\$ 15,940</u>	<u>\$ 13,312</u>

**Long-term restricted cash**

For our facility located at 1305 O'Brien Drive, Menlo Park, California (the "O'Brien Lease"), we were required to establish a letter of credit for the benefit of the landlord and to submit \$4.5 million as a deposit for the letter of credit in October 2015. Subsequently, pursuant to the terms of the O'Brien Lease, on May 1, 2019, the amount of the letter of credit was reduced from \$4.5 million to \$4.0 million. As such, \$4.0 million was recorded in "Long-term restricted cash" in the condensed consolidated balance sheet as of December 31, 2019. Pursuant to the terms of the O'Brien Lease, the letter of credit balance of \$4.0 million was reduced again in May 2020 by \$500,000. As such, \$3.5 million was recorded in "Long-term restricted cash" in the condensed consolidated balance sheet as of September 30, 2020.

**Deferred gain from Reverse Termination Fee**

As part of the Termination Agreement, Illumina paid us a Reverse Termination Fee of \$98.0 million, from which we owed our financial advisor associated fees of \$6.0 million. We recorded the \$6.0 million of associated fees owed to our financial advisor in the "Sales, general and administrative" expense line in the condensed consolidated statements of operations and comprehensive loss for the nine months ended September 30, 2020.

Pursuant to the Termination Agreement, in the event that, on or prior to September 30, 2020, we entered into a definitive agreement providing for, or consummated, a Change of Control Transaction, then we may have been required to repay the Reverse Termination Fee (without interest) to Illumina in connection with the consummation of such Change of Control Transaction. If such Change of Control Transaction was not consummated by the two year anniversary of the execution of the definitive agreement for such Change of Control Transaction, then we would not have been required to repay the Reverse Termination Fee. As indicated in ASC 450, *Contingencies*, a gain contingency usually is not recognized in the financial statements until the period in which all contingencies are resolved and the gain is realizable. As such, we deferred the gain from the Reverse Termination Fee from Illumina until the date when the associated contingency was resolved and accordingly, we recorded the \$98.0 million as "Deferred Gain from Reverse Termination Fee" in the condensed consolidated balance sheet as of September 30, 2020. Subsequently, on October 1, 2020, the contingency clauses lapsed.

**Notes payable, current**

As of December 31, 2019, a balance of \$16.0 million aggregate principal amount of debt remained outstanding under the debt agreement with Deerfield entered into in February 2013 (the "Facility Agreement") and was presented as "Notes payable, current" on the condensed consolidated balance sheet as of December 31, 2019.

In February 2020, upon the maturity of the Facility Agreement, we repaid the remaining outstanding principal of \$16.0 million and interest.

**Financing Derivative**

A number of features embedded in the Notes required accounting for them as a derivative, including the indemnification of certain withholding taxes and the acceleration of debt upon (i) a qualified financing, (ii) an event of default, (iii) a Major Transaction (as such term is defined in the Facility Agreement), and (iv) the exercise of the warrant via offset to the debt principal. These features represent a single derivative (the "Financing Derivative") that was bifurcated from the debt instrument and accounted for as a liability at fair value, with changes in fair value between reporting periods recorded in other income (expense), net.

The estimated fair value of the Financing Derivative 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 a 6.5% discount rate at December 31, 2019. The estimated fair value of the Financing Derivative as of December 31, 2019 was \$0.

In February 2020, after we repaid the remaining outstanding principal of \$16.0 million and interest to Deerfield, the related Financing Derivative expired.

**Deferred revenue**

As of September 30, 2020, we had a total of \$8.7 million of deferred revenue from our service contracts, \$6.9 million of which was recorded as “Deferred revenue, current” to be recognized over the next year and the remaining \$1.8 million was recorded as “Deferred revenue, non-current” to be recognized in the next 3 years. Revenue recorded in the three and nine months ended September 30, 2020 includes \$1.6 million and \$6.5 million, respectively, of previously deferred revenue that was included in “Deferred revenue, current” as of December 31, 2019. Contract assets as of September 30, 2020 and December 31, 2019 were not material.

As of September 30, 2020, we had a total of \$0.6 million of deferred commissions included in “Prepaid expenses and other current assets” which is recognized as the related revenue is recognized. Additionally, as a practical expedient, we expense costs to obtain a contract as incurred if the amortization period would have been a year or less.

## **NOTE 6. COMMITMENTS AND CONTINGENCIES**

### ***Leases***

On July 22, 2015, we entered into a lease agreement with respect to our facility located at 1305 O’Brien Drive, Menlo Park, California. The term of the O’Brien Lease is one hundred thirty-two (132) months. In December 2016, we entered into an amendment to the O’Brien Lease which defined the commencement date of the lease to be October 25, 2016, notwithstanding that such substantial completion did not occur until the first quarter of 2017. Base monthly rent was abated for the first six (6) months of the lease term and thereafter was \$540,000 per month during the first year of the lease term, with specified annual increases thereafter until reaching \$711,000 per month during the last twelve (12) months of the lease term. If the rent is not received within five days of the due date, there will be an additional sum equal to 5% of the amount overdue as a late charge. Any amount not paid within 10 days after receipt of landlord’s written notice will bear interest from the date due until paid, at the lesser rate of (1) the prime rate of interest as published in the Wall Street Journal, plus 2% or (2) the maximum rate allowed by law, in addition to the late payment charge. We were required to establish a letter of credit for the benefits of the landlord and to submit \$4.5 million as a deposit for the letter of credit in October 2015. Subsequently pursuant to the terms of the O’Brien Lease, on May 1, 2019 the \$4.5 million in restricted cash was reduced to \$4.0 million and on May 1, 2020 the \$4.0 million in restricted cash was reduced to \$3.5 million.

All of our leases are operating leases. Operating lease assets and liabilities are reflected within “Operating lease right-of-use assets, net”, “Operating lease liabilities, current” and “Operating lease liabilities, non-current” on the condensed consolidated balance sheets. These assets and liabilities are recognized at the commencement date based on the present value of remaining minimum lease payments over the lease term using our estimated secured incremental borrowing rates at the effective date of January 1, 2019. Lease payments included in the measurement of the lease liability comprise the base rent per the term of the Lease. Lease expense for these leases is recognized on a straight-line basis over the lease term, with variable lease payments, such as common area maintenance fees, recognized in the period those payments are incurred.

We often have options to renew lease terms for buildings. For the O’Brien Lease, the renewal option is 5 years and the rent will be based on fair market value at the time of renewal and was not included in the lease term. In addition, certain lease arrangements may be terminated prior to their original expiration date at our discretion. We evaluate renewal and termination options at the lease commencement date to determine if we are reasonably certain to exercise the option on the basis of economic factors. The weighted average remaining lease term for our operating leases as of September 30, 2020 was 7.1 years.

The discount rate implicit within our leases is generally not determinable and therefore we determine the discount rate based on our incremental borrowing rate. The incremental borrowing rate for our leases is determined based on lease term and currency in which lease payments are made, adjusted for impacts of collateral. The weighted average discount rate used to measure our operating lease liabilities as of September 30, 2020 was 7.9%.

The following table presents information as to the amount and timing of cash flows arising from our operating leases as of September 30, 2020:

**Maturity of Lease Liabilities**

Years ending December 31,	<b>Amount</b>	
	<b>(in thousands)</b>	
Remaining of 2020	\$	1,818
2021		7,328
2022		7,502
2023		7,704
2024		7,920
Thereafter		23,598
<b>Total undiscounted operating lease payments</b>		<b>55,870</b>
Less: imputed interest		(12,860)
<b>Present value of operating lease liabilities</b>		<b>43,010</b>

**Balance Sheet Classification**

Operating lease liabilities, current	4,217
Operating lease liabilities, non-current	38,793
<b>Total operating lease liabilities</b>	<b>43,010</b>

**Cash Flows**

Cash paid for amounts included in the present value of operating lease liabilities was \$1.8 million and \$5.4 million, respectively, for the three and nine months ended September 30, 2020 and included in operating cash flow.

**Operating Lease Costs**

Operating lease costs were \$1.6 million and \$4.7 million for the three and nine months ended September 30, 2020, respectively. Operating lease costs were \$1.6 million and \$4.7 million for the three and nine months ended September 30, 2019, respectively. For both 2020 and 2019 the operating lease costs primarily related to our operating leases, but also included immaterial amounts for variable leases.

**Contingencies**

We may become involved in legal proceedings, claims and assessments from time to time in the ordinary course of business. We accrue liabilities for such matters when it is probable that future expenditures will be made and such expenditures can be reasonably estimated.

**Legal***U.S. District Court Proceedings*

On March 15, 2017, we filed a complaint in the U.S. District Court for the District of Delaware against ONT Inc. for patent infringement (C.A. No. 17-cv-275 (“275 Action”). The complaint is based on our U.S. Patent No. 9,546,400 (the “400 Patent”) which covers novel methods for nanopore sequencing of nucleic acid molecules using the signals from multiple monomeric units. We are seeking remedies including injunctive relief, damages and costs. On August 23, 2018, we filed an amended complaint, adding allegations of willful infringement and adding ONT Ltd. as a defendant in the 275 Action, which was granted on August 15, 2019.

On September 25, 2017, we filed a second complaint in the U.S. District Court for the District of Delaware against ONT Inc. for patent infringement (C.A. No. 17-cv-1353 (“1353 Action”). The complaint is based on our U.S. Patent No. 9,678,056 (the “056 Patent”) and U.S. Patent No. 9,738,929. We are seeking remedies including injunctive relief, damages and costs. On March 28, 2018, we added a claim for infringement of our U.S. Patent No. 9,772,323 (the “323 Patent”). On August 23, 2018 we filed an amended complaint, adding allegations of willful infringement and adding ONT Ltd. as a defendant in the 1353 Action, which was granted on August 15, 2019.



A trial for the U.S. District Court matters was held from March 9 through March 18, 2020. The jury determined that ONT Inc. and ONT Ltd. infringed the '056 Patent, the '400 Patent, and the '323 Patent, but the jury declined to find these patents valid based on enablement and, in the case of claim one of the '056 Patent, written description and indefiniteness. The jury declined to find valid or infringed U.S. Patent No. 9,738,929. We are pursuing an appeal of the decision at the U.S. Court of Appeals for the Federal Circuit.

Unrelated to the preceding matters, on September 26, 2019, Personal Genomics of Taiwan, Inc. ("PGI") filed a complaint in the U.S. District Court for the District of Delaware against us for patent infringement (C.A. No. 19-cv-1810). The complaint (the "PGI District Court complaint") is based on PGI's U.S. Patent No. 7,767,441 (the "'441 Patent"). We plan to vigorously defend in this matter. On November 20, 2019, we filed our answer to the complaint, denying infringement and seeking a declaratory judgement of invalidity of the '441 Patent. A trial for this matter is scheduled to begin on March 14, 2022.

On June 22, 2020, we filed a petition requesting institution of an inter-partes review (IPR) to the Patent Trial and Appeals Board (the "Board") at the United States Patent Office requesting the Board to find a set of claims in the '441 invalid. On June 27, 2020, we filed a second petition requesting institution of an IPR requesting the Board to find another set of claims in the '441 invalid. The two petitions (the "PacBio IPR petitions") requesting IPRs assert that all of the claims relevant to the PGI complaint are invalid.

On August 19, 2020, the court ordered a stay of the PGI District Court complaint based on a joint stipulation by the parties. The matter is stayed pending the decision by the Patent Trial and Appeals Board on institution of the PacBio IPR petitions expected January 2021. If both IPR petitions are instituted, the stay will extend until the final written decision on the IPRs.

On May 19, 2020, PGI filed a complaint in the Wuhan People's Court alleging infringement of one or more claims of China patent No. CN101743321B, which is related to the '441 Patent. We have not received service. We plan to vigorously defend in this matter.

#### *Other Proceedings*

From time to time, we may also be involved in a variety of other claims, lawsuits, investigations and proceedings relating to securities laws, product liability, patent infringement, contract disputes, employment and other matters that arise in the normal course of our business. In addition, third parties may, from time to time, assert claims against us in the form of letters and other communications. We record a provision for contingent losses when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. We currently do not believe that the ultimate outcome of any of the matters described above is probable or reasonably estimable, or that these matters will have a material adverse effect on our business; however, the results of litigation and claims are inherently unpredictable. Regardless of the outcome, litigation can have an adverse impact on us because of litigation and settlement costs, diversion of management resources and other factors.

#### *Indemnification*

Pursuant to Delaware law and agreements entered into with each of our directors and officers, we may have obligations, under certain circumstances, to hold harmless and indemnify each of our directors and officers against losses suffered or incurred by the indemnified party in connection with their service to us, and judgements, fines, settlements and expenses related to claims arising against such directors and officers to the fullest extent permitted under Delaware law, our bylaws and certificate of incorporation. We also enter and have entered into indemnification agreements with our directors and officers that may require us to indemnify them against liabilities that arise by reason of their status or service as directors or officers, except as prohibited by applicable law. In addition, we may have obligations to hold harmless and indemnify third parties involved with our fundraising efforts and their respective affiliates, directors, officers, employees, agents or other representatives against any and all losses, claims, damages and liabilities related to claims arising against such parties pursuant to the terms of agreements entered into between such third parties and us in connection with such fundraising efforts. To the extent that any such indemnification obligations apply to the lawsuits described above, any associated expenses incurred are included within the related accrued litigation expense amounts. No additional liability associated with such indemnification obligations has been recorded as of September 30, 2020.

## **NOTE 7. STOCKHOLDERS' EQUITY**

### *Underwritten Public Equity Offering*

In June 2020, we filed a shelf registration statement on Form S-3 with the SEC pursuant to which we may, from time to time, sell up to an aggregate of \$250.0 million of our common stock, preferred stock, depository shares, warrants, units or debt securities. On July 14, 2020, the registration statement was declared effective by the SEC, which allows us to access the capital markets for the three year period following this effective date.

In August 2020, we entered into an underwriting agreement, relating to the public offering of 19,430,000 shares of our common stock, \$0.001 par value per share, at a price to the public of \$4.47 per share. Under the terms of the underwriting agreement, we also granted the underwriters a 30-day option to purchase up to an additional 2,914,500 shares of our common stock, which was subsequently exercised in full, and the offering including the sale of shares of common stock subject to the underwriters' option, closed in August 2020. In total, we sold 22.3 million shares of our common stock. We paid a commission equal to 6% of the gross proceeds from the sale of shares of our common stock. The total net proceeds to us from the offering after deducting the underwriting discount were approximately \$93.9 million, excluding approximately \$0.3 million of offering expenses, \$0.2 million of which was unpaid as of September 30, 2020.

The Termination Agreement currently limits our ability to issue additional securities or incur indebtedness as up to the \$52.0 million of the Continuation Advances paid to us are repayable without interest to Illumina if, within two years of March 31, 2020, we enter into, or consummate a Change of Control Transaction or raise at least \$100 million in a single equity or debt financing (that may have multiple closings), with the amount repayable dependent on the amount raised by us.

### Equity Plans

At June 30, 2020, in total, we had three active equity compensation plans: the 2010 Equity Incentive Plan ("2010 Plan"), the 2010 Outside Director Equity Incentive Plan ("2010 Director Plan") and the 2010 Employee Stock Purchase Plan ("ESPP"). Our 2010 Plan and 2010 Director Plan expired on July 29, 2020.

On August 4, 2020, stockholders approved our new 2020 Equity Incentive Plan. A description of the 2020 Equity Incentive Plan can be found in our Proxy Statement for the 2020 Annual Meeting of Stockholders, dated June 24, 2020.

Pursuant to the terms of the then-in-process Merger Agreement with Illumina, offerings under our ESPP were suspended after the completion of the purchase period ended March 1, 2019. After the merger with Illumina was terminated in January 2020, we began offerings under the ESPP again starting with the offering period beginning March 1, 2020.

### Stock Options

The following table summarizes stock option activity for all our stock option plans for the nine months ended September 30, 2020 (in thousands, except per share amounts):

	Stock Options Outstanding		
	Number of shares	Exercise price	Weighted average exercise price
Balances, December 31, 2019	22,697	\$ 1.16 – 16.00	\$ 5.57
Options granted	2,717	2.45 – 9.6	6.61
Options exercised	(2,763)	1.16 – 6.98	4.25
Options canceled	(2,730)	1.16 – 15.77	7.61
Balances, September 30, 2020	19,921	\$ 1.16 – 16.00	\$ 5.62

For the three and nine months ended September 30, 2020, we recognized stock-based compensation expense of \$1.4 million and \$4.2 million, respectively, related to options.

### RSUs

#### Time-based RSUs

The following table summarizes the time-based RSUs activity for the nine months ended September 30, 2020 (in thousands, except per share amounts):

	Number of shares	Weighted average grant date fair value
RSUs outstanding at December 31, 2019	1,086	\$ 6.12
RSUs granted	6,395	4.84
RSUs released	(876)	6.76
RSUs forfeited	(634)	4.40
Unvested RSUs outstanding at September 30, 2020	5,971	\$ 4.84

For the three and nine months ended September 30, 2020, we recognized stock-based compensation expense of \$1.7 million and \$5.5 million, respectively, related to time-based RSUs.

#### Performance-based RSUs

The following table summarizes the performance-based RSUs (“PSUs”) activity for the nine months ended September 30, 2020 (in thousands, except per share amounts):

	Number of shares	Weighted average grant date fair value
PSUs outstanding at December 31, 2019	138	\$ 2.63
PSUs granted	—	—
PSUs released	—	—
PSUs forfeited	(44)	2.63
Unvested PSUs outstanding at September 30, 2020	94	\$ 2.63

For the three and nine months ended September 30, 2020, we recognized stock-based compensation expense of \$0 related to the performance-based RSUs.

In January 2020, an additional 7.7 million shares and 1.5 million shares, respectively, were reserved under the 2010 Plan and the 2010 Director Plan. The 2010 Plan and the 2010 Director Plan expired on July 29, 2020. On August 4, 2020, stockholders at the 2020 Annual Meeting approved a new 2020 Equity Incentive Plan with 11,000,000 shares available for issuance and the 2010 Plan and 2010 Director Plan were terminated. As of September 30, 2020, we had 7.9 million shares of common stock available for future issuance.

#### *ESPP shares*

Shares issued under our ESPP were 834,677 and 1,306,329 during the nine months ended September 30, 2020 and 2019, respectively. In January 2020, an additional 3.1 million shares were reserved under the ESPP. As of September 30, 2020, 5,878,770 shares of our common stock remain available for issuance under our ESPP.

For the three and nine months ended September 30, 2020, we recognized stock-based compensation expense of \$1.8 million and \$2.3 million, respectively, related to the ESPP shares.

#### **Stock-Based Compensation**

The following table summarizes the stock-based compensation expense for the three and nine months ended September 30, 2020 and 2019, respectively (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Cost of revenue	\$ 735	\$ 450	\$ 1,714	\$ 1,406
Research and development	2,105	1,906	5,297	5,836
Sales, general and administrative	2,152	1,706	5,247	5,290
Total stock-based compensation expense	\$ 4,992	\$ 4,062	\$ 12,258	\$ 12,532

We estimated the fair value of employee stock options on the grant date using the Black-Scholes option pricing model. The estimated fair value of employee stock options is amortized on a straight-line basis over the requisite service period of the awards. We did not grant any stock options for the year ended December 31, 2019 due to the then-in-process merger with Illumina.

The fair value of shares to be purchased under our stock option was estimated using the following assumptions:

Stock Option	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Expected term in years	5.1	—	5.1	—
Expected volatility	71%	—	57% - 71%	—
Risk-free interest rate	0.3%	—	0.3% - 1.2%	—
Dividend yield	—	—	—	—

We estimate the value of employee stock purchase rights on the grant date using the Black-Scholes option pricing model. Pursuant to the terms of the then-in-process merger with Illumina, the ESPP was terminated after the completion of the purchase period ended March 1, 2019 and there were no offerings after March 1, 2019. As such there were no new Black-Scholes calculations performed to calculate the fair value of new purchase rights granted for the year ended December 31, 2019. After the merger with Illumina was terminated in January 2020, we began offerings under the ESPP again starting with the offering period on March 1, 2020.

The fair value of shares to be purchased under our ESPP was estimated using the following assumptions:

ESPP	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Expected term in years	0.5 - 2.0	—	0.5 - 2.0	—
Expected volatility	71%	—	57% - 71%	—
Risk-free interest rate	0.1%	—	0.1% - 1.0%	—
Dividend yield	—	—	—	—

**NOTE 8. REVENUE**

A summary of our revenue by geographic location for the three and nine months ended September 30, 2020 and 2019 is as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
North America	\$ 8,971	\$ 10,393	\$ 25,189	\$ 33,165
Europe (including the Middle East and Africa)	4,339	4,940	11,925	11,423
Asia Pacific	5,772	6,582	14,643	18,373
Total	\$ 19,082	\$ 21,915	\$ 51,757	\$ 62,961

A summary of our revenue by category for the three and nine months ended September 30, 2020 and 2019 is as follows (in thousands):

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Instrument revenue	\$ 7,727	\$ 11,583	\$ 20,685	\$ 29,870
Consumable revenue	8,022	6,901	21,113	23,321
Product revenue	15,749	18,484	41,798	53,191
Service and other revenue	3,333	3,431	9,959	9,770
Total revenue	\$ 19,082	\$ 21,915	\$ 51,757	\$ 62,961

## **Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations**

*You should read the following discussion and analysis of our financial condition and results of operations together with our condensed consolidated financial statements and the related notes included in this Quarterly Report on Form 10-Q and those in our Annual Report on Form 10-K for the year ended December 31, 2019. Some of the information contained in this discussion and analysis or set forth elsewhere in this report, including statements related to our expectations regarding the potential impacts of the COVID-19 pandemic on our business, financial condition, and results of operations, and information with respect to our products, plans and strategy for our business and related financing, includes forward-looking statements that involve risks and uncertainties, including statements regarding our expected financial results in future periods. The words “anticipates,” “believes,” “could,” “estimates,” “expects,” “intends,” “may,” “might,” “plans,” “potential,” “predicts,” “projects,” “seeks,” “should,” “target,” “will,” “would” and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. We may not actually achieve the plans, intentions or expectations disclosed in our forward-looking statements and you should not place undue reliance on our forward-looking statements. You should read the “Risk Factors” section of this Quarterly Report on Form 10-Q for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis. We do not assume any obligation to update any forward-looking statements.*

### **Termination of Merger with Illumina, Inc.**

On January 2, 2020, we, Illumina and Merger Subsidiary entered into the Termination Agreement. As part of the Termination Agreement, Illumina paid us a \$98.0 million Reverse Termination Fee, from which we paid our financial advisor associated fees of \$6 million in April 2020. In addition, Illumina paid us the final Continuation Advances of \$34 million during the first quarter of 2020.

However, pursuant to the Termination Agreement, in the event that, on or prior to September 30, 2020, we entered into a definitive agreement providing for, or consummated, a Change of Control Transaction (as defined in the Termination Agreement), then we may have been required to repay the Reverse Termination Fee (without interest) to Illumina in connection with the consummation of such Change of Control Transaction. No such definitive agreement was entered into nor was a Change of Control Transaction consummated as of September 30, 2020. The \$98.0 million in cash we received from Illumina for the reverse termination fee was recorded as a short-term liability as of September 30, 2020 and, on October 1, 2020, after the contingency clauses lapsed, it was subsequently recognized as a gain and will be reflected in the fourth quarter of 2020 as Other Income.

In addition, up to the \$52.0 million of Continuation Advances paid to us are repayable without interest to Illumina if, within two years of March 31, 2020, we enter into a Change of Control Transaction or raise at least \$100 million in a single equity or debt financing (that may have multiple closings), with the amount repayable dependent on the amount raised by us.

### **Senior Management**

Our President and Chief Executive Officer Christian O. Henry was appointed effective September 14, 2020, succeeding Dr. Michael Hunkapiller who announced his retirement, which will be effective at the end of the year. Our Chief Financial Officer Susan G. Kim was appointed effective September 28, 2020, succeeding Susan K. Barnes who retired on August 7, 2020. Also, our Vice President and Chief Accounting Officer Eric E. Schaefer was appointed effective May 26, 2020, and our Chairman of the Board Dr. John F. Milligan was appointed effective September 14, 2020.

### **Business 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 current products include the Sequel II instrument and SMRT Cell 8M, which together are capable of sequencing up to approximately eight million DNA molecules simultaneously, and the previous generation Sequel instrument and Sequel SMRT Cell 1M, which together are capable of sequencing up to approximately one million DNA molecules simultaneously. In October 2020, we launched the Sequel Iie System, which has increased computational capacity, and is designed to enable customers to generate PacBio HiFi reads more efficiently.

Our customers and our scientific collaborators have published numerous peer-reviewed articles in journals including Nature, Science, Cell, PNAS and The New England Journal of Medicine highlighting the power and applications of SMRT sequencing in projects such as finishing genomes, structural variation discovery, isoform transcriptome characterization, rare mutation discovery and the identification of chemical modifications of DNA related to virulence and pathogenicity. Our research and development efforts are focused on developing new products and further improving our existing products including continuing chemistry and sample preparation improvements to increase throughput and expand our supported applications. By providing access to genetic information that was previously inaccessible, we enable scientists to confidently increase their understanding of biological systems.

### **COVID-19 Update**

The COVID-19 pandemic and efforts to control its spread have significantly curtailed the movement of people, goods, and services worldwide, including in the regions in which we sell our products and services and conduct our business operations. The financial results for the three and nine months ended September 30, 2020 were impacted negatively as many of our customers in multiple regions around the world shut down operations for various periods of time in efforts to curb the spread of the COVID-19 pandemic. This resulted in lower product revenues for the three and nine months ended September 30, 2020 as compared to the same periods of 2019. A significant number of our customer sites that had shut down due to COVID-19 have re-opened. In addition, a significant number of customers have delayed purchases or difficulties obtaining funding for capital expenditures due to the negative impact of the pandemic on their businesses. This dynamic continues to negatively impact the recognition of revenue related to the sale of our Sequel and Sequel II instruments. The negative impacts of COVID-19 on our customers will likely continue to adversely impact our revenues during the fourth quarter of 2020. Due to the uncertain scope and duration of the pandemic, we cannot reasonably estimate the future impact to our operations and financial results.

In response to local stay-at-home orders and in alignment with CDC recommendations, we have limited our manufacturing and commercial operations based in Menlo Park, California. We will, however, continue to provide consumables, instruments and support to scientists at government, academic, and commercial labs that remain open. To aid in containing the spread of COVID-19, we have implemented remote-work options and are limiting employee travel as much as possible. We are monitoring this rapidly evolving situation.

Even after the COVID-19 pandemic has subsided, we may continue to experience an adverse impact to our business as a result of its global economic impact, including any recession that has occurred or may occur in the future. Specifically, difficult macroeconomic conditions, decreases in discretionary capital spending, increased and prolonged unemployment or a decline in consumer confidence as a result of the COVID-19 pandemic could have a continuing adverse effect on the demand for some of our products. Such economic disruption could have a material adverse effect on our business, results of operations and liquidity. The degree of impact of COVID-19 on our business will depend on several factors, such as the duration and the extent of the pandemic, as well as actions taken by governments, businesses and consumers in response to the pandemic, all of which continue to evolve and remain uncertain at this time. See the Risk Factors section for further discussion of the possible impact of the COVID-19 pandemic on our business.

### **Critical Accounting Policies and Estimates**

The discussion and analysis of our financial condition and results of operations are based upon our unaudited Financial Statements, which have been prepared in accordance with the rules and regulations of the SEC. The preparation of these Financial Statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. On an ongoing basis, we evaluate our critical accounting policies and estimates. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We adopted ASU 2016-13 *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* on January 1, 2020, using the modified retrospective method. Please see “Recently Adopted Accounting Standards” in the *Note 3. Summary of Significant Accounting Policies* of Item 1. Financial Statements.

Except as noted above, there have been no other material changes to our significant accounting policies as discussed in our Annual Report on Form 10-K for the year ended December 31, 2019.

**Results of Operations**

Comparison of the three months ended September 30, 2020 and 2019

(in thousands, except percentages)	Three Months Ended September 30,		\$ Change	% Change
	2020	2019		
	(unaudited)			
Revenue:				
Product revenue	\$ 15,749	\$ 18,484	\$ (2,735)	(15%)
Service and other revenue	3,333	3,431	(98)	(3%)
Total revenue	<u>19,082</u>	<u>21,915</u>	(2,833)	(13%)
Cost of Revenue:				
Cost of product revenue	9,228	12,188	(2,960)	(24%)
Cost of service and other revenue	2,790	2,813	(23)	(1%)
Total cost of revenue	<u>12,018</u>	<u>15,001</u>	(2,983)	(20%)
Gross profit	<u>7,064</u>	<u>6,914</u>	150	2%
Operating Expense:				
Research and development	16,467	14,962	1,505	10%
Sales, general and administrative	14,772	20,066	(5,294)	(26%)
Total operating expense	<u>31,239</u>	<u>35,028</u>	(3,789)	(11%)
Operating loss	(24,175)	(28,114)	3,939	14%
Interest expense	—	(664)	664	100%
Other income, net	467	(345)	812	235%
Net loss	<u>\$ (23,708)</u>	<u>\$ (29,123)</u>	\$ 5,415	19%

**Revenue**

Total revenue for the three months ended September 30, 2020 was \$19.1 million compared to \$21.9 million for the same period during 2019.

Product revenue of \$15.7 million for the three months ended September 30, 2020 consisted primarily of \$7.7 million from instrument revenue and \$8.0 million from consumables revenue, compared to total product revenue of \$18.5 million for the same period during 2019, consisting of \$11.6 million from instrument revenue and \$6.9 million of consumables revenue. The decrease in instrument sales was primarily attributable to a lower number of instrument shipments and installations due to COVID-19 as discussed above. The increase in consumable sales was primarily attributable to higher Sequel II consumables sales. The negative impact of COVID-19 on our customers will likely continue to adversely impact our revenues during the fourth quarter of 2020.

Service and other revenue of \$3.3 million and \$3.4 million for the three months ended September 30, 2020 and 2019, respectively, was primarily derived from product maintenance agreements sold on our installed instruments.

**Gross Profit**

Gross profit for the three months ended September 30, 2020 was \$7.1 million, resulting in a gross margin of 37.0%, compared to gross profit of \$6.9 million, resulting in a gross margin of 31.5% for the same period during 2019.

Cost of product revenue was \$9.2 million for the three months ended September 30, 2020, compared to cost of product revenue of \$12.2 million for the same period during 2019. The decrease of \$3.0 million in cost of product revenue was primarily attributable to our incurring \$2.8 million of product transition costs including inventory reserves taken in connection with the transition from Sequel to Sequel II during the three months ended September 30, 2019, partially offset by lower factory production in the three months ended September 30, 2020 resulting in under-absorbed overhead.

Cost of service and other revenue for the three months ended September 30, 2020 was \$2.8 million, compared to \$2.8 million for the same period during 2019.

**Research and Development Expense**

During the three months ended September 30, 2020, research and development expense increased by \$1.5 million, or 10%, compared to the same period during 2019. The increase in research and development expense was primarily driven by higher chip development costs. Research and development expense included stock-based compensation expense of \$2.1 million and \$1.9 million during the three months ended September 30, 2020 and 2019, respectively.



### Sales, General and Administrative Expense

During the three months ended September 30, 2020, sales, general and administrative expense decreased by \$5.3 million, or 26%, compared to the same period during 2019. The decrease in sales, general and administrative expense was primarily attributable to \$3.6 million in merger related expenses during the three months ended September 30, 2019, which did not recur during the three months ended September 30, 2020, and a decrease of \$1.4 million in patent litigation expenses incurred during the three months ended September 30, 2020 as compared to the same period in 2019. Sales, general and administrative expense included stock-based compensation expense of \$2.2 million and \$1.7 million during the three months ended September 30, 2020 and 2019, respectively.

### Interest Expense

Interest expense for the three months ended September 30, 2020 decreased \$0.7 million compared to the same period in 2019, as the debt agreement with Deerfield entered into in February 2013 (the "Facility Agreement") matured in February 2020.

### Other Income

The \$98.0 million in cash we received from Illumina for the Reverse Termination Fee was recorded as a short-term liability as of September 30, 2020. On October 1, 2020, the contingency clauses lapsed and, as a result, we expect to recognize a gain of \$98 million in our fourth quarter of 2020 financial results.

### *Comparison of the nine months ended September 30, 2020 and 2019*

(in thousands, except percentages)	Nine Months Ended September 30,		\$ Change	% Change
	2020	2019		
	(unaudited)			
<b>Revenue:</b>				
Product revenue	\$ 41,798	\$ 53,191	\$ (11,393)	(21%)
Service and other revenue	9,959	9,770	189	2%
Total revenue	51,757	62,961	(11,204)	(18%)
<b>Cost of Revenue:</b>				
Cost of product revenue	22,874	32,786	(9,912)	(30%)
Cost of service and other revenue	7,718	8,531	(813)	(10%)
Total cost of revenue	30,592	41,317	(10,725)	(26%)
Gross profit	21,165	21,644	(479)	(2%)
<b>Operating Expense:</b>				
Research and development	46,727	45,357	1,370	3%
Sales, general and administrative	54,846	58,915	(4,069)	(7%)
Total operating expense	101,573	104,272	(2,699)	(3%)
Operating loss	(80,408)	(82,628)	2,220	3%
Gain from Continuation Advances from Illumina	34,000	—		
Interest expense	(267)	(1,933)	1,666	86%
Other income, net	1,143	518	625	121%
Net loss	\$ (45,532)	\$ (84,043)	\$ 38,511	46%

### Revenue

Total revenue for the nine months ended September 30, 2020 was \$51.8 million, compared to \$63.0 million for the same period during 2019.

Product revenue of \$41.8 million for the nine months ended September 30, 2020 consisted of \$20.7 million from sales of Sequel and Sequel II instruments and \$21.1 million from sales of consumables, compared to total product revenue of \$53.2 million for the same period during 2019, consisting of \$29.9 million from sales of Sequel and Sequel II instruments and \$23.3 million from sales of consumables. The decrease in instrument sales was primarily attributable to a lower number of instrument shipments and installations due to COVID-19 as discussed above. The decrease in consumable sales was primarily attributable to lower utilization of the installed base of instruments due to COVID-19 as discussed above. The negative impact of COVID-19 on our customers will likely continue to adversely impact our revenues during the fourth quarter of 2020.

Service and other revenue of \$10.0 million and \$9.8 million for the nine months ended September 30, 2020 and 2019, respectively, was primarily derived from product maintenance agreements sold on our installed instruments.

#### Gross Profit

Gross profit for the nine months ended September 30, 2020 was \$21.2 million, resulting in a gross margin of 41.9%, compared to gross profit of \$21.6 million, resulting in a gross margin of 34.4% for the same period during 2019. Gross margin for the nine months ended September 30, 2019 was negatively impacted by product transition costs, including inventory reserves taken in connection with the transition from Sequel to Sequel II.

Cost of product revenue was \$22.9 million for the nine months ended September 30, 2020, compared to cost of product revenue of \$32.8 million for the same period during 2019. Cost of product revenue decreased by \$10.0 million for the nine months ended September 30, 2020 compared to the same period in 2019 primarily resulting from lower product shipments. In addition, during the nine months ended September 30, 2019, we incurred product transition costs including an inventory reserve taken in connection with the transition from Sequel to Sequel II.

Cost of service and other revenue for the nine months ended September 30, 2020 was \$7.7 million, compared to \$8.5 million for the same period during 2019.

#### Research and Development Expense

During the nine months ended September 30, 2020, research and development expense increased by \$1.4 million, or 3%, compared to the same period during 2019. The increase in research and development expense was primarily driven by higher chip development costs. Research and development expense included stock-based compensation expense of \$5.3 million and \$5.8 million during the nine months ended September 30, 2020 and 2019, respectively.

#### Sales, General and Administrative Expense

During the nine months ended September 30, 2020, sales, general and administrative expense decreased by \$4.1 million, or 7%, compared to the same period during 2019. The decrease in sales, general and administrative expense was primarily attributable to the acquisition-related legal fees of \$12.8 million incurred for the nine months ended September 30, 2019, partially offset by \$6.0 million merger advisory fee incurred in the first quarter of 2020; an increase of \$1.2 million in salary and bonus expenses for the nine months ended September 30, 2020, an increase of \$1.2 million in litigation expenses for the nine months ended September 30, 2020. Sales, general and administrative expense included stock-based compensation expense of \$5.2 million and \$5.3 million during the nine months ended September 30, 2020 and 2019, respectively.

#### Interest Expense

Interest expense for the nine months ended September 30, 2020 decreased \$1.7 million compared to the same period in 2019, as the Facility Agreement matured in February 2020.

### **Liquidity and Capital Resources**

#### *Liquidity*

Cash, cash equivalents and investments at September 30, 2020 totaled \$208.6 million, compared to \$49.1 million at December 31, 2019. The increase was attributable to the proceeds from our public offering of common stock completed in August 2020, as well as the Reverse Termination Fee and Continuation Advances we received from Illumina, partially offset by cash used in operations and a \$16.0 million repayment of debt in the first quarter of 2020. We believe that our existing cash, cash equivalents and investments will be sufficient to fund our projected operating requirements for at least the next 12 months from the date of filing of this Quarterly Report on Form 10-Q for the quarter ended September 30, 2020. However, the potential economic or other disruptions caused by the COVID-19 pandemic could have a material adverse effect on our business, results of operations and liquidity. We will continue to monitor our operating expenses and cash flows in response to the evolving market conditions.

On January 2, 2020, we and Illumina mutually agreed to terminate the Merger Agreement. As part of the Termination Agreement, up to \$52.0 million of the Continuation Advances that we received from Illumina are repayable without interest to Illumina if, within two years of March 31, 2020, we enter into, or consummate a Change of Control Transaction or raise at least \$100 million in a single equity or debt financing (may have multiple closings), with the amount repayable dependent on the amount raised by us.

Factors that may affect our capital needs include, but are not limited to, whether we will have to repay the Continuation Advances; the pace of adoption of our products which affects the sales of our products and services; our ability to obtain new collaboration and customer arrangements; the progress of our research and development programs; initiation or expansion of research programs and collaborations; the purchase of patent licenses; future acquisitions; manufacturing costs, service costs, the impact of product quality, litigation costs, including the costs involved in preparing, filing, prosecuting, defending and enforcing intellectual property rights; costs of developing new and enhanced products; and other factors.

We expect to raise additional capital in the future. To the extent that we raise additional funds through the sale of equity or convertible debt, 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 the Termination 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.

### Operating Activities

Our primary uses of cash in operating activities are for the development of ongoing product enhancements and future products, manufacturing, and support functions related to our sales, general and administrative activities.

We had \$33.8 million of cash provided from operating activities for the nine months ended September 30, 2020, compared to cash usage of \$60.1 million from operating activities for the same period in 2019.

Cash provided by operating activities for the nine months ended September 30, 2020 was due to the \$98.0 million Reverse Termination Fee received from Illumina, non-cash items such as stock-based compensation of \$12.3 million and depreciation of \$4.8 million, partially offset by a net loss of \$45.5 million and a gain from Continuation Advances from Illumina of \$34.0 million, which is considered to be a financing activity. The change in net operating assets and liabilities was primarily attributed to a decrease of \$3.4 million in accounts receivable, partially offset by an increase of \$3.0 million in inventory.

Cash used in operating activities for the nine months ended September 30, 2019 was due primarily to a net loss of \$84.0 million, offset by non-cash items such as stock-based compensation of \$12.5 million and depreciation of \$5.5 million. The change in net operating assets and liabilities was primarily attributed to an increase of \$1.4 million in accounts receivable, partially offset by an increase of \$4.9 million in accrued expenses and a decrease of \$2.3 million in inventory.

### Investing Activities

Our investing activities consist primarily of capital expenditures and investment purchases, sales and maturities. We used \$120.8 million of cash for investing activities for the nine months ended September 30, 2020, compared to receiving cash of \$65.5 million from investing activities for the same period in 2019.

Cash used in investing activities for the nine months ended September 30, 2020 was due primarily to net purchases of investments of \$119.9 million and purchases of property and equipment of \$1.0 million.

Cash provided in investing activities for the nine months ended September 30, 2019 was due primarily to net maturities of investments of \$68.2 million.

### Financing Activities

Cash provided from financing activities was \$126.0 million and \$8.4 million for the nine months ended September 30, 2020 and 2019, respectively.

Cash provided by financing activities during the nine months ended September 30, 2020 stemmed from the net proceeds of \$93.8 million from our August 2020 underwritten public equity offering after deducting underwriter commissions and paid offering expenses, \$34.0 million of Continuation Advances from Illumina and proceeds of \$14.2 million from the issuance of common stock through our equity compensation plans, partially offset by \$16.0 million we repaid for the remaining outstanding principal to Deerfield upon the maturity of the Facility Agreement.

Cash provided by financing activities during the nine months ended September 30, 2019 was due to \$8.4 million from the issuance of common stock through our equity compensation plans.

#### *Capital Resources*

In June 2020, we filed a shelf registration statement on Form S-3 with the SEC pursuant to which we may, from time to time, sell up to an aggregate of \$250.0 million of our common stock, preferred stock, depository shares, warrants, units or debt securities. On July 14, 2020, the registration statement was declared effective by the SEC, which allows us to access the capital markets for the three-year period following this effective date.

In August 2020 we entered into an underwriting agreement, relating to the public offering of 19,430,000 shares of our common stock, \$0.001 par value per share, at a price to the public of \$4.47 per share. Under the terms of the underwriting agreement, we also granted the underwriters a 30-day option to purchase up to an additional 2,914,500 shares of our common stock, which was subsequently exercised in full, and the offering including the sale of shares of common stock subject to the underwriters' option, closed in August 2020. In total, we sold 22.3 million shares of our common stock. We paid a commission equal to 6% of the gross proceeds from the sale of shares of our common stock. The total net proceeds to us from the offering after deducting the underwriting discount were approximately \$93.9 million, excluding approximately \$0.3 million of offering expenses, \$0.2 million of which was unpaid as of September 30, 2020. As a result, \$150.1 million remains available under the current shelf registration.

However, the Termination Agreement currently limits our ability to issue additional securities or incur indebtedness as up to the \$52.0 million of Continuation Advances paid to us are repayable without interest to Illumina if, within two years of March 31, 2020, we enter into a Change of Control Transaction or raise at least \$100 million in a single equity or debt financing (that may have multiple closings), with the amount repayable dependent on the amount raised by us.

#### *Off-Balance Sheet Arrangements*

As of September 30, 2020, we did not have any off-balance sheet arrangements.

In the ordinary course of business, we enter into standard indemnification arrangements. Pursuant to these arrangements, we indemnify, hold harmless, and agree to reimburse the indemnified parties for losses suffered or incurred by the indemnified party in connection with any trade secret, copyright, patent or other intellectual property infringement claim by any third party with respect to its technology, or from claims relating to our performance or non-performance under a contract, any defective products supplied by us, or any acts or omissions, or willful misconduct, committed by us or any of our employees, agents or representatives. The term of these indemnification agreements is generally perpetual after the execution of the agreement. The maximum potential amount of future payments we could be required to make under these agreements is not determinable because it involves claims that may be made against us in future periods but have not yet been made. To date, we have not incurred costs to defend lawsuits or settle claims related to these indemnification agreements.

We also enter and have entered into indemnification agreements with our directors and officers that may require us to indemnify them against liabilities that arise by reason of their status or service as directors or officers, except as prohibited by applicable law. In addition, we may have obligations to hold harmless and indemnify third parties involved with our fundraising efforts and their respective affiliates, directors, officers, employees, agents or other representatives against any and all losses, claims, damages and liabilities related to claims arising against such parties pursuant to the terms of agreements entered into between us and such third parties in connection with such fundraising efforts. To the extent that such indemnification obligations apply to the lawsuits described in "Note 6. Commitments and Contingencies" in Part I, Item 1 of this Form 10-Q, any associated expenses incurred are included within the related accrued litigation expense amounts. No additional liability associated with such indemnification agreements has been recorded as of September 30, 2020.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Except for the broad effects of COVID-19 and its negative impact on the global economy and financial markets, there have been no material changes in market risk from the information provided in our Annual Report on Form 10-K for the year ended December 31, 2019.

## **Item 4. Controls and Procedures**

### **Disclosure Controls and Procedures**

Our management, with the participation of our chief executive officer and our chief financial officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our chief executive officer and our chief financial officer concluded that our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to our management, including our chief executive officer and our chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

### **Changes in Internal Control Over Financial Reporting**

There were no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2020 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II – OTHER INFORMATION

### Item 1. Legal Proceedings

Please see Note 6. *Commitments and Contingencies* of Item 1. of Financial Statements under Part I – Financial Information.

### Item 1A. Risk Factors

*You should consider carefully the risks and uncertainties described below, together with all of the other information in our public filings with the Securities and Exchange Commission, which could materially affect our business, financial condition, results of operations and prospects. The risks described below are not the only risks facing us. Risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially affect our business, financial condition, results of operations and prospects. In addition, the impact of COVID-19 and any worsening of the economic environment may exacerbate the risks described below, any of which could have a material impact on us. This situation is changing rapidly and additional impacts may arise that we are not aware of currently.*

#### Risks Related to Our Business

***Our business may be adversely affected by health epidemics including the recent coronavirus outbreak.***

Our business could be adversely impacted by the effects of COVID-19 or other epidemics. As a result of COVID-19, our first nine months of 2020 financial results were impacted negatively as our customers in multiple regions around the world suspended their normal operations in efforts to curb the spread of the COVID-19 pandemic. However, a significant number of our customer sites that had shut down due to COVID-19 have re-opened. In addition, a significant number of customers have delayed purchases of capital due to the negative impact of the pandemic on their businesses. This dynamic continues to negatively impact the recognition of revenue related to the sale of our Sequel and Sequel II/IIe instruments. The negative impacts of COVID-19 on our customers will likely continue to adversely impact our revenues during the fourth quarter of 2020. The inability to receive or accept shipment of orders for our products on a timely basis, or at all, the delay or possible cancellation of orders for our products, and the reduced utilization of our products has negatively affected and may negatively affect in the future our operations and revenues. In response to local stay-at-home orders and in alignment with CDC recommendations, we have limited our manufacturing and commercial operations based in Menlo Park, California. We will, however, continue to provide consumables and support to scientists at government, academic, and commercial labs that remain open. To aid in containing the spread of COVID-19, we have implemented remote-work options and are limiting employee travel as much as possible. We are monitoring this rapidly evolving situation.

Our manufacturing partners and suppliers could also be disrupted by conditions related to COVID-19 or other epidemics, possibly resulting in disruption to the production of our products. If our manufacturing partners or suppliers are unable or fail to fulfill their obligations to us for any reason, we may not be able to manufacture our products and satisfy customer demand or our obligations under sales agreements in a timely manner, and our business could be harmed as a result. At this point in time, there is significant uncertainty relating to the potential effect of COVID-19 on our business. Infections may resurge or become more widespread and the limitation on our ability to travel and timely sell and distribute our products, as well as any closures or supply disruptions, may be extended for longer periods of time, which could have a negative impact on our business, financial condition and operating results.

Even after the COVID-19 pandemic has subsided, we may continue to experience an adverse impact to our business as a result of its global economic impact, including any recession that has occurred or may occur in the future. Specifically, difficult macroeconomic conditions, such as decreases in discretionary capital expenditure spending, increased and prolonged unemployment or a decline in consumer confidence as a result of the COVID-19 pandemic, as well as limited or significantly reduced points of access of our products, could have a continuing adverse effect on the demand for some of our products. The degree of impact of COVID-19 on our business will depend on several factors, such as the duration and the extent of the pandemic, as well as actions taken by governments, businesses and consumers in response to the pandemic, all of which continue to evolve and remain uncertain at this time.

***We have limited commercial sales to date and the commercialization and sales of our current or future products may be unsuccessful or less successful than anticipated.***

Our first commercial product launched in 2011 and we have had limited sales to date. As such, we have limited historical financial data upon which to base our projected revenue and planned operating expenses or upon which to evaluate our company and our commercial prospects. Furthermore, in September 2015, we launched the PacBio Sequel<sup>®</sup> System, and concurrently began phasing out production of PacBio RS II instruments, and, in April 2019 we announced the commercial launch of the Sequel II System. In October 2020, we launched the Sequel IIe System, which has increased computational capacity, and is designed to enable customers to generate PacBio HiFi reads more efficiently. Based on our limited experience in developing and marketing our existing products and launching new products, we may not be able to effectively:

- manage the timeliness of our new product introductions and the rate at which sales of our new products may cannibalize sales of our older products;
- drive adoption of our current and future products, including the Sequel II/IIe Systems;
- attract and retain customers for our products;
- provide appropriate levels of customer training and support for our products;
- implement an effective marketing strategy to promote awareness of our products;
- develop and implement an effective sales and distribution strategy for our current and future products;
- develop, manufacture and commercialize new products or achieve an acceptable return on our manufacturing or research and development efforts and expenses;
- comply with regulatory requirements applicable to our products;
- anticipate and adapt to changes in our market;
- accommodate customer expectations and demands with respect to our products, increase product adoption by our existing customers or develop new customer relationships;
- grow our share by marketing and selling our products for new and additional applications;
- maintain and develop strategic relationships with vendors, manufacturers and other industry partners to acquire necessary materials for the production of, and to develop, manufacture and commercialize, our existing or future products;
- adapt or scale our manufacturing activities to meet performance specifications and potential demand at a reasonable cost;
- avoid infringement and misappropriation of third-party intellectual property;
- obtain and maintain any necessary licenses to third-party intellectual property on commercially reasonable terms;
- obtain valid and enforceable patents that give us a competitive advantage or enforce existing patents;
- protect our proprietary technology; and
- attract, retain and motivate qualified personnel.

The risks noted above, especially with respect to the marketing, sales, and commercialization of our products, may be heightened by the termination of our Merger Agreement with Illumina and the impact of the COVID-19. In addition, a high percentage of our expenses is and will continue to be fixed. Accordingly, if we do not generate revenue as and when anticipated, our losses may be greater than expected and our operating results will suffer.

***We have incurred losses to date, and we expect to continue to incur significant losses as we develop our business and may never achieve profitability.***

Except for the quarter ended March 31, 2020 and the quarter ended September 30, 2015 (as a result of a one-time gain on lease amendments), we have incurred net losses since inception and we cannot be certain if or when we will produce sufficient revenue from our operations to support our costs. While we achieved profitability for the quarter ended March 31, 2020, this result was largely due to income recognition of the Continuation Advances. Even if profitability is achieved in the future, we may not be able to sustain profitability on a consistent basis. Excluding the recognition in October 2020 of gain relating to the Reverse Termination Fee, we expect to continue to incur substantial losses and negative cash flow from operations for the foreseeable future.

Our net losses since inception and our expectation of incurring substantial losses and negative cash flow for the foreseeable future could:

- make it more difficult for us to satisfy our obligations;
- increase our vulnerability to general adverse economic and industry conditions;
- limit our ability to fund future working capital, capital expenditures, research and development and other business opportunities;
- increase the volatility of the price of our common stock;

- limit our flexibility to react to changes in our business and the industry in which we operate;
- place us at a disadvantage to other companies that offer nucleic acid sequencing equipment or consumables; and
- limit our ability to borrow additional funds.

***We are not cash flow positive and may not have sufficient cash to fund our current and planned operations.***

Our operations have consumed substantial amounts of cash since inception, and we expect to continue to incur substantial losses and negative cash flow from operations for the foreseeable future. We believe that our growth will depend, in part, on our ability to fund our commercialization efforts and our efforts to develop new products, including any improvements to the SMRT Cell 8M and Sequel II System. Our existing resources may not allow us to conduct all of these activities that we believe would be beneficial for our future growth. We may need to raise additional funds through public or private debt or equity financing or alternative financing arrangements, which may include collaborations or licensing arrangements. 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 and launching of new products, operations or to increase or maintain the level of our research and development activities.

Additional funds may not be available on terms acceptable to us or at all, particularly in light of restrictions under the Termination Agreement. We have incurred and may further incur additional debt. Debt holders have rights senior to common stockholders to make claims on our assets. We may not be able to issue equity securities due to unacceptable terms and conditions to us in the capital markets. To the extent that we raise additional funds through the sale of our common stock, continued downward fluctuations in our stock price could adversely affect such fundraising efforts. Furthermore, equity financings normally involve shares sold at a discount to the current market price, and fundraising through sales of additional shares of common stock or other equity securities will have a dilutive effect on our existing investors. The shares may also be sold at a time when the market price for our common stock is low because we are in need of the funds, which will further dilute existing holders more than if the market price for our common stock was higher.

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 we may need to cease operations. Any of these actions could impede our ability to achieve our business objectives and could materially harm our operating results. 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.

***If we are unable to successfully develop and timely manufacture our current and future products, including with respect to the Sequel System, the SMRT Cell 8M and Sequel II/IIe Systems and related products, our business may be adversely affected.***

In light of the highly complex technologies involved in our products, there can be no assurance that we will be able to manufacture and commercialize our current and future products on a timely basis or continue providing adequate support for our existing products. The commercial success of our products, including the Sequel and Sequel II/IIe Systems, depends on a number of factors, including performance and reliability of the system, our anticipating and effectively addressing customer preferences and demands, the success of our sales and marketing efforts, effective forecasting and management of product demand, purchase commitments and inventory levels, effective management of manufacturing and supply costs, and the quality of our products, including consumables such as SMRT Cells and reagents. Should we face delays in or discover unexpected defects during the further development or manufacturing process of instruments or consumables related to our products, including with respect to the SMRT Cell 8M, reagents and Sequel II/IIe Systems, and including any delays or defects in software development or product functionality, the timing and success of the continued rollout and scaling of our products may be significantly impacted, which may materially and negatively impact our revenue and gross margin. The ability of our customers to successfully utilize our products will also depend on our ability to deliver high quality SMRT Cells and reagents, including with respect to the SMRT Cell 8M. We have designed SMRT Cells and other consumables specifically for the Sequel System, and may need to develop in the future, other customized SMRT Cells and consumables for our future products, including the SMRT Cell 8M for the Sequel II/IIe Systems. Our production of the SMRT Cells for the Sequel System has been and may in the future be below desired levels, and we have experienced and may experience in the future manufacturing delays, product or quality defects, SMRT Cell variability, and other issues. For example, the recent COVID-19 outbreak has impacted and could result in more pronounced impacts to our manufacturing and our ability to supply products. The performance of our consumables is critical to our customers' successful utilization of our products, and any defects or performance issues with our consumables would adversely affect our business. All of the foregoing could



negatively impact our ability to sell our products or result in other material adverse effects on our business, financial condition and results of operations.

The development of our products is complex and costly. Problems in the design or quality of our products may have a material and adverse effect on our brand, business, financial condition, and operating results, and could result in us losing our certifications from the International Organization for Standardization (“ISO”). If we were to lose ISO certification, then our customers might choose not to purchase products from us and this could adversely impact our ability to develop products approved for clinical uses. Unanticipated problems with our products could divert substantial resources, which may impair our ability to support our new and existing products, and could substantially increase our costs. If we encounter development challenges or discover errors in our products late in our development cycle, we may be forced to delay product shipments or the scaling of manufacturing or supply. In particular, if the continued rollout of our current and future products, including with respect to the SMRT Cell 8M and Sequel II/Iie Systems, is delayed or is not successful or less successful than anticipated, then we may not be able to achieve an acceptable return, if any, on our substantial research and development efforts, and our business may be materially and adversely affected. The expenses or losses associated with delayed or unsuccessful product development or lack of market acceptance of our existing and new products, including the SMRT Cell 8M and Sequel II/Iie Systems, could materially and adversely affect our business, financial condition and results of operations.

***Our research and development efforts may not result in the benefits that we anticipate, and our failure to successfully market, sell, and commercialize our current and future products could have a material adverse effect on our business, financial condition and results of operations.***

We have dedicated significant resources to developing our current products, including sequencing systems and consumables based on our proprietary SMRT sequencing technology and our Sequel and Sequel II/Iie Systems. We are also engaged in substantial and complex research and development efforts, which, if successful, may result in the introduction of new products in the future, including with respect to the SMRT Cell 8M and the Sequel II/Iie Systems. Our research and development efforts are complex and require us to incur substantial expenses. We may not be able to develop, manufacture and commercialize new products, obtain regulatory approval if necessary, or achieve an acceptable return, if any, on our research and development efforts and expenses. Furthermore, we need to continue to expand our internal capabilities or seek new partnerships or collaborations, or both, in order to successfully market, sell and commercialize our products in the markets we seek to reach.

***We must successfully manage new product introductions and transitions, including with respect to the SMRT Cell 8M and Sequel II/Iie Systems, we may incur significant costs during these transitions, and they may not result in the benefits we anticipate.***

If our products and services fail to deliver the performance, scalability or results expected by our current and future customers, or are not delivered on a timely basis, our reputation and credibility may suffer, our current and future sales and revenue may be materially harmed and our business may not succeed. For instance, if we are not able to realize the benefits we anticipate from the development and commercialization of the SMRT Cell 8M and Sequel II/Iie Systems and also any future products that may be developed for clinical uses, it could have a material adverse effect on our business, financial condition and results of operations. In addition, the introduction of future products, including with respect to the SMRT Cell 8M and Sequel II/Iie Systems, has and may in the future lead to our limiting or ceasing development of further enhancements to our existing products as we focus our resources on new products, and has resulted and could in the future result in reduced marketplace acceptance and loss of sales of our existing products, materially adversely affecting our revenue and operating results. The introduction of new products has had and may in the future also have a negative impact on our revenue in the near-term as our current and future customers have delayed or cancelled and may in the future delay or cancel orders of existing products in anticipation of new products and we may also be pressured to decrease prices for our existing products. Further, we have experienced, and may in the future experience, difficulty in managing or forecasting customer reactions, purchasing decisions or transition requirements with respect to newly launched products. We have incurred and may continue to incur significant costs in completing the transitions, including costs of write-downs of our products, as current or future customers’ transition to new products. If we do not successfully manage these product transitions, including with respect to the SMRT Cell 8M and Sequel II/Iie System, our business, reputation and financial condition may be materially and adversely affected.

***Our terminated merger with Illumina has affected and may in the future, materially and adversely affect our results of operations and stock price.***

On January 2, 2020, we, Illumina and Merger Subsidiary terminated the Merger Agreement. Although difficult to quantify, we believe that the terminated merger with Illumina has affected and may, in the future, materially and adversely affect our results of operations, due to the following:

- the restrictions in the Merger Agreement that limited our ability to take certain actions while the Merger Agreement was in effect;
- diverted management attention;
- disruption of our business, including our relationships with our customers, employees, partners and other parties, due to uncertainty over when or if the merger would be completed;
- our obligation to repay the Continuation Advances in certain circumstances; and
- other uncertainties that have impaired our ability to retain, recruit and motivate key personnel.

The occurrence, continuation or exacerbation of any of these events individually or in combination could materially and adversely affect our results of operations.

***We may need to repay the Continuation Advances to Illumina.***

Pursuant to the Termination Agreement, up to the \$52.0 million of Continuation Advances actually paid to us are repayable without interest to Illumina if, within two years of March 31, 2020, we enter into, or consummate a Change of Control Transaction or raises at least \$100 million in equity or debt financing in a single transaction (with the amount repayable dependent on the amount raised by us). If we are required to repay the Continuation Advances, 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 we may need to cease operations. Any of these actions could impede our ability to achieve our business objectives and could materially harm our operating results. 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.

***Recent significant changes to our leadership team and the resulting management transitions might harm our future operating results.***

We have recently experienced significant changes to our leadership team. Our President and Chief Executive Officer Christian O. Henry was appointed effective September 14, 2020, succeeding Dr. Michael Hunkapiller who announced his retirement at the end of the year. Our Chief Financial Officer Susan G. Kim was appointed effective September 28, 2020, succeeding Susan K. Barnes who retired on August 7, 2020. Also, our Vice President and Chief Accounting Officer Eric E. Schaefer was appointed effective May 26, 2020, and our Chairman of the Board Dr. John F. Milligan was appointed effective September 14, 2020.

Although we believe these leadership transitions are in the best interest of our stakeholders, these transitions may result in the loss of personnel with deep institutional or technical knowledge. Further, the transition could potentially disrupt our operations and relationships with employees, suppliers, partners and customers due to added costs, operational inefficiencies, decreased employee morale and productivity and increased turnover. We must successfully recruit and integrate our new leadership team members within our organization to achieve our operating objectives; as such, the leadership transition may temporarily affect our business performance and results of operations while the new members of our leadership team become familiar with our business. In addition, our competitors may seek to use this transition and the related potential disruptions to gain a competitive advantage over us. Furthermore, these changes increase our dependency on the other members of our leadership team that remain with us, who are not contractually obligated to remain employed with us and may leave at any time. Any such departure could be particularly disruptive given that we are already experiencing leadership transitions and, to the extent we experience additional management turnover, competition for top management is high such that it may take some time to find a candidate that meets our requirements. Our future operating results depend substantially upon the continued service of our key personnel and in significant part upon our ability to attract and retain qualified management personnel. If we are unable to mitigate these or other similar risks, our business, results of operation and financial condition may be adversely affected.

***We depend on the continuing efforts of our senior management team and other key personnel. If we lose members of our senior management team or other key personnel or are unable to successfully retain, recruit and train qualified scientists, engineers and other personnel, our ability to maintain and develop our products could be harmed and we may be unable to achieve our goals.***

Our success depends upon the continuing services of members of our senior management team and scientific and engineering personnel. In particular, our scientists and engineers are critical to our technological and product innovations

and we will need to hire additional qualified personnel. Our industry, particularly in the San Francisco Bay Area, is characterized by high demand and intense competition for talent, and the turnover rate can be high. We compete for qualified management and scientific personnel with other life science companies, academic institutions and research institutions, particularly those focusing on genomics. Our employees could leave our company with little or no prior notice and would be free to work for a competitor. In addition, changes to U.S. immigration policies, particularly to H-1B and other visa programs, could restrain the flow of technical and professional talent into the U.S. and may inhibit our ability to hire qualified personnel. If one or more of our senior executives or other key personnel were unable or unwilling to continue in their present positions, we may not be able to replace them easily or at all, and other senior management may be required to divert attention from other aspects of the business. In addition, we do not have “key person” life insurance policies covering any member of our management team or other key personnel. The loss of any of these individuals or any inability to attract or retain qualified personnel, including scientists, engineers and others, could prevent us from pursuing collaborations and materially and adversely affect our support of existing products, product development and introductions, business growth prospects, results of operations and financial condition.

***Our success is highly dependent on our ability to further penetrate nucleic acid sequencing applications as well as on the growth and expansion of the demand for our products. If our products fail to achieve and sustain sufficient market acceptance, we will not generate expected revenue and our business may not succeed.***

Although nucleic acid sequencing technology is well-established, our SMRT Sequencing technology is relatively new and evolving. We cannot be sure that our current or future products will gain acceptance in the marketplace at levels sufficient to support our costs. Our success depends, in part, on our ability to expand overall demand for nucleic acid sequencing to include new applications that are not practicable with other current technologies and to introduce new products that capture a larger share of growing overall demand for sequencing. To accomplish this, we must successfully commercialize, and continue development of, our proprietary SMRT Sequencing technology for use in a variety of life science and other applications, including uses by academic, government and clinical laboratories, as well as pharmaceutical, diagnostic, biotechnology and agriculture companies, among others. For example, the sale and commercialization of the SMRT Cell 8M and Sequel II/IIe Systems, and related products may not be successful.

There can be no assurance that we will be successful in adding new products or securing additional customers for our current and future products, including with respect to the SMRT Cell 8M and Sequel II/IIe Systems. Our ability to further penetrate existing applications and any new applications depends on a number of factors, including the cost, performance and perceived value associated with our products, as well as customers’ willingness to adopt a different approach to nucleic acid sequencing. Potential customers may have already made significant investments in other sequencing technologies and may be unwilling to invest in new technologies. We have limited experience commercializing and selling products outside of the academic and research settings, and we cannot assure you that we can successfully acquire additional customers. Furthermore, we cannot guarantee that our products will be satisfactory to potential customers we seek to reach or that our products will perform in accordance with customer expectations.

These applications are new and dynamic, and there can be no assurance that they will develop as quickly as we anticipate, that they will reach their full potential or that they will be receptive to any of our products. As a result, we may be required to refocus our marketing efforts, and we may have to make changes to the specifications of our products to enhance our ability to enter particular applications more quickly. We may also need to delay full-scale commercial deployment of new products as we develop them in order to perform quality control and early access user testing, including with respect to the SMRT Cell 8M and Sequel II/IIe Systems. Even if we are able to implement our technology successfully, we and/or our sales and distribution partners may fail to achieve or sustain market acceptance of our current or future products across the full range of our intended life science and other applications. We need to continue to expand and update our internal capabilities or to collaborate with other partners, or both, in order to successfully expand sales of our products in the applications that we seek to reach, which we may be unable to do at the scale required to support our business.

If the demand for our products grows more slowly than anticipated, if we are unable to successfully scale or otherwise ensure sufficient manufacturing capacity for new products to meet demand, if we are not able to successfully market and sell our products, if competitors develop better or more cost-effective products, if our product launches and commercialization are not successful, or if we are unable to further grow our customer base or do not realize the growth with existing customers that we are expecting, our current and future sales and revenue would be materially harmed and our business may not succeed.

***We rely on other companies for the manufacture of certain components and sub-assemblies and intend to outsource additional sub-assemblies in the future. We may not be able to successfully scale the manufacturing process necessary to build and test multiple products on a full commercial basis, which could materially harm our business.***

Our products are complex and involve a large number of unique components, many of which require precision in manufacturing. The nature of our products requires customized components that are currently available only from a limited number of sources, and in some cases, single sources. We have chosen to source certain critical components from a single source, including suppliers for our SMRT Cells, reagents and instruments. If we are required to purchase these components from alternative sources, it could take several months or longer to qualify the alternative sources. If we are unable to secure a sufficient supply of these product components on a timely basis, or if these components do not meet our expectations or specifications for quality and functionality, our operations and manufacturing will be materially and adversely affected, we could be unable to meet customer demand and our business and results of operations may be materially and adversely affected.

The operations of our third-party manufacturing partners and suppliers could be disrupted by conditions unrelated to our business or operations or that are beyond our control, including but not limited to international trade restrictions and conditions related to COVID-19 or other epidemics. If our manufacturing partners or suppliers are unable or fail to fulfill their obligations to us for any reason, we may not be able to manufacture our products and satisfy customer demand or our obligations under sales agreements in a timely manner, and our business could be harmed as a result. Our current manufacturing process is characterized by long lead times between the placement of orders for and delivery of our products. If we have received insufficient components to manufacture our products on a timely basis to meet customer demand, our sales and our gross margin may be adversely affected and our business could be materially harmed. If we are unable to reduce our manufacturing costs and establish and maintain reliable, high-volume manufacturing suppliers as we scale our operations, our business could be materially harmed.

***We may be unable to consistently manufacture our instruments and consumable kits, including SMRT Cells, to the necessary specifications or in quantities necessary to meet demand at an acceptable cost or at an acceptable performance level.***

In order to successfully generate revenue from our products, we need to supply our customers with products that meet their expectations for quality and functionality in accordance with established specifications. Our customers have experienced variability in the performance of our products. We have experienced and may continue to experience delays, quality issues or other difficulties leading to customer dissatisfaction with our products. Our production of SMRT Cells and reagents involves a long and complex manufacturing process, has been and may in the future be below desired levels, and we have experienced and may experience in the future manufacturing delays, product defects, variability in the performance of SMRT Cells and other products, inadequate reserves for inventory, or other issues. There is no assurance that we will be able to manufacture our products so that they consistently achieve the product specifications and quality that our customers expect, including any products developed for clinical uses. Problems in the design or quality of our products, including low manufacturing yields of SMRT Cells, or sub-performing reagent lots may have a material adverse effect on our brand, business, financial condition, and operating results, and could result in us losing our ISO certifications. If we were to lose our ISO certifications, then our customers might choose not to purchase products from us. There is also no assurance that we will be able to increase manufacturing yields and decrease costs, or that we will be successful in forecasting customer demand or manufacturing and supply costs. Furthermore, we may not be able to increase manufacturing to meet anticipated demand or may experience downtime in our manufacturing facilities. An inability to manufacture products and components that consistently meet specifications, in necessary quantities and at commercially acceptable costs, will have a negative impact, and may have a material adverse effect, on our business, financial condition and results of operations.

***Rapidly changing technology in life sciences and diagnostics could make our products obsolete unless we continue to develop, manufacture and commercialize new and improved products and pursue new opportunities.***

Our industry is characterized by rapid and significant technological changes, frequent new product introductions and enhancements and evolving industry standards. Our future success depends on our ability to continually improve our products, to develop and introduce new products that address the evolving needs of our customers on a timely and cost-effective basis and to pursue new opportunities. These new opportunities may be outside the scope of our proven expertise or in areas where demand is unproven, and new products and services developed by us may not gain market acceptance or may not adequately perform in order to capture market share. Our inability to develop and introduce new products and to gain market acceptance of our existing and new products could harm our future operating results. Unanticipated difficulties or delays in replacing existing products with new products or in commercializing our existing or new products in sufficient quantities and of acceptable quality to meet customer demand, including with respect to the SMRT Cell 8M and Sequel II System, could diminish future demand for our products and materially harm our future operating results.

***Increased market adoption of our products by customers may depend on the availability of sample preparation and informatics tools, some of which may be developed by third parties.***

Our commercial success may depend in part upon the development of sample preparation and software and informatics tools by third parties for use with our products. We cannot guarantee that third parties will develop tools that our current and future customers will find useful with our products, or that customers will adopt such third-party tools on a timely basis or at all. A lack of complementary sample preparation and informatics tools, or delayed updates of such tools, may impede the adoption of our products and may materially and adversely impact our business.

***We operate in a highly competitive industry and if we are not able to compete effectively, our business and operating results will likely be harmed.***

There are a significant number of companies offering nucleic acid sequencing products and/or services, including Illumina, BGI Genomics, Thermo, ONT Ltd., Roche, and Qiagen. Many of these companies currently have greater name recognition, more substantial intellectual property portfolios, longer operating histories, significantly greater financial, technical, research and/or other resources, more experience in new product development, larger and more established manufacturing capabilities and marketing, sales and support functions, and/or more established distribution channels to deliver products to customers than we do. These companies may be able to respond more quickly and effectively than we can to new or changing opportunities, technologies, standards or customer requirements.

There are also several companies that are in the process of developing or have already developed and commercialized new, competing or potentially competing technologies, products and/or services, including ONT Ltd. and its subsidiaries, against whom we have filed complaints for patent infringement in the U.S. District Court for the District of Delaware and, previously, with the U.S. International Trade Commission, in the High Court of England and Wales and in the District Court of Mannheim, Germany. ONT Ltd. previously filed claims against us in the High Court of England and Wales and the District Court of Mannheim, Germany, also for patent infringement, and its subsidiary, ONT Inc., filed counterclaims against us in the U.S. District Court for the District of Delaware seeking declaratory judgements of non-infringement, invalidity and unenforceability of the asserted patents, as well as antitrust, false advertising and unfair competition counterclaims that were subsequently dismissed by the Court. Roche is developing potentially competing sequencing products. Increased competition may result in pricing pressures, which could harm our sales, profitability or market share. Our failure to further enhance our existing products and to introduce new products to compete effectively could materially and adversely affect our business, financial condition or results of operations.

***We may be unable to successfully increase sales of our current products or market and sell our future products.***

Our ability to achieve profitability depends on our ability to attract customers for our current and future products, and we may be unable to effectively market or sell our products, or find appropriate partners to do so. To perform sales, marketing, distribution and customer support functions successfully, we face a number of risks, including:

- our ability to attract, retain and manage qualified sales, marketing and service personnel necessary to expand market acceptance for our technologies;
- the performance and commercial availability expectations of our existing and potential customers with respect to new and existing products;
- availability of potential sales and distribution partners to sell our technologies, and our ability to attract and retain such sales and distribution partners;
- the time and cost of maintaining and growing a specialized sales, marketing and service force for a particular application, which may be difficult to justify in light of the revenue generated; and
- our sales, marketing and service force may be unable to execute successful commercial activities.

We have enlisted and may continue to enlist third parties to assist with sales, distribution and customer support. There is no guarantee that we will be successful in attracting desirable sales and distribution partners, that we will be able to enter into arrangements with such partners on terms favorable to us or that we will be able to retain such partners on a going-forward basis. If our sales and marketing efforts, or those of any of our third-party sales and distribution partners, are not successful, or our products do not perform in accordance with customer expectations, our technologies and products may not gain market acceptance, which could materially impact our business operations.

***Large purchases by a limited number of customers represent a significant portion of our revenue, and any loss or delay of expected purchases has resulted, and in the future could result, in material quarter-to-quarter fluctuations of our revenue or otherwise adversely affect our results of operations.***

We receive a significant portion of our revenue from a limited number of customers. For example, for the fiscal year ended December 31, 2019 and 2018, one of our customers, Gene Company Limited, accounted for approximately 17% and 26% of our total revenue, respectively. Gene Company Limited is our primary distributor in China. Many of these

customers make large purchases on a purchase-order basis rather than pursuant to long-term contracts. As a consequence of the concentrated nature of our customer base and their purchasing behavior, our quarterly revenue and results of operations have fluctuated, and may fluctuate in the future, from quarter to quarter and are difficult to forecast. For example, the cancellation of orders or acceleration or delay in anticipated product purchases or the acceptance of shipped products by our larger customers has materially affected, and in the future could materially affect, our revenue and results of operations in any quarterly period. We have been, and may be in the future be, unable to sustain or increase our revenue from our larger customers, or offset any discontinuation or decrease of purchases by our larger customers with purchases by new or other existing customers. To the extent one or more of our larger customers experience significant financial difficulty, bankruptcy or insolvency, this could have a material adverse effect on our sales and our ability to collect on receivables, which could harm our financial condition and results of operations.

In addition, many of our customers, including some of our larger customers, have negotiated, or may in the future negotiate, volume-based discounts or other more favorable terms from us or our sales and distribution partners, which can and have had a negative effect on our gross margins or revenue.

We expect that such concentrated purchases will continue to contribute materially to our revenue for the foreseeable future and that our results of operations may fluctuate materially as a result of such larger customers' buying patterns. In addition, we may see consolidation of our customer base. The loss of one of our larger customers, a significant delay or reduction in its purchases, or any volume-based discount or other more favorable terms that we or our sales and distribution partner(s) may agree to provide in light of the aggregated purchase volume or buying power resulting from such consolidation, has harmed, and in the future could harm, our business, financial condition, results of operations and prospects.

***Our products are highly complex, have recurring support requirements and could have unknown defects or errors, which may give rise to claims against us or divert application of our resources from other purposes.***

Products using our SMRT sequencing technology are highly complex and may develop or contain undetected defects or errors. Our customers have experienced and may continue to experience reliability issues with our existing and future products, including the Sequel System and the Sequel II System. Despite testing, defects or errors may arise in our products, which could result in a failure to obtain, maintain or increase market acceptance of our products, diversion of development resources, injury to our reputation and increased warranty, service and maintenance costs. New products, including the SMRT Cell 8M and Sequel II/IIe Systems, or enhancements to our existing products in particular may contain undetected errors or performance problems that are discovered only after delivery to customers. If our products have reliability or other quality issues or require unexpected levels of support in the future, the market acceptance and utilization of our products may not grow to levels sufficient to support our costs and our reputation and business could be harmed. Low utilization rates of our products could cause our revenue and gross margins to be adversely affected. We generally ship our sequencing instruments with one year of service included in the purchase price with an option to purchase one or more additional years of service. We also provide a warranty for our consumables, which is generally limited to replacing, or at our option, giving credit for any consumable with defects in material or workmanship. Defects or errors in our products may also discourage customers from purchasing our products. The costs incurred in correcting any defects or errors may be substantial and could materially and adversely affect our operating margins. If our service and support costs increase, our business and operations may be materially and adversely affected.

In addition, such defects or errors could lead to the filing of product liability claims against us or against third parties who we may have an obligation to indemnify against such claims, which could be costly and time-consuming to defend and result in substantial damages. Although we have product liability insurance, any product liability insurance that we have or procure in the future may not protect our business from the financial impact of a product liability claim. Moreover, we may not be able to obtain adequate insurance coverage on acceptable terms. Any insurance that we have or obtain will be subject to deductibles and coverage limits. A product liability claim could have a serious adverse effect on our business, financial condition and results of operations.

***A significant portion of our sales depends on customers' spending budgets that may be subject to significant and unexpected variation which could have a negative effect on the demand for our products.***

Our instruments represent significant capital expenditures for our customers. Current and potential customers for our current or future products include academic and government institutions, genome centers, medical research institutions, clinical laboratories, pharmaceutical, agricultural, biotechnology, diagnostic and chemical companies. Their spending budgets can have a significant effect on the demand for our products. Spending budgets are based on a wide variety of factors, including the allocation of available resources to make purchases, funding from government sources which is highly uncertain and subject to change, the spending priorities among various types of research equipment, policies regarding

capital expenditures during economically uncertain periods and the impact of COVID-19. Any decrease in capital spending or change in spending priorities of our current and potential customers could significantly reduce the demand for our products. Any delay or reduction in purchases by current or potential customers or our inability to forecast fluctuations in demand could harm our future operating results.

***We may not be able to convert our orders in backlog into revenue.***

Our backlog represents product orders from our customers that we have confirmed and for which we have not yet recognized revenue. We may not receive revenue from these orders, and any order backlog we report may not be indicative of our future revenue.

Many events can cause an order to be delayed or not completed at all, some of which may be out of our control, including the potential impacts from COVID-19. If we delay fulfilling customer orders or if customers reconsider their orders, those customers may seek to cancel or modify their orders with us. Customers may otherwise seek to cancel or delay their orders even if we are prepared to fulfill them. If our orders in backlog do not result in sales, our operating results may suffer.

***Our sales cycle is unpredictable and lengthy, which makes it difficult to forecast revenue and may increase the magnitude of quarterly or annual fluctuations in our operating results.***

The sales cycle for our sequencing instruments is lengthy because they represent a major capital expenditure and generally require the approval of our customers' senior management. This may contribute to substantial fluctuations in our quarterly or annual operating results, particularly during the periods in which our sales volume is low. Factors that may cause fluctuations in our quarterly or operating results include, without limitation, market acceptance for our products; our ability to attract new customers; publications of studies by us, competitors or third parties; the timing and success of new product introductions by us or our competitors or other changes in the competitive dynamics of our industry, such as consolidation; the amount and timing of our costs and expenses; changes in our pricing policies or those of our competitors; general economic, industry and market conditions; the effects of seasonality; the regulatory environment; expenses associated with warranty costs or unforeseen product quality issues; the hiring, training and retention of key employees, including our ability to grow our sales organization; litigation or other claims against us for intellectual property infringement or otherwise; our ability to obtain additional financing as necessary; changes or trends in new technologies and industry standards; and the impact of COVID-19. Because of these fluctuations, it is likely that in some future quarters our operating results will fall below the expectations of securities analysts or investors. If that happens, the market price of our stock would likely decrease. Past fluctuations in our quarterly and annual operating results have resulted in decreases in our stock price. Such fluctuations also mean that investors may not be able to rely on our operating results in any particular period as an indication of future performance. Sales to existing customers and the establishment of a business relationship with other potential customers is a lengthy process, generally taking several months and sometimes longer. Following the establishment of the relationship, the negotiation of purchase terms can be time-consuming, and a potential customer may require an extended evaluation and testing period. In anticipation of product orders, we may incur substantial costs before the sales cycle is complete and before we receive any customer payments. As a result, in the event that a sale is not completed or is canceled or delayed, we may have incurred substantial expenses, making it more difficult for us to become profitable or otherwise negatively impacting our financial results. Furthermore, because of our lengthy sales cycle, the realization of revenue from our selling efforts may be substantially delayed, our ability to forecast our future revenue may be more limited and our revenue may fluctuate significantly from quarter to quarter.

***Seasonality may cause fluctuations in our revenue and results of operations.***

We operate on a December 31st year-end and believe that there are significant seasonal factors which may cause sales of our products, and particularly our sequencing instruments, to vary on a quarterly or yearly basis, contribute to the lengthy sales cycle for our sequencing instruments, and increase the magnitude of quarterly or annual fluctuations in our operating results. We believe that this seasonality results from a number of factors, including the procurement and budgeting cycles of many of our customers, especially government-funded customers, which cycles often coincide with government fiscal year ends. For example, the U.S. government's fiscal year-end occurs in our third quarter and may result in increased sales of our products during this quarter if government-funded customers have unused funds that may be forfeit, or future budgets that may be reduced, if such funds remain unspent at such fiscal year-end. Furthermore, celebrations of the Lunar New Year, which occurs during our first quarter, may last for a week or longer, during which time many of our customers' offices in China and elsewhere in the Asia-Pacific region may be closed due to the holiday, and have in the past caused, and may in the future cause, decreased sales of our consumables during such quarter. These factors have contributed, and may contribute in the future, to substantial fluctuations in our quarterly operating results. Because of these fluctuations, it is possible that in some quarters our operating results will fall below the expectations of securities analysts or investors. If that

happens, the market price of our stock would likely decrease. These fluctuations, among other factors, also mean that our operating results in any particular period may not be relied upon as an indication of future performance. Seasonal or cyclical variations in our sales have in the past, and may become in the future, more, or less pronounced over time, and have in the past materially affected, and may in the future materially affect, our business, financial condition, results of operations and prospects.

***Our ability to use net operating losses to offset future taxable income may be subject to substantial limitations, and changes to U.S. tax laws may cause us to make adjustments to our financial statements.***

Under Section 382 of the Internal Revenue Code, a corporation that undergoes an “ownership change” is subject to limitations on its ability to utilize its pre-change net operating losses (“NOLs”) to offset future taxable income. We believe that we have had one or more ownership changes, as a result of which our existing NOLs are currently subject to limitation. Future changes in our stock ownership could result in additional ownership changes under Section 382. We may not be able to utilize a material portion of our NOLs even if we attain profitability. Furthermore, the changes to deductions, credits and expense recognition resulting from the Tax Cuts and Jobs Act of 2018 enacted on December 22, 2017 have materially impacted the value of our deferred tax assets and liabilities, and could adversely affect our future taxable income and effective tax rate.

***Our facilities in California are located near earthquake faults, and the occurrence of an earthquake or other catastrophic disaster could cause damage to our facilities and equipment, which could require us to cease or curtail operations.***

Our facilities in the San Francisco Bay Area are located near earthquake fault zones and are vulnerable to damage from earthquakes. We are also vulnerable to damage from other types of disasters, including fire, floods, power loss, communications failures and similar events. If any disaster were to occur, our ability to operate our business at our facilities would be seriously, or potentially completely, impaired. In addition, the nature of our activities could cause significant delays in our research programs and commercial activities and make it difficult for us to recover from a disaster. The insurance we maintain may not be adequate to cover our losses resulting from disasters or other business interruptions. Accordingly, an earthquake or other disaster could materially and adversely harm our ability to conduct business.

### **Risks Related to Our Intellectual Property**

***Failure to secure patent or other intellectual property protection for our products and improvements to our products may reduce our ability to maintain any technological or competitive advantage over our current and potential competitors.***

Our ability to protect and enforce our intellectual property rights is uncertain and depends on complex legal and factual questions. Our ability to establish or maintain a technological or competitive advantage over our competitors may be diminished because of these uncertainties. For example:

- we or our licensors might not have been the first to make the inventions covered by each of our pending patent applications or issued patents;
- we or our licensors might not have been the first to file patent applications for these inventions;
- it is possible that neither our pending patent applications nor the pending patent applications of our licensors will result in issued patents;
- the scope of the patent protection we or our licensors obtain may not be sufficiently broad to prevent others from practicing our technologies, developing competing products, designing around our patented technologies or independently developing similar or alternative technologies;
- our and our licensors’ patent applications or patents have been, are and may in the future be, subject to interference, opposition or similar administrative proceedings, which could result in those patent applications failing to issue as patents, those patents being held invalid or the scope of those patents being substantially reduced;
- our enforcement of patents and proprietary rights in other countries may be problematic or unpredictable;
- we may not be able to prevent third parties from practicing our inventions in all countries outside the United States, or from selling or importing products made using our inventions in and into the United States or other jurisdictions;
- we or our partners may not adequately protect our trade secrets;
- we may not develop additional proprietary technologies that are patentable; or



□ the patents of others may limit our freedom to operate and prevent us from commercializing our technology in accordance with our plans.

The occurrence of any of these events could impair our ability to operate without infringing upon the proprietary rights of others or prevent us from establishing or maintaining a competitive advantage over our competitors.

***Variability in intellectual property laws may adversely affect our intellectual property position.***

Intellectual property laws, and patent laws and regulations in particular, have been subject to significant variability either through administrative or legislative changes to such laws or regulations or changes or differences in judicial interpretation, and it is expected that such variability will continue to occur. Additionally, intellectual property laws and regulations differ by country. Variations in the patent laws and regulations or in interpretations of patent laws and regulations in the United States and other countries may diminish the value of our intellectual property and may change the impact of third-party intellectual property on us. Accordingly, we cannot predict the scope of the patents that may be granted to us with certainty, the extent to which we will be able to enforce our patents against third parties or the extent to which third parties may be able to enforce their patents against us.

***Some of the intellectual property that is important to our business is owned by other companies or institutions and licensed to us, and changes to the rights we have licensed may adversely impact our business.***

We license from third parties some of the intellectual property that is important to our business. If we fail to meet our obligations under these licenses, or if we have a dispute regarding the terms of the licenses, these third parties could terminate the licenses. If the third parties who license intellectual property to us fail to maintain the intellectual property that we have licensed, or lose rights to that intellectual property, the rights we have licensed may be reduced or eliminated, which could subject us to claims of intellectual property infringement. Termination of these licenses or reduction or elimination of our licensed rights may result in our having to negotiate new or reinstated licenses with less favorable terms, or could subject us to claims of intellectual property infringement or contract breach in litigation or other administrative proceedings that could result in damage awards against us and injunctions that could prohibit us from selling our products. In addition, some of our licenses from third parties limit the field in which we can use the licensed technology. Therefore, in order for us to use such licensed technology in potential future applications that are outside the licensed field of use, we may be required to negotiate new licenses with our licensors or expand our rights under our existing licenses. We cannot assure you that we will be able to obtain such licenses or expanded rights on reasonable terms or at all. In the event a dispute with our licensors were to occur, our licensors may seek to renegotiate the terms of our licenses, increase the royalty rates that we pay to obtain and maintain those licenses, limit the field or scope of the licenses, or terminate the license agreements. In addition, we have limited rights to participate in the prosecution and enforcement of the patents and patent applications that we have licensed. As a result, we cannot be certain that these patents and applications will be prosecuted and enforced in a manner consistent with the best interests of our business. Further, because of the rapid pace of technological change in our industry, we may need to rely on key technologies developed or licensed by third parties, and we may not be able to obtain licenses and technologies from these third parties at all or on reasonable terms. The occurrence of these events may have a material adverse effect on our business, financial condition or results of operations.

***The measures that we use to protect the security of and enforce our intellectual property and other proprietary rights may not be adequate, which could result in the loss of legal protection for, and thereby diminish the value of, such intellectual property and other rights.***

In addition to patents, we also rely upon trademarks, trade secrets, copyrights and unfair competition laws, as well as license agreements and other contractual provisions, to protect our intellectual property and other proprietary rights. Despite these measures, any of our intellectual property rights could be challenged, invalidated, circumvented or misappropriated. In addition, we attempt to protect our intellectual property and proprietary information by requiring our employees and consultants to enter into confidentiality and assignment of inventions agreements, and by entering into confidentiality agreements with our third-party development, manufacturing, sales and distribution partners, who may also acquire, develop and/or commercialize alternative or competing products or provide services to our competitors. For example, Roche had certain access to our trade secrets and other proprietary information pursuant to our agreement with them, subject to the confidentiality provisions thereof (certain of which provisions survive the termination of the agreement); however, Roche is developing potentially competing sequencing products. There can be no assurance that our measures have provided or will provide adequate protection for our intellectual property and proprietary information. These agreements may be breached, and we may not have adequate remedies for any such breach. In addition, our trade secrets and other proprietary information may be disclosed to others, or others may gain access to or disclose our trade secrets and other proprietary information. Enforcing a claim that a third party illegally obtained and is using our trade secrets is expensive and time consuming, and the outcome is unpredictable. Additionally, others may independently develop

proprietary information and techniques that are substantially equivalent to ours. The occurrence of these events may have a material adverse effect on our business, financial condition or results of operations.

***Our intellectual property may be subject to challenges in the United States or foreign jurisdictions that could adversely affect our intellectual property position.***

Our pending, issued and granted U.S. and foreign patents and patent applications have been, are and may in the future be, subject to challenges by Oxford Nanopore Technologies Ltd. (“ONT Ltd.”), Oxford Nanopore Technologies, Inc. (“ONT Inc.”) and Metrichor, Ltd. (“Metrichor” and, together with ONT Ltd. and ONT Inc., “ONT”) and other parties asserting prior invention by others or invalidity on various grounds, through proceedings, such as interferences, reexaminations or opposition proceedings. Addressing these challenges to our intellectual property has been, and any future challenges can be, costly and distract management’s attention and resources. For example, we previously incurred significant legal expenses to litigate and settle a complaint seeking review of a patent interference decision of the U.S. Patent and Trademark Office. Additionally, ONT previously requested that the U.S. Patent and Trademark Office institute *inter partes* reviews of certain patents that we have asserted against ONT Inc. and ONT Ltd. in litigation proceedings for patent infringement. While none of the *inter partes* reviews requested by ONT were instituted by the U.S. Patent and Trademark Office, challenges of this nature in the future could result in determinations that our patents or pending patent applications are unpatentable to us, invalidated or unenforceable in whole or in part. Accordingly, adverse rulings in such proceedings could negatively impact the scope of our intellectual property protection for our products and technology, and could materially and adversely affect our business.

***Some of our technology is subject to “march-in” rights by the U.S. government.***

Some of our patented technology was developed with U.S. federal government funding. When new technologies are developed with U.S. government funding, the government obtains certain rights in any resulting patents, including a nonexclusive license authorizing the government to use the invention for non-commercial purposes. These rights may permit the government to disclose our confidential information to third parties and to exercise “march-in” rights to use or allow third parties to use our patented technology. The government can exercise its march-in rights if it determines that such action is necessary to (i) achieve practical application of the U.S. government-funded technology, (ii) alleviate health or safety needs, (iii) meet requirements of federal regulations, or (iv) give preference to U.S. industry. In addition, U.S. government-funded inventions must be reported to the government and such government funding must be disclosed in any resulting patent applications. Furthermore, our rights in such inventions are subject to government license rights and foreign manufacturing restrictions.

***We are involved in legal proceedings to enforce our intellectual property rights.***

Our intellectual property rights involve complex factual, scientific and legal questions. We operate in an industry characterized by significant intellectual property litigation. Even though we may believe that we have a valid patent on a particular technology, other companies have from time to time taken, and may in the future take, actions that we believe violate our patent rights. For example, we are involved in legal proceedings for patent infringement and related matters in the United States with ONT and with PGI, and we were previously involved in other legal proceedings with ONT and Harvard University in several United States and European jurisdictions. We have received adverse rulings against us with respect to our complaint with the USITC in one of these proceedings and additionally as described in *Note 6. Commitments and Contingencies* of Item 1. of Financial Statements under Part I – Financial Information. Legal actions to enforce our patent rights have been, and will continue to be, expensive, and may divert significant management time and resources. Adverse parties from previous legal actions have brought, and may in the future bring, claims against us and/or our intellectual property. Litigation is a significant ongoing expense, recognized in sales, general and administrative expense, with an uncertain outcome, and has been, and may in the future be, a material expense for us. Our enforcement actions may not be successful, have given rise to legal claims against us and could result in some of our intellectual property rights being determined to be invalid or not enforceable. Furthermore, an adverse determination or judgement could lead to an award of damages against us, or the issuance of an injunction against us that could prevent us from selling any products found to be infringing the intellectual property rights of another party.

***We have been, are currently, and could in the future be, subject to legal proceedings with third parties who may claim that our products infringe or misappropriate their intellectual property rights.***

Our products are based on complex, rapidly developing technologies. We may not be aware of issued or previously filed patent applications that belong to third parties that mature into issued patents that cover some aspect of our products or their use. In addition, because patent litigation is complex and the outcome inherently uncertain, our belief that our products do not infringe third-party patents of which we are aware or that such third-party patents are invalid and unenforceable may

be determined to be incorrect. As a result, third parties have claimed, and may in the future claim, that we infringe their patent rights and have filed, and may in the future file, lawsuits or engage in other proceedings against us to enforce their patent rights. For example, ONT Ltd. and Harvard University previously filed claims against us in the High Court of England and Wales and the District Court of Mannheim, Germany for patent infringement, and PGI has filed claims against us in the U.S. District Court for the District of Delaware and in the Wuhan People's Court in China. We are aware of other issued patents and patent applications owned by third parties that could be construed to read on our products and services. Although we do not believe that our products or services infringe any valid issued patents, the third-party owners of these patents and applications may in the future claim that we infringe their patent rights and file lawsuits against us. In addition, as we enter new markets, our competitors and other third parties may claim that our products infringe their intellectual property rights as part of a business strategy to impede our successful entry into those markets. Furthermore, parties making claims against us may be able to obtain injunctive or other relief, which effectively could block our ability to develop further, commercialize, or sell products or services, and could result in the award of substantial damages against us. Patent litigation between competitors in our industry is common. Additionally, we have certain obligations to many of our customers and suppliers to indemnify and defend them against claims by third parties that our products or their use infringe any intellectual property of these third parties. In defending ourselves against any of these claims, we have in the past incurred, and could in the future incur, substantial costs, and the attention of our management and technical personnel could be diverted. For example, we previously incurred significant legal expenses to litigate and settle a complaint alleging patent infringement. Even if we have an agreement that indemnifies us against such costs, the indemnifying party may be unable to uphold its contractual obligations. To avoid or settle legal claims, it may be necessary or desirable in the future to obtain licenses relating to one or more products or relating to current or future technologies, which could negatively affect our gross margins. We may not be able to obtain these licenses on commercially reasonable terms, or at all. We may be unable to modify our products so that they do not infringe the intellectual property rights of third parties. In some situations, the results of litigation or settlement of claims may require us to cease allegedly infringing activities which could prevent us from selling some or all of our products. The occurrence of these events may have a material adverse effect on our business, financial condition or results of operations.

In addition, in the course of our business, we may from time to time have access or be alleged to have access to confidential or proprietary information of others, which, though not patented, may be protected as trade secrets. Others could bring claims against us asserting that we improperly used their confidential or proprietary information, or that we misappropriated their technologies and incorporated those technologies into our products. A determination that we illegally used the confidential or proprietary information or misappropriated technologies of others in our products could result in us paying substantial damage awards or being prevented from selling some or all of our products, which could materially and adversely affect our business.

***We have not yet registered some of our trademarks in all of our potential markets, and failure to secure those registrations could adversely affect our business.***

Some of our trademark applications may not be allowed for registration, and our registered trademarks may not be maintained or enforced. In addition, in the U.S. Patent and Trademark Office and in comparable agencies in many foreign jurisdictions, third parties are given an opportunity to oppose pending trademark applications and to seek to cancel registered trademarks. Opposition or cancellation proceedings may be filed against our trademarks, and our trademarks may not survive such proceedings.

***Our use of "open source" software could adversely affect our ability to sell our products and subject us to possible litigation.***

A portion of the products or technologies developed and/or distributed by us incorporate "open source" software, and we may incorporate open source software into other products or technologies in the future. Some open source software licenses require that we disclose the source code for any modifications to such open source software that we make and distribute to one or more third parties, and that we license the source code for such modifications to third parties, including our competitors, at no cost. We monitor the use of open source software in our products to avoid uses in a manner that would require us to disclose or grant licenses under our source code that we wish to maintain as proprietary; however, there can be no assurance that such efforts have been or will be successful. In some circumstances, distribution of our software that includes or is linked with open source software could require that we disclose and license some or all of our proprietary source code in that software, which could include permitting the use of such software and source code at no cost to the user. Open source license terms are often ambiguous and there is little legal precedent governing the interpretation of these licenses. Successful claims made by the licensors of open source software that we have violated the terms of these licenses could result in unanticipated obligations, including being subject to significant damages, being enjoined from distributing products that incorporate open source software and being required to make available our proprietary source code pursuant to

an open source license, which could substantially help our competitors develop products that are similar to or better than ours or otherwise materially and adversely affect our business.

## **Risks Related to Regulation**

***We are, and may become, subject to governmental regulations that may impose burdens on our operations, and the markets for our products may be narrowed.***

We are subject, both directly and indirectly, to the adverse impact of government regulation of our operations and markets. For example, export of our instruments may be subject to strict regulatory control in a number of jurisdictions. We have expanded and are continuing to expand the international jurisdictions into which we supply products, which increase the risks surrounding governmental regulations relating to our business. The failure to satisfy export control criteria or to obtain necessary clearances could delay or prevent shipment of products, which could materially and adversely affect our revenue and profitability. Moreover, the life sciences industry, which is expected to continue to be one of the primary markets for our technology, has historically been heavily regulated. There are, for example, laws in several jurisdictions restricting research in genetic engineering, which may narrow our markets. Given the evolving nature of this industry, legislative bodies or regulatory authorities may adopt additional regulations that may adversely affect our market opportunities. Additionally, if ethical and other concerns surrounding the use of genetic information, diagnostics or therapies become widespread, there may be less demand for our products.

Our business is also directly affected by a wide variety of government regulations applicable to business enterprises generally and to companies operating in the life science industry in particular. Failure to comply with government regulations or obtain or maintain necessary permits and licenses could result in a variety of fines or other censures or an interruption in our business operations which may have a negative impact on our ability to generate revenue and the cost of operating our business. In addition, changes to laws and government regulations could cause a material adverse effect on our business as we will need to adapt our business to comply with such changes. For example, a governmental prohibition on the use of human *in vitro* diagnostics would adversely impact our commercialization of products on which we have expended significant research and development resources, which would in turn have a material adverse impact on our business and prospects.

***Our products could become subject to regulation by the U.S. Food and Drug Administration or other domestic and international regulatory agencies, which could increase our costs and impede or delay our commercialization efforts, thereby materially and adversely affecting our business and results of operations.***

Our products are not currently subject to U.S. Food and Drug Administration (“FDA”) clearance or approval since they are not intended for use in the diagnosis or treatment of disease. However, in the future, certain of our products or related applications, such as those that may be developed for clinical uses, could be subject to FDA regulation, or the FDA’s regulatory jurisdiction could be expanded to include our products. Even where a product is exempted from FDA clearance or approval, the FDA may impose restrictions as to the types of customers to which we or our partners can market and sell our products. Such regulation and restrictions may materially and adversely affect our business, financial condition and results of operations. In the event that we fail to obtain and maintain necessary regulatory clearances or approvals for products that we develop for clinical uses, or if clearances or approvals for future products and indications are delayed or not issued, our commercial operations may be materially harmed. Furthermore, even if we are granted regulatory clearances or approvals, they may include significant limitations on the indicated uses for the product, which may limit the market for the product. We do not have experience in obtaining FDA approvals and no assurance can be given that we will be able to obtain or to maintain such approvals. Furthermore, any approvals that we may obtain can be revoked if safety or efficacy problems develop.

Many countries have laws and regulations that could affect our products, such as 510(k) clearances, premarket approvals or CE Mark requirements, and failure to adhere to applicable statutory or regulatory requirements by us or our business partners would have a material adverse effect on our operations and financial condition. The number and scope of these requirements are increasing. Unlike many of the other companies offering nucleic acid sequencing equipment or consumables, this is an area where we do not have expertise. We, or our other third-party sales and distribution partners, may not be able to obtain regulatory approvals in such countries or may incur significant costs in obtaining or maintaining our foreign regulatory approvals. In addition, the export by us of certain of our products, which have not yet been cleared for domestic commercial distribution, may be subject to FDA or other export restrictions. Any action brought against us for violations of these laws or regulations, even if successfully defended, could cause us to incur significant legal expenses and divert our management’s attention from the operation of our business.

***Enhanced trade tariffs, import restrictions, export restrictions, Chinese regulations or other trade barriers may materially harm our business.***

We are continuing to expand our international operations as part of our growth strategy and have experienced an increasing concentration of sales in certain regions outside the U.S., especially the Asia-Pacific region. There is currently significant uncertainty about the future relationship between the United States and various other countries, most significantly China, with respect to trade policies, treaties, government regulations and tariffs. The current U.S. presidential administration has called for substantial changes to U.S. foreign trade policy with respect to China and other countries, including the possibility of imposing greater restrictions on international trade and significant increases in tariffs on goods imported into the United States. Starting September 2018, the U.S. Trade Representative (the “USTR”) has enacted various tariffs of 7.5%, 10%, 15% and 25% on the import of Chinese products, including non-U.S. components and materials that may be used in our products. Additionally, China has also imposed tariffs on imports into China from the United States. These tariffs could raise our costs. Furthermore, tariffs, trade restrictions, or trade barriers that have been, and may in the future be, placed on products such as ours by foreign governments, especially China, have raised, and could further raise, amounts paid for some or all of our products, which may result in the loss of customers and our business, and our financial condition and results of operations may be harmed. Further tariffs may be imposed that could cover imports of components and materials used in our products, or our business may be adversely impacted by retaliatory trade measures taken by China or other countries, including restricted access to components or materials used in our products or increased amounts that must be paid for our products, which could materially harm our business, financial condition and results of operations. Further, the continued threats of tariffs, trade restrictions and trade barriers could have a generally disruptive impact on the global economy and, therefore, negatively impact our sales. Given the relatively fluid regulatory environment in China and the United States and uncertainty how the U.S. or foreign governments will act with respect to tariffs, international trade agreements and policies, there could be additional tax or other regulatory changes in the future. Any such changes could directly and adversely impact our financial results and results of operations.

Additionally, in November 2018, the U.S. Commerce Department’s Bureau of Industry and Security (“BIS”) released an advance notice of proposed rulemaking to control the export of emerging technologies. This notice included “[b]iotechnology, including nanobiology; synthetic biology; genomic and genetic engineering; or neurotech” as possible areas of increased export controls. Therefore, it is possible that our ability to export our products may be restricted in the future.

Finally, in April 2020, BIS expanded its controls on the export, reexport, and transfer of certain items for military end-use or to military end-users in China, Russia, and Venezuela. These expanded controls could impact our ability to sell our products to certain end-users in these countries, most notably China.

***If we fail to comply with healthcare and other governmental laws and regulations, we could face substantial penalties and our business, results of operations and financial condition could be adversely affected.***

The products that we may develop for clinical uses may be highly regulated, and there can be no assurance that the regulatory environment in which we would operate will not change significantly and adversely in the future. Any arrangements with physicians, hospitals and clinics may expose us to broadly applicable fraud and abuse and other laws and regulations that may restrict the financial arrangements and relationships through which we market, sell and distribute our products and services. Our employees, consultants, and commercial partners may engage in misconduct or other improper activities, including non-compliance with regulatory standards and requirements. Federal and state healthcare and other laws and regulations that may affect our ability to conduct business, include, without limitation:

- federal and state laws and regulations regarding billing and claims payment applicable to products that we may develop for clinical uses, and regulatory agencies enforcing those laws and regulations;
- the federal Anti-Kickback Statute, which prohibits, among other things, any person from knowingly and willfully offering, soliciting, receiving or providing remuneration, directly or indirectly, in exchange for or to induce either the referral of an individual for, or the purchase, order or recommendation of, any good or service for which payment may be made under federal healthcare programs;
- the federal False Claims Act, which prohibits, among other things, individuals or entities from knowingly presenting, or causing to be presented, false claims, or knowingly using false statements, to obtain payment from the federal government;
- federal criminal laws that prohibit executing a scheme to defraud any healthcare benefit program or making false statements relating to healthcare matters;
- the FCPA, the U.K. Bribery Act of 2010, and other local anti-corruption laws that apply to our international activities;

- the federal Physician Payment Sunshine Act, or Open Payments, created under the Affordable Care Act, and its implementing regulations, which requires manufacturers of drugs, medical devices, biologicals and medical supplies for which payment is available under Medicare, Medicaid, or the Children’s Health Insurance Program to report annually to the U.S. Department of Health and Human Services, or HHS, information related to payments or other transfers of value made to licensed physicians and teaching hospitals, as well as ownership and investment interests held by physicians and their immediate family members;
- the Health Insurance Portability and Accountability Act (“HIPAA”), as amended by the Health Information Technology for Economic and Clinical Health Act, and its implementing regulations, and other laws and regulations relating to privacy and data protection including the European Union’s GDPR, which impose certain requirements relating to the privacy, security and transmission of individually identifiable health information; HIPAA also created criminal liability for knowingly and willfully falsifying or concealing a material fact or making a materially false statement in connection with the delivery of or payment for healthcare benefits, items or services; additionally, California has enacted the California Consumer Privacy Act (“CCPA”), which requires enhanced disclosures related to California residents regarding the use or disclosure of their personal information, allows California residents to opt-out of certain uses and disclosures of their personal information without penalty, provides Californians with other choices related to personal data in our possession, and requires obtaining opt-in consent before engaging in certain uses of personal information relating to Californians under the age of 16. The California Attorney General may, once enforcement commences on July 1, 2020, seek substantial monetary penalties and injunctive relief in the event of non-compliance with the CCPA after it became operative on January 1, 2020. The CCPA also allows for private lawsuits from Californians in the event of certain data breaches. Certain aspects of the CCPA and its interpretation remain uncertain, and we may need to modify our policies or practices in an effort to comply with it;
- the federal physician self-referral prohibition, commonly known as the Stark Law; and
- state law equivalents of each of the above federal laws, such as anti-kickback and false claims laws which may apply to items or services reimbursed by any third-party payor, including commercial insurers, and state and foreign laws governing the privacy and security of health information in certain circumstances, many of which differ from each other in significant ways and often are not preempted by HIPAA, thus complicating compliance efforts.

The Patient Protection and Affordable Care Act, as amended by the Health Care and Education Affordability Reconciliation Act, or Affordable Care Act, was enacted in 2010. The Affordable Care Act, among other things, amends the intent requirement of the federal Anti-Kickback Statute and criminal healthcare fraud statutes. A person or entity no longer needs to have actual knowledge of this statute or specific intent to violate it. In addition, the Affordable Care Act provides that the government may assert that a claim including items or services resulting from a violation of the federal Anti-Kickback Statute constitutes a false or fraudulent claim for purposes of the False Claims Act.

Because of the breadth of these laws and the narrowness of available statutory and regulatory exemptions, it is possible that some of our activities could be subject to challenge under one or more of such laws. Any action brought against us for violations of these laws or regulations, even successfully defended, could cause us to incur significant legal expenses and divert our management’s attention from the operation of our business. We may be subject to private “qui tam” actions brought by individual whistleblowers on behalf of the federal or state governments, with potential liability under the federal False Claims Act including mandatory treble damages and significant per-claim penalties.

The growth of our business and sales organization and our expansion outside of the United States may increase the potential of violating these laws. The risk of our being found in violation of these or other laws and regulations is further increased by the fact that many have not been fully interpreted by the regulatory authorities or the courts, and their provisions are open to a variety of interpretations. Any action brought against us for violation of these or other laws or regulations, even if we successfully defend against it, could cause us to incur significant legal expenses and divert our management’s attention from the operation of our business. If our operations are found to be in violation of any of the federal, state and foreign laws described above or any other current or future fraud and abuse or other healthcare laws and regulations that apply to us, we may be subject to penalties, including significant criminal, civil, and administrative penalties, damages, fines, imprisonment, for individuals, exclusion from participation in government programs, such as Medicare and Medicaid, and we could be required to curtail or cease certain of our operations. Any of the foregoing consequences could seriously harm our business and our financial results.

***Our operations involve the use of hazardous materials, and we must comply with environmental, health and safety laws, which can be expensive and may adversely affect our business, operating results and financial condition.***

Our research and development and manufacturing activities involve the use of hazardous materials, including chemicals and biological materials, and some of our products include hazardous materials. Accordingly, we are subject to federal, state, local and foreign laws, regulations and permits relating to environmental, health and safety matters, including, among others, those governing the use, storage, handling, exposure to and disposal of hazardous materials and wastes, the health and safety of our employees, and the shipment, labeling, collection, recycling, treatment and disposal of products containing hazardous materials. Liability under environmental laws and regulations can be joint and several and without regard to fault or negligence. For example, under certain circumstances and under certain environmental laws, we could be held liable for costs relating to contamination at our or our predecessors' past or present facilities and at third-party waste disposal sites. We could also be held liable for damages arising out of human exposure to hazardous materials. There can be no assurance that violations of environmental, health and safety laws will not occur as a result of human error, accident, equipment failure or other causes. The failure to comply with past, present or future laws could result in the imposition of substantial fines and penalties, remediation costs, property damage and personal injury claims, investigations, the suspension of production or product sales, loss of permits or a cessation of operations. Any of these events could harm our business, operating results and financial condition. We also expect that our operations will be affected by new environmental, health and safety laws and regulations on an ongoing basis, or more stringent enforcement of existing laws and regulations. New laws or changes to existing laws may result in additional costs and may increase penalties associated with violations or require us to change the content of our products or how we manufacture them, which could have a material adverse effect on our business, operating results and financial condition.

***Ethical, legal, privacy and social concerns or governmental restrictions surrounding the use of genetic information could reduce demand for our technology.***

Our products may be used to provide genetic information about humans, agricultural crops and other living organisms. The information obtained from our products could be used in a variety of applications which may have underlying ethical, legal, privacy and social concerns, including the genetic engineering or modification of agricultural products or testing for genetic predisposition for certain medical conditions. Governmental authorities could, for safety, social or other purposes, call for limits on or regulation of the use of genetic testing. Such concerns or governmental restrictions could limit the use of our products, which could have a material adverse effect on our business, financial condition and results of operations.

***Regulations related to conflict minerals has caused us to incur, and will continue to cause us to incur, additional expenses and could limit the supply and increase the costs of certain materials used in the manufacture of our products.***

We are subject to requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 that require us to conduct diligence, and report whether or not our products contain conflict minerals. The implementation of these requirements could adversely affect the sourcing, availability and pricing of the materials used in the manufacture of components used in our products. Furthermore, the complex nature of our products requires components and materials that may be available only from a limited number of sources and, in some cases, from only a single source. We have incurred, and will continue to incur, additional costs to comply with the disclosure requirements, including costs related to conducting diligence procedures to determine the sources of conflict minerals that may be used or necessary to the production of our products and, if applicable, potential changes to components, processes or sources of supply as a consequence of such verification activities. We may face reputational harm if we determine that certain of our products contain minerals that are not determined to be conflict free or if we are unable to alter our processes or sources of supply to avoid using such materials. Reputational harm could materially and adversely affect our business, financial condition or results of operations.

#### **Risks Related to Owning Our Common Stock**

***The price of our common stock has been, is, and may continue to be, highly volatile, and you may be unable to sell your shares at or above the price you paid to acquire them.***

The market price of our common stock is highly volatile, and we expect it to continue to be volatile for the foreseeable future in response to many risk factors listed in this section, and others beyond our control, including:

- actual or anticipated fluctuations in our financial condition and operating results;
- announcements of new products, technological innovations or strategic partnerships by us or our competitors;
- announcements by us, our customers, partners or suppliers relating directly or indirectly to our products, services or technologies;
- overall conditions in our industry and market;

- addition or loss of significant customers;
- changes in laws or regulations applicable to our products;
- actual or anticipated changes in our growth rate relative to our competitors;
- announcements by us or our competitors of significant acquisitions, strategic partnerships, joint ventures, capital commitments or achievement of significant milestones;
- additions or departures of key personnel;
- competition from existing products or new products that may emerge;
- issuance of new or updated research or reports by securities analysts;
- fluctuations in the valuation of companies perceived by investors to be comparable to us;
- disputes or other developments related to proprietary rights, including patents, litigation matters or our ability to obtain intellectual property protection for our technologies;
- announcement or expectation of additional financing efforts;
- sales of our common stock by us or our stockholders;
- stock price and volume fluctuations attributable to inconsistent trading volume levels of our shares;
- reports, guidance and ratings issued by securities or industry analysts;
- operating results below the expectations of securities analysts or investors; and
- general economic and market conditions, which could be impacted by various events including COVID-19.

If any of the forgoing occurs, it would cause our stock price or trading volume to decline. Stock markets in general and the market for companies in our industry in particular have experienced price and volume fluctuations, which have been exacerbated by COVID-19, that have affected and continue to affect the market prices of equity securities of many companies. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. These broad market and industry fluctuations, as well as general economic, political and market conditions such as recessions, interest rate changes or international currency fluctuations, may negatively impact the market price of our common stock. You may not realize any return on your investment in us and may lose some or all of your investment. In the past, companies that have experienced volatility in the market price of their stock have been subject to securities class action litigation. We have been a party to this type of litigation in the past and may be the target of this type of litigation again in the future. Securities litigation against us could result in substantial costs and divert our management's attention from other business concerns, which could seriously harm our business.

***Future sales of our common stock could cause our stock price to fall.***

We filed a shelf registration statement on Form S-3 with the SEC that was declared effective on July 14, 2020, pursuant to which we may, from time to time, sell up to an aggregate of \$250.0 million of our common stock, preferred stock, debt securities, depositary shares, warrants, subscription rights, purchase contracts or units. In August 2020, we sold 22.3 million shares of our common stock in an underwritten public offering pursuant to this shelf registration statement on Form S-3, for aggregate gross proceeds of \$99.9 million.

We have sold, and plan in the future to sell, shares of our common stock in underwritten offerings and have established, and may in the future establish, "at-the-market" offering programs pursuant to which we may offer and sell shares of our common stock. However, up to the \$52.0 million of Continuation Advances actually paid to us are repayable without interest to Illumina if, within two years of March 31, 2020, we raise at least \$100 million in equity financing in a single transaction (with the amount repayable dependent on the amount raised by us). Sales of securities have resulted and will continue to result in dilution of our existing stockholders, and such sales could cause our stock price to fall.

In addition, if our existing stockholders sell, or indicate an intent to sell, a large number of shares of our common stock in the public market, it could cause our stock price to fall. We may also issue shares of common stock or securities convertible into our common stock from time to time in connection with financings, acquisitions, investments or otherwise. Any such issuance would result in dilution to our existing stockholders and could cause our stock price to fall.

***Concentration of ownership by our principal stockholders may result in control by such stockholders of the composition of our board of directors.***

Our existing principal stockholders, executive officers, directors and their affiliates beneficially own a significant number of our outstanding shares of common stock. In addition, such parties may acquire additional control by purchasing



stock that we issue in connection with our future fundraising efforts. As a result, these stockholders may now and in the future be able to exercise a significant level of control over all matters requiring stockholder approval, including the election of directors. This control could have the effect of delaying or preventing a change of control of our company or changes in management and will make the approval of certain transactions difficult or impossible without the support of these stockholders.

***Anti-takeover provisions in our charter documents and under Delaware law could make an acquisition of us, which may be beneficial to our stockholders, more difficult and may prevent attempts by our stockholders to replace or remove our current management and limit the market price of our common stock.***

Provisions in our certificate of incorporation and bylaws, as amended and restated, may have the effect of delaying or preventing a change of control or changes in our management. Our amended and restated certificate of incorporation and bylaws include provisions that:

- authorize our board of directors to issue, without further action by the stockholders, up to 50,000,000 shares of undesignated preferred stock and up to approximately 1,000,000,000 shares of authorized but unissued shares of common stock;
- require that any action to be taken by our stockholders be effected at a duly called annual or special meeting and not by written consent;
- specify that special meetings of our stockholders can be called only by our board of directors, the Chairman of the Board, the Chief Executive Officer or the President;
- establish an advance notice procedure for stockholder approvals to be brought before an annual meeting of our stockholders, including proposed nominations of persons for election to our board of directors;
- establish that our board of directors is divided into three classes, Class I, Class II and Class III, with each class serving staggered terms;
- provide that our directors may be removed only for cause; and
- provide that vacancies on our board of directors may be filled only by a majority of directors then in office, even though less than a quorum.

These provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors, which is responsible for appointing the members of our management. Furthermore, our amended and restated bylaws provide that unless we consent in writing to the selection of an alternative forum, the Court of Chancery of the State of Delaware will be the sole and exclusive forum for: (i) any derivative action or proceeding brought on our behalf; (ii) any action asserting a breach of fiduciary duty owed by any of our current or former directors, officers or other employees to us or our stockholders; (iii) any action asserting a claim arising pursuant to any provision of the Delaware General Corporation Law; (iv) any action to interpret, apply, enforce or determine the validity of our amended and restated certificate of incorporation or our amended and restated bylaws; or (v) any action asserting a claim against us that is governed by the internal affairs doctrine, subject to the court having personal jurisdiction over the indispensable parties named as defendants therein. This provision is not intended to apply to actions arising under the Securities Act or the Exchange Act, or any claim for which the federal courts have exclusive jurisdiction. Any person or entity purchasing or otherwise acquiring any interest in shares of our capital stock shall be deemed to have notice of and consented to this provision. This exclusive-forum provision may discourage lawsuits against us or our directors, officers, and employees. In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which limits the ability of stockholders owning in excess of 15% of our outstanding voting stock to merge or combine with us.

***Our large number of authorized but unissued shares of common stock may potentially dilute existing stockholders' stockholdings.***

We have a significant number of authorized but unissued shares of common stock. Our board of directors may issue shares of common stock from this authorized but unissued pool from time to time without stockholder approval, resulting in the dilution of our existing stockholders.

***We do not intend to pay dividends for the foreseeable future.***

We have never declared or paid any dividends on our common stock and do not intend to pay any dividends in the foreseeable future. We anticipate that we will retain all of our future earnings for use in the operation of our business and for general corporate purposes. Any determination to pay dividends in the future will be at the discretion of our board of

directors. Accordingly, investors must rely on sales of their common stock after price appreciation, which may never occur, as the only way to realize any future gains on their investments.

## **General Risk Factors**

### ***Unfavorable global economic or political conditions could adversely affect our business, financial condition or results of operations.***

General conditions in the global economy and in the global financial markets could adversely affect our results of operations, including the potential effects from COVID-19 as discussed above, the overall demand for nucleic acid sequencing products may be particularly vulnerable to unfavorable economic conditions. A global financial crisis or a global or regional political disruption could cause extreme volatility in the capital and credit markets. A severe or prolonged economic downturn or political disruption could result in a variety of risks to our business, including weakened demand for our products and our ability to raise additional capital when needed on acceptable terms, if at all. A weak or declining economy or political disruption could also strain our manufacturers or suppliers, possibly resulting in supply disruption, or cause our customers to delay making payments for our product and services. Any of the foregoing could harm our business and we cannot anticipate all of the ways in which the political or economic climate and financial market conditions could adversely impact our business.

### ***Delivery of our products could be delayed or disrupted by factors beyond our control, and we could lose customers as a result.***

We rely on third-party carriers for the timely delivery of our products. As a result, we are subject to carrier disruptions and increased costs that are beyond our control. Any failure to deliver products to our customers in a safe and timely manner may damage our reputation and brand and could cause us to lose customers. If our relationship with any of these third-party carriers is terminated or impaired or if any of these carriers are unable to deliver our products, the delivery and acceptance of our products by our customers may be delayed, which could harm our business and financial results. The failure to deliver our products in a safe and timely manner may harm our relationship with our customers, increase our costs and otherwise disrupt our operations.

### ***Doing business internationally creates operational and financial risks for our business.***

We currently conduct operations in various countries and jurisdictions, and continue to expand to new international jurisdictions as part of our growth strategy and have experienced an increasing concentration of sales in certain regions outside the U.S. We sell directly and through distribution partners throughout Europe, the Asia-Pacific region, Mexico, Brazil, and South Africa and have a significant portion of our sales and customer support personnel in Europe and the Asia-Pacific region. As a result, we or our distribution partners may be subject to additional regulations and increased diversion of management time and efforts. Conducting and launching operations on an international scale requires close coordination of activities across multiple jurisdictions and time zones and consumes significant management resources. If we fail to coordinate and manage these activities effectively, our business, financial condition or results of operations could be materially and adversely affected and failure to comply with laws and regulations applicable to business operations in foreign jurisdictions may also subject us to significant liabilities and other penalties. International operations entail a variety of other risks, including, without limitation:

- limits to travel as a result of COVID-19
- challenges in staffing and managing foreign operations;
- potentially longer sales cycles and more time required to engage and educate customers on the benefits of our platform outside of the United States;
- the potential need for localized software and documentation;
- reduced protection for intellectual property rights in some countries and practical difficulties of enforcing intellectual property and contract rights abroad;
- restriction on cross-border investment, including enhanced oversight by the Committee on Foreign Investment in the United States (CFIUS) and substantial restrictions on investment from China;
- U.S. and foreign government trade restrictions, including those which may impose restrictions on the importation, exportation, re-exportation, sale, shipment or other transfer of programming, technology, components, and/or services to foreign persons;

- changes in diplomatic and trade relationships, including new tariffs, trade protection measures, import or export licensing requirements, trade embargoes and other trade barriers;
- tariffs imposed by the U.S. on goods from other countries and tariffs imposed by other countries on U.S. goods, including the tariffs by the U.S. government on various imports from China, Canada, Mexico and the EU and by the governments of these jurisdictions on certain U.S. goods, and any other possible tariffs that may be imposed on products such as ours, the scope and duration of which, if implemented, remains uncertain;
- deterioration of political relations between the U.S. and China, Canada, the U.K. and the EU, which could have a material adverse effect on our sales and operations in these countries;
- changes in social, political and economic conditions or in laws, regulations and policies governing foreign trade, manufacturing, development and investment both domestically as well as in the other countries and jurisdictions into which we sell our products, including as a result of the withdrawal of the United Kingdom from the European Union;
- difficulties in obtaining export licenses or in overcoming other trade barriers and restrictions resulting in delivery delays;
- fluctuations in currency exchange rates and the related effect on our results of operations;
- increased financial accounting and reporting burdens and complexities;
- disruptions to global trade due to disease outbreaks;
- potential increases on tariffs or restrictions on trade generally; and
- significant taxes or other burdens of complying with a variety of foreign laws and regulations, including laws and regulations relating to privacy and data protection such as the EU General Data Protection Regulation (“GDPR”) which took effect in the European Union in 2018.

In conducting our international operations, we are subject to U.S. laws relating to our international activities, such as the Foreign Corrupt Practices Act of 1977, as well as foreign laws relating to our activities in other countries, such as the United Kingdom Bribery Act of 2010. Additionally, the inclusion of one of our foreign customers on any U.S. Government sanctioned persons list, including but not limited to the U.S. Department of Commerce’s List of Denied Persons and the U.S. Department of Treasury’s List of Specially Designated Nationals and Blocked Persons List, could be material to our earnings. Failure to comply with these laws may subject us to claims or financial and/or other penalties in the United States and/or foreign countries that could materially and adversely impact our operations or financial condition. These risks have become increasingly prevalent as we have expanded our sales into countries that are generally recognized as having a higher risk of corruption.

We face risks related to the current global economic environment, which could delay or prevent our customers from purchasing our products, which could in turn harm our business, financial condition and results of operations. The state of the global economy continues to be uncertain. The current global economic conditions and uncertain credit markets and concerns regarding the availability of credit pose a risk that could impact customer demand for our products, as well as our ability to manage normal commercial relationships with our customers, suppliers and creditors, including financial institutions. If the current global economic environment deteriorates, our business could be negatively affected.

Moreover, changes in the value of the relevant currencies may affect the cost of certain items required in our operations. Changes in currency exchange rates may also affect the relative prices at which we are able to sell products in the same market. Our revenue from international customers may be negatively impacted as increases in the U.S. dollar relative to our international customers’ local currencies could make our products more expensive, impacting our ability to compete or as a result of financial or other instability in such locations which could result in decreased sales of our products. Our costs of materials from international suppliers may also increase as the value of the U.S. dollar decreases relative to their local currency. Foreign policies and actions regarding currency valuation could result in actions by the United States and other countries to offset the effects of such fluctuations. Such actions may materially and adversely impact our financial condition and results of operations.

Violations of complex foreign and U.S. laws and regulations could result in fines and penalties, criminal sanctions against us, our officers, or our employees, prohibitions on the conduct of our business and on our ability to offer our products and services in one or more countries, and could also materially affect our brand, our international growth efforts, our ability to attract and retain employees, our business, and our operating results. Even if we implement policies or procedures designed to ensure compliance with these laws and regulations, there can be no assurance that our distribution partners, our employees, contractors, or agents will not violate our policies and subject us to potential claims or penalties.

***If we fail to maintain proper and effective internal controls, our ability to produce accurate financial statements on a timely basis could be impaired, which would adversely affect our business and our stock price.***

Ensuring that we have adequate internal financial and accounting controls and procedures in place to produce accurate financial statements on a timely basis is a costly and time-consuming effort that needs to be evaluated frequently. We may in the future discover areas of our internal financial and accounting controls and procedures that need improvement. Operating as a public company requires sufficient resources within the accounting and finance functions in order to produce timely financial information, ensure the level of segregation of duties, and maintain adequate internal control over financial reporting customary for a U.S. public company.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States, or U.S. GAAP. Our management does not expect that our internal control over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Because of the inherent limitations in all control systems, no evaluation of controls 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, within our company will have been detected.

Pursuant to Section 404 of the Sarbanes-Oxley Act, we perform periodic evaluations of our internal control over financial reporting. While we have in the past performed this evaluation and concluded that our internal control over financial reporting was operating effectively, there can be no assurance that in the future material weaknesses or significant deficiencies will not exist or otherwise be discovered. In addition, if we are unable to produce accurate financial statements on a timely basis, investors could lose confidence in the reliability of our financial statements, which could cause the market price of our common stock to decline and make it more difficult for us to finance our operations and growth.

***Our business could be negatively impacted by changes in the United States political environment.***

There is significant ongoing uncertainty with respect to potential legislation, regulation and government policy at the federal level, as well as the state and local levels, such as during this presidential election year. Any such changes could significantly impact our business as well as the markets in which we compete. Specific legislative and regulatory proposals discussed during election campaigns and more recently that might materially impact us include, but are not limited to, changes to spending priorities and potential reductions in research funding. Uncertainty about U.S. government funding has posed, and may continue to pose, a risk as customers may choose to postpone or reduce spending in response to actual or anticipated restraints on funding. To the extent changes in the political environment have a negative impact on us or on our markets, our business, results of operation and financial condition could be materially and adversely impacted in the future.

***Disruption of critical information technology systems or material breaches in the security of our systems could harm our business, customer relations and financial condition.***

Information technology ("IT") helps us to operate efficiently, interface with customers, maintain financial accuracy and efficiently and accurately produce our financial statements. IT systems are used extensively in virtually all aspects of our business, including sales forecast, order fulfillment and billing, customer service, logistics, and management of data from running samples on our products. Our success depends, in part, on the continued and uninterrupted performance of our IT systems. IT systems may be vulnerable to damage from a variety of sources, including telecommunications or network failures, power loss, natural disasters, human acts, computer viruses, computer denial-of-service attacks, unauthorized access to customer or employee data or company trade secrets, and other attempts to harm our systems. Certain of our systems are not redundant, and our disaster recovery planning is not sufficient for every eventuality. Despite any precautions we may take, such problems could result in, among other consequences, disruption of our operations, which could harm our reputation and financial results.

If we do not allocate and effectively manage the resources necessary to build and sustain the proper IT infrastructure, we could be subject to transaction errors, processing inefficiencies, loss of customers, business disruptions or loss of or damage to intellectual property through security breach. If our data management systems do not effectively collect, store, process and report relevant data for the operation of our business, whether due to equipment malfunction or constraints, software deficiencies or human error, our ability to effectively plan, forecast and execute our business plan and comply with applicable laws and regulations will be impaired, perhaps materially. Any such impairment could materially

and adversely affect our reputation, financial condition, results of operations, cash flows and the timeliness with which we report our internal and external operating results.

***Security breaches and other disruptions could compromise our information and expose us to liability, which would cause our business and reputation to suffer.***

In the ordinary course of our business, we collect and store sensitive data, including intellectual property, our proprietary business information and that of our customers, suppliers and business partners, and personally identifiable information of our customers and employees, in our data centers and on our networks. The secure processing, maintenance and transmission of this information is critical to our operations. Despite our security measures, our IT infrastructure may be vulnerable to attacks by hackers, computer viruses, malicious codes, unauthorized access attempts, and cyber- or phishing-attacks, or breached due to employee error, malfeasance, faulty password management or other disruptions. Third parties may attempt to fraudulently induce employees or other persons into disclosing usernames, passwords or other sensitive information, which may in turn be used to access our IT systems, commit identity theft or carry out other unauthorized or illegal activities. Any such breach could compromise our networks and the information stored there could be accessed, publicly disclosed, lost or stolen. We engage third-party vendors and service providers to store and otherwise process some of our data, including sensitive and personal information. Our vendors and service providers may also be the targets of the risks described above, including cyberattacks, malicious software, phishing schemes, and fraud. Our ability to monitor our vendors and service providers' data security is limited, and, in any event, third parties may be able to circumvent those security measures, resulting in the unauthorized access to, misuse, disclosure, loss or destruction of our data, including sensitive and personal information. We and our third-party service providers may face difficulties in identifying, or promptly responding to, potential security breaches and other instances of unauthorized access to, or disclosure or other loss of, information. Any unauthorized access to, or disclosure or other loss of, information suffered by us or our third-party service providers or vendors, or the perception that any of these have occurred, could result in legal claims or proceedings, loss of intellectual property, liability under laws that protect the privacy of personal information, negative publicity, disruption of our operations and damage to our reputation, which could divert our management's attention from the operation of our business and materially and adversely affect our business, revenues and competitive position. Moreover, we may need to increase our efforts to train our personnel to detect and defend against cyber- or phishing-attacks, which are becoming more sophisticated and frequent, and we may need to implement additional protective measures to reduce the risk of potential security breaches, which could cause us to incur significant additional expenses.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

Not applicable.

**Item 3. Default Upon Senior Securities**

Not applicable.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

Not applicable.

**Item 6. Exhibits**

Exhibit Number	Description	Incorporated by reference herein		
		Form	Exhibit No.	Filing Date
10.1+	<a href="#">2020 Equity Incentive Plan and related forms of agreement</a>	8-K	10.1	August 5, 2020
10.2+	<a href="#">Letter Relating to Employment Terms – Susan G. Kim effective as of September 28, 2020</a>			Filed herewith
10.3+	<a href="#">Change in Control and Severance Agreement by and between the Company and Susan G. Kim effective as of September 28, 2020</a>			Filed herewith
31.1	<a href="#">Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</a>			Filed herewith
31.2	<a href="#">Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</a>			Filed herewith
32.1*	<a href="#">Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</a>			Furnished herewith
32.2*	<a href="#">Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</a>			Furnished herewith
101.INS	XBRL Instance Document (the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document)			
101.SCH	XBRL Taxonomy Extension Schema Document			
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document			
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document			
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document			
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document			
104	Cover Page Interactive File (formatted as inline XBRL and contained in Exhibit 101)			

+ Indicates management contract or compensatory plan

\* The certifications attached as Exhibit 32.1 and 32.2 that accompany this Quarterly Report on Form 10-Q are deemed furnished and not filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of Pacific Biosciences of California, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Quarterly Report on Form 10-Q, irrespective of any general incorporation language contained in such filing

**Signatures**

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

**PACIFIC BIOSCIENCES OF CALIFORNIA, INC.**

Date: November 2, 2020

By: /s/ SUSAN G. Kim

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Susan G. Kim  
Chief Financial Officer

Date: November 2, 2020

By: /s/ Eric E. Schaefer

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Eric E. Schaefer  
Vice President and Chief Accounting Officer



August 28, 2020

Susan G. Kim  
16 Carriage Court  
Los Altos, CA 94022

Dear Susan,

On behalf of Pacific Biosciences of California, Inc. (the "**Company**"), I am pleased to offer you a position at the Company as Chief Financial Officer ("**CFO**"). You will be reporting to the Chief Executive Officer.

You will receive a salary of \$415,000 annually, paid twice monthly according to the Company's payroll schedule.

You will be eligible for a one-time signing bonus of \$75,000, to be paid in your first full payroll cycle paycheck, subject to payroll deductions and in accordance with the Company's customary payroll procedures (the "**Sign-On Bonus**"). If you resign from your employment with the Company for any reason prior to completing 12 months of continuous employment, you hereby agree to repay a pro-rata portion of the gross Sign-On Bonus (based on a 365 day year less the number of days you were employed by the Company) within 10 days after your employment termination date.

You will also be eligible to participate in The Employee Incentive Bonus Plan (the "**Bonus Plan**") with a target of 50% of your base salary (subject to the Company's achievement of certain corporate goals and objectives). The details of the Bonus Plan are set forth in the Employee Handbook.

Subject to approval by the Company's Board of Directors (the "**Board**") and as otherwise described below, you will be granted (i) a nonstatutory stock option (the "**Option**") to purchase a total of 400,000 shares of the Company's common stock (each a "**Share**" and, collectively, the "**Shares**"), having an exercise price per Share equal to the fair market value of a Share on the date of grant, and (ii) an award of restricted stock units covering 150,000 Shares (the "**RSUs**").

The effectiveness of the Option will be subject to your being employed by the Company on the date of grant. The specific terms of the Option will be determined by the Board and will be subject to the terms and conditions of the Company's 2020 Equity Incentive Plan (the "**Plan**") and related agreements thereunder. The Option will be scheduled to vest as to one-fourth (1/4<sup>th</sup>) of the Shares subject at grant to the Option on the one-year anniversary of your start date with the Company (the "**Start Date**") and as to one forty-eighth (1/48<sup>th</sup>) of the Shares subject at grant to the Option each month thereafter on the same day of the month as the Start Date, provided that you remain employed with the Company through the applicable vesting date. Any portion of the Option that has not vested as of the date of cessation of your continuous status as an employee of the Company will terminate as of the date of such cessation.

The RSU award will be subject to your being employed by the Company on the date of grant. The specific terms of the RSU award will be determined when granted by the Board and will be subject to the Plan and the related agreements thereunder. The RSUs will be scheduled to vest as to one fourth (1/4<sup>th</sup>) of the Shares on each of the one (1), two (2), three (3) and four (4) year anniversaries of the date of grant, provided that you remain employed with the Company through the applicable vesting date. Any portion of the award of RSUs that has not vested as of the date of cessation of your continuous status as an employee of the Company will terminate as of the date of such cessation.

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You will be eligible to receive equity awards covering Shares pursuant to any plans or arrangements the Company may have in effect from time to time, including but not limited to any focal grants. The Board will determine in its discretion whether you will be granted any such equity awards and the terms of any such award in accordance with the terms of any applicable plan or arrangement that may be in effect from time to time.

You will also be offered our standard executive Change in Control Severance Agreement, subject to approval by the Compensation Committee of the Board, and our standard director/officer Indemnification Agreement, copies of which are attached.

We will be offering you our standard benefits package. You will also be eligible for up to 15 days of vacation and 10 days of sick time per year, and you will receive designated Company holidays. The terms of our time off with pay policies are outlined in our employee handbook. The Company reserves the right to modify or terminate the benefit plans and programs it offers to its employees at any time.

All forms of compensation referred to in this letter agreement are subject to reduction to reflect applicable withholding and payroll taxes and other deductions required by law.

Your employment with the Company is for no specified period of time. Your employment with the Company will be "at will," meaning that either you or the Company may terminate your employment at any time and for any reason, with or without cause. Any contrary representations that may have been made to you are superseded by this letter agreement. This is the full and complete agreement between you and the Company on this term. Although your job duties, title, compensation and benefits, as well as the Company's personnel policies and procedures, may change from time to time, the "at will" nature of your employment may only be changed in an express written agreement signed by you and a duly authorized officer of the Company (other than you).

You represent that the performance of your duties in the position described above will not violate the terms of any agreements you may have with others, including your former employer. You also understand that you are not to bring to or use at the Company any confidential information of your prior employers.

Your employment is also conditioned upon your agreement and execution of the attached Pacific Biosciences At Will Employment, Confidential Information, Invention Assignment, and Arbitration Agreement.

Upon your acceptance of this offer (as evidenced by your return of a signed copy of this letter and the attached agreement to the Company), this letter agreement, the Pacific Biosciences At Will Employment, Confidential Information, Invention Assignment, and Arbitration Agreement, the Change in Control Severance Agreement (if signed by you) and the Indemnification Agreement (if signed by you) together constitute the complete agreement between you and the Company, contain all of the terms of your employment with the Company and supersede any prior agreements, representations or understandings (whether written, oral or implied) between you and the Company.

As required by law, your employment with the Company is contingent upon your providing legal proof of identity and authorization to work within the United States on your first day of employment. In addition, to the extent permitted by applicable law, the Company may require current or new employees to submit to, and pass, a background check if such testing is required by a Company customer in order for that individual to provide goods or services to the customer. Additionally, any employee authorized to drive a Company vehicle, or who is receiving a vehicle allowance, must provide a valid and current driver's license and consent to a DMV check.

To accept our offer, please sign and date this letter in the space provided below. If you accept our offer, your first day of employment will be September 28, 2020.

This offer of employment will terminate if it is not accepted, signed, and returned by midnight Pacific Time, September 2, 2020.

The Company is committed to hiring employees like you that have the courage, creativity, and experience to develop new ideas for new markets.

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We look forward to your joining us!

/s/ Michael Hunkapiller August 28, 2020

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**Pacific Biosciences of California, Inc. By: Michael Hunkapiller, Ph.D., CEO & President**

I have read and accept this employment offer:

/s/ Susan G. Kim September 1, 2020

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**Susan G. Kim**

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## PACIFIC BIOSCIENCES OF CALIFORNIA, INC.

## CHANGE IN CONTROL AND SEVERANCE AGREEMENT

This Change in Control and Severance Agreement (the “*Agreement*”) is made and entered into by and between Susan Kim (“*Executive*”) and Pacific Biosciences of California, Inc., a Delaware corporation (the “*Company*”), effective as of September 28, 2020 (the “*Effective Date*”).

**RECITALS**

1. It is expected that the Company from time to time will consider the possibility of an acquisition by another company or other change in control. The Board of Directors of the Company (the “*Board*”) recognizes that such considerations can be a distraction to Executive and can cause Executive to consider alternative employment opportunities. The Board has determined that it is in the best interests of the Company and its stockholders to assure that the Company will have the continued dedication and objectivity of Executive, notwithstanding the possibility, threat or occurrence of such a termination of employment or the occurrence of a Change in Control (as defined herein) of the Company.
2. The Board believes that it is in the best interests of the Company and its stockholders to provide Executive with an incentive to continue Executive’s employment and to motivate Executive to maximize the value of the Company for the benefit of its stockholders.
3. The Board believes that it is imperative to provide Executive with certain severance benefits upon Executive’s termination of employment in connection with a Change in Control. These benefits will provide Executive with enhanced financial security, incentive and encouragement to remain with the Company.
4. Certain capitalized terms used in the Agreement are defined in Section 6 below.

**AGREEMENT**

NOW, THEREFORE, in consideration of the mutual covenants contained herein, the parties hereto agree as follows:

5. **Term of Agreement.** This Agreement will have an initial term of three (3) years commencing on the Effective Date (the “*Initial Term*”). On the third anniversary of the Effective Date, this Agreement will renew automatically for additional one (1) year terms (each an “*Additional Term*”), unless either party provides the other party with written notice of non-renewal at least sixty (60) days prior to the date of automatic renewal. Notwithstanding the foregoing provisions of this paragraph, if a Change in Control occurs when there are fewer than twelve (12) months remaining during the Initial Term or an Additional Term, the term of this Agreement will extend automatically through the date that is twelve (12) months following the effective date of the Change in Control. If Executive becomes entitled to benefits under Section 3(a) or Section 3(b) during the term of this Agreement, the Agreement will not terminate until all of the obligations of the parties hereto with respect to this Agreement have been satisfied.

6. **At-Will Employment.** The Company and Executive acknowledge that Executive’s employment is and will continue to be at-will, as defined under applicable law. No payments, benefits, or provisions under this Agreement will confer upon Executive any right to continue Executive’s employment with the Company, nor will they interfere with or limit in any way the right of the Company or Executive to terminate such relationship at any time, with or without cause, to the extent permitted by applicable laws.

7. **Severance Benefits.**

(a) **Termination without Cause or Other than Death or Disability or Resignation for Good Reason Other than During the Change in Control Period.** If a Qualifying Termination occurs other than during the Change in Control Period, then subject to Section 4, Executive will receive the following severance from the Company:

**Base Salary Severance.** Executive will receive continuing payments of Salary, less any applicable withholdings, for a period of twelve (12) months following the date of such termination of employment, to be paid periodically in accordance with the Company’s normal payroll policies.

**Continued Employee Benefits.** If Executive elects continuation coverage pursuant to the Consolidated Omnibus Budget Reconciliation Act of 1985, as amended (“*COBRA*”) for Executive and Executive’s eligible dependents (as applicable), within the time period

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prescribed pursuant to COBRA, Executive will receive Company-paid group health, dental and vision coverage for Executive and Executive's eligible dependents, as applicable, at the coverage levels in effect immediately prior to the termination of Executive's employment (the "COBRA Severance") until the earliest of: (A) a period of twelve (12) months from the last date of employment of the Executive with the Company, (B) the date upon which Executive and/or Executive's eligible dependents becomes covered under similar plans, or (C) the expiration of Executive's and Executive's eligible dependents' (as applicable) eligibility for continuation coverage under COBRA.

(b) Termination without Cause or Other than Death or Disability or Resignation for Good Reason On or Within Twelve Months Following a Change in Control. If a Qualifying Termination occurs during the Change in Control Period, then subject to Section 4, Executive will receive the following severance from the Company:

(i) Base Salary Severance. Executive will receive continuing payments of Salary, less any applicable withholdings, for a period of twelve (12) months following the date of such termination of employment, to be paid periodically in accordance with the Company's normal payroll policies.

(ii) Continued Employee Benefits. If Executive elects continuation coverage pursuant to COBRA for Executive and Executive's eligible dependents (as applicable), within the time period prescribed pursuant to COBRA, the Company will provide the COBRA Severance until the earliest of: (A) a period of twelve (12) months from the last date of employment of the Executive with the Company, (B) the date upon which Executive and/or Executive's eligible dependents becomes covered under similar plans, or (C) the expiration of Executive's and Executive's eligible dependents' (as applicable) eligibility for continuation coverage under COBRA.

(iii) Equity. One hundred percent (100%) of the unvested portion of the Executive's then-outstanding equity awards (the "Awards") will immediately vest and, to the extent applicable, become exercisable, as of the date of such termination. To the extent that an Award is subject to performance-based vesting at the time of such termination, such performance goals will be deemed achieved at one hundred percent (100%) of target levels and all other terms and conditions met, unless specifically provided otherwise under the applicable Award agreement. The Awards will remain exercisable, to the extent applicable, following Executive's termination for the period prescribed in the applicable equity plan and agreement for each Award.

(c) Other Termination. If Executive's employment with the Company terminates other than as set forth in Section 3(a) or 3(b) above, then (i) all vesting will terminate immediately with respect to Executive's outstanding Awards, (ii) all payments of compensation by the Company to Executive hereunder will terminate immediately (except as to amounts already earned), and (iii) Executive will only be eligible for severance benefits in accordance with the Company's established policies, if any, as then in effect.

(d) Accrued Amounts. On any termination of Executive's employment with the Company, Executive will be entitled to receive all accrued but unpaid vacation, expense reimbursements, wages, and other benefits due to Executive under any Company-provided plans, policies, and arrangements.

(e) Non-duplication of Payment or Benefits. Notwithstanding any provision of this Agreement to the contrary, if Executive is entitled to any cash severance, continued health coverage severance benefits, vesting acceleration of any Awards, or other severance or separation benefits similar to those provided under this Agreement, by operation of applicable law or under a plan, policy, contract, or arrangement sponsored by or to which the Company is a party other than this Agreement ("Other Benefits"), then the corresponding severance payments and benefits under this Agreement will be reduced by the amount of Other Benefits paid or provided to Executive.

## 8. Conditions to Receipt of Severance.

(a) Release of Claims Agreement. The receipt of any severance payments or benefits pursuant to this Agreement is subject to Executive signing and not revoking a separation agreement and release of claims in a form acceptable to the Company (the "Release"), which must become effective and irrevocable no later than the sixtieth (60<sup>th</sup>) day following Executive's termination of employment (the "Release Deadline Date"). If the Release does not become effective and irrevocable by the Release Deadline Date, Executive will forfeit any right to severance payments or benefits under this Agreement. No severance payments and benefits under Section 3(a) or 3(b) of this Agreement will be paid or provided until the Release becomes effective and irrevocable, and any such severance payments and benefits otherwise payable between the date of Executive's termination of employment and the date the Release becomes effective and irrevocable (including, if applicable, the lump sum cash payment under Section 4(c) below) will be paid, subject to the requirements of Section 4(d) below, on the Company's first regularly scheduled payroll date on or following the date the Release becomes effective and irrevocable. Any restricted stock units, performance units, performance shares, and/or similar full value awards

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that accelerate vesting under this Agreement (“*Full Value Awards*”) will be settled (subject to Section 4(d) below and the terms of any award agreement or other Company plan, policy, or arrangement governing the settlement timing of such award to the extent such terms specifically require different payment timing in order to comply with the requirements of Section 409A, as applicable (the “*Full Value Settlement Provisions*”), on a date within ten (10) days following the date the Release becomes effective and irrevocable.

(b) Confidential Information and Invention Assignment Agreements. Executive’s receipt of any payments or benefits under Sections 3(a) and 3(b) will be subject to Executive continuing to comply with the terms of any confidential information and invention assignment agreement executed by Executive in favor of the Company and the provisions of this Agreement.

(c) COBRA Severance Limitations. Notwithstanding the provisions of Sections 3(a)(ii) and 3(b)(ii), if the Company determines in its sole discretion that it cannot provide the COBRA Severance without potentially violating applicable laws (including, without limitation, Section 2716 of the Public Health Service Act and the Employee Retirement Income Security Act of 1974, as amended), then in lieu of such COBRA Severance, and subject to any delay required by this Section 4, the Company will provide to Executive a taxable lump sum cash payment in an amount equal to the product of (x) the number of months of Salary severance specified in Section 3(a)(i) or 3(b)(i), as applicable, multiplied by (y) the monthly COBRA premium that Executive otherwise would be required to pay to continue the group health, dental and vision coverage for Executive and Executive’s eligible dependents, as applicable, as in effect on the date of termination of Executive’s employment (which amount will be based on the premium for the first month of COBRA coverage for Executive and Executive’s eligible dependents), which payment will be made regardless of whether Executive elects COBRA continuation coverage (the “*Taxable Payment*”). For the avoidance of doubt, the Taxable Payment may be used for any purpose, including, but not limited to continuation coverage under COBRA, and will be subject to all applicable tax withholdings. Notwithstanding anything to the contrary under this Agreement, if the Company determines in its sole discretion at any time that it cannot provide the COBRA Severance or the Taxable Payment without violating applicable law (including, without limitation, Section 2716 of the Public Health Service Act and the Employee Retirement Income Security Act of 1974, as amended), Executive will not receive any COBRA Severance or Taxable Amount under this Agreement.

(d) Section 409A.

(i) Notwithstanding anything to the contrary in this Agreement, no severance payments or benefits payable to Executive, if any, pursuant to this Agreement that, when considered together with any other severance payments or separation benefits, is considered deferred compensation under Internal Revenue Code Section 409A (together, the “*Deferred Payments*”) will be payable until Executive has a “separation from service” within the meaning of Section 409A of the Internal Revenue Code of 1986, as amended (the “*Code*”), and the Treasury Regulations and guidance thereunder, and any applicable state law equivalent, as each may be promulgated, amended or modified from time to time (“*Section 409A*”). Similarly, no severance payable to Executive, if any, pursuant to this Agreement that otherwise would be exempt from Section 409A pursuant to Treasury Regulations Section 1.409A-1(b)(9) will be payable until Executive has a “separation from service” within the meaning of Section 409A. To the extent required to be exempt from or comply with Section 409A, references to the termination of Executive’s employment or similar phrases used in this Agreement will mean Executive’s “separation from service” within the meaning of Section 409A.

(ii) Any severance payments or benefits under this Agreement that would be considered Deferred Payments will be paid on, or, in the case of installments, will not commence until, the sixtieth (60<sup>th</sup>) day following Executive’s separation from service, or, if later, such time as required by Section 4(d)(iii) (or with respect to Full Value Awards, such time or times as required by any applicable Full Value Settlement Provisions). Except as required by Section 4(d)(iii) and any applicable Full Value Settlement Provisions, any Deferred Payments payable in installments that would have been made to Executive during the sixty (60) day period immediately following Executive’s separation from service but for the preceding sentence will be paid to Executive on the sixtieth (60<sup>th</sup>) day following Executive’s separation from service and the remaining payments shall be made as provided in this Agreement.

(iii) Further, if Executive is a “specified employee” within the meaning of Section 409A at the time of Executive’s separation from service (other than due to death), any Deferred Payments that otherwise are payable within the first six (6) months following Executive’s separation from service will become payable on the first payroll date that occurs on or after the date six (6) months and one (1) day following the date of Executive’s separation from service. All subsequent Deferred Payments, if any, will be payable in accordance with the payment schedule applicable to each payment or benefit. Notwithstanding anything herein to the contrary, in the event of Executive’s death following Executive’s separation from service but prior to the six (6) month anniversary of Executive’s separation from service (or any later delay date), then any payments delayed in accordance with this paragraph will be payable in a lump sum as soon as administratively practicable after the date of Executive’s death and all other Deferred Payments will be payable in accordance with the payment schedule applicable to each payment or benefit. Each payment and benefit payable under the Agreement is intended to constitute a separate payment for purposes of Section 1.409A-2(b)(2) of the Treasury Regulations.

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(iv) Any amount paid under this Agreement that satisfies the requirements of the “short-term deferral” rule set forth in Section 1.409A-1(b)(4) of the Treasury Regulations will not constitute Deferred Payments for purposes of clause (i) above. Any amount paid under this Agreement that qualifies as a payment made as a result of an involuntary separation from service pursuant to Section 1.409A-1(b)(9)(iii) of the Treasury Regulations that is within the limit set forth thereunder will not constitute Deferred Payments for purposes of clause (i) above.

(v) The foregoing provisions are intended to comply with, or be exempt from, the requirements of Section 409A so that none of the severance payments and benefits to be provided under the Agreement will be subject to the additional tax imposed under Section 409A, and any ambiguities and ambiguous terms herein will be interpreted to so comply or be exempt. Executive and the Company agree to work together in good faith to consider amendments to the Agreement and to take such reasonable actions which are necessary, appropriate or desirable to avoid imposition of any additional tax or income recognition prior to actual payment to Executive under Section 409A. In no event will the Company or any of its subsidiaries or other affiliates have any obligation, responsibility or liability to reimburse, indemnify or hold harmless Executive for any taxes imposed, or other costs incurred, as result of Section 409A.

9. Limitation on Payments. In the event that the severance and other benefits provided for in this Agreement or otherwise that Executive would receive from the Company or any other party whether in connection with the provisions of this Agreement or otherwise (the “Payments”) would (i) constitute “parachute payments” within the meaning of Section 280G of the Code and (ii) but for this Section 5, would be subject to the excise tax imposed by Section 4999 of the Code, then the Payments will be either:

- (a) delivered in full, or
- (b) delivered as to such lesser extent which would result in no portion of such Payments being subject to excise tax under Section 4999 of the Code,

whichever of the foregoing amounts, taking into account the applicable federal, state and local income taxes and the excise tax imposed by Section 4999, results in the receipt by Executive on an after-tax basis, of the greatest amount of Payments, notwithstanding that all or some portion of such Payments may be taxable under Section 4999 of the Code. If a reduction in severance and other benefits constituting “parachute payments” is necessary so that benefits are delivered to a lesser extent, reduction will occur in the following order: (i) reduction of cash payments in reverse chronological order (that is, the cash payment owed on the latest date following the occurrence of the event triggering the excise tax under Code Section 4999 will be the first cash payment to be reduced); (ii) cancellation of equity awards granted “contingent on a change in ownership or control” (within the meaning of Code Section 280G) in the reverse order of date of grant of the equity awards (that is, the most recently granted equity awards will be cancelled first), (iii) reduction of accelerated vesting of equity awards in the reverse order of date of grant of the equity awards (that is, the vesting of the most recently granted equity awards will be cancelled first); (iv) reduction of employee benefits in reverse chronological order (that is, the benefit owed on the latest date following the occurrence of the event triggering such excise tax will be the first benefit to be reduced). In no event will Executive have any discretion with respect to the ordering of Payment reductions. Executive will be solely responsible for the payment of all personal tax liability that is incurred as a result of the payments and benefits received under this Agreement, and neither the Company nor any parent, subsidiary or other affiliate of the Company will have any responsibility, liability or obligation to reimburse, indemnify or hold harmless Executive for any of those payments of personal tax liability.

Unless the Company and Executive otherwise agree in writing, any determination required under this Section 5 will be made in writing by a nationally recognized accounting or valuation firm (the “Firm”) selected by the Company, whose determination will be conclusive and binding upon Executive and the Company for all purposes. For purposes of making the calculations required by this Section 5, the Firm may make reasonable assumptions and approximations concerning applicable taxes and may rely on reasonable, good faith interpretations concerning the application of Sections 280G and 4999 of the Code. The Company and Executive will furnish to the Firm such information and documents as the Firm may reasonably request in order to make a determination under this Section. The Company will bear all costs and make all payments required to be made to the Firm for the Firm’s services that are rendered in connection with any calculations contemplated by this Section 5. The Company will have no liability to Executive for the determinations of the Firm.

10. Definition of Terms. For purposes of this Agreement, the following terms referred to in this Agreement will have the following meanings:

(a) Cause. “Cause” means (i) conviction of any felony; (ii) conviction of any crime involving moral turpitude or dishonesty that causes, or is likely to cause, material harm to the Company; (iii) participation in a fraud or willful act of dishonesty against the Company that causes, or is likely to cause, material harm to the Company; (iv) intentional and material damage to the Company’s property; or (v) material breach of the Company’s Proprietary Information and Inventions Agreement.

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(b) Change in Control. “*Change in Control*” means the first occurrence of any of the following on or after the Effective Date:

(i) A change in the ownership of the Company which occurs on the date that any one person, or more than one person acting as a group (“*Person*”), acquires ownership of the stock of the Company that, together with the stock held by such Person, constitutes more than 50% of the total voting power of the stock of the Company; provided, however, that for purposes of this subsection (i), the acquisition of additional stock by any one Person, who is considered to own more than 50% of the total voting power of the stock of the Company will not be considered a Change in Control. Further, if the stockholders of the Company immediately before such change in ownership continue to retain immediately after the change in ownership, in substantially the same proportions as their ownership of shares of the Company’s voting stock immediately prior to the change in ownership, direct or indirect beneficial ownership of fifty percent (50%) or more of the total voting power of the stock of the Company or of the ultimate parent entity of the Company, such event will not be considered a Change in Control under this subsection (i). For this purpose, indirect beneficial ownership will include, without limitation, an interest resulting from ownership of the voting securities of one or more corporations or other business entities which own the Company, as the case may be, either directly or through one or more subsidiary corporations or other business entities; or

(ii) A change in the effective control of the Company which occurs on the date that a majority of members of the Board (each, a “*Director*”) is replaced during any twelve (12) month period by Directors whose appointment or election is not endorsed by a majority of the members of the Board prior to the date of the appointment or election. For purposes of this subsection (ii), if any Person is considered to be in effective control of the Company, the acquisition of additional control of the Company by the same Person will not be considered a Change in Control; or

(iii) A change in the ownership of a substantial portion of the Company’s assets which occurs on the date that any Person acquires (or has acquired during the twelve (12) month period ending on the date of the most recent acquisition by such Person) assets from the Company that have a total gross fair market value equal to or more than 50% of the total gross fair market value of all of the assets of the Company immediately prior to such acquisition or acquisitions; provided, however, that for purposes of this subsection (iii), the following will not constitute a change in the ownership of a substantial portion of the Company’s assets: (A) a transfer to an entity that is controlled by the Company’s stockholders immediately after the transfer, or (B) a transfer of assets by the Company to: (1) a stockholder of the Company (immediately before the asset transfer) in exchange for or with respect to the Company’s stock, (2) an entity, 50% or more of the total value or voting power of which is owned, directly or indirectly, by the Company, (3) a Person, that owns, directly or indirectly, 50% or more of the total value or voting power of all the outstanding stock of the Company, or (4) an entity, at least 50% of the total value or voting power of which is owned, directly or indirectly, by a Person described in this subsection (iii)(B)(3). For purposes of this subsection (iii), gross fair market value means the value of the assets of the Company, or the value of the assets being disposed of, determined without regard to any liabilities associated with such assets.

For purposes of this definition of Change in Control, persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase or acquisition of stock, or similar business transaction with the Company.

Notwithstanding the foregoing, a transaction will not be deemed a Change in Control unless the transaction qualifies as a change in control event within the meaning of Section 409A.

Further and for the avoidance of doubt, a transaction will not constitute a Change in Control if: (i) its sole purpose is to change the jurisdiction of the Company’s incorporation, or (ii) its sole purpose is to create a holding company that will be owned in substantially the same proportions by the persons who held the Company’s securities immediately before such transaction.

(c) Change in Control Period. “*Change in Control Period*” means the period beginning upon the occurrence of a Change in Control through the date twelve (12) months following a Change in Control.

(d) Disability. “*Disability*” means Executive is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or can be expected to last for a continuous period of not less than twelve (12) months.

(e) Good Reason. “*Good Reason*” means Executive’s termination of his or her employment with the Company within thirty (30) days following the expiration of any cure period (discussed below) following the occurrence of one or more of the following, without Executive’s express written consent: (i) a material reduction of Executive’s duties, authority, or responsibilities, relative to Employee’s duties, authority, or responsibilities as in effect immediately prior to such reduction; *provided, however*, that a reduction in duties, authority, or responsibilities solely by virtue of the Company being acquired and made part of a larger entity (for example, where Executive retains essentially the same responsibility and duties of the subsidiary, business unit or division substantially containing the Company’s business following a Change in Control) shall not constitute “*Good Reason*”; (ii) a material reduction by the

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Company in Executive's annualized base pay as in effect immediately prior to such reduction (in other words, a reduction of more than ten percent (10%) of Executive's annualized base compensation in any one year, other than a reduction applicable to executives generally that does not adversely affect Executive to a greater extent than other similarly situated executives); (iii) the relocation of Executive's principal place of performing his or her duties as an employee of the Company by more than fifty (50) miles; or (iv) the failure of the Company to obtain the assumption of this Agreement by a successor. In order for an event to qualify as Good Reason, Executive must not terminate employment with the Company without first providing the Company with written notice of the acts or omissions constituting the grounds for "Good Reason" within ninety (90) days of the initial existence of the grounds for "Good Reason" and a reasonable cure period of not less than thirty (30) days following the date of such notice. To the extent Executive's primary work location is not the Company's corporate offices due to a shelter-in-place order, quarantine order, or similar work-from-home requirement that applies to Executive, Executive's primary office location, from which a change in location under the foregoing clause (iii) will be measured, will be considered the Company's office location where Executive's employment with the Company primarily was based immediately prior to the commencement of such shelter-in-place order, quarantine order, or similar work-from-home requirement.

(f) Qualifying Termination. "Qualifying Termination" means either (i) the Company terminates Executive's employment with the Company for a reason other than (A) Cause, (B) Executive's death, or (C) Executive's Disability or (ii) Executive resigns for Good Reason.

(g) Salary. "Salary" means Executive's base salary as in effect immediately prior to the termination of Executive's employment (unless such termination occurs as a result of clause (ii) of the definition of "Good Reason" under Section 6(e), in which case the amount will be equal to Executive's base salary as in effect immediately prior to such reduction) or, if greater in the case of a Qualifying Termination during the Change in Control Period, as in effect immediately prior to the Change in Control.

#### 11. Successors.

(a) The Company's Successors. Any successor to the Company (whether direct or indirect and whether by purchase, merger, consolidation, liquidation or otherwise) to all or substantially all of the Company's business and/or assets will assume the obligations under this Agreement and agree expressly to perform the obligations under this Agreement in the same manner and to the same extent as the Company would be required to perform such obligations in the absence of a succession. For all purposes under this Agreement, the term "Company" will include any successor to the Company's business and/or assets which executes and delivers the assumption agreement described in this Section 7(a) or which becomes bound by the terms of this Agreement by operation of law.

(b) Executive's Successors. The terms of this Agreement and all rights of Executive hereunder will inure to the benefit of, and be enforceable by, Executive's personal or legal representatives, executors, administrators, successors, heirs, distributees, devisees and legatees. Notwithstanding the foregoing, none of the rights of Executive to receive any form of compensation payable pursuant to this Agreement may be assigned or transferred except by will or the laws of descent and distribution. Any other attempted assignment, transfer, conveyance, or other disposition of Executive's right to compensation or other benefits will be null and void.

#### 12. Notice.

(a) General. Notices and all other communications contemplated by this Agreement will be in writing and will be deemed to have been duly given (a) upon actual delivery to the party to be notified, (b) twenty-four (24) hours after confirmed facsimile transmission, (c) one (1) business day after deposit with a recognized overnight courier, or (d) three (3) business days after deposit with the U.S. Postal Service by first class certified or registered mail, return receipt requested, postage prepaid, addressed: (i) if to Executive, at the address Executive will have most recently furnished to the Company in writing, or (ii) if to the Company, to its corporate headquarters and all notices will be directed to the General Counsel of the Company.

(b) Notice of Termination. Any termination of Executive's employment by the Company for Cause or by Executive for Good Reason or as a result of a voluntary resignation will be communicated by a notice of termination to the other party hereto given in accordance with Section 8(a) of this Agreement. Such notice will indicate the specific termination provision in this Agreement relied upon, will set forth in reasonable detail the facts and circumstances claimed to provide a basis for termination under the provision so indicated, and will specify the termination date (which will be not more than thirty (30) days after the giving of such notice or in the case of Executive's resignation for Good Reason, in accordance with the requirements under Section 6(e)). The failure by Executive to include in the notice any fact or circumstance which contributes to a showing of Good Reason will not waive any right of Executive hereunder or preclude Executive from asserting such fact or circumstance in enforcing Executive's rights hereunder.

(c) Resignation. The termination of Executive's employment for any reason also will constitute, without any further required action by Executive, Executive's voluntary resignation from all officer and/or director positions held at the Company or any of

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its subsidiaries or affiliates, and at the Board's request, Executive will execute any documents reasonably necessary to reflect the resignations.

13. Miscellaneous Provisions.

(a) No Duty to Mitigate. Executive will not be required to mitigate the amount of any payment contemplated by this Agreement, nor will any such payment be reduced by any earnings that Executive may receive from any other source except as specified in Sections 3(e), 4(d) and 5.

(b) Waiver. No provision of this Agreement will be modified, waived or discharged unless the modification, waiver or discharge is agreed to in writing and signed by Executive and by an authorized officer of the Company (other than Executive). No waiver by either party of any breach of, or of compliance with, any condition or provision of this Agreement by the other party will be considered a waiver of any other condition or provision or of the same condition or provision at another time.

(c) Headings. All captions and section headings used in this Agreement are for convenient reference only and do not form a part of this Agreement.

(d) Entire Agreement. This Agreement constitutes the entire agreement of the parties hereto and supersedes in their entirety all prior representations, understandings, undertakings or agreements (whether oral or written and whether expressed or implied) of the parties. No waiver, alteration, or modification of any of the provisions of this Agreement will be binding unless in writing and signed by duly authorized representatives of the parties hereto and which specifically mention this Agreement.

(e) Choice of Law. The validity, interpretation, construction, and performance of this Agreement will be governed by the laws of the State of California (with the exception of its conflict of laws provisions). Any claims or legal actions by one party against the other arising out of the relationship between the parties contemplated herein (whether or not arising under this Agreement) will be commenced or maintained in any state or federal court located in San Mateo County, California, and Executive and the Company hereby submit to the jurisdiction and venue of any such court.

(f) Severability. The invalidity, illegality, or unenforceability of any provision or provisions of this Agreement will not affect the validity, legality or enforceability of any other provision hereof, which will remain in full force and effect, and this Agreement will be construed and enforced as if the invalid, illegal, or unenforceable provision had not been included.

(g) Withholding. The Company (and any parent, subsidiary or other affiliate of the Company, as applicable) will have the right and authority to deduct from any payments or benefits all applicable federal, state, local, and/or non-U.S. taxes or other required withholdings and payroll deductions ("Withholdings"). Prior to the payment of any amounts or provision of any benefits under this Agreement, the Company (and any parent, subsidiary or other affiliate of the Company, as applicable) is permitted to deduct or withhold, or require Executive to remit to the Company, an amount sufficient to satisfy any applicable Withholdings with respect to such payments and benefits. Neither the Company nor any parent, subsidiary or other affiliate of the Company will have any responsibility, liability or obligation to pay Executive's taxes arising from or relating to any payments or benefits under this Agreement.

(h) Counterparts. This Agreement may be executed in counterparts, each of which will be deemed an original, but all of which together will constitute one and the same instrument.

IN WITNESS WHEREOF, each of the parties has executed this Agreement, in the case of the Company by its duly authorized officer, as of the Effective Date set forth above.

COMPANY

PACIFIC BIOSCIENCES OF CALIFORNIA, INC.

By: /s/ Christian O. Henry

Name: Christian O. Henry

Title: President and Chief Executive Officer

EXECUTIVE

By: /s/ Susan G. Kim

Name: Susan Kim

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**CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO  
SECURITIES EXCHANGE ACT RULES 13a-15(e), AS ADOPTED PURSUANT  
TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Christian Henry, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Pacific Biosciences of California, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 2, 2020

By: \_\_\_\_\_  
/s/ Christian O. Henry  
Christian O. Henry  
Chief Executive Officer and President  
(Principal Executive Officer)

**CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO  
SECURITIES EXCHANGE ACT RULES 13a-15(e), AS ADOPTED PURSUANT  
TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Susan Kim, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Pacific Biosciences of California, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 2, 2020

By: \_\_\_\_\_ /s/ Susan G. Kim  
Susan G. Kim  
Chief Financial Officer  
(Principal Financial Officer)

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**Certification of CEO Furnished Pursuant to 18 U.S.C. Section 1350,  
As Adopted Pursuant To  
Section 906 of The Sarbanes-Oxley Act of 2002**

In connection with the Quarterly Report of Pacific Biosciences of California, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2020, as filed with the Securities and Exchange Commission on the date hereof, I, Christian Henry, Chief Executive Officer of the Company, certify for the purposes of section 1350 of chapter 63 of title 18 of the United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge,

(i) the Quarterly Report of the Company on Form 10-Q for the period ended September 30, 2020 (the "Report"), fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 2, 2020

/s/ Christian O. Henry

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Christian O. Henry  
Chief Executive Officer and President  
(Principal Executive Officer)

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**Certification of CFO Furnished Pursuant to 18 U.S.C. Section 1350,  
As Adopted Pursuant To  
Section 906 of The Sarbanes-Oxley Act of 2002**

In connection with the Quarterly Report of Pacific Biosciences of California, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2020, as filed with the Securities and Exchange Commission on the date hereof, I, Susan Kim, Chief Financial Officer of the Company, certify for the purposes of section 1350 of chapter 63 of title 18 of the United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge,

(i) the Quarterly Report of the Company on Form 10-Q for the period ended September 30, 2020 (the "Report"), fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 2, 2020

\_\_\_\_\_  
/s/ Susan G. Kim  
Susan G. Kim  
Chief Financial Officer  
(Principal Financial Officer)