

Forward Looking Statements - Todd Friedman (Investor Relations)

Good afternoon and welcome to PacBio's third-quarter 2022 earnings conference call.

Earlier today, we issued a press release outlining the financial results we will be discussing on today's call, a copy of which is available on the Investor's section of our website at www.pacb.com or as furnished on Form 8-K available on the Securities and Exchange Commission website at www.sec.gov.

With me today are:

- Christian Henry, President and Chief Executive Officer, and
- Susan Kim, Chief Financial Officer

Before we begin, I would like to remind you that on today's call, we will be making "forward-looking statements," including statements regarding predictions, progress, estimates, plans, intentions, guidance, and others, including expectations regarding our Revio and Onso systems and their commercialization timeframes. You should not place undue reliance on forward-looking statements because they are subject to assumptions, risks, and uncertainties that could cause our actual results to differ materially from those projected or discussed, including those inherent in developing and commercializing new products. We refer you to the documents that we file with the SEC, including our most recent Forms 10-Q and 10-K, and our recent press releases to better understand the risks and uncertainties that could cause actual results to differ. We disclaim any obligation to update or revise these forward-looking statements except as required by law.

During the call, we will also present certain financial information on a non-GAAP basis. Management believes that non-GAAP financial measures, combined with U.S. GAAP financial measures, provide useful information to compare our performance relative to forecasts and strategic plans and benchmark our performance externally against competitors. Reconciliations between U.S. GAAP and non-GAAP results are presented in tables within our earnings release.

In addition, please note that today's call is being recorded and will be available for audio replay on the Investor's section of our website shortly after the call. Investors electing to use the audio replay are cautioned that forward-looking statements made on today's call may differ or change materially after the completion of the live call.

Finally, we'll be hosting a question-and-answer session after our prepared remarks. We ask that analysts please limit themselves to one question and one follow-up question only so that we can accommodate everybody in the queue.

I will now turn the call over to Christian.

Christian Henry, President and CEO

Good afternoon, everybody. Thanks for joining us today as we discuss our third-quarter results and business highlights. Before I begin with my prepared remarks, I'd like to remind everyone that we are hosting our first Investor Day in New York City on November 15. You can find out more about the event in the investor section of our website.

On today's call, we will

- First, recap the product announcements we shared two weeks ago at the American Society for Human Genetics conference in Los Angeles
- Then we will discuss our third-quarter financial results
- And then I will provide some commentary on our commercial activity in the quarter
- I'll then hand it off to Susan to walk through the quarterly financials in more detail
- And as always, there will be plenty of time for Q&A

When I joined the Company in September of 2020, I outlined two important aspects of our strategy for growth. First, we needed to develop a new long-read platform that offered our customers significantly higher throughput at much lower cost, and, second, since we believe that understanding biology is becoming a more multi-omic endeavor, we needed to develop multi-omic capabilities so that we could provide the right solution for our customers, depending on the biological question they are trying to answer.

At ASHG on October 25, with the announcements of Revio and Onso, two groundbreaking new sequencers, we demonstrated that we are well on our way to achieving the two critical aspects of our strategy.

Let's start with Revio, our next-generation long-read sequencer. Revio is expected to provide 15 times more data output than our current flagship sequencer the Sequel IIe. At the core of Revio is a completely redesigned SMRT cell which has 25 million zero mode wave guides, more than three times as many as the Sequel IIe. Revio then utilizes up to four 25M SMRT cells in every run to enable the sequencing of up to 100 million single molecules of DNA simultaneously. As a result, the system provides up to 360 gigabases of highly accurate HiFi data, enabling researchers to not only see SNV's and indels, but also structural variation and important epigenetic data, in every single run. Finally, the run time has been reduced by 20% to just 24 hours.

Revio was designed with the customer in mind, including requiring fewer consumables and the ability to load the next run while an existing run is in progress. In addition, the 20-fold increase in relative compute power leverages the latest NVIDIA GPUs and enhances base calling with Google DeepConsensus on board. This makes it easier for our customers to start interpreting the data directly from the instrument.

We believe Revio is poised to transform the whole genome sequencing market. This platform enables customers to take on large-scale genome projects with the accuracy and completeness of HiFi. One Revio system can sequence up to 1,300 human genomes a year at under \$1,000 per genome at 30x depth coverage, or approximately \$11 per gigabase at list price. And, at lower coverage, several thousands of genomes per year at just hundreds of dollars per genome.

At ASHG, we hosted a packed booth over all three days and demoed the Revio over 150 times. Feedback from potential customers has been fantastic. On social media, we had more than 10 million impressions over the course of the

conference – more than 10-fold over other instrument providers. Some comments included one researcher calling it *“the most important genome sequencer to launch since the Illumina GAIIx,”* and another customer, who has already placed a multi-system order, said, *“it’ll be a game changer in the medical genomics field.”* We’ve already booked multi-unit orders from several customers and are actively discussing system orders with dozens more. With excitement around Revio, several customers have asked about an upgrade path and we’re pleased to have customer loyalty programs in place to support their transition from the Sequel IIe to Revio.

It’s a seminal moment that we launch this paradigm-shifting sequencer as PacBio recently surpassed its 1,000th sequencer shipped since the launch of the RS platform in 2011. Over the past decade, PacBio long reads have enabled approximately 400 instrument customers to accelerate their research by allowing them to view biology in ways others can’t. From assembling telomere-to-telomere pangenomes to sequencing some of the largest, most complex genomes on this planet – hundreds of publications over the past few years reinforce our belief that the combined accuracy and length of HiFi are unmatched. With the throughput, power and attractive price point of Revio, we’re thrilled to usher in the next phase of PacBio.

In addition to Revio, we announced Onso- a mid-throughput short-read sequencer based on the highly-accurate Sequencing by Binding technology we acquired through Omniome last year. Onso is a highly differentiated sequencer due to the incredible accuracy of the SBB chemistry. Internally, we’ve consistently demonstrated accuracy at the Q40 plus levels – which we believe is over 10 times more accurate than other recently-announced chemistries. The beta program has commenced, and we’ve started shipping units to our beta partners. These partners include the Broad Institute, Weill Cornell, and Corteva Agriscience, who will be sequencing on their Onso systems over the next few months. We look forward to these partners providing valuable feedback on Onso’s performance in the field. Once the beta program is complete and we incorporate their feedback into the product, we will finalize the development and begin commercial scale-up activities. We expect to begin shipping Onso commercially in the first half of 2023.

As a result of all these announcements, we’ve suspended our financial guidance so that we can understand the impact that Revio will have on the demand for Sequel IIe. However, at our investor day on November 15, we expect to share our longer-term financial targets and update you on market response to Revio and Onso.

Let’s move on to our Q3 results, we reported \$32.3 million in revenue representing a 7% year-over-year decline, with changes in foreign exchange rates driving 2% of that decline.

The decline was primarily driven by lower Sequel IIe sales. We believe with some customers deferring purchases in anticipation of a new product launch and that this impact was greater than anticipated in the quarter, particularly in the Americas region. Other drivers of the instrument shortfall included customers deferring purchases due to lab space issues and funding delays.

We expect many of the current and deferred opportunities to migrate to Revio. However, we anticipate sustained, albeit lower, demand for Sequel IIe going into the fourth quarter and into 2023. Since Sequel II’s launch nearly four years ago, we’ve advanced the platform with the IIe upgrade, significantly reducing the secondary analysis time and lowering data storage needs by up to 90%. Additionally, we launched new kits that reduced DNA input requirements 5-fold, seamlessly integrated methylation calling on every run, and released several application protocols and workflows for AAV, SARS-

CoV-2 sequencing, and single-cell transcriptomics. As you can see, we've built a robust ecosystem around Sequel IIe. It remains an extremely reliable and powerful sequencer at an attractive entry price for customers looking to do lower throughput, long-read sequencing.

Although we shipped fewer instruments than we were forecasting, we continued to expand the Sequel IIe customer base, with over 40% of our instrument shipments in the quarter to new PacBio customers. In the past four quarters, we onboarded approximately 65 new instrument customers. Sequel IIe's success in attracting new users gives us confidence that the throughput, economic, and workflow improvements of Revio will even further catalyze the next wave of new customers to PacBio.

In the third quarter, we were also pleased to report record consumables of \$16.1 million, an increase of 10% year-over-year. We saw pull-through steadily increase sequentially as customers in China increased utilization and EMEA booked record consumables sales.

Outside of new sequencing platforms, perhaps what our customers are most excited about is our recently-launched MAS Seq kit and its game-changing potential for transcriptomics and single-cell research. This new kit leverages 10x Genomics' single-cell expression technology and allows customers to achieve a 16-fold throughput increase compared to a regular single-cell Iso-Seq library. Despite being an important component in understanding genetic variation and disease, we still know so little about isoforms because of short read limitations in sequencing them at their full length. With the combination of throughput and cost improvement provided by MAS seq coupled with the 15x improvement with Revio, we believe, HiFi will be the go-to technology in single-cell transcriptomics. In response to this launch, a principal investigator from a major university told us that he believes that, *"It is clear that in the next few years, long-read sequencing will become the de facto gold standard in transcriptomics research."*

Over the past couple of years, we've been broadening our collaborations to deliver customers turnkey solutions for understanding biology. An example is the release of off-the-shelf target enrichment panels for long-read, HiFi sequencing in collaboration with Twist Bioscience. These panels include a nearly 400-gene panel covering medically relevant genes in regions that are difficult to sequence using short-read methods, including genes tied to Spinal Muscular Atrophy, Alzheimer's, and cardiovascular diseases. We're also offering another panel to capture 50 pharmacogenomic genes. By providing targeted panels, in addition to whole genome workflows, we can address a broader set of customers across human genomics.

Further, we also launched the Tandem Repeat Genotyping Tool or TRGT to allow scientists to fully characterize the sequence and methylation status of tandem repeats across the genome. Genetic variation in tandem repeat regions has been linked to many neurological and intellectual disorders such as ALS, Huntington's disease, and Fragile X.

Turning to commercial highlights, in human germline applications, which again in Q3 represented over 1/3 of our product revenue, we delivered additional Sequel IIes to support multiple customers in their sequencing for a large, population-scale genome project in the U.S.

Additionally, we shipped multiple Sequel IIes in a competitive deal to a customer in the middle east planning to launch a population scale program. We expect this customer to transition to Revio over the next year to accelerate its sample volume.

As previously mentioned, we expect some customers to continue sequencing on their Sequel IIE platforms, like DNA Link in Korea who purchased a Sequel IIE to begin sequencing for the Korea Disease Control and Prevention Agency and plans to use HiFi Viral to sequence 10,000 SARS-CoV-2 genomes.

And Avero Diagnostics, a new PacBio customer, who purchased a Sequel IIE in the third quarter to support its new microbiome DTC test offering and can potentially scale this system to provide tens of thousands of tests per year.

We also expect AAV sequencing applications to continue to use this system with three additional Sequel IIEs in the third quarter shipped to customers in this application area.

Lastly, I'd like to welcome the members of our newly-created Scientific Advisory Board – Dr. Euan Ashley and Dr. Jody Puglisi of Stanford University, and Dr. Jay Shendure from the University of Washington. These renowned leaders in biology and chemistry will provide critical feedback and direction to our product roadmap. We had our first meeting this past week, and I was delighted to hear the SAB's enthusiasm for PacBio's new platforms and what they believe can be accomplished in many diverse genomics applications.

With that, I'll hand the call over to Susan to talk about our financial results in more detail, Susan?

Susan Kim, CFO

Thank you, Christian. As discussed, we reported \$32.3 million in product and service revenue in the third quarter of 2022, which represented a decrease of 7% from \$34.9 million in the third quarter of 2021.

Instrument revenue in the third quarter was \$11.4 million, a decrease of 28% from \$15.9 million in the third quarter of 2021.

We delivered 34 Sequel IIe Systems during Q3, growing the installed base to 494 Sequel II and IIe systems as of September 30, 2022.

Turning to consumables, revenue of \$16.1 million in the third quarter grew 10% from \$14.6 million in the third quarter of last year and was a record for PacBio. Sequel II and IIe consumables represented approximately 90% of our total consumable revenue in the third quarter, with the rest from older systems and other consumables.

Annualized pull-through per system on the Sequel II and IIe installed base in the third quarter was approximately \$125 thousand. Consumable revenue in China continued to improve, partially offset by newer PacBio customers being slower to ramp and certain customers dealing with sample delays. Of note, global supply chain constraints related to auxiliary equipment has had an impact on new instrument ramp time and one of the other reasons noted was a lack of nitrogen at the time of installation, which we're pleased to say will not be a requirement with our new Revo platform.

Finally, service and other revenue grew to \$4.8 million in the third quarter compared to \$4.4 million in the third quarter of 2021, reflecting our growing installed base.

From a regional perspective,

Americas revenue of \$16.7 million declined 14% compared to the third quarter of 2021, primarily driven by lower Sequel IIe placements as customers delayed purchases due to lab space limitations, funding, and deferred orders due to the anticipation of a potential new sequencer launch. The region also experienced lower utilization as certain customers dealt with sample shortages, and as newer customers take longer to ramp.

Asia Pacific revenue of \$9.6 million grew 4% over the prior year, primarily driven by a recovery in China post-lockdowns. The region posted its highest consumable quarter in nearly 5 years. Lower instrument ASPs partially offset the growth in consumables.

Finally, EMEA revenue of \$6.0 million was 6% lower compared to the prior year period with currency fluctuations in the pound sterling and euro driving a 10% headwind. The region was most affected by FX, which represented approximately a 10% headwind compared to Q3 2021. The region posted record consumables in the quarter, particularly as a large plant and animal sequencing project regained momentum.

Moving down the P&L, GAAP gross profit of \$13.5 million in the third quarter of 2022 represented a gross margin of 42%. Excluding amortization of intangible assets, third-quarter 2022 non-GAAP gross profit of \$13.7 million represented a gross margin of 42%, compared to a non-GAAP gross profit of \$15.7 million or 45% in the third quarter of last year. The decrease compared to the third quarter of last year was partially driven by lower instrument volumes and lower instrument ASPs partially offset by higher consumable volumes.

GAAP operating expenses were \$88.2 million in the third quarter of 2022; excluding change in fair value of contingent consideration of \$4.3 million and amortization of intangible assets, non-GAAP operating expenses were \$83.8 million. This represents a 42% increase from non-GAAP operating expenses of \$59.1 million in the third quarter of last year, reflecting a full quarter of operating expenses from Omniome and increased headcount.

In terms of headcount, we ended the quarter with 771 employees compared to 728 at the end of 2021.

Operating expenses in the third quarter included total non-cash stock-based compensation of \$18.0 million, compared to \$26.6 million in the third quarter of last year. Excluding merger-related expenses, non-GAAP operating expenses in the third quarter of 2021 included \$15.1 million of non-cash stock-based compensation.

GAAP net loss in the third quarter of 2022 was \$77.0 million, or 34 cents per share. Excluding amortization of acquired intangibles and change in fair value of contingent consideration, non-GAAP net loss was \$72.5 million representing 32 cents per share, compared to a GAAP net income of \$16.5 million and a non-GAAP net loss of \$47.2 million, representing 23 cents per share.

Now, turning to our Balance Sheet.

We ended the third quarter with \$834 million in unrestricted cash and investments, compared with \$899 million at the end of the second quarter of 2022.

Inventory balances increased in the third quarter to \$43.5 million, representing 1.9 inventory turns, compared with \$36.1 million at the end of the second quarter of 2022, representing 2.3 inventory turns. The increase in inventory primarily reflects purchases of Revio and Onso inventory coupled with lower-than-expected Sequel IIe shipments.

Accounts Receivable decreased in the third quarter to \$22.8 million, reflecting a DSO of 71 days, compared with \$27.1 million at the end of the second quarter of 2022, reflecting a DSO of 70 days.

Moving to guidance, as a result of our announcement of Revio, our latest high throughput long-read sequencing system expected to ship in the first quarter of 2023, we withdrew all prior 2022 financial guidance. We look forward to connecting with you next week on November 15 at our Investor Day in New York, where we plan on providing additional details related to our longer-range financial outlook.

With that, I will turn the call back to Christian.

Christian Henry, President, and CEO

Thank you, Susan. It's an exciting time for PacBio and the field of genomics. We're months away from the first Revio shipments and from what we believe represents the biggest technological milestone in long-read sequencing. We hope to see you all next week as we dive deeper into our strategy, products, markets, and financial outlook at our Inaugural Investor Day. I will now turn the call back to the operator to begin Q&A. Operator?