

PACIFIC BIOSCIENCES OF CALIFORNIA, INC.
Form 10-Q
May 03, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2019

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

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

(650) 521-8000

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant has submitted electronically 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 No

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
Emerging growth company	

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

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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 April 30, 2019: 152,674,751

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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)	March 31, 2019	December 31, 2018
Assets		
Current assets		
Cash and cash equivalents	\$ 38,205	\$ 18,844
Investments	44,667	83,510
Accounts receivable	7,279	8,595
Inventory	19,650	17,878
Prepaid expenses and other current assets	2,787	2,832
Total current assets	112,588	131,659
Property and equipment, net	33,613	34,073
Operating lease right-of-use assets, net	34,811	—
Long-term restricted cash	4,500	4,500
Other long-term assets	65	43
Total assets	\$ 185,577	\$ 170,275
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	\$ 8,740	\$ 6,736
Accrued expenses	11,158	12,823
Deferred service revenue, current	6,428	6,537
Operating lease liabilities, current	3,521	—
Notes payable, current	14,938	—
Other liabilities, current	312	788
Total current liabilities	45,097	26,884
Deferred service revenue, non-current	769	890
Operating lease liabilities, non-current	44,861	—
Deferred rent, non-current	—	13,765
Notes payable, non-current	—	14,659
Financing derivative	—	16
Total liabilities	90,727	56,214

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 152,672 and 150,244 shares at
March 31, 2019 and December 31, 2018, respectively 153 150

Additional paid-in capital

1,107,121 1,096,053

Accumulated other comprehensive income (loss)

6 (36)

Accumulated deficit

(1,012,430) (982,106)

Total stockholders' equity

94,850 114,061

Total liabilities and stockholders' equity

\$ 185,577 \$ 170,275

See accompanying notes to the condensed consolidated financial statements.

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PACIFIC BIOSCIENCES OF CALIFORNIA, INC.

Condensed Consolidated Statements of Operations and Comprehensive Loss

(Unaudited)

(in thousands, except per share amounts)	Three Months Ended	
	March 31, 2019	2018
Revenue:		
Product revenue	\$ 13,457	\$ 16,282
Service and other revenue	2,968	3,080
Total revenue	16,425	19,362
Cost of revenue:		
Cost of product revenue	8,618	9,019
Cost of service and other revenue	2,690	3,047
Total cost of revenue	11,308	12,066
Gross profit	5,117	7,296
Operating expense:		
Research and development	15,485	16,311
Sales, general and administrative	19,766	14,934
Total operating expense	35,251	31,245
Operating loss	(30,134)	(23,949)
Interest expense	(625)	(581)
Other income, net	435	351
Net loss	(30,324)	(24,179)
Other comprehensive income (loss):		
Unrealized income (loss) on investments	42	(6)
Comprehensive loss	\$ (30,282)	\$ (24,185)
Net loss per share:		
Basic and diluted net loss per share	\$ (0.20)	\$ (0.20)
Shares used in computing basic and diluted net loss per share	151,274	123,768

See accompanying notes to the condensed consolidated financial statements.

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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
	Shares	Amount				
Balance at December 31, 2018	150,244	\$ 150	\$ 1,096,053	\$ (36)	\$ (982,106)	\$ 114,061
Net loss	—	—	—	—	(30,324)	(30,324)
Other comprehensive income	—	—	—	42	—	42
Issuance of common stock in conjunction with equity plans	2,428	3	6,687	—	—	6,690
Stock-based compensation expense	—	—	4,381	—	—	4,381
Balance at March 31, 2019	152,672	\$ 153	\$ 1,107,121	\$ 6	\$ (1,012,430)	\$ 94,850
Balance at December 31, 2017	116,277	\$ 116	\$ 965,752	\$ (32)	\$ (879,733)	\$ 86,103
Net loss	—	—	—	—	(24,179)	(24,179)
Other comprehensive loss	—	—	—	(6)	—	(6)
ASC 606 adoption effect	—	—	—	—	189	189
Issuance of common stock in conjunction with equity plans	1,220	2	2,485	—	—	2,487
Issuance of common stock from ATM equity offering, net of issuance costs	14,375	14	32,848	—	—	32,862
Stock-based compensation expense	—	—	5,282	—	—	5,282
Balance at March 31, 2018	131,872	\$ 132	\$ 1,006,367	\$ (38)	\$ (903,723)	\$ 102,738

See accompanying notes to the consolidated financial statements.

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PACIFIC BIOSCIENCES OF CALIFORNIA, INC.

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(in thousands)	Three Months Ended	
	March 31, 2019	2018
Cash flows from operating activities		
Net loss	\$ (30,324)	\$ (24,179)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation	1,796	1,802
Amortization of operating lease right-of-use assets	653	—
Amortization of debt discount and financing costs	279	237
Gain on derivative	(16)	(171)
Stock-based compensation	4,381	5,282
Amortization (accretion) from investment premium (discount)	(416)	(38)
Changes in assets and liabilities		
Accounts receivable	1,316	4,981
Inventory	(1,888)	(2,720)
Prepaid expenses and other assets	87	312
Accounts payable	2,075	(942)
Accrued expenses	(1,703)	(2,402)
Deferred service revenue	(230)	(307)
Other liabilities	(1,323)	(628)
Net cash used in operating activities	(25,313)	(18,773)
Cash flows from investing activities		
Purchase of property and equipment	(1,253)	(344)
Purchase of investments	(17,623)	(31,547)
Sales of investments	—	2,442
Maturities of investments	56,860	21,700
Net cash provided by (used in) investing activities	37,984	(7,749)
Cash flows from financing activities		
Proceeds from issuance of common stock from equity plans	6,690	2,487
Proceeds from issuance of common stock from underwritten public equity offering, net of issuance costs	—	32,986
Net cash provided by financing activities	6,690	35,473
Net increase in cash and cash equivalents and restricted cash	19,361	8,951
Cash and cash equivalents and restricted cash at beginning of period	23,344	21,007
Cash and cash equivalents and restricted cash at end of period	\$ 42,705	\$ 29,958
Cash and cash equivalents at end of period	38,205	25,458
Restricted cash at end of period	4,500	4,500

Cash and cash equivalents and restricted cash at end of period	\$ 42,705	\$ 29,958
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See accompanying notes to the condensed consolidated financial statements.

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PACIFIC BIOSCIENCES OF CALIFORNIA, INC.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

NOTE 1. OVERVIEW

We design, develop and manufacture sequencing systems to help scientists resolve genetically complex problems. Based on our novel Single Molecule, Real-Time (SMRT®) sequencing technology, our products enable: de novo genome assembly to finish genomes in order to more fully identify, annotate and decipher genomic structures; full-length transcript analysis to improve annotations in reference genomes, characterize alternatively spliced isoforms in important gene families, and find novel genes; targeted sequencing to more comprehensively characterize genetic variations; and real-time kinetic information for epigenome characterization. Our technology provides high accuracy, ultra-long reads, uniform coverage and the ability to simultaneously detect epigenetic changes. PacBio® sequencing systems, including consumables and software, provide a simple and fast end-to-end workflow for SMRT sequencing.

On November 1, 2018, we entered into an Agreement and Plan of Merger with Illumina, Inc. (“Illumina”) and FC Ops Corp., a wholly-owned subsidiary of Illumina (the “Merger Agreement”) pursuant to which Illumina will acquire us for \$8.00 per share of our common stock in an all-cash transaction and FC Ops Corp. will be merged with and into us (the “Merger”), with us surviving the Merger and becoming a wholly-owned subsidiary of Illumina. Completion of the transaction is subject to terms and conditions set forth in the Merger Agreement, including expiration or termination of any waiting periods applicable to the consummation of the Merger under the United States Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and clearance under the antitrust laws of certain non-U. S. jurisdictions. At a Special Meeting of Stockholders held on January 24, 2019, our stockholders, among other things, approved the adoption of the Merger Agreement. The Merger has been notified to the United States Federal Trade Commission (“FTC”) and to the Competition and Markets Authority of the United Kingdom (“CMA”). We and Illumina continue to expect the Merger to be completed in mid-2019, at which time we will become a wholly-owned subsidiary of Illumina and will cease to be a publicly-traded company. No assurance can be given that the required regulatory approvals will be obtained or that the required conditions to closing will be satisfied, and, even if all such approvals are obtained and the conditions are satisfied, no assurance can be given as to the terms, conditions and timing of the approvals. Under certain circumstances specified in the Merger Agreement, Illumina may be required to pay us a termination fee of \$98.0 million (the “Reverse Termination Fee”). For more information about the effects of our agreement to be acquired by Illumina please see Risk Factors under the section “Risks Related to Our Business”.

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

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Consolidation

In the opinion of management, our accompanying unaudited Condensed Consolidated Financial Statements (“Financial Statements”) have been prepared on a consistent basis with our December 31, 2018 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, 2018. The results of operations for the three months ended March 31, 2019 are not necessarily indicative of the results to be expected for the entire year or any future periods.

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

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 valuation and recognition of share-based compensation, the expected renewal period for service contracts, the useful lives assigned to long-lived assets, the computation of provisions for income taxes and the determination of the internal borrow rate used in calculating the operating lease right-of-use assets and operating lease liabilities. Actual results could differ materially from these estimates.

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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 March 31, 2019 and December 31, 2018 respectively (in thousands):

March 31, 2019

December 31, 2018

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(in thousands)	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets								
Cash and cash equivalents:								
Cash and money market funds	\$ 29,329	\$ —	\$ —	\$ 29,329	\$ 18,844	\$ —	\$ —	\$ 18,844
Commercial paper	—	8,876	—	8,876	—	—	—	—
Total cash and cash equivalents	29,329	8,876	—	38,205	18,844	—	—	18,844
Investments:								
Commercial paper	—	31,306	—	31,306	—	53,469	—	53,469
Corporate debt securities	—	6,979	—	6,979	—	10,214	—	10,214
US government & agency securities	—	6,382	—	6,382	—	19,827	—	19,827
Total investments	—	44,667	—	44,667	—	83,510	—	83,510
Long-term restricted cash:								
Cash	4,500	—	—	4,500	4,500	—	—	4,500
Total assets measured at fair value	\$ 33,829	\$ 53,543	\$ —	\$ 87,372	\$ 23,344	\$ 83,510	\$ —	\$ 106,854
Liabilities								
Financing derivative	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 16	\$ 16
Total liabilities measured at fair value	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 16	\$ 16

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

During the three months ended March 31, 2019, there were no transfers between Level 1, Level 2, or Level 3 assets or liabilities reported at fair value on a recurring basis and our valuation techniques did not change compared to the prior year.

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

We determined the fair value of the Notes from the debt facility that we entered into during the first quarter of 2013 using Level 3 inputs, or significant unobservable inputs. The value of the Notes was determined by comparing the difference between the fair value of the Notes with and without the Financing Derivative by calculating the respective present values from future cash flows using 8.4% and 9.6% weighted average market yield at March 31, 2019 and December 31, 2018, respectively. Refer to Note 5. Notes Payable for additional details regarding the Notes. The estimated fair value and carrying value of the Notes are as follows (in thousands):

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