Investor Relations – Todd Friedman

Good afternoon and welcome to PacBio's first-quarter 2023 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 financial guidance, our Revio and Onso systems and their commercialization plans, the future availability, uses, accuracy, coverage, advantages, quality or performance of, or benefits or expected benefits of using, PacBio products or technologies, including our Revio and Onso systems; and expectations with respect to customer demand for our products and technologies and growth in our business. 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.

We will also present certain financial information on a non-GAAP basis during the call. Non-GAAP information is not prepared under a comprehensive set of accounting rules and should only be used to supplement an understanding of the company's operating results as reported under U.S. GAAP. 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 historical U.S. GAAP and non-GAAP results are presented in tables within our earnings release. For future periods we are unable to reconcile the non-GAAP gross margin and non-GAAP operating expenses without unreasonable effort due to the items indicated in 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 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, everyone. Thank you for joining our call today.

Last October, we unveiled Revio, a long-read sequencer that is 15 times more powerful than our previous generation sequencer. The system enables researchers to analyze what we believe are the most complete genomes in the industry with paradigm-changing scale and economics. As we saw in Q4, these features captured the imagination of scientists and researchers across the community, and we started 2023 with a backlog of 76 systems.

In March, we began shipping the Revio system, at scale, to customers around the world. I'm pleased to say our launch of Revio is progressing extremely well and is ahead of our targets. The demand for our new system continues to be robust, so much so that orders for Revio in the first quarter outpaced our shipments of Revio, resulting in a net increase in instrument backlog. This sets us up favorably to deliver on our growth targets for the rest of 2023.

During the first quarter, we delivered 32 Revio systems, surpassing our expectations and demonstrating that our robust manufacturing capabilities can scale and deliver on new instrument launches. With Revio manufacturing capacity scaling up in the first quarter and customers beginning to ramp down Sequel II and IIe consumable spending, PacBio *still* delivered record revenue of $38.9 million in the first quarter.

The initial customer reception of Revio, its robust field performance, and our ability to scale manufacturing has given us the confidence to raise our full-year guidance. We now expect revenue to be $170 million to $185 million for the full year – or 33% to 44% growth year over year.

Interestingly, the 32 Revio shipments in Q1 nearly match the total HiFi capacity in the market for our cumulative Sequel II and IIe installed base. This is extremely important for our growth as the increased demand for long-read sequencing is clear, and I believe our customers will ramp and fill their sequencers with both new projects and existing samples that may have been sequenced using other short-read technologies.

Before I move on, I'd like to congratulate our global service and support teams. They were essential to the successful launch of the platform. I'm happy to report that all 32 instruments have been installed, in all regions and have completed their first sequencing runs. Additionally, the platform's early field performance has exceeded our expectations. For runs with sample libraries that are 15 kilobases and higher, our customers average above 90 gigabases of output per SMRT cell, with many customers exceeding 100 gigabases per SMRT cell – that's 400 gigabases per 24-hour run on Revio. To put that in perspective, Sequel IIe generates just 30 gigabases of sequence in 30 hours. The strong early field performance has given us the confidence to accelerate some shipments in April, and we are now actively shipping instruments according to our manufacturing plan.

I'd like to take a minute to discuss the composition of customers who have already received Revio. They are a diverse group that spans ten countries and includes commercial service providers, academic core labs, children's hospitals, pharma, and agriculture. These customers are expected to use their Revio from large-scale human genome projects and human disease research to plant, animal, and microbial research. The scalability and flexibility of Revio can power multiple 'omic applications and is expected to ultimately drive a diversified customer and installed base as the product launch progresses.

To highlight the specifics behind a few of our customers in the past quarter,

GrandOmics, a long-time PacBio service provider based in China, successfully implemented Revio and is now preparing to run large-scale cohort studies, pangenome projects, and biodiversity sequencing efforts. In its first sequencing run, the company reported an average SMRT cell yield of over 102 gigabases per SMRT cell with median Q-scores of Q30 or better.

Additionally, the Australian Genome Research Facility (or AGRF), they plan to implement Revio to offer long reads at an extraordinary scale and affordable cost to its customers.

We've also shipped Revio units to multiple sequencing centers that plan to use Revio to scale up long reads for the NIH's All of Us program.

These examples were just a few, as many other early Revio customers were willing to share their excitement for the platform and their initial experience on social media. I look forward to many more of these posts this quarter and into the future.

Revio opens the door to large-scale genomics, and we are currently tracking several multi-thousand sample genome project opportunities. Revio has already enabled us to win some of these projects, and we are in discussions with several other potential partners. Revio not only gets PacBio a seat at the table for these large-scale programs, but it makes us a top competitor as we can deliver what we believe is the most complete, highest-value human genome. This means potentially more insights into genetic disease, a better understanding of cancer, and ultimately, improving human health.

We take pride in delivering our customers the high quality, complete sequencing products and services. Delighting our customers, after all, is one of our core values and a critical part of our mission. So, I'm incredibly pleased with our initial results from our in-progress annual customer survey showing a Net Promoter Score of over 60 – a significant improvement over last year and higher than other sequencing providers have reported. Our survey closes in a few days, and I look forward to relaying more feedback.

We've also continued to see interest from new PacBio instrument customers, as one-third of the Revio systems ordered in the first quarter were from brand-new customers, and over one-third of the systems in our sales pipeline for the remainder of 2023 consist of new customers.

In fact, our largest instrument order in Q1 was from a new customer, a European genomic testing lab looking to incorporate HiFi genomes to investigate rare disease cases. The customer ordered multiple systems. They indicated that one of the key factors to implementing Revio was the ability to sequence thousands of HiFi genomes under $1,000 a genome so that they can shift from short-read exomes directly to long-read genomes.

Another new customer, a hospital in Canada, decided to reallocate a portion of its budget for a high-throughput short-read sequencer towards acquiring a Revio and expanding its capabilities in highly accurate long-read sequencing.

Revio is also reigniting legacy PacBio customers' interest in leveraging long reads as Weill Cornell Medical Center ordered Revio for their Genomics Core, which will be their first PacBio instrument since the RSII. Their team is looking forward to partnering with PacBio and has shared with us that they plan to move several active short-read projects in applications like human whole genome, RNA, and epigenetics to Revio once the system is installed.

In the near term, we expect most Revio shipments will be to existing Sequel II and IIe customers – which is why we've been investing so heavily in expanding our installed base over the past couple of years. Since the end of 2020, we have grown our Sequel II/IIe installed base by 150% and more than doubled our Sequel II and IIe customers. This has helped set the foundation for a multi-year product transition. After our strong launch, we believe the customer conversion cycle to Revio still has a long runway, as only about 1/5th of our nearly 300 Sequel IIe customers have placed orders for Revio.

As we turn our focus to our groundbreaking short read sequencer, Onso, I'm pleased to report that our beta program has been quite successful, and our partners continue to sequence on their systems. We have recently enabled each site with our latest 2x150 paired-end chemistry delivering increased sequencing robustness and reliability over our previous versions.

Regarding its performance, we are excited to share that beta sites are seeing output that achieves our commercial specification of 800 million paired-end reads and regularly get over 90% of reads between Q40 and Q50. Our beta partners are running samples where low variant allele detection is critical, such as circulating tumor DNA and gene editing analysis and they look forward to sharing additional data from these challenging sample types.

On the operational side, our manufacturing team is finalizing scale-up plans for Onso. We've completed our first Onso pilot manufacturing builds in-house, with the first runs going well. And on the commercial front, I am pleased to announce that we've already received multiple Onso orders as we continue to build our sales pipeline. We believe Onso is likely to be available for commercial shipment around the end of the second quarter.

As one would expect, there has been a lot of attention on the Revio and Onso platforms, but we continue to make great progress on improving the sequencing workflow. During the quarter, we launched our latest high-throughput Nanobind extraction kits to enable fast, reliable, and scalable large fragment DNA extraction across blood, cell, and tissue samples. This new offering lowers extraction time to less than two hours, minimizes sample input, and eliminates the need of harmful chemicals or mechanical homogenization. The new high throughput protocol is automated for a complete walkaway solution, enabling labs to scale their PacBio sequencing.

Also, on the front-end workflow, we partnered with Corteva Agriscience. We released end-to-end workflows that streamline DNA extraction through library preparation, enabling thousands of samples to be sequenced annually. Corteva received its first Revios during the first quarter and is beginning to transition sequencing over to the platform.

On the informatics front, we continue to develop the tools for researchers to make impactful discoveries. For example, some of the recent tools we have developed include: SMRT Analysis to phase de novo assemblies, TRGT (or Target) for tandem repeat genotyping and visualization, Paraphase to help call highly homologous genes, and HiFi CNV, for identifying large Copy Number Variants across the genome. Rolling out new and improved ways to interpret long-read data and collaborating with third-party providers is a key pillar of our informatics strategy and will help further drive adoption of our platforms.

In addition to making the workflow more accessible, we develop kits to power customers' research across various omic applications. In transcriptomics, our recently launched MAS-Seq kit has already been ordered by 100 of our customers since its launch late last year.

MAS-Seq addresses transcriptomics and single-cell research, which are incredibly important and rapidly growing areas in sequencing. For example, in a preprint in March, researchers at UCLA and other institutions used PacBio Iso-seq to build a full-length transcriptome atlas of the developing human brain, mapping over 200,000 unique isoforms – over 70% of which had never been detected before – this can allow us to understand better risk variants associated with neurodevelopmental disorders and help us reshape our understanding of brain development and disease.

And then, just a few weeks ago, in cancer research, another preprint described the first isoform-resolution colorectal cancer transcriptomic atlas, using PacBio Iso-Seq to identify several hundred dysregulated transcript structures in tumor cells.

Both studies used our legacy IsoSeq solution on Sequel II, but with new solutions like MAS-seq and the expansion into bulk Iso-Seq, along with the throughput of Revio, we can further enable these groundbreaking studies, which ultimately may translate into improved clinical research outcomes.

With that, I'll turn the call over to Susan to discuss our financial results in more detail, Susan?

Susan Kim (CFO)

Thank you, Christian. As discussed, we reported $38.9 million in product, service, and other revenue in the first quarter of 2023, which represented an increase of 17% from $33.2 million in the first quarter of 2022.

Instrument revenue in the first quarter was $20.7 million, an increase of 33% from $15.6 million in the first quarter of 2022. The increase in revenue was primarily driven by the launch of Revio in the first quarter, which is sold at a higher ASP than our previous Sequel II and IIe platform. We ended the quarter with an installed base of 32 Revio systems and shipped 6 Sequel IIe systems.

Turning to consumables, revenue of $14.0 million in the first quarter grew 10% from $12.7 million in the first quarter of last year, with approximately 10% of consumable revenue coming from Revio systems and the remainder from other platforms and other consumables. We expect Revio as a percent of total consumables to increase throughout 2023 as we continue shipping Revio and customers transition to the new system.

Finally, service and other revenue was $4.2 million in the first quarter compared to $4.9 million in the first quarter of 2022.

From a regional perspective,

Americas revenue of $19.1 million was roughly flat compared to the first quarter of 2022, as the higher ASP in Revio offset a record Sequel II/IIe placement quarter for the region in the first quarter of 2022. As a reminder, the first quarter of 2022 included 18 Sequel IIes delivered to the Broad Institute.

For Asia Pacific, revenue of $12.0 million grew 43% over the prior year. China grew approximately 40% year-over-year and posted its highest revenue since the second quarter of 2021 as customers in the region are taking to Revio and as the country recovered from last year's COVID-19 related lockdowns. Japan also showed strength as consumables continued to grow on top of its record consumable quarter in Q1 of 2022.

Finally, EMEA revenue of $7.9 million grew 38% over the prior year period, with changes in FX rates representing an approximate 5% headwind in the region year-over-year. The region had its highest instrument revenue quarter in over a year as customers like the Wellcome Sanger Institute, Radboud University, and MBRU received their first Revios to scale their long-read genome projects.

Moving down the P&L, a GAAP gross profit of $9.8 million in the first quarter of 2023 represented a gross margin of 25% compared to a GAAP gross profit of $14.2 million in the first quarter of 2022 which represented a gross margin of 43%.

First quarter 2023 non-GAAP gross profit of $9.9 million represented a non-GAAP gross margin of 26%, compared to a non-GAAP gross profit of $14.3 million or 43% in the first quarter of last year. Gross margin declined year-over-year due in part to instrument mix, as Revio instruments sold during the quarter had a lower margin primarily due to loyalty discounts provided and higher initial manufacturing costs. Additionally, GAAP and non-GAAP gross profit in the first quarter reflect adjustments of approximately $3.5 million primarily related to excess consumables inventory resulting from a faster-than-expected decline in demand for Sequel II/IIe consumables due to the product transition to Revio. This accounted for an approximate 900 basis point headwind on gross margin in the quarter.

While we expect gross margin to expand during the remainder of the year, gross margin could fluctuate depending on the pace at which Sequel II/IIe usage declines and Revio manufacturing is scaled.

GAAP operating expenses were $101 million in the first quarter of 2023 compared to $91.7 million in the first quarter of 2022. Non-GAAP operating expenses were $88.7 million in the first quarter of 2023, representing a 4% decrease from non-GAAP operating expenses of $92.7 million in the first quarter of 2022. The increase in GAAP operating expenses primarily reflects an increase in the fair value of the contingent consideration liability during the first quarter of 2023 of $12.3 million related to the milestone payment to Omniome shareholders. Non-GAAP operating expenses declined year-over-year, primarily driven by the transition of Revio from development to commercialization.

Regarding headcount, we ended the quarter with 793 employees compared to 769 at the end of Q4 2022 and 774 at the end of the first quarter of 2022.

Operating expenses in the first quarter included non-cash share-based compensation of $16.0 million, compared to $20.9 million in the first quarter of last year.

GAAP net loss in the first quarter of 2023 was $88.0 million, or 36 cents per share, compared to a GAAP net loss of $81.5 million in the first quarter of 2022, or 37 cents per share. Non-GAAP net loss was $75.5 million representing 31 cents per share, in the first quarter of 2023, compared to a non-GAAP net loss of $82.3 million, representing 37 cents per share in the first quarter of 2022.

Turning to our Balance Sheet items,

We ended the first quarter with $875 million in unrestricted cash and investments, compared with $772 million at the end of the fourth quarter of 2022. The change in cash reflects net proceeds from our public offering in January of approximately $189 million, less cash burn of approximately $86 million, which included our annual employee bonus payout and a prepayment for future inventory in the first quarter 2023. As a reminder, we expect to pay the Omniome shareholders approximately $200 million in cash and equity, dependent upon the achievement of a milestone in connection with commercial shipments of the Onso platform.

Inventory balances increased in the first quarter to $62.0 million, representing 2.1 inventory turns, compared with $50.4 million at the end of the fourth quarter of 2022, representing 1.6 inventory turns. The increase in inventory primarily reflects purchases of Revio and Onso instrument and consumables inventory.

Accounts Receivable increased in the first quarter to $29.6 million compared with $18.8 million at the end of the fourth quarter of 2022, while our DSO of 56 days declined in the first quarter compared to a DSO of 70 days in the fourth quarter of 2022.

Turning to guidance,

As discussed earlier, given the successful launch and positive customer reception toward Revio, we are increasing our guidance for 2023. We now expect revenue in the range of $170 million to $185 million, representing a growth rate of approximately 33% to 44% compared to 2022.

The lower end of the range continues to assume a year-over-year decline in consumables as customers transition to Revio. The high end assumes consumable revenue is slightly higher compared to 2022. Service and other revenue is still expected to be lower compared to 2022.

We continue to ramp up manufacturing capacity and expect to reach our planned production rate for 2023 during Q2. As such, we expect to continue to increase Revio shipments every quarter this year, and as a result, we expect revenue to be more weighted toward the second half.

Moving down the P&L, we expect the 2023 non-GAAP gross margin, which will exclude the amortization of intangible assets, to be lower than our previously guided range of 36% to 40% due to inventory reserves in Q1 resulting primarily from the decline in demand of Sequel II and IIe consumables due to customers' product transition to Revio.

We expect margin expansion beyond 2023 as Revio placements will help drive a mix shift toward higher margin consumables, and higher volume and optimization drive lower manufacturing unit costs.

We continue to expect non-GAAP operating expenses to grow less than 5% in 2023 compared to 2022.

Additionally, we expect interest and other expenses to have a minimal impact on our full-year EPS, as interest income on our cash and investments is expected to offset our interest expense from the convertible debt.

We expect the weighted average share count for EPS for the full year to be approximately 255 million, reflecting the recent sale of common shares and shares expected to be issued as part of the Omniome milestone later this year.

I'll hand it back to Christian for some final remarks.

Christian Henry (CEO)

As you can see from our prepared remarks, we are off to a strong start for the year.

We are driving the rapid adoption of Revio, with over one-third of our sales funnel being new-to-PacBio instrument customers and existing customers sharing how they plan to increase the amount of long-read sequencing with the platform's 15 fold throughput capacity.

For Onso, our beta program is progressing well, and we are scaling our operations with an eye toward commercial launch around the end of the second quarter. We look forward to more customers getting their hands on Q40+ accuracy and becoming the only company with both leading long and short-read technologies on the market.

Financially, we remain well positioned with $875 million in cash and investments on our balance sheet. We believe our strong financial position allows us to drive toward both our growth targets and our goal to become cash flow positive during 2026.

2023 is the first step on our journey to becoming a multi-platform, multi-product company, and we look forward to updating you on Revio and Onso throughout the year.