

Investor Relations – Todd Friedman

Good afternoon, and welcome to PacBio's third-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

On today's call, we will be making "forward-looking statements," including statements regarding predictions, progress, estimates, plans, intentions, guidance, and others, including expectations with respect to our growth potential, instrument and consumable sales, and GAAP and non-GAAP guidance. 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.

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. 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.

In addition, please note that today's call is being recorded and will be available for 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)

Thank you, everyone, for joining our call today.

PacBio achieved another milestone in the third quarter as we grew revenue by 72% year over year to \$55.7 million – exceeding \$50 million in quarterly revenue for the first time in PacBio's history.

All three regions, again, posted record quarterly revenue.

In the third quarter, we shipped 52 Revio instruments for revenue, which is a record number of instrument shipments in one quarter. This brings our installed base as of September 30 to 129 Revio systems.

We also shipped our first Onso units in the third quarter. I'm pleased with our order momentum and broad customer interest in this new platform. We've received orders from ten countries across various customer and application types and expect to continue ramping up shipments in the fourth quarter. I look forward to sharing the installed base for the Onso system at a later date as the platform matures and we further scale manufacturing.

We also recorded record consumable revenue of \$16.9 million in Q3. In just its second full quarter on the market, Revio consumables of approximately \$9.3 million surpassed Sequel II and IIe consumables. This ramp was faster than we had originally expected. We shipped well over 9 thousand Revio SMRT cells in the quarter – for context, it took Sequel II/IIe eleven quarters to surpass 9 thousand cells – which further underscores customers' rapid adoption and the elasticity of the new platform.

In Q3, Revio utilization increased compared to the second quarter. Our customers used more cells per installed system as they began their ramp into production. In fact, the total data output for the Revio fleet in the third quarter already surpassed the output from the total 500-plus unit Sequel II/IIe fleet at its peak. The increased instrument utilization resulted in annualized consumable pull-through of \$483 thousand. Although it is exciting to see our customers generating more data than ever before, I would also say that we are still early in our launch cycle, and we do not know if this level of consumable pull-through will represent the long-term pull-through of the Revio platform.

The continued uptake and adoption of Revio is allowing us to increase our 2023 revenue guidance again this year.

We now expect full-year revenue to be between \$195 and \$200 million, representing 52% to 56% growth over 2022 – and above the long-term targets we set out at our investor day last November.

One of the most important metrics we're tracking for Revio adoption is new customer uptake, as it shows how the platform enables more and more users to migrate from other sequencing technologies onto PacBio. Again, we're pleased to report that over 40% of our Revio system orders in the third quarter were from new PacBio instrument customers. Additionally, we continue to expect a multi-year opportunity for existing Sequel II customers migrating over to Revio, as less than 30% of the approximate 300 Sequel II and IIe customers have ordered a Revio to date.

Our new customers include Helix – who ordered a Revio system to strengthen its offering by incorporating native and accurate long-reads into its population genomics business, which currently provides an end-to-end sequencing platform for several large-scale programs across the United States.

In addition to new customers purchasing the platform, some of our existing customers are already expanding their Revio capacity, like Children's Mercy Hospital in Kansas City, which has recently shared how Revio has enabled them to consolidate tests, increase efficiency, and improve solve rates while accelerating turnaround time. Further, the hospital shared that they can achieve results in just two weeks with 5-base HiFi sequencing compared to months using multiple legacy tests.

Similarly, we are also collaborating with GeneDx and the University of Washington to study the capabilities of HiFi long-read whole genome sequencing to improve our ability to understand genetic conditions in pediatric patients. We believe that with HiFi and Revio, our customers may be able to consolidate a menu of different tests into one integrated, complete, long-read genome.

We continue to see strong momentum in the genetic disease segment for HiFi sequencing as other children's hospitals implemented Revio in the quarter. This includes another leading institution in the Midwest that upgraded from Sequel IIe to scale whole genome sequencing for its rare disease cohorts and to implement Iso-Seq to further its research in pediatric and adolescent cancer patients.

In large-scale genomics projects, we were pleased to see initial data from researchers at Mohammed Bin Rashid University of Medicine and Health Sciences, or MBRU, in developing an Arab Pangenome Reference, which uncovered over 100 million base pairs of novel sequence compared to other recent pangenome references. PacBio HiFi was a key contributor to unlocking this new data, which is why the team decided to ramp on Revio to begin a larger multi-thousand genome sequencing project this year.

One of the hallmarks of PacBio has been our ability to create additional value for our customers by adding new features to our sequencing platforms. With Revio, we are continuing this tradition by improving the performance of our systems in the field and adding valuable new features to the platform later this year. I'd like to spend a few minutes discussing some of these enhancements.

In Q3, we rolled out a software update that optimizes the 'preload feature' on Revio. The preload feature enables customers to load their next run onto the instrument while a sequencing run is underway. This gives Revio the potential to always be running and truly enables production-scale long-read sequencing. Over the past few months, we learned that some of our highest throughput, most industrialized customers, were having some challenges using this feature. As a result, we made some changes to improve the preload function, which was included in this recent software release. Now, customers can preload as expected, allowing high-volume customers to potentially further increase Revio utilization.

In the fourth quarter, we plan to add several new enhancements to the Revio platform.

First, we will incorporate the highly anticipated 'adaptive loading' feature popular on our Sequel IIe platform. Adaptive loading tailors the DNA loading to better fit the customers' sample, providing a backstop to prevent SMRT cell overloading. This can enable customers to load more DNA more confidently and ultimately achieve higher and more consistent yields.

We will also enable support for libraries less than three kilobases long – which will position Revio more favorably in applications like AAV, Iso-Seq, and 16s microbial sequencing. Further, it will enable twelve-hour and thirty-hour run times so users can optimize their runs for shorter and longer DNA inserts.

Finally, the update also includes a 'Run Preview' feature, allowing users to see their run statistics after the first 4 hours during the sequencing process and enabling customers to better plan for future sequencing runs.

We are not just focused on enhancing the sequencing platform, but we are also improving the end-to-end workflow. We believe that by improving the workflow- from sample preparation through data analysis, we will enable our customers to truly leverage the power of HiFi sequencing.

In the sample preparation process, next year, we plan to release improvements that leverage the technology acquired from Circulomics to improve size selection on the SMRT cell. This will improve our customers' ability to achieve higher sequencing output with each SMRT cell and consistently achieve longer read lengths.

Additionally, in order to enable our customers to take full advantage of the throughput of Revio, we have collaborated with leading automation providers including, Hamilton, Integra, Revvity, and Tecan, to create fully automated sample preparation protocols for both the Revio and Sequel II/IIe systems.

On the analysis front, earlier this month, we launched the PacBio WGS Variant Pipeline. This standardized computational method consolidates over ten separate secondary and tertiary analysis tools into a single user-friendly workflow, enabling users with all levels of bioinformatics experience to access HiFi whole genome sequencing.

Over the past few years, I've often discussed our goal to make PacBio a more multi-omic company. This is important as multi-omic approaches allow us to better understand the underlying connections from the genome and the epigenome to the transcriptome and the proteome – and ultimately glean greater insights into biology and disease. With the flexibility and increased throughput of Revio combined with HiFi's single-molecule detection capabilities, we're starting to see how Revio can be a multi-omic Swiss army knife of sorts.

For example, in a preprint last month, researchers from the University of Washington and other institutions showed how Revio could produce data on four separate, high-quality 'omes' on just one Revio SMRT cell – the genome, methylome, chromatin epigenome, and the transcriptome.

In analyzing a participant in the Undiagnosed Diseases Network, the researchers reported how data from each of the four 'omes' explained one or more of the participant's phenotypes. This study is yet another example of how a synchronized, single long-read multi-omic test can more effectively uncover unexplained rare conditions than multiple one-off tests.

In another study, scientists from the University of Dresden and Max Planck Institute used PacBio Iso-Seq to look deeper into the transcriptome to understand the impact of alternative splicing on isoform diversity and protein structure and showed that isoforms have a critical role in determining protein structures and biological functions in brain development, and concluding that "alternative splicing has a greater potential to impact protein diversity and function than previously thought independently from changes in gene expression."

To address this growing transcriptomics market, we're excited to launch our new Kinnex kits, enabling scalable, cost-effective full-length RNA sequencing on PacBio Revio and Sequel IIe.

With the MAS-seq method launched late last year, customers can concatenate smaller inserts into one long insert to dramatically increase output in single-cell RNA experiments.

Now, with the expanded and rebranded Kinnex kits, we can better address bulk RNA applications – allowing scientists to reveal the role of isoforms for the biology of health and disease, in addition to obtaining gene expression information. This truly enables this application on Revio, allowing customers to perform large studies – thousands of samples per year – on a single Revio system, thereby accessing projects in neurology, rare disease and cancer research, and well as other markets.

The Kinnex line of kits also includes the 16S kit. The 16S gene is found in bacterial genomes and has long been used to identify, classify, and quantify species and strains in a microbial community sample.

At about 1,500 base pairs long, short-read sequencing has difficulty reading the whole gene, while long-read sequencing would leave unused capacity on the sequencer. With Kinnex, customers can concatenate the 16S gene into long libraries for HiFi sequencing. This puts Revio and Sequel II on par with short-read sequencing regarding cost – positioning Revio to better address the multi-hundred-million-dollar microbial genomics market.

These kits further expand our competitive offerings in human genetics, oncology, and microbiology, and we look forward to discussing them more with researchers at ASHG later this week.

Before I pass it over to Susan, I'd like to welcome David Meline to our Board of Directors. David brings extensive experience to our board as a finance leader in various life science and healthcare companies, most recently with Moderna, Inc.

And with that, I'll pass the call to Susan to discuss the financials. Susan?

Susan Kim (CFO)

Thank you, Christian. As discussed, we are pleased to have reported \$55.7 million in product, service, and other revenue in the third quarter of 2023, which represented an increase of 72% from \$32.3 million in the third quarter of 2022.

Instrument revenue in the third quarter was \$34.7 million, an increase of 203% from \$11.4 million in the third quarter of 2022. The continued momentum of Revio primarily drove the increase in revenue as we shipped 52 systems for revenue in the quarter. We ended the quarter with an installed base of 129 Revio systems.

Turning to consumables, revenue of \$16.9 million in the third quarter increased 5% from \$16.1 million in the third quarter of last year. It was a record for PacBio, with approximately 55% of consumable revenue coming from Revio systems and the remainder from other systems and other consumables. We expect Sequel II and IIe as a percent of total consumables to continue declining as we ship Revio and customers transition to the new system.

Finally, service, and other revenue was \$4.1 million in the third quarter compared to \$4.8 million in the third quarter of 2022.

From a regional perspective, as Christian mentioned earlier, all three regions posted record revenue in the third quarter.

Americas revenue of \$29.0 million grew 73% compared to the third quarter of 2022, with sequential and year-over-year growth across instruments and consumables.

For Asia Pacific, revenue of \$15.7 million grew 64% over the prior year. China recorded year-over-year growth but was lower from the second quarter as customers in the region slowed their CapEx purchases, though we were encouraged to see sequential consumables as customers ramp up their Revio usage in the country with healthy levels of utilization.

Finally, EMEA revenue of \$11.0 million grew 83% over the prior year period, driven by both instrument and consumable growth as customers like MBRU ramped up its large-scale genome project and the Wellcome Sanger Institute reached its milestone of 1,000 species sequenced as part of the Darwin Tree of Life project.

Moving down the P&L,

GAAP gross profit of \$17.9 million in the third quarter of 2023 represented a gross margin of 32% compared to a GAAP gross profit of \$13.5 million in the third quarter of 2022, which represented a gross margin of 42%.

Third quarter 2023 non-GAAP gross profit of \$18.1 million represented a non-GAAP gross margin of 32%, compared to a non-GAAP gross profit of \$13.7 million or 42% in the third quarter of last year.

The year-over-year decrease in gross margin was due to product mix as instrument revenue accounted for a higher proportion of overall revenue in the third quarter of 2023 compared to the third quarter of 2022 and due to instrument mix as Revio instruments sold in the third quarter of 2023 had a lower gross margin than Sequel IIe systems sold in the third quarter of last year. Additionally, we realized inventory scrap and reserve charges, as well as additional warranty-related material expenses on the Revio platform in the third quarter of 2023.

GAAP operating expenses were \$100.4 million in the third quarter of 2023 compared to \$88.2 million in the third quarter of 2022.

Non-GAAP operating expenses were \$90.9 million in the third quarter of 2023, representing an 8% increase from non-GAAP operating expenses of \$83.8 million in the third quarter of 2022 and excluded merger-related expenses of approximately \$9.0 million related to our acquisition of Apton in the third quarter of 2023.

The increase in operating expenses primarily reflects expenses related to the Apton acquisition in the third quarter of 2023 and increased sales and marketing expenses primarily related to increased investment in the commercial organization, partially offset by lower engineering and lab-related expenses resulting from the transition of Revio from development to commercialization.

Regarding headcount, we ended the quarter with 844 employees compared to 818 at the end of Q2 2023 and 771 at the end of the third quarter of 2022.

Operating expenses in the third quarter included non-cash share-based compensation of \$18.6 million, compared to \$18.0 million in the third quarter of last year.

GAAP net loss in the third quarter of 2023 was \$66.9 million, or \$0.26 per share, compared to a GAAP net loss of \$77.0 million in the third quarter of 2022, or \$0.34 per share.

In Q3, we booked a discrete income tax benefit related to the acquisition of Apton. The acquisition was considered a business combination for tax purposes and therefore the acquired intangibles are disallowed for book tax purposes which resulted in a one-time discrete non-cash income tax benefit on the GAAP P&L of \$10.7M in the quarter.

Non-GAAP net loss was \$67.9 million, representing \$0.27 per share, in the third quarter of 2023, compared to a non-GAAP net loss of \$72.5 million, representing \$0.32 per share in the third quarter of 2022.

On to our Balance Sheet, we ended the third quarter with \$767.8 million in unrestricted cash and investments, compared with \$829.9 million at the end of the second quarter of 2023. The ending cash balance on September 30 does not reflect the milestone payment to the Omniome shareholders, including approximately \$96.2 million in cash and 9.0 million shares of common stock, which was paid and distributed on or about October 4, 2023.

Inventory balances increased in the third quarter to \$68.3 million, representing 2.2 inventory turns, compared with \$67.6 million at the end of the second quarter of 2023, representing 2.0 inventory turns. Accounts Receivable increased in the third quarter to \$30.5 million compared with \$24.0 million at the end of the second quarter of 2023.

To expand a bit on our guidance. As Christian indicated, our strong performance in the third quarter leads us to believe that revenue for the year will be \$195 million to \$200 million, representing a growth rate of approximately 52% to 56% compared to 2022. This represents an increase of \$10 million over our guidance last quarter, and we have now raised our guidance every quarter this year.

Around the midpoint, our guidance assumes fourth-quarter revenue is approximately flat sequentially compared to the third quarter, with the \$5 million range reflecting macro factors that are lengthening sales cycles for our customers globally and affecting the timing of customer capex purchases.

Moving down the P&L, we expect the 2023 non-GAAP gross margin to be around the low end of the previously guided 32% to 34% range due to higher-than-expected inventory scrap and reserves in the third quarter and higher warranty costs associated with the Revio instrument.

We continue to 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. Specifically, we've made good progress this year in reducing cost by lowering the manufacturing labor time for the Revio system production, which we expect to continue into 2024, and we have now commenced consolidating our San Diego manufacturing operations into Menlo Park, which will give us the benefit of running our manufacturing operations more efficiently.

We now also expect non-GAAP operating expenses to grow by 2 to 3% compared to 2022. This is lower than our previously guided growth rate as PacBio continues to focus on spending discipline.

We expect interest income to more than offset interest expense for the remainder of the year and the weighted average share count for EPS for the full year to be approximately 254 million due to the timing of the issuance of the Omniome milestone shares.

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

Christian Henry (CEO)

Thank you, Susan. With a couple of months left, 2023 is on track to be the most successful year in PacBio's history, and when looking back, I believe it can mark an inflection point on our strategic journey.

For the year, PacBio is on track to ship more systems than at any other point in its history. What is perhaps more encouraging is that we now expect to achieve record consumable revenue, in spite of the fact that 2023 has been a product transition year. I believe that this is an indication of the fundamental demand for long-read sequencing in the market and that highly accurate, high throughput systems such as Revio are enabling that demand.

Our projected revenue growth for this year is well above our 40 to 50% compound annual growth target established at our investor day last year. When I look back and compare where we are now versus our internal expectations twelve months ago, what really stands out is the pace of Revio adoption, as it is well above where we had envisioned it last November.

However, as we look toward 2024, we see an economic backdrop that is substantially more challenging than a year ago. On that topic, I wanted to zoom out a bit and provide some high-level commentary on 2024.

While we're not providing specific 2024 guidance today, I wanted to give you a rough framework of how we're thinking about the year as we build our 2024 budget.

First, we continue to focus our R&D efforts on the creation of a multi-product, multi-platform portfolio that includes both leading long and short-read sequencing systems. We are deep into the development of several new sequencing systems which we believe will enable us to reach more of the sequencing market and drive long-term revenue growth. Even with this focus in R&D, we still believe that total expenses in 2024 will be within the range of the long-term guidance that we provided on our investor day.

Additionally, our sales funnel for Revio continues to be robust as potential new PacBio customers remain enthusiastic about implementing the power of native, long reads into their research, and existing customers are eager to upgrade their Sequel II fleet. However, due to broader global macroeconomic issues, customers have lengthened their capital purchasing timelines, which will likely have some impact on our growth trajectory in 2024.

So, while we still expect to achieve significant revenue growth in 2024, the current challenges in the global macroeconomic environment are likely to have an impact on our growth rate. As we complete our 2024 forecast and continue to monitor market conditions, we plan to provide more detailed guidance on our Q4 earnings call in early 2024.

As we close the call, I want to reiterate how pleased I am with the team's execution since we announced the Revio and Onso platforms just over one year ago, especially in this environment where we've seen prolonged inflation and worsening macroeconomic conditions.

Thank you for your time today. Operator, let's start the Q&A session.