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NanoString Technologies, Inc. (NSTG)

Q3 2015 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon, and welcome to the NanoString's Third Quarter 2015 Earnings Conference Call. My name is Trisha, and I'll be your coordinator for the call today. At this time, all participants are in a listen-only mode. We will be facilitating a question-and-answer session towards the end of today's call. As a reminder, this call is being recorded for replay purposes.

I will now turn the call over to Leigh Salvo of Westwicke Partners.

Leigh J. Salvo
Principal, Westwicke Partners LLC

Thank you, Trisha.

On the call with me today is Brad Gray, NanoString President, and CEO; and Jim Johnson, CFO. Earlier today NanoString released financial results for the third quarter ended September 30, 2015, and a copy of the press release can be found on the company's website at nanonstring.com.

During this call we'll make a number of statements that are forward-looking including statements about financial projections, existing and future collaborations, future business growth, trends and related factors, prospects for expanding and penetrating addressable markets, interactions with third-party payers and the timing and outcome of any related reimbursement decisions, our strategic focus and objectives, and the development status and anticipated success of recent and other planned product offerings. Forward-looking statements are subject to numerous risks and uncertainties, many of which are beyond our control, including the risks and uncertainties described from time-to-time in our SEC filings. Our results may differ materially from those projected on today's call. We undertake no obligation to publicly update any forward-looking statements.

With that I'd like to turn the call over to Brad.

Robert Bradley Gray

President, Chief Executive Officer & Director

Thanks, Leigh.

Good afternoon, and thank you for joining us today. The momentum we saw in the first half of the year continued into our third quarter. We delivered solid revenue growth and made substantial progress toward our objectives for the year. In addition, during our Investor Day in September, we outlined our strategic roadmap, highlighting that the markets we serve are rapidly expanding through an estimated $6 billion through the launch of our more affordable nCounter SPRINT profiler, our introduction of powerful 3D Biology applications, and the expansion of our diagnostic menu through the development of companion diagnostics.

On our call today, I'd like to start with a brief review of our third quarter performance, followed by an update on our strategic objectives. Jim will comment in more detail on our financial performance and outlook. And I'll then make some brief closing remarks before opening up the call for your questions.

Total revenue for the third quarter was $15.7 million, up 27% over the prior year driven primarily by strong consumable sales. We expanded our installed base of nCounter systems to over 320 worldwide, while achieving annualized total consumable pull-through of over $100,000 per system.

Instrument sales were $4.3 million in the third quarter. A slight year-over-year decline of strength in North America and Europe was offset by weakness in Asia Pacific, which we expect to recover during the fourth quarter. Consistent with our expectations, during the first 10 weeks of nCounter SPRINT availability, we sold four systems.

Life science consumable revenue, which excludes Prosigna, was $8.4 million for the quarter, up 40% year-on-year and 22% sequentially. Consumable growth was strong across all regions, and customer segments. Prosigna sales were $662,000 in Q3 with the majority of sales driven by ex-US laboratories. Overall, we are pleased with Q3 results, and the outlook for the remainder of the year.

Now, I'd like to spend some time covering our progress on the four strategic objectives that we identified for 2015. Our first strategic objective this year has been to sharpen our focus on oncology by solidifying our leadership in tumor profiling and expanding into the field of immuno-oncology. We believe that we offer the most complete solution available for precision oncology, supporting both research and the ability to translate discoveries into diagnostics.

This has provided us the opportunity to position the Company at the center of the Cancer Ecosystem, and our customers today include the majority of NCI's Comprehensive Cancer Care Centers, 17 of the top 20 biopharma companies, as well as over 50 clinical labs. Our oncology focus continues to drive nCounter system placements as approximately 70% of our instrument sales in Q3 were the labs focused on cancer. Our PanCancer panels have become a workhorse of many cancer research labs, driving panels to approximately 40% of our consumable revenue and setting another sales record for us during Q3.

Over the last year, we've rapidly increased our impact in the field of immuno-oncology, or IO for short, which looks to harness the power of the body's immune system to fight cancer. We introduced our first IO product, the PanCancer Immune Profiling Panel, a little more than a year-ago, and it quickly gained popularity among our customers. Over the same period, we've established several collaborations that have begun to bear fruit.

Demonstrating our leadership in IO, we plan a significant scientific and commercial presence at the annual meeting of the Society for Immunotherapy of Cancer, or SITC later this week in National Harbor Maryland.

On the commercial front, we plan to introduce several new assays that we believe will make our platform an even more valuable tool in immuno-oncology research. On a scientific front, our collaborators from the cancer immuno therapy networks are expected to present a late breaking abstract demonstrating the power of our platform to profile the immune system during clinical trials using both FFPE and blood samples.

We will also be hosting a seminar on bringing the next generation of IO biomarkers to the clinic that will include a panel of experts from our biopharma collaborators, Celgene and Merck. These collaborations represent an important part of meeting our second strategy objective for the year, which is to deepen our relationships with biopharmaceutical companies, including building a pipeline of companion diagnostics. Today over 70 nCounter systems are dedicated to biomarker discovery in over 50 different biopharma companies and CROs. During Q3, demand from these customers were strong contributing over 40% of consumable revenue in the quarter, and increasing over 60% year-on-year.

We expect that biopharma use of our technology will yield new assays that may help select patients for specific therapies. We intend to partner with biopharma companies to develop and commercialize companion diagnostics, which over time will build a menu of tests with compelling clinical utilities.

As we highlighted during our Investor Day, we believe that the diagnostic opportunity represents a market value of $2.5 billion. Our first major biopharma collaboration is with Celgene, and it's focused on developing the gold standard clinical assay for subtype in diffuse large B-cell lymphoma, or DLBCL.

Today, our assay is being used to enroll patients with ABC-type DLBCL in the Phase 3 robust study. During 2014, we received approximately of $12 million in payments from Celgene, demonstrating the ability of companion diagnostic collaborations to contribute non-dilutive capital. In early October, at Celgene's request, we expanded our collaboration and included clinical trial enrollment in additional countries such as China and Russia, which is expected to grant an additional payment of approximately $1.6 million in the fourth quarter.

Our second major biopharma collaboration is with Merck, and it's focused on developing clinical assays in the field of immuno-oncology. Since initiating the collaboration in May, we've made significant progress in proving the technical feasibility of an immune-related gene expression assay with the potential to predict which patients may benefit from the treatment with KEYTRUDA.

Wherever possible, we seek to create gold standard clinical assays that can be used to predict response for multiple therapies. This aspiration extends across breast cancer using PAM50, DLBCL using our lymphoma subtyping test, and broadly within immuno-oncology.

To-date, we've entered undisclosed agreements to conduct exploratory biomarker studies using these assays with a total of nine different biopharma companies, including three agreements entered during the third quarter. Given the breadth and intensity of partnering discussions currently under way, we are optimistic regarding the outlook for completing additional partnership agreements that will expand our opportunity in the biopharma markets even further.

Meanwhile, Prosigna has been driving us toward our third strategic objective, which is to further penetrate the clinical laboratory market. Clinical labs are continuing to adopt Prosigna, and today the number of Prosigna sites has increased to 49 clinical labs across 13 countries, with a total of 34 labs worldwide actively offering Prosigna testing services.

Just as importantly, we continue to achieve major milestones with Prosigna that demonstrate a growing capability in diagnostic commercialization that we believe will be leveraged across an entire menu of tests over time. Within Europe, Prosigna has now been included with several influential breast cancer diagnostics. In September, Prosigna was added to the European Society of Medical Oncology, or ESMO's, clinical practice guideline, recognizing Prosigna's value for determining the potential benefit of chemotherapy. The conclusion of the guidelines panel placed Prosigna at parity with other established gene expression assays. This is the third European guideline to include Prosigna, following additions to the St. Gallen and German AGO guidelines earlier this year.

Within the United States, we have continued to make substantial progress towards reimbursement for Prosigna. On October 1, Medicare began reimbursing for Prosigna testing in three jurisdictions managed by Palmetto, CGF, and Cahaba, which collectively covered nine states.

Noridian, which administers Medicare in California and 12 other states, published a favorable low – draft local coverage determination. Noridian's draft coverage policy is open for comment until December 7, and we expect that it will become effective during the first half of 2016.

Meanwhile, Medicare has issued a draft clinical lab fee schedule that sets Prosigna reimbursement of $3,416, consistent with our expectations of parity pricing with other leading breast cancer tests. While the competitive and reimbursement environment for Prosigna is improving, it will take time for these improvements to translate into substantially increased Prosigna sales. For example, we expect it will take several quarters before the recent Palmetto Medicare decision yields a meaningful increase in Prosigna kit sales. Specifically, we expect very little impact in Q4 followed by gradual growth in 2016.

Finally, our fourth strategic objective for the year has been to expand our addressable markets by launching products with broad affordability and appeal. During the third quarter, we made two exciting product introductions that we believe together expand our serviceable market by $2 billion. First, in mid-July, we launched the nCounter SPRINT Profiler, which offered the individual researcher the same highly precise nCounter chemistry and data as our previous systems, but with a smaller footprint, and lower price.

Reaction to the system has been extremely positive. In the weeks since the launch, SPRINT has accounted for approximately half of the new instrument opportunities that have entered our sales funnel. It has been rewarding to see the sales funnel begin to build with many individual researchers and institutions that has not had access to nCounter technology in the past.

Importantly, these systems are largely incremental to our previous existing funnel, and we are not seeing customers who are already in the funnel for a MAX or FLEX system, downsize their order to a SPRINT. While the funnel is building nicely, the sales cycle for SPRINT is expected to be approximately six months, similar to our other systems. As a result, we don't expect many of these new opportunities to convert to sales until 2016. We currently expect SPRINT system sales to number approximately 10 units during the fourth quarter.

Our second major product announcement of Q3 was the unveiling of 3D Biology. This unique application of our bar-coding technology allows measurement of any combination of DNA, RNA, and protein, simultaneously on a single system from a single tissue sample. Importantly, 3D Biology applications run on all of our nCounter systems and enable researchers to make entirely new observations about cancer biology while maximizing the data generated from valuable samples.

We believe that our new 3D Biology application will broadly appeal of our technology to researchers who have traditionally focused more in proteomics, and provide another distinctive capability not generally available from other competing technology platforms. In addition, by including proteomics in DNA analysis, and the gene expression experiments already being run on nCounter, we believe that over the next several years we can increase our consumable revenue per sample.

In September, we launched the first product in the 3D Biology family, the RNA Protein PanCancer Immune Profiling Panel. This product builds on the success of our existing gene expression panel, and enables researchers to simultaneously measure important proteins that are therapeutic targets such as CTLA-4, PD-1, and PDL-1.

Over the next two years, we expect to launch a family of 3D Biology consumables that we believe in combination with the nCounter SPRINT Profiler will provide a product suite that is both powerful and affordable to the cancer research community.

Now, I'd like turn the call over to Jim to review our financial results and provide financial guidance.

James Algot Johnson

Chief Financial Officer

Thanks, Brad.

Total revenue for the quarter was $15.7 million, up 27% versus the third quarter of last year. Total product and service revenue was $13.9 million, up 23% year-over-year. Foreign exchange rate fluctuations reduced the growth in total products and service revenue by approximately 4.5 percentage points.

Instrument revenue for the quarter was $4.3 million, 6% lower than in the third quarter of last year. System sales were in line with our expectations in North America and Europe. However, they were less than expected in the Asia Pacific region, reflecting lumpiness and a shift of a relatively low number of systems between quarters. Accordingly, we have a robust funnel for Q4 in APAC.

Consumable revenues for the quarter was strong with total pull-through including Prosigna of $9 million, up 44% versus third quarter of last year; and well above $100,000 per system on an annualized basis. Life sciences consumables were $8.4 million of this total, up 40% year-over-year. This strength can be attributed to a larger-than-normal volume of biopharma business, which represented approximately 40% of the total. Also, we continued to see strong demand for our panel, which represented approximately 40% of total life sciences consumables revenues for the quarter, and grew by more than 50% year-over-year.

Prosigna test kit revenue for the quarter was $662,000 growing 12% sequentially. We recorded $1.8 million of collaboration revenue for the quarter. Most of this relates to our collaboration with Merck, and to a lesser extent our Celgene collaboration.

Gross margin on product and service revenue for the quarter was 55% up from 53% reported on the third quarter of last year. The increase largely resulted from a shift in product mix toward consumables versus instruments.

R&D expense was $5.8 million for the quarter, relatively flat compared to $6 million in the third quarter of last year. While we have increased our investment in the development of new nCounter products and technology, for example 3D Biology, this increase has been offset by a reduced engineering cost relating to the development of nCounter SPRINT.

SG&A expense was down slightly year-over-year to $12 million for the quarter. This reduction reflects cost efficiencies resulting from the reorganization of sales and marketing that occurred in the first quarter of this year.

Stock-based compensation expense was $1.8 million compared to $1.3 million in the third quarter of 2014. Our GAAP net loss decreased to $9.5 million or $0.49 per share, compared to $12.1 million or $0.67 per share for the third quarter of last year.

We ended the quarter with $45 million of cash investments. We're continuing to pursue a three-pronged financing strategy based on the generation of non-dilutive cash from companion diagnostic collaborations, opportunistic equity issuance through the at-the-market arrangement we have in place with Cowen and Company, and term debt.

To that end, we recently amended our existing term loan agreement to increase the total available funding from $45 million to $60 million, to extend the draw period through the end of 2016, and to extend the interest-only period to 2021. We did not utilize the ATM in the third quarter.

So now I'll turn to financial guidance for 2015. We're maintaining our total revenue guidance for the year at $60 million to $63 million. With the continued strong performance in our companion diagnostic programs, including the amendment to our Celgene collaboration, we expect Q4 revenue mix to shift toward collaboration. We now expect collaboration revenue to be $5 million to $6 million for the year, up from $4.5 million previously. Our product and service revenue for the year is now expected to be $55 million to $57 million compared to $55.5 million to $58.5 million previously.

Our current expectations for fourth quarter consumables revenue growth have been modestly reduced based on our current funnel visibility. The fourth quarter of last year included some very large biopharma consumable orders that are not expected to be repeated this year. Regardless, we continue to expect consumable pull-through to be at or above $100,000 per system for the year.

With respect to Prosigna, we do not foresee substantial growth in Q4 versus Q3, and although we expect to finish the year ahead of our original guidance to $2 million, total Prosigna revenue for the year is expected to be less than $2.5 million.

We expect fourth quarter product revenue mix to shift toward instruments. As a result, we expect gross margin on product consumables revenue for the full-year 2015 to be at or near the low end of the range of 53% to 55% that we guided to previously. As a reminder, collaboration revenue is excluded from our calculation of gross margin.

For operating expenses, we're lowering our range of guidance for the year to $76 million to $78 million from $77 million to $81 million previously. This includes approximately $7 million of stock-based compensation expense.

While operating expenses have declined in the past two quarters; we do not expect this trend to continue. In 2016, we expect operating expenses to increase as we continue to invest in advancing our nCounter technology, developing new products based on 3D Biology, and continuing to build our sales channel as a means of driving robust top-line growth over the long-term. However, we're focused on continuing to drive operating leverage in our business, and we expect to continue closing the gap between revenue and operating expenses.

Our anticipated gap operating loss for 2015 is now expected to be in the range of $40 million to $44 million. Previously we guided to a range of $41 million to $47 million. We continue to expect interest expense of approximately $4 million for the year, bringing our revised GAAP net loss guidance to $44 million to $48 million.

We still expect capital expenditures of $4 million to $5 million, approximately half of which has been funded by our landlord, and leasehold improvements.

So with that I'll turn it back over to Brad to wrap up.

Robert Bradley Gray
President, Chief Executive Officer & Director

Thanks, Jim.

In summary, we continue to build our stature in the field of precision oncology and believe that we've established a roadmap that positions us for continued growth. Our commitment to oncology cuts across all aspects of our business as we seek to provide best-in-class products for unlocking tumor biology, yielding insights that can lead to better therapies.

We plan to continue to raise our profile among academic researchers, biopharma companies, and clinical labs focused on oncology by adding powerful 3D biology applications, broadening our assets, and with our new and affordable nCounter SPRINT profiler and expanding our diagnostic menu to include tests, enabling key decisions in cancer treatment.

I would now like to open the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from the line of Tycho Peterson with JPMorgan. Your line is now open.

Tycho W. Peterson
JPMorgan Securities LLC

Q

Hey, thanks. Brad, maybe can you just add a little bit more color on APAC? It sounds like that you expect it to recover in 4Q, and maybe some of those orders have already come through. But where did you see the softness, and maybe what gives you conviction in a 4Q recovery?

Robert Bradley Gray
President, Chief Executive Officer & Director

A

Sure. So in the first half APAC was a strong contributor to growth, and it was up 30% year-on-year on total revenue. In the third quarter, we basically saw a reversal, and revenue dropped 30% year-on-year. As we dug in, we really saw this was due to the slippage of several instrument orders in our distributors funnel from Q3 likely into Q4. And as we look into the sales funnel now, we see its tremendously strong instrument funnel in APAC. So we believe that it was a temporary blip that is likely to recover in the fourth quarter.

Tycho W. Peterson
JPMorgan Securities LLC

Q

Okay. And then can you talk a little bit about on 3D Biology, obviously interesting opportunity, and going after a number of different technologies in proteomics, DNA, and RNA. Can you maybe just talk a little bit about how you think about getting written into grant cycles and how you see that business ramping?

Robert Bradley Gray
President, Chief Executive Officer & Director

A

Sure. So, 3D Biology is a very novel concept. And we – but we believe it's a new way of doing, in some cases science that has been done for a while. So if you read many of the papers published by long-time nCounter users, about 30% of the time, they'll already include proteomics data right alongside the genomics. So from an academic perspective, we're not necessarily taking the view that these have to get written into grant funding because it's just a different way of executing the science that was already planned, but they do so in a much more efficient way.

I'd say importantly, however, 3D Biology is likely to appeal most strongly to the biopharma customer segment, as evidenced by our early access program for our RNA protein immune profiling panel which had six biopharma companies and three academic centers. The biopharma company hunger for getting a maximum amount of data from the minimum amount of tissue is very high. And of course, grant funding cycles are not the dynamic at play in the biopharma customer set.

Tycho W. Peterson
JPMorgan Securities LLC

Q

Okay. And then maybe last one for Jim, just on spending, you talked about expanding the term agreement. Can you maybe just give us a sense as to how you're thinking about OpEx for 2016? And are you pulling forward some spending into 2016 from the out years?

James Algot Johnson
Chief Financial Officer

A

Sure, Tycho. Well, generally speaking, we've – as part of our financing strategy, we expanded the term loan, and that's an important part of our three-pronged strategy. When we think about OpEx going forward, for us, it's really about growing the top line. We are not specifically planning on pulling anything forward. But generally speaking, we see a lot of opportunities to build both the nCounter technology and the products, the 3D Biology products. And that's – investing in that is really going to grow our top line. So that combined with an investment in continuing to build our sales channel, which we've been doing over the last few years, we think is a great investment that's going to generate growth for the long-term and the near-term.

Tycho W. Peterson
JPMorgan Securities LLC

Q

Okay. I'll leave it at that. Thank you.

Operator: Thank you. And our next question comes from the line of Steve Beuchaw with Morgan Stanley. Your line is now open.

Steve C. Beuchaw
Morgan Stanley & Co. LLC

Q

Hi. Good afternoon, guys. Thanks for taking the questions. First, I'll start on the – I guess I'd call it the core business, so FLEX and MAX. Brad, now that you've seen SPRINT out there in the field – first off, thanks for the color on how you see that evolving. But I wonder if you could spend just a minute on FLEX and MAX, and how you see the funnel evolving for FLEX and MAX now that we've got SPRINT out there in the field. Is that still growing, and have you seen any changes to the pattern?

Robert Bradley Gray
President, Chief Executive Officer & Director

A

Yes, thanks for the question. I think we will continue to see strong demand for FLEX and MAX. As we outlined in the Investor Day, although we've been focused on core labs and clinical labs with those two systems in the past, we're still very early in penetrating that segment of the market. So I think there's a lot of growth left at the MAX and FLEX end of the spectrum. And in some conversations that start with centers really around SPRINT may actually transition to a MAX and FLEX sale ultimately as we get into a deeper dialogue with those customers about their throughput needs and their aspirations to have a clinical testing offering. So I'd say a lot of our new lead generation activity has been based around SPRINT in the last several months, and of course an affordable system is a very good way to start a dialogue with a customer that we haven't engaged with in the past. But we do expect to continue to move FLEX and MAX systems.

Steve C. Beuchaw
Morgan Stanley & Co. LLC

Q

Got it. And then Jim, a question on gross margins and how they trend from here. Consumables, really strong in the quarter, drove a nice gross margin quarter. SPRINT has a bit of a different gross margin profile relative to FLEX and MAX. And now we've a little bit more visibility on Prosigna and how that's likely to trend here over the next few quarters. Can you give us a bit of a refresher on what the puts and takes are in terms of product mix relative to gross margin, excluding companion diagnostics' collaboration revenues, and just to help us think about how it evolves into next year? Thanks.

James Algot Johnson
Chief Financial Officer

A

Sure. So I think that our consumables – the most important concept, I think, is that our consumable revenues have much higher gross margin than instruments. But there are some finer points within each of those. Obviously, Prosigna is a high-value assay that we make at large scale, and it's probably the most profitable of any of our assays. And then the panels that we produce, which are growing significantly, are also high-margin within the world of consumables. And so as we displace custom assays with panels, that should help to drive higher margins as well within the consumable area.

As far as instruments are concerned, we don't really have the opportunity to gain leverage there like we do on consumables, because we're outsourcing the manufacturing of all our systems. And so – but with the launch of SPRINT, we do believe that over time, as we get to kind of normalized production volumes, that that will slightly improve our margins with respect to instruments.

So putting that all together, we feel we have conviction that over the next several years, as we continue to grow our business, particularly with scale on the consumables side, that our gross margins will continue to increase. And long-term, we think that overall gross margins in the 60% to 70% range are likely.

Steve C. Beuchaw
Morgan Stanley & Co. LLC

Q

Got it. Thanks so much, guys.

Operator: Thank you. And our next question comes from the line of Doug Schenkel with Cowen and Company. Your line is now open.

Doug Schenkel
Cowen & Co. LLC

Q

Okay. Thank you, and good afternoon, guys. My first question – actually, probably the first couple are just clarifying questions on guidance. So, full-year revenue guidance is unchanged. Collaboration revenue, I believe, has gone up by $1 million at the midpoint. Prosigna, I believe, you increased by about $0.5 million, so the offset clearly appears to be the balance of product and services revenue. It sounds like Q3 instrument revenue was a bit weaker than you expected, but you said this was largely a timing dynamic. So in terms of just trying to kind of pull this all together, relative to your original expectations, have you lowered consumable revenue for the year?

Robert Bradley Gray
President, Chief Executive Officer & Director

A

Yeah, this is Brad. I'll take it, Doug. I think as we set guidance for the beginning of the year, we had hoped that some of the dynamics that we observed around consumable revenue in the second half and specifically in the fourth quarter that we experienced in 2014 would repeat themselves. You may – people who were following us at that time may recall we had an extraordinary Q4 consumable quarter in 2014, and we attributed that to several large biopharma orders that totaled over a $1 million in orders from a single customer. And as we approached the end of the year where we actually have visibility into the sales funnel, we can see now that that is not going to repeat itself. That Q4 budget flush associated with consumables is not likely to repeat in 2015. And so I think that is the primary difference between our earlier outlook and our current one.

Doug Schenkel
Cowen & Co. LLC

Q

Okay. That's helpful. So I guess with that in mind, we shouldn't, I guess, accordingly expect the same type of drop-off we saw from Q4 to Q1? You would expect something that's a little smoother than that?

Robert Bradley Gray
President, Chief Executive Officer & Director

A

You mean as we began to look through Q1 2016?

Doug Schenkel
Cowen & Co. LLC

Q

Yes. Well, what you talked about was really – you had a budget flush in Q4, and that made Q1 a little bit tougher. So really what you're saying is you would expect a more normalized Q4-to-Q1 sequence.

Robert Bradley Gray
President, Chief Executive Officer & Director

A

Yes. I think that's right, Doug, because I don't think we're going to see the spike in Q4 2015 that we saw in Q4 2014.

Doug Schenkel
Cowen & Co. LLC

Q

Okay. So then turning to instruments, in 2013, 41% of full-year instrument sales occurred in Q4. In 2014, this dropped to a still robust 35% of the total. So given what you said about SPRINT not impacting demand for MAX and FLEX, your guidance for SPRINT, the timing dynamic you talked about in Asia Pac, and then just normal seasonality, are you comfortable that in Q4 you can do 35% to 40% of total instrument sales for the year?

Robert Bradley Gray
President, Chief Executive Officer & Director

A

Yes. I believe we are, Doug, and I think there's a few different things contributing to that. One is, of course, 10 SPRINT systems which is our approximate estimation for what the contribution is there. That's a new product cycle that's being layered in. Two is, of course, the normal seasonality that we've experienced in each of those years. And three is a series of sales reps and expansion of the field force that was layered in late last year and early this year, and those sales reps are now becoming effective. We usually find that sales reps take six to nine months in the field before they become effective. So when we put all those pieces together, when we look at the overall funnel, it's the strongest we've ever had with respect to instruments.

Doug Schenkel
Cowen & Co. LLC

Q

Okay, and one last one. One area of focus for some of us in the past has been on your visibility on instrument placements through distributors in Asia Pac. In the past, it's been pretty rare where you got surprised. It seems like you were surprised in the quarter. Can you just describe what steps you took to make sure that there's no other surprise in Q4? Presumably, you dug in here a little bit more than normal. So anything you could share there would be helpful. Thank you.

Robert Bradley Gray
President, Chief Executive Officer & Director

A

Sure. So maybe just a little bit of how we manage Asia overall. We manage our Asian region out of Singapore, where we have a small staff there who manage some direct markets, and then also coordinate very closely with our distributors. Our sales leadership also visits Asia quarterly, and they visit Asia near the very end of the third quarter of – just a few months ago, and had a chance to meet face-to-face with many of our distributors in that region, and get a very clear sense of what was and wasn't in the funnel. So I'd say that's how we've gotten the visibility that we're communicating here. Just in terms of the trends, Asia's a big place, so the trends that we're seeing within Asia so far this year, really maybe isolating the weakness a little bit more that we experienced in Q3. The sales were weakest in Japan and the Australia-New Zealand area, and were relatively stable in China. And I think it gets to be law of small numbers if you slice the region up, but that's what our due diligence has unearthed so far.

Doug Schenkel
Cowen & Co. LLC

Q

Okay. Thanks, Brad. I appreciate it.

Operator: Thank you. And our next question comes from the line of Catherine Ramsey with Robert W. Baird. Your line is now open.

Catherine W. Ramsey
Robert W. Baird & Co., Inc. (Broker)

Q

Thanks, guys, for taking the questions. Can you provide any more color on what the mix was for Prosigna in terms of U.S. versus international in the third quarter? And then, if you've seen any change in the U.S. since Palmetto and since other MAX came on board?

Robert Bradley Gray
President, Chief Executive Officer & Director

A

Sure. So the revenue split for Signa was about 60% North America – I'm sorry, I got that backwards. Jim's correcting me. It was about 60% ex-North America, 40% North America. We saw growth in both regions sequentially and year-on-year. I wouldn't attribute any of that growth, though, to the Palmetto decision. As we've said in the prepared remarks the Palmetto reimbursement became effective on October 1, and so, of course, that was beyond the end of the quarter. And then in addition, we expect that Medicare reimbursement to take time to play through first – for physicians to become aware of it, and for physicians to begin to make trial usage of Prosigna, and then finally for labs to respond to that demand by ordering kits. So we did not experience an increase associated with Palmetto during the third quarter. I'd say I do not think we should expect to see it in the fourth quarter either. I think it will take time to gradually impact Prosigna kit sales in the quarters ahead.

Catherine W. Ramsey
Robert W. Baird & Co., Inc. (Broker)

Q

Okay. That's helpful. And then for the overall pull-through number you talk about exceeding $100,000 per system per year, does that average include SPRINT systems, or is that only for MAX and FLEX?

Robert Bradley Gray
President, Chief Executive Officer & Director

A

Today, it includes SPRINT systems, but in the long run we would expect a differential pull-through on SPRINTs versus the MAX and FLEX. But for now with only six SPRINTs sold to date, SPRINT overall is not affecting our pull-through for the fourth quarter, and the third quarter.

Catherine W. Ramsey
Robert W. Baird & Co., Inc. (Broker)

Q

All right. Great. Thank you.

Operator: Thank you. And our next question comes from the line of Dane Leone with BTIG. Your line is now open.

Dane Leone
BTIG LLC

Q

Hi. Thanks, guys. Hopefully you can hear me. I apologize. I'm in an airport right now. Going on Prosigna again, how much do you see in terms of new accounts starting to [ph] test (40:12) versus increased volumes at existing accounts, as you've seen higher revenues or higher utilization post some of these guideline inclusions?

Robert Bradley Gray
President, Chief Executive Officer & Director

A

Sure. So, I think the question, Dane, was how much of the sequential growth came from new accounts versus account just growing their book of business. It's very small numbers [inaudible] (40:40) was there, but reasonably modest between the second and third quarter. I'd say most of our revenues in the third quarter came from accounts who were already active at the beginning of the quarter. And again, just to reiterate, I do not attribute any of the sequential growth from Q2 to Q3 to the improving reimbursement situation with respect to Medicare, because that reimbursement was not effective during the quarter.

Dane Leone
BTIG LLC

Q

Okay; great. And then on the three unnamed partnerships that you announced you had signed during the third quarter, can you give us any color in terms of the nature of those relationships, kind of compared to what you have with Merck and Celgene existing?

Robert Bradley Gray
President, Chief Executive Officer & Director

A

Sure. So these are very different types of relationships compared with Celgene and Merck's relationships. These are very small exploratory pilot or feasibility studies where we make available our assays such as Prosigna with a subtyping feature enabled, or the DLBCL subtyping test. We make those available to a drug company to view – to determine whether or not the test predicts response to their therapy and development, usually on a small number of samples from a trial that they've already conducted. And this is really exploratory, and the idea would be that in those cases where it turns out that one of the subtypes or test outputs is predictive, that we can then get into a more serious conversation with that biopharma company about a companion diagnostic partnership. So I think of these as nominal in terms of their economics, but hopefully setting the stage for much more substantial companion diagnostic partnerships in the future.

Dane Leone
BTIG LLC

Q

Great; thank you.

Operator: Thank you. And our next question comes from the line of Dan Leonard with Leerink Partners. Your line is now open.

Michael A. Sarcone
Leerink Partners LLC

Q

This is Mike Sarcone filling in for Dan. Just one question from me. You had mentioned, in terms of investment spending for next year one of the prongs is a continued buildout of the sales channel. Could you just give us any color or frame that in terms of head count and timing through the course of the year?

Robert Bradley Gray
President, Chief Executive Officer & Director

A

Hi. This is Brad. I'll take it. Yes, I think we're in the midst of our – the one area that it's very clear we're watching closely and evaluating is the SPRINT launch. And SPRINT has substantially increased our ability to reach individual researchers and institutions who wouldn't have been able to afford Prosigna – I'm sorry; the nCounter system in the past. And so we're looking at that, and we're watching that funnel build, and we're working as a leadership team to make sure that we're making the right investments to maximize that opportunity.

Now that's not going to necessarily mean a very substantial increase in our field force than the sales reps who are actually out in their territories. But what it will more likely mean is an investment in a new inside sales capability at NanoString that would help to relieve the field-based resources of some of the burdens of consumable sales. And that's something that we've piloted here over the last year and we've shown it can be very effective, having really Seattle headquarters-based staff who are helping support consumables sales, keeping our instrument reps focused on moving the new instrument sales. So that will require some additional head count. We would probably execute that expansion relatively early in the year once we've gotten a handle on what the right mix of field-based and inside sales resources are.

Michael A. Sarcone
Leerink Partners LLC

Q

Okay. Thank you.

Operator: Thank you. And I'm showing no further questions at this time. I would now like to turn the call back to Brad Gray for any closing remarks.

Robert Bradley Gray
President, Chief Executive Officer & Director

Thank you. We appreciate you taking an interest in our call – joining our call today, and we look forward to seeing you at some of the upcoming meetings. We'll be at the AMP meeting in Austin later this week as well as the CISI meeting near the end of the week in Maryland. Hope to see some of you there. Thank you.

Operator: Ladies, and gentlemen, thank you for participating in today's call. That does conclude the conference. You may all disconnect. Everyone have a great day.