NanoString Technologies Inc
Form 10-Q
August 08, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018
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 001-35980

NANOSTRING TECHNOLOGIES, INC.
(Exact name of registrant as specified in its charter)

Delaware	20-0094687
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

530 Fairview Avenue North
Seattle, Washington 98109
(Address of principal executive offices)
(206) 378-6266
(Registrant's telephone number, including area code)

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 ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý 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	ý
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨
Emerging growth company	ý		

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
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). ¨

As of August 3, 2018 there were 29,787,812 shares of registrant’s common stock outstanding.

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NANOSTRING TECHNOLOGIES, INC.
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FOR THE QUARTER ENDED JUNE 30, 2018
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PART 1. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

NanoString Technologies, Inc.
Condensed Consolidated Balance Sheets
(in thousands, except par value)
(Unaudited)

	June 30, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$24,286	$26,136
Short-term investments	26,406	51,419
Accounts receivable, net	17,387	19,564
Inventory, net	17,596	20,057
Prepaid expenses and other	5,934	4,745
Total current assets	91,609	121,921
Restricted cash	—	143
Property and equipment, net	14,453	14,057
Other assets	655	641
Total assets	$106,717	$136,762
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$5,107	$4,092
Accrued liabilities	3,801	4,507
Accrued compensation and other employee benefits	7,977	8,634
Customer deposits	9,502	8,945
Deferred revenue, current portion	9,878	9,229
Deferred rent, current portion	582	512
Total current liabilities	36,847	35,919
Deferred revenue, net of current portion	3,264	3,304
Deferred rent and other long-term liabilities	8,263	8,499
Long-term debt, net of debt issuance costs	49,725	48,931
Total liabilities	98,099	96,653
Commitment and contingencies		
Stockholders' equity:		
Preferred stock, $0.0001 par value, 15,000 shares authorized; none issued	—	—
Common stock, $0.0001 par value, 150,000 shares authorized; 25,785 and 25,421 shares issued and outstanding at June 30, 2018 and December 31, 2017, respectively	3	2
Additional paid-in capital	362,340	353,308
Accumulated other comprehensive loss	(66)	(99)
Accumulated deficit	(353,659)	(313,102)
Total stockholders' equity	8,618	40,109
Total liabilities and stockholders' equity	$106,717	$136,762

The accompanying notes are an integral part of these condensed consolidated financial statements.

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NanoString Technologies, Inc.
Condensed Consolidated Statements of Operations
(in thousands, except per share amounts)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenue:				
Product and service	$20,384	$18,310	$38,429	$34,075
Collaboration	4,615	16,282	9,655	18,581
Total revenue	24,999	34,592	48,084	52,656
Costs and expenses:				
Cost of product and service revenue	8,552	8,224	16,247	15,387
Research and development	14,585	11,038	28,417	21,839
Selling, general and administrative	20,649	18,644	40,086	36,210
Total costs and expenses	43,786	37,906	84,750	73,436
Loss from operations	(18,787)	(3,314)	(36,666)	(20,780)
Other income (expense):				
Interest income	204	150	442	297
Interest expense	(1,604)	(1,528)	(3,167)	(3,029)
Other income (expense), net	(349)	184	(284)	197
Total other income (expense), net	(1,749)	(1,194)	(3,009)	(2,535)
Net loss before provision for income tax	(20,536)	(4,508)	(39,675)	(23,315)
Provision for income tax	(65)	(47)	(128)	(92)
Net loss	$(20,601)	$(4,555)	$(39,803)	$(23,407)
Net loss per share - basic and diluted	$(0.80)	$(0.20)	$(1.55)	$(1.06)
Weighted average shares used in computing basic and diluted net loss per share	25,757	22,672	25,619	22,121

The accompanying notes are an integral part of these condensed consolidated financial statements.

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NanoString Technologies, Inc.
Condensed Consolidated Statements of Comprehensive Loss
(in thousands)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net loss	$(20,601)	$(4,555)	$(39,803)	$(23,407)
Change in unrealized gain (loss) on short-term investments	46	(5)	33	4
Comprehensive loss	$(20,555)	$(4,560)	$(39,770)	$(23,403)

The accompanying notes are an integral part of these condensed consolidated financial statements.

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NanoString Technologies, Inc.
Condensed Consolidated Statements of Cash Flows
(in thousands)
(Unaudited)

	Six Months Ended June 30,	
	2018	2017
Operating activities		
Net loss	$(39,803)	$(23,407)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	2,017	1,661
Stock-based compensation expense	5,848	5,109
Amortization of premium on short-term investments	36	78
Interest accrued on long-term debt	88	85
Conversion of accrued interest to long-term debt	747	724
Provision for bad debts	445	201
Provision for inventory obsolescence	45	—
Changes in operating assets and liabilities:		
Accounts receivable	1,727	3,515
Inventory	1,636	(2,472)
Prepaid expenses and other	(1,207)	(1,506)
Other assets	(2)	(87)
Accounts payable	1,127	(392)
Accrued liabilities	(501)	1,017
Accrued compensation and other employee benefits	(621)	(1,669)
Customer deposits	557	164
Deferred revenue	(145)	(13,307)
Deferred rent and other liabilities	(254)	1,320
Net cash used in operating activities	(28,260)	(28,966)
Investing activities		
Purchases of property and equipment	(1,732)	(3,384)
Proceeds from sale of short-term investments	5,410	1,000
Proceeds from maturity of short-term investments	25,600	28,474
Purchases of short-term investments	(6,000)	(34,785)
Net cash provided by (used in) investing activities	23,278	(8,695)
Financing activities		
Repayment of lease financing obligations	—	(58)
Proceeds from sale of common stock, net	—	56,486
Proceeds from issuance of common stock warrants	1,423	—
Deferred financing costs	(63)	—
Tax withholdings related to net share settlements of restricted stock units	(108)	(248)
Proceeds from issuance of common stock for employee stock purchase plan	767	926
Proceeds from exercise of stock options	994	601
Net cash provided by financing activities	3,013	57,707
Net (decrease) increase in cash, cash equivalents and restricted cash	(1,969)	20,046
Effect of exchange rate changes on cash and cash equivalents and restricted cash	(24)	18
Cash and cash equivalents and restricted cash		
Beginning of period	26,279	20,726
End of period	$24,286	$40,790

Reconciliation of cash and cash equivalents and restricted cash at end of period:		
Cash and cash equivalents	$24,286	$40,647
Restricted cash	—	143
Cash and cash equivalents and restricted cash at end of period	$24,286	$40,790

The accompanying notes are an integral part of these condensed consolidated financial statements.

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NanoString Technologies, Inc.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

1. Description of the Business

NanoString Technologies, Inc. (the "Company") was incorporated in the state of Delaware on June 20, 2003. The Company's headquarters is located in Seattle, Washington. The Company's technology enables direct detection, identification and quantification of individual target molecules in a biological sample by attaching a unique color coded fluorescent reporter to each target molecule of interest. The Company markets its proprietary nCounter Analysis System, consisting of instruments and consumables, including its Prosigna Breast Cancer Assay, to academic, government, biopharmaceutical and clinical laboratory customers. In addition, the Company is collaborating with biopharmaceutical companies to develop companion diagnostic tests for various cancer therapies. The Company has incurred losses to date and expects to incur additional losses for the foreseeable future. The Company continues to invest the majority of its resources in the development and growth of its business, including significant investments in new product development and sales and marketing efforts. The Company's activities have been financed primarily through the sale of equity securities and incurrence of indebtedness, and to a lesser extent, the incurrence of capital leases and other borrowings.

In January 2018, the Company entered into a Sales Agreement with a sales agent to sell shares of the Company's common stock through an "at the market" equity offering program for up to $40.0 million in gross cash proceeds. The Sales Agreement allows the Company to set the parameters for the sale of shares, including the number of shares to be issued, the time period during which sales are requested to be made, limits on the number of shares that may be sold in any one trading day and a minimum price below which sales may not be made. Under the terms of the Sales Agreement, commission expenses to the sales agent will be 3% of the gross sales price per share sold through the sales agent. The Sales Agreement shall automatically terminate upon the issuance and sale of shares that provide gross proceeds of $40.0 million and may be terminated earlier by either the Company or the sales agent upon five days' notice.

2. Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements reflect the accounts of the Company and its wholly-owned subsidiaries. The unaudited condensed consolidated balance sheet at December 31, 2017 has been derived from the audited consolidated financial statements at that date but does not include all of the information and disclosures required by generally accepted accounting principles in the United States of America ("U.S. GAAP") for annual financial statements. These unaudited condensed consolidated financial statements and notes should be read in conjunction with the Company's audited consolidated financial statements and accompanying notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission ("SEC") and U.S. GAAP for unaudited condensed consolidated financial information. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. The accompanying unaudited condensed consolidated financial statements reflect all adjustments consisting of normal recurring adjustments which, in the opinion of management, are necessary for a fair statement of the Company's financial position and results of its operations as of and for the periods presented. Unless indicated otherwise, all amounts presented in financial tables are presented in thousands, except for per share and par value amounts.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The results of the Company's operations for the three and six month periods ended June 30, 2018 are not necessarily indicative of the results to be expected for the full year or for any other period.

Reclassifications

Certain reclassifications have been made to prior year financial statements to conform to current year presentation.

Revenue Recognition

The Company recognizes revenue when control of the promised goods or services are transferred to its customers, in an amount that reflects the consideration expected to be received in exchange for those products and services. This process

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involves identifying the contract with a customer, determining the performance obligations in the contract, determining the contract price, allocating the contract price to the distinct performance obligations in the contract, and recognizing revenue when the performance obligations have been satisfied. A performance obligation is considered distinct from other obligations in a contract when it provides a benefit to the customer either on its own or together with other resources that are readily available to the customer and is separately identified in the contract. Performance obligations are considered satisfied once the Company has transferred control of a product or service to the customer, meaning the customer has the ability to use and obtain the benefit of the product or service. The Company recognizes revenue for satisfied performance obligations only when there are no uncertainties regarding payment terms or transfer of control.

The Company generates the majority of its revenue from the sale of products and services. The Company's products consist of its proprietary nCounter Analysis Systems and related consumables. Services consist of instrument service contracts and service fees for assay processing.

Revenue from instruments, consumables and in vitro diagnostic kits is recognized generally upon delivery to the end customer, which is when title of the product has been transferred to the customer. Instrument revenue related to installation and calibration services is recognized when the customer has possession of the instrument and the services have been performed. Such services can also be provided by the Company's distribution partners and other third parties. For instruments sold solely to run Prosigna assays, an initial training course must be provided by the Company prior to instrument revenue recognition.

Instrument service contracts are sold with contract terms ranging from 12–36 months and cover periods after the end of the initial 12-month warranty. These contracts include services to maintain performance within the Company's designed specifications and a minimum of one preventative maintenance service procedure during the contract term. Revenue from services to maintain designed specifications is considered a stand-ready obligation and recognized evenly over the contract term and service revenue related to preventative maintenance of instruments is recognized when the procedure is completed. Revenue from service fees for assay processing is recognized upon the rendering of the related performance obligation.

For arrangements with multiple performance obligations, the Company allocates the contract price in proportion to its stand-alone selling price. The Company uses its best estimate of stand-alone selling price for its products and services based on average selling prices over a 12-month period and reviews its stand-alone prices annually.

Product and service revenues from sales to customers through distributors are recognized consistent with the terms of direct sales to customers.

The Company enters into collaborative agreements that may generate upfront fees with subsequent milestone payments that may be earned upon completion of development-related milestones. The Company is able to estimate the total cost of services under these arrangements and recognizes collaboration revenue using a contingency-adjusted proportional performance model. Costs incurred to date compared to total expected costs are used to determine proportional performance, as this is considered to be representative of the delivery of outputs under the arrangements. Revenue recognized at any point in time is limited to cash received, amounts contractually due, and a development-related milestone when achievement is probable. Changes in estimates of total expected costs are accounted for prospectively as a change in estimate. From period to period, collaboration revenue can fluctuate substantially based on the achievement or probable achievement of development-related milestones. The Company recognizes revenue from collaborative agreements that do not include upfront and/or milestone-based payments when earned. Amounts due to collaboration partners are recognized when the related activities have occurred and are classified in the statement of operations, generally as research and development expense, based on the nature of the related activities.

Recently Adopted Accounting Pronouncement

In May 2014, the Financial Accounting Standards Board ("FASB") issued "ASU 2014-09, Revenue from Contracts with Customers." The standard requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to a customer. In March 2016, the FASB issued "ASU 2016-08, Principal vs Agent Considerations (Reporting Revenue Gross versus Net)" which clarifies the implementation guidance on principal versus agent considerations. In April 2016, the FASB issued "ASU 2016-10, Identifying Performance Obligations and

Licensing" which clarifies the implementation guidance on identifying performance obligations and the licensing implementation guidance. In May 2016, the FASB issued "ASU 2016-12, Narrow-Scope Improvements and Practical Expedients" which provides practical expedients for contract modifications and clarification on assessing the collectability criterion, presentation of sales taxes, measurement date for non-cash consideration and completed contracts at transition. The standards require an entity to recognize the amount of revenue which it expects to be entitled for the transfer of promised goods or services to a customer. This guidance replaces most existing revenue recognition guidance and requires more extensive disclosures related to revenue recognition, particularly in quarterly financial statements. A cumulative effect of applying the new revenue standard has been recognized as an adjustment to the opening balance of retained earnings as of January 1, 2018, using the modified retrospective

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transition method. The comparative information has not been restated and continues to be reported under the accounting standards in effect for the period presented.

See Note 3. Revenue from Contracts with Customers, for additional accounting policy and transition disclosures.

In January 2016, FASB issued “ASU 2016-01, Financial Instruments: Overall.” The standard addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The Company adopted the standard in the first quarter of 2018 and adoption did not have a material impact on its consolidated results of operations, financial condition, cash flows, and financial statement disclosures.

In August 2016, FASB issued “ASU No. 2016-15, Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments.” The standard provides guidance on the presentation of certain cash receipts and cash payments in the statement of cash flows in order to reduce diversity in existing practice. The Company adopted the standard in the first quarter of 2018 and there was no material impact on its consolidated results of operations, financial condition, cash flows, and financial statement disclosures.

In November 2016, FASB issued “ASU 2016-18, Statement of Cash Flows: Restricted Cash.” The standard requires companies to include amounts generally described as restricted cash and restricted cash equivalents, along with cash and cash equivalents, when reconciling the beginning-of-period and end-of-period amounts shown on the statement of cash flows. The Company adopted the standard in the first quarter of 2018 using the retrospective transition method and reflected the impact of this standard in its consolidated cash flows.

In May 2017, FASB issued “ASU 2017-09, Compensation - Stock Compensation: Scope of Modification Accounting.” The standard clarifies which changes to the terms or conditions of a share-based payment award are required to be accounted for as modifications. The Company adopted the standard in the first quarter of 2018 prospectively and adoption did not have an impact on its consolidated results of operations, financial condition, cash flows, and financial statement disclosures.

Recent Accounting Pronouncements

As an “emerging growth company,” the Jumpstart Our Business Startups Act allows the Company to delay adoption of new or revised accounting pronouncements until December 31, 2018, applicable to public companies until such pronouncements are made applicable to private companies. As a result, its financial statements may not be comparable to the financial statements of issuers who are required to comply with the effective dates for new or revised accounting standards that are applicable to public companies.

In February 2016, FASB issued “ASU 2016-02, Leases – Recognition and Measurement of Financial Assets and Financial Liabilities.” The standard requires the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition. The standard requires lessors to classify leases as either sales-type, finance or operating. A sales-type lease occurs if the lessor transfers all of the risks and rewards, as well as control of the underlying asset, to the lessee. If risks and rewards are conveyed without the transfer of control, the lease is treated as a financing lease. If the lessor does not convey risks and rewards or control, an operating lease results. The standard will become effective for the Company beginning January 1, 2019 with early adoption permitted. The Company is currently assessing the impact adoption of this standard will have on its consolidated results of operations, financial condition, cash flows, and financial statement disclosures, and currently expects that most of its operating lease commitments will be recognized as right-of-use assets and operating lease liabilities upon the adoption of ASU 2016-02, which will increase the total assets and liabilities that the Company reports relative to such amounts prior to adoption.

In June 2016, FASB issued “ASU 2016-13, Financial Instruments: Credit Losses.” The standard provides information about expected credit losses on financial instruments at each reporting date, and to change how other than temporary impairments on investments securities are recorded. The standard will become effective for the Company beginning January 1, 2020 with early adoption permitted. The Company is currently assessing the impact adoption of this standard will have on its consolidated results of operations, financial condition, cash flows, and financial statement disclosures.

In February 2018, FASB issued “ASU 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.” The new guidance permits

companies to reclassify the stranded tax effects of the Tax Cuts and Jobs Act (the "Act") on items within accumulated other comprehensive income to retained earnings. This standard will become effective for the Company beginning January 1, 2019 with early adoption permitted. The Company is currently assessing the impact adoption of this standard will have on its consolidated results of operations, financial condition, cash flows, and financial statement disclosures.

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3. Revenue from Contracts with Customers

On January 1, 2018, the Company adopted the new standard for revenue recognition provided in “ASU 2014-09, Revenue from Contracts with Customers” and has applied the modified retrospective transition method to all contracts that were not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under the new standard, while prior period amounts are not adjusted and continue to be reported under the accounting standards in effect for the prior period. The Company recorded a transition adjustment which reduced opening retained earnings by $0.8 million as of January 1, 2018 due to the cumulative impact of adopting the new revenue standard. The Company's revenues for the three and six months ended June 30, 2018 included the recognition of $0.2 million and $0.4 million, respectively, as a result of adopting the new revenue standard and satisfying certain performance obligations during the period.

The Company has determined that its collaborative agreements fall within the scope of ASC 808, Collaborative Arrangements, and intends to apply the principles of ASC 606, Revenue from Contracts with Customers, in the measurement and recognition of revenue. In addition, the Company has concluded that when service contracts are sold as part of a bundled arrangement with other products and services, these contracts will no longer be accounted for under separate accounting guidance, but rather included as a separate performance obligation within a contract subject to the new standard, which includes their inclusion in the determination and allocation of the aggregate transaction price, and recognition of revenue upon the delivery of the performance obligation.

Performance obligations

Performance obligations related to instrument sales are reviewed on a contract-by-contract basis, as individual contract terms may vary, and may include installation and calibration services. For instruments sold solely to run Prosigna assays, training to the customer is a required performance obligation. Performance obligations for the Company's consumable products are generally completed upon shipment to the customer.

Disaggregated Revenues

The following table provides information about disaggregated revenue by major product line and primary geographic market (in thousands):

	Three Months Ended June 30, 2018				Six Months Ended June 30, 2018			
	Americas	Europe and Middle East	Asia Pacific	Total	Americas	Europe and Middle East	Asia Pacific	Total
Product revenue:								
Instruments	$3,131	$1,555	$802	$5,488	$5,817	$3,040	$1,305	$10,162
Consumables	6,801	2,872	608	10,281	12,961	5,249	1,428	19,638
In vitro diagnostic kits	918	1,516	87	2,521	1,599	2,913	175	4,687
Total product revenue	10,850	5,943	1,497	18,290	20,377	11,202	2,908	34,487
Service revenue	1,540	449	105	2,094	2,801	948	193	3,942
Total product and service revenue	12,390	6,392	1,602	20,384	23,178	12,150	3,101	38,429
Collaboration revenue	4,615	—	—	4,615	9,655	—	—	9,655
Total revenues	$17,005	$6,392	$1,602	$24,999	$32,833	$12,150	$3,101	$48,084

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	Three Months Ended June 30, 2017				Six Months Ended June 30, 2017			
	Americas	Europe and Middle East	Asia Pacific	Total	Americas	Europe and Middle East	Asia Pacific	Total
Product revenue:								
Instruments	$3,029	$1,653	$1,353	$6,035	$5,843	$2,840	$1,822	$10,505
Consumables	6,537	2,067	590	9,194	12,120	4,195	1,471	17,786
In vitro diagnostic kits	697	1,105	33	1,835	1,178	2,021	75	3,274
Total product revenue	10,263	4,825	1,976	17,064	19,141	9,056	3,368	31,565
Service revenue	796	412	38	1,246	1,830	597	83	2,510
Total product and service revenue	11,059	5,237	2,014	18,310	20,971	9,653	3,451	34,075
Collaboration revenue	16,282	—	—	16,282	18,581	—	—	18,581
Total revenues	$27,341	$5,237	$2,014	$34,592	$39,552	$9,653	$3,451	$52,656

Contract balances and remaining performance obligations

Contract liabilities are included in the current and long-term portions of deferred revenue of $13.1 million and $12.5 million as of June 30, 2018 and December 31, 2017, respectively, and within customer deposits of $9.5 million and $8.9 million as of June 30, 2018 and December 31, 2017, respectively, on the condensed consolidated balance sheets. Total contract liabilities increased by $1.2 million for the six months ended June 30, 2018 as a result of cash payments received of $11.4 million related to our collaborations and service contracts, partially offset by the recognition of previously deferred revenue of $10.4 million for the completion of certain performance obligations during the period. The Company did not record any contract assets as of June 30, 2018.

Unsatisfied or partially unsatisfied performance obligations related to collaboration agreements as of June 30, 2018 were $17.5 million and are expected to be completed over the period of each collaboration agreement, through June 2020. Performance obligations related to product and service contracts as of June 30, 2018 were $5.1 million and are expected to be completed over the term of the related contract, through April 2023.

Practical expedients

The Company generally recognizes expense related to the acquisition of contracts, such as sales commissions, at the time of revenue recognition, which is generally in the same period products are sold, and in the case of services, revenue is recognized as services are rendered or over the period of time covered by the service contract, which is typically 12-months from the sale. The Company has not established any contract assets or liabilities related to contract acquisition costs as of June 30, 2018. The Company records commission expenses within selling, general and administrative expenses.

Impact of new revenue standard

In accordance with the new revenue guidance, the disclosure of the impact of adoption of this new standard to our condensed consolidated statements of operations and balance sheets was as follows:

	Three Months Ended June 30, 2018			Six Months Ended June 30, 2018		
(in thousands, except per share amounts)	As Reported	Amounts under previous revenue standard	Effect of Change	As Reported	Amounts under previous revenue standard	Effect of Change
Revenue:						
Product and service	$20,384	$20,224	$ 160	$38,429	$38,030	$ 399
Collaboration	4,615	4,615	—	9,655	9,655	—
Total revenue	24,999	24,839	160	48,084	47,685	399
Net loss	$(20,601)	$(20,761)	$ 160	$(39,803)	$(40,202)	$ 399

Net loss per share - basic and diluted	$(0.80)	$(0.81)	$ 0.01	$(1.55)	$(1.57)	$ 0.02

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(in thousands)	June 30, 2018 As Reported	Balances under previous revenue standard	Effect of Change
Liabilities:			
Deferred revenue, current portion	$9,878	$9,523	$ 355
Stockholders' equity			
Accumulated deficit	$(353,659)	$(353,304)	$ (355)

The adoption of the new revenue standard did not have an aggregate impact on the Company's net cash provided by operating activities, but resulted in offsetting changes in certain liabilities presented within net cash provided by operating activities in the Company's condensed consolidated statement of cash flows, as reflected in the above tables.

4. Net Loss Per Share

Net loss per share is computed by dividing the net loss by the weighted average number of shares of common stock outstanding. Outstanding stock options, restricted stock units and warrants have not been included in the calculation of diluted net loss per share because to do so would be anti-dilutive. Accordingly, the numerator and the denominator used in computing both basic and diluted net loss per share for each period are the same.

The following shares underlying outstanding options, restricted stock units and warrants were excluded from the computation of basic and diluted net loss per share for the periods presented because their effect would have been anti-dilutive (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Options to purchase common stock	5,525	5,409	5,595	5,284
Restricted stock units	1,193	272	1,106	255
Common stock warrants	468	332	413	332

5. Concentration of Risks

Financial instruments that potentially expose the Company to concentrations of credit risk consist principally of cash and cash equivalents, short-term investments and accounts receivable. Cash is invested in accordance with the Company's investment policy, which includes guidelines intended to minimize and diversify credit risk. Most of the Company's investments are not federally insured. The Company has credit risk related to the collectability of its accounts receivable. The Company performs initial and ongoing evaluations of its customers' credit history or financial position and generally extends credit on account without collateral. The Company has not experienced any significant credit losses to date.

The Company had one customer/collaborator, Lam Research Corporation ("Lam") that individually represented 16% and 17% of total revenue during the three and six months ended June 30, 2018, respectively. During the three months ended June 30, 2017, the Company had two customers/collaborators, Medivation, Inc. ("Medivation") and Astellas Pharma Inc. ("Astellas"), and Merck Sharp & Dohme Corp., a subsidiary of Merck & Co., Inc. ("Merck") that individually represented 33% and 13% of total revenue, respectively. During the six months ended June 30, 2017, Medivation and Astellas, and Merck represented 21% and 13% of total revenue, respectively. The Company had no customers or collaborators that represented more than 10% of total accounts receivable as of June 30, 2018 or December 31, 2017.

The Company is also subject to supply chain risks related to the outsourcing of the manufacturing and production of its instruments to sole suppliers. Although there are a limited number of manufacturers for instruments of this type, the Company believes that other suppliers could provide similar products on comparable terms. Similarly, the Company sources certain raw materials used in the manufacture of consumables from certain sole suppliers. A change in suppliers could cause a delay in manufacturing and a possible loss of sales, which would adversely affect operating

results.

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6. Short-term Investments

Short-term investments consisted of available-for-sale securities as follows (in thousands):

Type of securities as of June 30, 2018	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Corporate debt securities	$ 17,500	$ —	$ (24)	$ 17,476
U.S. government-related debt securities	8,973	—	(43)	8,930
Total available-for-sale securities	$ 26,473	$ —	$ (67)	$ 26,406

Type of securities as of December 31, 2017	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Corporate debt securities	$ 35,567	$ —	$ (53)	$ 35,514
U.S. government-related debt securities	15,951	—	(46)	15,905
Total available-for-sale securities	$ 51,518	$ —	$ (99)	$ 51,419

The fair values of available-for-sale securities by contractual maturity were as follows (in thousands):

	June 30, 2018	December 31, 2017
Maturing in one year or less	$ 26,406	$ 39,985
Maturing in one to three years	—	11,434
Total available-for-sale securities	$ 26,406	$ 51,419

The Company has both the intent and ability to sell its available-for-sale investments maturing greater than one year within 12 months from the balance sheet date and, accordingly, has classified these securities as current in the condensed consolidated balance sheets.

The following table summarizes investments that have been in a continuous unrealized loss position as of June 30, 2018 (in thousands).

	Less Than 12 Months		12 Months or Greater		Total	
	Fair value	Gross unrealized losses	Fair value	Gross unrealized losses	Fair value	Gross unrealized losses
Corporate debt securities	$ 9,008	$ (24)	$ —	$ —	$ 9,008	$ (24)
U.S. government-related debt securities	8,930	(43)	—	—	8,930	(43)
Total	$ 17,938	$ (67)	$ —	$ —	$ 17,938	$ (67)

The Company invests in securities that are rated investment grade or better. The unrealized losses on investments as of June 30, 2018 and December 31, 2017 were primarily caused by interest rate increases.

The Company reviews the individual securities in its portfolio to determine whether a decline in a security's fair value below the amortized cost basis is other-than-temporary. The Company determined that as of June 30, 2018, there were no investments in its portfolio that were other-than-temporarily impaired.

7. Fair Value Measurements

The Company establishes the fair value of its assets and liabilities using the price that would be received to sell an asset or paid to transfer a financial liability in an orderly transaction between market participants at the measurement date. A fair value hierarchy is used to measure fair value. The three levels of the fair value hierarchy are as follows:

- Level 1 — Quoted prices in active markets for identical assets and liabilities.
- Level 2 — Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.

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- Level 3 — Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

The recorded amounts of certain financial instruments, including cash, accounts receivable, prepaid expenses and other, accounts payable and accrued liabilities, approximate fair value due to their relatively short-term maturities. The recorded amount of the Company's long-term debt approximates fair value because the related interest rates approximate rates currently available to the Company.

The Company's available-for-sale securities by level within the fair value hierarchy were as follows (in thousands):

As of June 30, 2018	Level 1	Level 2	Level 3	Total
Cash equivalents:				
Money market fund	$16,728	$—	$ —	$16,728
Short-term investments:				
Corporate debt securities	—	17,476	—	17,476
U.S. government-related debt securities	—	8,930	—	8,930
Total	$16,728	$26,406	$ —	$43,134

As of December 31, 2017	Level 1	Level 2	Level 3	Total
Cash equivalents:				
Money market fund	$22,398	$—	$ —	$22,398
Short-term investments:				
Corporate debt securities	—	35,514	—	35,514
U.S. government-related debt securities	—	15,905	—	15,905
Total	$22,398	$51,419	$ —	$73,817

8. Inventory

Inventory consisted of the following as of the date indicated (in thousands):

	June 30, 2018	December 31, 2017
Raw materials	$5,429	$ 5,743
Work in process	5,296	4,845
Finished goods	6,871	9,469
Total inventory	$17,596	$ 20,057

9. Long-term Debt

In April 2014, the Company entered into a term loan agreement under which it could borrow up to $45.0 million, including an option to defer payment of a portion of the interest that would accrue on the borrowing under the term loan agreement. Upon initial closing, the Company borrowed $20.0 million, and in October 2014, the Company borrowed an additional $10.0 million under the term loan agreement.

In October 2015, the Company amended the term loan agreement to, among other provisions, increase the maximum borrowing capacity to $60.0 million (excluding deferred interest), reduce the applicable interest rate from 12.5% to 12.0%, extend the interest-only period through March 2021, and extend the final maturity to March 2022. Under the amended agreement, borrowings accrue interest at 12.0% annually, payable quarterly, of which 3.0% can be deferred during the first six years of the term at the Company's option and paid together with the principal at maturity. The Company has elected to exercise the option to defer payment of a portion of the interest and has recorded $5.1 million of deferred interest through June 30, 2018. In December 2015, the Company borrowed an additional $10.0 million under the terms of the amended agreement. In June 2016, the Company borrowed an additional $5.0 million. At December 31, 2016, the Company's option to borrow $15.0 million more under the amended term loan agreement expired. Total borrowings and deferred interest under the amended term loan agreement were $50.1 million and $49.3 million as of June 30, 2018 and December 31, 2017, respectively.

Under the amended term loan agreement, the Company may pay interest-only for the first seven years of the term and principal payments are due in four equal installments during the eighth year of the term. The amended term loan agreement included a declining redemption fee payable upon prepayment during the first four years after we entered

into the agreement.

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However, this period has lapsed and we have the option to prepay the term loan, in whole or part, at any time, with no penalty. A facility fee equal to 2.0% of the amount borrowed plus any accrued interest is payable at the end of the term or when the loan is repaid in full. A long-term liability of $1.1 million for the facility fee is being accreted using the effective interest method over the term of the loan agreement. Obligations under the term loan agreement are collateralized by substantially all of the Company's assets.

The term loan agreement contains customary conditions to borrowings, events of default and negative covenants, including covenants that could limit the Company's ability to, among other things, incur additional indebtedness, liens or other encumbrances, make dividends or other distributions; buy, sell or transfer assets; engage in any new line of business; and enter into certain transactions with affiliates. The term loan agreement also includes a $2.0 million minimum liquidity covenant and revenue-based financial requirements, specifically $100.0 million for 2018 with annual increases of $15.0 million for each subsequent fiscal year thereafter. If the Company's actual revenue is below the minimum annual revenue requirement for any given year, it may avoid a related default by generating proceeds from an equity or subordinated debt issuance equal to the shortfall between its actual revenue and the minimum revenue requirement.

In January 2018, the Company entered into a $15.0 million secured revolving loan facility, with availability subject to a borrowing base consisting of eligible accounts receivable. The agreement matures in January 2021, at which time the outstanding principal will become due and payable. Interest on borrowings is payable monthly and accrues at a yearly rate equal to the greater of the prime rate, as reported in the Wall Street Journal, plus 0.50% or 4.75%. During an event of default amounts drawn accrue interest at a yearly rate equal to 8.75%. Obligations under the agreement are secured by the Company's cash and cash equivalents, accounts receivable and proceeds thereof, and inventory and proceeds from the sale thereof. The lender's interest in the collateral under the loan facility is senior to the lender's interest in such collateral under the term loan agreement. The loan facility contains various customary representations and warranties, conditions to borrowing, events of default, including cross default provisions with respect to the loan facility, and covenants, including financial covenants requiring the maintenance of minimum annual revenue and liquidity. There were no borrowings under the secured revolving loan facility as of June 30, 2018.

The Company was in compliance with its financial covenants under the term loan agreement and the secured revolving loan facility as of June 30, 2018.

Long-term debt consisted of the following (in thousands):

	June 30, 2018	December 31, 2017
Term loans payable	$50,062	$49,315
Unamortized debt issuance costs	(337)	(384)
Long-term debt, net of debt issuance costs	$49,725	$48,931

Scheduled future principal payments for outstanding debt were as follows at June 30, 2018 (in thousands):

Years Ending December 31,	
Remainder of 2018	$—
2019	—
2020	—
2021	37,547
2022	12,515
	$50,062

10. Collaboration Agreements

The Company evaluates the classification of payments within the statements of operations between the participants in each of its collaboration agreements at inception of the agreement based on the nature of the arrangement, the nature of its business operations and the contractual terms of the arrangement. The Company has determined that amounts to be received from collaborators in connection with the collaboration agreements entered into through June 30, 2018 are related to revenue generating activities.

The Company uses a contingency-adjusted proportional performance model to recognize revenue over the Company's performance period for each collaboration agreement that includes upfront and/or milestone-based payments. Costs

incurred to date compared to total expected costs are used to determine proportional performance, as this is considered to be representative

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of the delivery of outputs under the arrangement. Revenue recognized at any point in time is a factor of and limited to cash received and amounts contractually due. Changes in estimates of total expected costs are accounted for prospectively.

The Company recognizes revenue from collaboration agreements that do not include upfront and/or milestone-based payments when earned, which is generally in the same period related costs are incurred. Amounts due to collaboration partners are recognized when the related activities have occurred and are classified in the statement of operations, generally as research and development expense, based on the nature of the related activities.

Lam Research Corporation

In August 2017, the Company entered into a collaboration agreement with Lam Research Corporation (“Lam”) with respect to the development and commercialization of the Company's Hyb & Seq sequencing platform and related assays. Pursuant to the terms of the collaboration agreement, Lam will contribute up to an aggregate of $50.0 million, payable quarterly, to be applied to the research and development of the Company's Hyb & Seq platform, based on allowable development costs. Lam is eligible to receive certain single-digit percentage royalty payments from the Company on net sales of certain products and technologies developed under the collaboration agreement. The maximum amount of royalties payable to Lam will be capped at an amount up to three times the amount of development funding actually provided by Lam. The Company will retain exclusive rights to obtain regulatory approval, manufacture and commercialize the Hyb & Seq products. Lam will participate in research and product development through a joint steering committee. The Company will reimburse Lam for the cost of up to 10 full-time Lam employees each year in accordance with the product development plan.

In connection with the execution of the collaboration agreement, the Company issued Lam a warrant to purchase up to 1.0 million shares of the Company’s common stock with the number of underlying shares exercisable at any time proportionate to the amount of the $50.0 million commitment that has been provided by Lam. The exercise price of the warrant is $16.75 per share, and the warrant will expire on the seventh anniversary of the issuance date. The warrant was determined to have a fair value of $6.7 million upon issuance, and such amount will be recorded as additional paid in capital proportionately from the quarterly collaboration payments made by Lam.

During the three and six months ended June 30, 2018, the Company recognized collaboration revenue relating to the agreement with Lam of $4.0 million and $8.2 million, respectively. The Company received development funding of $7.9 million and $11.4 million related to the Lam collaboration for the three and six months ended June 30, 2018, respectively. At June 30, 2018, the Company had recorded $1.7 million of deferred revenue related to the Lam collaboration, of which $0.8 million is estimated to be recognizable as revenue within one year. In addition, $9.1 million is included in customer deposits in the condensed consolidated balance sheet as of June 30, 2018 representing amounts received in advance. The Company incurred costs of $0.1 million during the three and six months ended June 30, 2018 related to services provided by Lam employees under the terms of the agreement. During the three and six months ended June 30, 2018, Lam did not exercise any warrants.

Celgene Corporation

In March 2014, the Company entered into a collaboration agreement with Celgene Corporation (“Celgene”) to develop, seek regulatory approval for, and commercialize a companion diagnostic using the nCounter Analysis System to identify a subset of patients with Diffuse Large B-Cell Lymphoma. In February 2018, the Company and Celgene entered into an amendment to their collaboration agreement in which Celgene agreed to provide the Company additional funding for work intended to enable a subtype and prognostic indication for the test being developed under the agreement for Celgene’s drug REVLIMID. In addition, the amendment provides an additional milestone payment to the Company payable upon achievement of certain regulatory activities and timelines. In connection with this amendment, the Company agreed to remove the right to receive payments from Celgene in the event commercial sales of the companion diagnostic test do not exceed certain pre-specified minimum annual revenues during the first three years following regulatory approval. In addition, the amendment allows Celgene, at its election, to use trial samples with additional technologies for companion diagnostics.

Pursuant to the Company's agreement as amended in February 2018, the Company is eligible to receive payments from Celgene totaling up to $27.3 million, of which $5.8 million was received as an upfront payment upon delivery of certain information to Celgene and $21.5 million is for development funding and potential success-based development

and regulatory milestones. There have been several amendments to the collaboration agreement and in return the Company has received additional payments totaling $2.1 million. The Company will retain all commercial rights to the diagnostic test developed under this collaboration, subject to certain backup rights granted to Celgene to commercialize the diagnostic test in a particular country if the Company elects to cease distribution or elects not to distribute the diagnostic in such country. Assuming success in the clinical trial process, and subject to regulatory approval, the Company will market and sell the diagnostic assay.

The Company achieved and was paid for milestones totaling $6.0 million during 2014. The process of successfully developing a product candidate, obtaining regulatory approval and ultimately commercializing a product candidate is highly

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uncertain and the attainment of any additional milestones is therefore uncertain and difficult to predict. In addition, certain milestones are outside the Company's control and are dependent on the performance of Celgene and the outcome of a clinical trial and related regulatory processes. Accordingly, the Company is not able to reasonably estimate when, if at all, any additional milestone payments may be payable to the Company by Celgene.

During the three and six months ended June 30, 2018, the Company increased its estimated future costs, in part as a result of the amended agreement which expanded the scope and nature of the work being performed in future periods. Additionally, the Company became aware of new information during the quarter which resulted in an increase of future costs related primarily to ongoing regulatory activities associated with the collaboration. As a result of the higher cost estimates in future periods, the Company recognized a reduction of cumulative revenue of $0.2 million for the six months ended June 30, 2018. The Company recognized collaboration revenue related to the Celgene agreement of $0.5 million and $0.6 million for the three and six months ended June 30, 2017, respectively. At June 30, 2018, the Company had recorded $6.4 million of deferred revenue related to the Celgene collaboration, of which $5.2 million is estimated to be recognizable as revenue within one year.

Merck & Co., Inc.

In May 2015, the Company entered into a clinical research collaboration agreement with Merck, to develop an assay intended to optimize immune-related gene expression signatures and evaluate the potential to predict benefit from Merck's anti-PD-1therapy, KEYTRUDA. Under the terms of the collaboration agreement, the Company received $3.9 million in payments during 2015. In connection with the execution of the development collaboration agreement, the Company and Merck terminated the May 2015 clinical research collaboration and moved all remaining activities under the related work plan to the new development collaboration agreement. In February 2016, the Company expanded its collaboration with Merck by entering into a new development collaboration agreement to clinically develop, seek regulatory approval for, and commercialize a diagnostic test, to predict response to KEYTRUDA in multiple tumor types. During 2016, the Company received $12.0 million upfront as a technology access fee and $8.5 million of preclinical milestone payments. In October 2017, Merck notified the Company of its decision not to pursue regulatory approval of the companion diagnostic test for KEYTRUDA and, in August 2018, the Company and Merck agreed to mutually terminate their development collaboration agreement, effective as of September 30, 2018, following the completion of certain close-out activities. As part of the mutual termination agreement, Merck granted to the Company a non-exclusive license to certain intellectual property that relates to Merck's tumor inflammation signature.

The Company recognized collaboration revenue of $0.5 million and $4.5 million related to the Merck agreement for the three months ended June 30, 2018 and 2017, respectively, and $1.4 million and $6.6 million for the six months ended June 30, 2018 and 2017, respectively. The Company received development funding of $0.3 million and $1.5 million for the three months ended June 30, 2018 and 2017, respectively, and $0.9 million and $3.3 million for the six months ended June 30, 2018 and 2017, respectively. At June 30, 2018, the Company had recorded $0.1 million of deferred revenue related to the Merck collaboration which is estimated to be recognizable as revenue within one year.

Medivation, Inc. and Astellas Pharma, Inc.

In January 2016, the Company entered into a collaboration agreement with Medivation and Astellas to pursue the translation of a novel gene expression signature algorithm discovered by Medivation into a companion diagnostic assay using the nCounter Analysis System. In September 2016, Medivation was acquired by Pfizer, Inc. ("Pfizer") and became a wholly owned subsidiary of Pfizer. In May 2017, the Company received notification from Pfizer and Astellas terminating the collaboration agreement as a result of a decision to discontinue the related clinical trial.

11. Commitments and Contingencies

From time to time, the Company may become involved in litigation relating to claims arising from the ordinary course of business. Management believes that there are no claims or actions pending against the Company currently, the ultimate disposition of which would have a material adverse effect on the Company's consolidated results of operations, financial condition or cash flows.

12. Information about Geographic Areas

The Company operates as a single reportable segment and enables customers to perform both research and clinical testing on its nCounter Analysis Systems. The Company has one sales force that sells these systems to both research

and clinical testing labs, and its nCounter Elements reagents can be used for both research and diagnostic testing. In addition, the Company's Prosigna Breast Cancer Assay is marketed to clinical laboratories.

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The following table of total revenue is based on the geographic location of distributors or end users who purchase products and services and collaborators. For sales to distributors, their geographic location may be different from the geographic locations of the ultimate end user. For collaboration agreements, revenues are derived primarily from partners located primarily in the United States. Americas consists of the United States, Canada, Mexico and South America; and Asia Pacific includes Japan, China, South Korea, Singapore, Malaysia, India and Australia. Revenue by geography was as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Americas	$17,005	$27,341	$32,833	$39,552
Europe & Middle East	6,392	5,237	12,150	9,653
Asia Pacific	1,602	2,014	3,101	3,451
Total revenue	$24,999	$34,592	$48,084	$52,656

Total revenue in the United States was $15.9 million and $26.8 million for the three months ended June 30, 2018 and 2017, respectively, and $30.8 million and $38.6 million for the six months ended June 30, 2018 and 2017, respectively. The Company’s assets are primarily located in the United States and not allocated to any specific geographic region. Substantially all of the Company’s long-lived assets are located in the United States.

13. Subsequent Event

In July 2018, the Company completed an underwritten public offering of 4,000,000 shares of common stock for total gross proceeds of $50 million. After underwriters’ fees and commissions and other expenses of the offering, the Company’s aggregate net proceeds were approximately $46.8 million.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Special Note Regarding Forward-Looking Information

This Quarterly Report on Form 10-Q contains forward-looking statements that are based on our management's beliefs and assumptions and on information currently available. This section should be read in conjunction with our unaudited condensed consolidated financial statements and related notes included in Part I, Item 1 of this report. The statements contained in this Quarterly Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended.

Forward-looking statements can be identified by words such as "believe," "anticipate," "could," "continue," "depends," "expec "expand," "forecast," "intend," "predict," "plan," "rely," "should," "will," "may," "seek," or the negative of these terms or and expressions, although not all forward-looking statements contain these words. You should read these statements carefully because they discuss future expectations, contain projections of future results of operations or financial condition, or state other "forward-looking" information. These statements relate to our future plans, objectives, expectations, intentions and financial performance and the assumptions that underlie these statements. These forward-looking statements include, but are not limited to:

- our expectations regarding our future operating results and capital needs, including our expectations regarding instrument, consumable and total revenue, operating expenses, sufficiency of cash on hand and operating and net loss;
- our ability to successfully launch and commercialize our Digital Spatial Profiling and Hyb & Seq. platforms;
- the success, costs and timing of implementation of our business model, strategic plans for our business and future product development plans;
- the regulatory regime and our ability to secure regulatory clearance or approval or reimbursement for the clinical use of our products, domestically and internationally;
- our ability to realize the potential payments set forth in our collaboration agreements;
- our strategic relationships, including with patent holders of our technologies, manufacturers and distributors of our products, collaboration partners and third parties who conduct our clinical studies;
- our intellectual property position;
- our ability to attract and retain key scientific or management personnel;
- our expectations regarding the market size and growth potential for our business; and
- our ability to sustain and manage growth, including our ability to expand our customer base, develop new products, enter new markets and hire and retain key personnel.

These forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those anticipated in the forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed in this report in Part II, Item 1A — "Risk Factors," and elsewhere in this report. These statements, like all statements in this report, speak only as of their date, and we undertake no obligation to update or revise these statements in light of future developments. In this report, "we," "our," "us," "NanoString," and "the Company" refer to NanoString Technologies, Inc. and its subsidiaries.

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Overview

We develop, manufacture and sell robust, intuitive products that unlock scientifically valuable and clinically actionable biologic information from minute amounts of tissue. Our nCounter Analysis System directly profiles hundreds of molecules simultaneously using a novel optical barcoding technology that is powerful enough for use in research, yet simple enough for use in clinical laboratories worldwide. We market systems and related consumables to researchers in academic, government and biopharmaceutical laboratories for use in understanding fundamental biology and the molecular basis of disease, and to clinical laboratories and medical centers for diagnostic use. As of June 30, 2018, we had an installed base of approximately 670 nCounter systems, which our customers have used to publish more than 2,000 peer-reviewed papers. As researchers using our systems discover new biologic insights to improve clinical decision-making, these discoveries may be translated and validated as diagnostic tests. For example, our first molecular diagnostic product is the Prosigna Breast Cancer Assay, which provides an assessment of a patient's risk of recurrence for breast cancer. In addition, we collaborate with biopharmaceutical companies to develop companion diagnostics that may be used to identify which patients are most likely to respond to a particular therapeutic treatment.

We derive a substantial majority of our revenue from the sale of our products to life science researchers, which consist of our nCounter instruments and related proprietary consumables. After buying an nCounter Analysis System, research customers purchase consumables from us for use in their experiments. Our instruments are designed to work only with our consumable products. Accordingly, as the installed base of our instruments grows, we expect recurring revenue from consumable sales to become an increasingly important driver of our operating results. We also derive revenue from processing fees related to proof-of-principle studies we conduct for potential customers and extended service contracts for our nCounter Analysis Systems. Additionally, we generate revenue through product development collaborations.

We use third-party contract manufacturers to produce the instruments comprising our nCounter Analysis Systems. We manufacture consumables at our Seattle, Washington facility. This operating model is designed to be capital efficient and to scale efficiently as our product volumes grow. We focus a substantial portion of our resources on developing new technologies, products and solutions. We sell our products and services through our own sales force in the United States, Canada, Singapore, Israel and certain European countries. We sell through distributors in other parts of the world.

In addition to the nCounter Analysis System, we are currently developing two new systems enabled by our proprietary optical barcoding technology. Following completion of product development, each of these new systems is expected to be commercialized as a new instrument along with associated consumables.

The first new platform under development, Digital Spatial Profiling, or DSP, is designed to allow researchers to address important questions regarding how protein and gene expression vary spatially in different selected regions of interest across the landscape of a heterogeneous tissue biopsy. Our DSP instruments are expected to image slide-mounted tissue biopsies, allow selection of regions of interest for analysis by the researcher, and automate the preparation of samples from selected regions of interest for molecular profiling, using either an nCounter system or next generation gene sequencer. The Company's DSP technology is expected to offer a number of advantages when compared with traditional technologies, including the ability to profile a larger number of different genes or proteins in each selected region of interest, more flexibility on the selection of regions, and processing of a larger number of samples per day. Early access sales of DSP instruments are expected to start in late 2018 and the commercial sale of DSP instruments is expected to commence during the first half of 2019.

The second new platform under development, Hyb & Seq, is a next generation gene sequencing platform. Hyb & Seq is designed with a work flow that is simpler and faster than current sequencing methods, due to the absence of library preparation, enzymes and amplification. Hyb & Seq's simple work flow and compatibility with a variety of tissue sample types offers the potential for a sample-to-answer solution for clinical sequencing. The commercial launch of a research version of Hyb & Seq is expected during 2020.

Our product and service revenue increased to $38.4 million for the six months ended June 30, 2018,compared to $34.1 million for the first six months of 2017. Our collaboration revenue decreased to $9.7 million for the six months ended June 30, 2018, compared to $18.6 million for the first six months of 2017. Historically, we have generated a majority

of our revenue from sales to customers in North America; however, we expect sales in other regions to increase over time. We have never been profitable and had net losses of $39.8 million and $23.4 million for the six months ended June 30, 2018 and 2017, respectively, and as of June 30, 2018 our accumulated deficit was $353.7 million.

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Results of Operations

Revenue

Our product revenue consists of sales of our nCounter Analysis Systems and related consumables, including Prosigna in vitro diagnostic kits. Service revenue consists of fees associated with service contracts and conducting proof-of-principle studies, including programs in which we offer customers early access to technologies under development for which we generate data and perform analysis services on their behalf. Our customer base is primarily comprised of academic institutions, government laboratories, biopharmaceutical companies and clinical laboratories that perform analyses or testing using our nCounter Analysis Systems and purchase related consumables. Collaboration revenue is derived primarily from our collaborations with Lam and Celgene and, historically, from our collaboration with Merck, which is terminating by mutual agreement as of September 30, 2018, and our terminated collaboration with Medivation and Astellas.

The following table reflects total revenue by geography based on the geographic location of our customers, distributors and collaborators. For sales to distributors, their geographic location may be different from the geographic locations of the ultimate end user.

	Three Months Ended June 30,			Six Months Ended June 30,		
	2018	2017	% Change	2018	2017	% Change
	(In thousands)			(In thousands)		
Americas	$17,005	$27,341	(38)%	$32,833	$39,552	(17)%
Europe & Middle East	6,392	5,237	22 %	12,150	9,653	26 %
Asia Pacific	1,602	2,014	(20)%	3,101	3,451	(10)%
Total revenue	$24,999	$34,592	(28)%	$48,084	$52,656	(9)%

The following table reflects the breakdown of revenue.

	Three Months Ended June 30,			Six Months Ended June 30,		
	2018	2017	% Change	2018	2017	% Change
	(In thousands)			(In thousands)		
Product revenue:						
Instruments	$5,488	$6,035	(9)%	$10,162	$10,505	(3)%
Consumables	10,281	9,194	12 %	19,638	17,786	10 %
In vitro diagnostic kits	2,521	1,835	37 %	4,687	3,274	43 %
Total product revenue	18,290	17,064	7 %	34,487	31,565	9 %
Service revenue	2,094	1,246	68 %	3,942	2,510	57 %
Total product and service revenue	20,384	18,310	11 %	38,429	34,075	13 %
Collaboration revenue	4,615	16,282	(72)%	9,655	18,581	(48)%
Total revenue	$24,999	$34,592	(28)%	$48,084	$52,656	(9)%

Instrument revenue during the three and six months ended June 30, 2018 decreased as compared to the same periods in 2017, due primarily to a shift in sales mix towards our SPRINT instruments, which generally have lower average selling prices than our FLEX and MAX instruments. The number of units sold during the three and six months ended June 30, 2018 has generally been consistent with the number of units sold during the same periods in 2017.

Consumables revenue increased for the three and six months ended June 30, 2018, primarily as a result of our growing installed base of nCounter Analysis Systems, as well as growth in various European markets. In vitro diagnostic kit revenue represents sales of Prosigna assays, which increased for the three and six months ended June 30, 2018 as more testing providers commenced providing services and testing volumes increased, most significantly in territories outside of the United States. The increase in service revenue was primarily related to an increase in the number of instruments covered by service contracts, and also increases in revenue generated from technology access fees, particularly fees related to services offered pursuant to our DSP Technology Access Program. Our product and service

revenue may continue to increase in future periods as a result of our increased investments in sales and marketing activities, the growth in sales of our consumable products as driven by our increasing installed base of nCounter instruments, the continued sale of additional nCounter instruments, the introduction of new nCounter consumable products and the potential commercial launch of our DSP and Hyb & Seq product candidates.

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Collaboration revenue decreased for the three and six months ended June 30, 2018 as compared to the same periods in 2017, due primarily to the terminations in 2017 of our collaborations with Medivation and Astellas. These terminations resulted in the recognition of deferred collaboration revenue of $11.3 million and $11.1 million for the three and six months ended June 30, 2017, respectively, which represented all of the remaining deferred revenue relating to the two terminated collaborations. In addition, the scope of our collaboration with Merck changed during the fourth quarter of 2017, resulting in a further reduction of collaboration revenue in 2018 as compared to the same period in 2017. These decreases were partially offset by collaboration revenue generated from our collaboration agreement with Lam, which was entered into during the third quarter of 2017 and represented $4.0 million and $8.2 million of collaboration revenue for the three and six months ended June 30, 2018, respectively.

Cost of Product and Service Revenue; Gross Profit; and Gross Margin

Cost of product and service revenue consists primarily of costs incurred in the production process, including costs of purchasing instruments from third-party contract manufacturers, consumable component materials and assembly labor and overhead, installation, warranty, service and packaging and delivery costs. In addition, cost of product and service revenue includes royalty costs for licensed technologies included in our products, provisions for slow-moving and obsolete inventory and stock-based compensation expense. We provide a one-year warranty on each nCounter Analysis System sold and establish a reserve for warranty repairs based on historical warranty repair costs incurred.

	Three Months Ended June 30,			Six Months Ended June 30,		
	2018	2017	% Change	2018	2017	% Change
	(Dollars in thousands)			(Dollars in thousands)		
Cost of product and service revenue	$8,552	$8,224	4 %	$16,247	$15,387	6 %
Product and service gross profit	$11,832	$10,086	17 %	$22,182	$18,688	19 %
Product and service gross margin	58 %	55 %		58 %	55 %	

For the three and six months ended June 30, 2018, cost of product and service revenue increased as compared to the same periods in 2017, due to higher volumes of instruments and consumables sold, including our Prosigna in vitro diagnostic kits, as well as increased volume of service contracts associated with our growing install base of nCounter instruments. Our gross margin on product and service revenue for the three and six months ended June 30, 2018 increased compared to the same periods in 2017 primarily as a result of increased consumable revenue as a percentage of our overall sales mix, including sales of our Prosigna in vitro diagnostic kits, which generally have higher gross margins than our instrument placements, as well increasing sales of our panel products as a percentage of our life sciences consumables revenue. This increase has been partially offset by the mix of our current period instrument sales, with a greater percentage of our instrument sales represented by SPRINT sales as compared to the same periods of 2017.

We expect our cost of product and service revenue to increase in future periods, primarily due to our expected continued growth in product and service revenue. We expect our gross margin on product and service revenue may fluctuate in future periods, depending upon our mix of instrument sales, from which we typically record lower gross margins, as compared to our sales of consumable products or services, and the impact of the launch, and any sales achieved, of our new product platforms such as our DSP or Hyb & Seq product platforms, which during any initial launch may impact our mix of sales of instruments as compared to consumables. Costs related to collaboration revenue are included in research and development expense.

Research and Development Expense

Research and development expenses consist primarily of salaries and benefits, occupancy, laboratory supplies, engineering services, consulting fees, costs associated with licensing molecular diagnostics rights and clinical study expenses to support the regulatory approval or clearance of diagnostic products. We have made substantial investments in research and development since our inception. Our research and development efforts have focused primarily on the tasks required to enhance our technologies and to support development and commercialization of new and existing products and applications. We believe that our continued investment in research and development is essential to our long-term competitive position and expect these expenses to continue to increase in future periods. In

particular, following our entry into the Lam collaboration in August 2017, which provides up to $50 million of funding for our Hyb & Seq program, we have experienced a significant increase in related research and development expenses.

Given the size of our research and development staff and the number of active projects at any given time, we have found that it has been effective for us to manage our research and development activities on a departmental basis. Accordingly, other than for collaborations and certain major technology development programs, we have neither required employees to

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report their time by project nor allocated our research and development costs to individual projects, other than collaborations. Research and development expense by functional area was as follows:

	Three Months Ended June 30,			Six Months Ended June 30,		
	2018	2017	% Change	2018	2017	% Change
	(In thousands)			(In thousands)		
Platform technology	$5,852	$3,670	59 %	$12,209	$7,065	73 %
Manufacturing process development	1,460	712	105 %	2,278	1,439	58 %
Life sciences products and applications	2,735	2,039	34 %	5,150	3,741	38 %
Diagnostic product development	1,977	1,744	13 %	3,344	3,744	(11)%
Clinical, regulatory and medical affairs	1,167	1,589	(27)%	2,743	3,282	(16)%
Facility allocation	1,394	1,284	9 %	2,693	2,568	5 %
Total research and development expense	$14,585	$11,038				