

Emerging Company Research

Complete Genomics — Outperform (1)

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Q4 Results A Strong Start, Backlog Building

Summary: Complete Genomics reported Q4:10 results yesterday. In their first quarter as a public company, the company posted a modest beat at the top line driven by sequencing of over 360 genomes in Q4. Operating expenses were a bit lower than expected but are still anticipated to ramp over the course of the year. Given the company's building backlog, strong overall sequencing demand, and relatively strong positioning in an uncertain funding environment, we remain optimistic. Reiterate Outperform.

- **Revenue a Modest Beat, Sequencing Volume Up, Pricing as Expected.** Complete Genomics reported Q4:10 revenue of \$3.8MM (Cowen and Consensus: \$3.1MM). The beat was driven by a stronger than expected volume of genomes sequenced (approximately 360 in Q4:10) which exceeded our expectations by about 85 genomes and did not include any contributions from the NCI order. Q1:11 guidance of at least 500 genomes sequenced was about in line with our current Q1:11 estimate.
- **Operational Cost A Bit Lower Than Expected, Modest Ramp Still Expected in 2011.** Start up costs (COGS), S&M, and R&D were all a bit below our expectations in Q4:10; however, the company noted that it still expects the spend to increase modestly over 2011.
- **Backlog Continues to Move in the Right Direction.** The company highlighted new orders of 1,400 genomes in Q1:11, combined with a backlog of 1,000 genomes entering the year. this represents over half of our estimated genome volume for 2011. While there is still a ways to go, given we are only 2 months into the year, we view this as encouraging. The customer reorder rate is above 50%.

GNOM (03/10)	\$7.46	Revenue \$MM							
Mkt cap	\$193.2MM	FY	2010	2011E	2012E	2013E			
Dil shares out	25.9MM	Dec	Actual	Prior	Current	Prior	Current	Prior	Current
Avg daily vol	290.8K	Q1	0.3	—	4.7	—	12.9	—	—
52-wk range	\$6.6-9.0	Q2	1.1	5.4	6.4	—	14.8	—	—
Dividend	Nil	Q3	4.2	9.9	10.1	—	22.8	—	—
Dividend yield	Nil	Q4	3.8	13.0	12.9	—	24.5	—	—
BV/sh	\$0.45	Year	9.4	—	34.0	—	75.0	—	140.0
Net cash/sh	\$0.23	EV/S	—	—	5.5x	—	2.5x	—	1.4x
Debt/cap	2.4%								
ROA (LTM)	NA								
5-yr fwd EPS growth (Norm)	NA								
S&P 500	1295.1	EPS \$	2010	2011E	2012E	2013E			
		FY	Actual	Prior	Current	Prior	Current	Prior	Current
		Q1	0.00	—	(0.54)	—	(0.34)	—	—
		Q2	0.00	—	(0.52)	—	(0.31)	—	—
		Q3	—	—	(0.48)	—	(0.11)	—	—
		Q4	(0.69)	—	(0.35)	—	(0.08)	—	—
		Year	(0.69)	—	(1.89)	(0.85)	(0.86)	—	0.42
		P/E	—	—	—	—	—	—	17.8x

Please see addendum of this report for important disclosures.

Positives

1. Leadership in emerging Next Generation Sequencing outsourcing sub segment.
2. Well positioned in an unclear funding environment.
3. Technology and approach affirmed by existing customers and peer reviewed publications.
4. Robust expansion potential in new verticals

Negatives

1. Early stage of commercial development.
2. Rapidly evolving market and pricing dynamics.
3. Business model somewhat capital intensive, particularly in early stages.

Investment Thesis

Complete Genomics utilizes its proprietary DNA sequencing platform to compete in the rapidly growing \$1B genetic sequencing industry as an “end-to-end” whole human genome sequencing outsource service targeting the life science research, clinical, and consumer genetics markets. The company enables customers to offload the complex processes of sample preparation, sequencing, computing, and data storage and management at a cost per genome below that currently available on competitive platforms sold by instrument vendors. The company is positioned to opportunistically use its first-mover advantage in the sequencing outsourcing market and the cost-advantages unique to its proprietary instrumentation to expand and capitalize on this highly-elastic market opportunity. Our comparable company valuation and DCF analyses suggest GNOM shares are positioned to outperform the market by 15% over the next 12-18 months. Recognizing the company’s commercial stage of development remains early, we believe the bias is to the upside given our proprietary industry checks suggesting demand for sequencing services is robust, and given that our forecast incorporates seemingly conservative market assumptions.

Summary of Consensus Expectations (\$MM, Except EPS)

	Actual	Cowen	Consensus			Guidance
			Average	High	Low	
Q4:10						
Revenue	\$3.8	\$3.1	\$3.1	\$3.1	\$3.0	\$3MM
EPS	-\$0.69	-\$0.60	-\$0.65	-\$0.56	-\$0.87	
Q1:11						
Revenue		\$4.7	\$4.4	\$5.4	\$3.6	
EPS		-\$0.54	-\$0.57	-\$0.54	-\$0.59	
FY:10						
Revenue		\$9.4	\$8.7	\$8.8	\$8.6	
EPS		-\$12.87	-\$2.46	-\$2.06	-\$3.07	
FY:11						
Revenue		\$34.0	\$34.4	\$35.6	\$32.4	
EPS		-\$1.89	-\$1.98	-\$1.78	-\$2.18	

Source: Company reports, Thomson One, Cowen and Company estimates.

Complete Genomics - Quarterly Variance

(MM, except EPS)	Q4:10E	Q4:10A	Variance
Segment Revenue			
Total Revenue(\$MM)	\$3.1	\$3.8	\$0.7
# of Genomes	275	360	85
Average ASP(\$000's)	\$11.2	\$10.6	-\$0.6
Backlog (Genomes)	969	1,009	40
Total Revenue	\$3.1	\$3.8	\$0.7
Gross profit	-\$3.7	-\$1.1	\$2.6
margin	-121.6%	-29.0%	
SG&A	5.3	4.1	-\$1.2
R&D	6.4	5.6	-\$0.8
Operating income	-\$15.5	-\$10.9	\$4.6
margin	NM	NM	
Net Interest Expense	0	1	\$0.7
Other	0	-1	-\$1.4
Pre-tax earnings	-\$15.6	-\$10.3	\$5.3
Taxes	0	0	\$0.0
rate	0.0%	0.0%	
Net Income	-\$15.6	-\$10.3	\$5.3
EPS	-\$0.60	-\$0.69	-\$0.09
Shares Outstanding	26	15	-11

Source: Cowen and Company and company reports.

Complete Genomics - Summary Revenue Forecast

	Q1:10	Q2:10	Q3:10	Q4:10	Q1:11	Q2:11	Q3:11	Q4:11	Q1:12	Q2:12	Q3:12	Q4:12	2010	2011	2012	2013	2014	2015	5-yr CAGR
REVENUES																			
Growth	\$0.3	\$1.1	\$4.2	\$3.8	\$4.7	\$6.4	\$10.1	\$12.9	\$11.1	\$16.3	\$22.8	\$24.8	\$9.4	\$34.0	\$75.0	\$140.0	\$150.0	\$172.5	78.9%
Genomes Shipped	11	83	350	360	500	800	1,550	1,895	1,860	3,625	5,725	6,495	804	4,745	17,705	46,795	74,260	109,985	167.4%
ASP/Period	\$30.5	\$13.1	\$12.0	\$10.6	\$9.3	\$8.0	\$6.5	\$6.8	\$6.0	\$4.5	\$4.0	\$3.8	\$11.7	\$7.2	\$4.2	\$3.0	\$2.0	\$1.6	-33.1%
SALES PIPELINE (Sales Productivity & Demand)																			
Value of Deals Closed (MM)				\$3.7	\$4.8	\$9.8	\$12.2	\$11.9	\$22.9	\$21.0	\$28.2	\$27.7	\$8.5	\$45.1	\$99.8	\$141.8	\$151.6	\$179.5	84.0%
Deals Closed: # of Genomes			400	600	1,500	1,800	2,000	2,500	5,750	5,500	8,000	8,750	1,000	7,800	28,000	56,750	85,250	124,750	162.5%
Growth							400%	317%	275%	200%	300%	250%		680%	259%	103%	50%	46%	
ASP (1,000s)			\$9.3	\$8.0	\$6.5	\$6.8	\$6.0	\$4.5	\$4.0	\$3.8	\$3.5	\$3.2	\$8.5	\$5.8	\$3.6	\$2.5	\$1.8	\$1.4	-29.9%
Growth							-36%	-44%	-39%	-44%	-41%	-30%		-32%	-38%	-30%	-29%	-19%	

Source: Company reports and Cowen and Company estimates.

Complete Genomics - Summary Income Statement Forecast

\$MM, except per share data	Q1:10	Q2:10	Q3:10	Q4:10	Q1:11	Q2:11	Q3:11	Q4:11	2010	2011E	2012E	2013E	2014E	2015E	5-yr CAGR
Revenues	\$0.3	\$1.1	\$4.2	\$3.8	\$4.7	\$6.4	\$10.1	\$12.9	\$9.4	\$34.0	\$75.0	\$140.0	\$150.0	\$172.5	79.0%
COGS	3.2	3.6	6.0	4.9	6.4	7.4	9.4	8.7	17.7	31.9	41.0	63.0	64.5	69.0	31.3%
Gross profit	-\$2.8	-\$2.5	-\$1.8	-\$1.1	-\$1.7	-\$1.0	\$0.7	\$4.1	-\$8.3	\$2.1	\$33.9	\$77.0	\$85.5	\$103.5	NM
Sales & Marketing	1.3	1.3	1.6	2.0	3.2	3.5	4.0	4.3	6.2	15.1	17.8	20.0	22.0	23.7	30.8%
General & Administrative	2.0	1.7	2.3	2.2	2.4	2.5	2.5	2.5	8.2	9.9	10.4	11.2	12.0	12.7	9.3%
Research & Development	6.1	6.5	5.0	5.6	6.5	6.5	6.5	6.5	23.2	26.0	28.1	30.0	31.8	33.4	7.6%
Operating Profit	-\$12.3	-\$12.0	-\$10.7	-\$10.9	-\$13.9	-\$13.5	-\$12.4	-\$9.2	-\$45.9	-\$48.9	-\$22.3	15.8	19.7	33.6	
Other Expense (Income)	0.0	0.0	8.8	-1.4	0.0	0.0	0.0	0.0	7.4	0.0	0.0	0.0	0.0	0.0	
Interest Expense (Income)	0.0	0.0	0.9	0.8	0.1	0.0	0.0	0.0	1.7	0.1	0.0	0.0	0.0	0.0	
Pre-Tax Income	-\$12.3	-\$12.0	-\$20.5	-\$10.3	-\$13.9	-\$13.6	-\$12.4	-\$9.2	-\$55.0	-\$49.1	-\$22.3	\$15.8	\$19.7	\$33.6	
Taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	4.7	6.9	11.8	
Net Income	-\$12.3	-\$12.0	-\$20.5	-\$10.3	-\$13.9	-\$13.6	-\$12.4	-\$9.2	-\$55.0	-\$49.1	-\$22.3	\$11.0	\$12.8	\$21.9	
EPS				-\$0.69	-\$0.54	-\$0.52	-\$0.48	-\$0.35	-12.8736	-\$1.89	-\$0.86	\$0.42	\$0.49	\$0.84	
Share Count				14.8	26.0	26.0	26.0	26.0	4.3	26.0	26.0	26.0	26.0	26.0	
Margin Analysis:															
Gross Profit	-848%	-231%	-44%	-29%	-37.3%	-15.8%	6.7%	32.2%	-88.5%	6.1%	45.3%	55.0%	57.0%	60.0%	
Sales & Marketing	387%	121%	38%	52%	69.6%	54.8%	40.1%	33.6%	65.9%	44.4%	23.7%	14.3%	14.6%	13.7%	
General & Administrative	596%	154%	56%	57%	51.6%	39.1%	24.8%	19.4%	86.9%	29.1%	13.8%	8.0%	8.0%	7.4%	
Research & Development	1820%	599%	119%	148%	139.8%	101.6%	64.5%	50.4%	247.4%	76.4%	37.5%	21.5%	21.2%	19.4%	
Operating margin	-3651%	-1105%	-258%	-286%	-298.2%	-211.2%	-122.7%	-71.3%	-488.7%	-143.9%	-29.7%	11.3%	13.1%	19.5%	
Tax Rate	0%	0%	0%	0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
Net Income	-3651%	-1105%	-492%	-270%	-299.9%	-211.9%	-122.9%	-71.3%	-586.0%	-144.3%	-29.7%	7.9%	8.5%	12.7%	
Growth Analysis:															
Revenue	NM	NM	NM	510%	NM	489%	142%	239%	NM	262%	120%	87%	7%	15%	
Gross Profit	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	127%	11%	21%	
Sales & Marketing	205%	583%	335%	144%	149%	166%	154%	119%	244%	144%	17%	12%	10%	8%	
General & Administrative	54%	104%	72%	45%	20%	49%	7%	16%	65%	21%	5%	8%	7%	6%	
Research & Development	-9%	76%	-12%	-11%	6%	0%	31%	15%	3.5%	12.0%	8.0%	7%	6%	5%	
Operating Income	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	25%	71%	
Income Taxes									NA	NA	NA	30%	35%	35%	
Net Income									NM	NM	NM	NM	16%	71%	
Earnings Per Share									NM	NM	NM	NM	16%	71%	

Source: Company reports and Cowen and Company estimates.

Addendum

STOCKS MENTIONED IN IMPORTANT DISCLOSURES

Ticker	Company Name
GNOM	Complete Genomics

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(a) Assumptions: Time horizon is 12 months; S&P 500 is flat over forecast period.

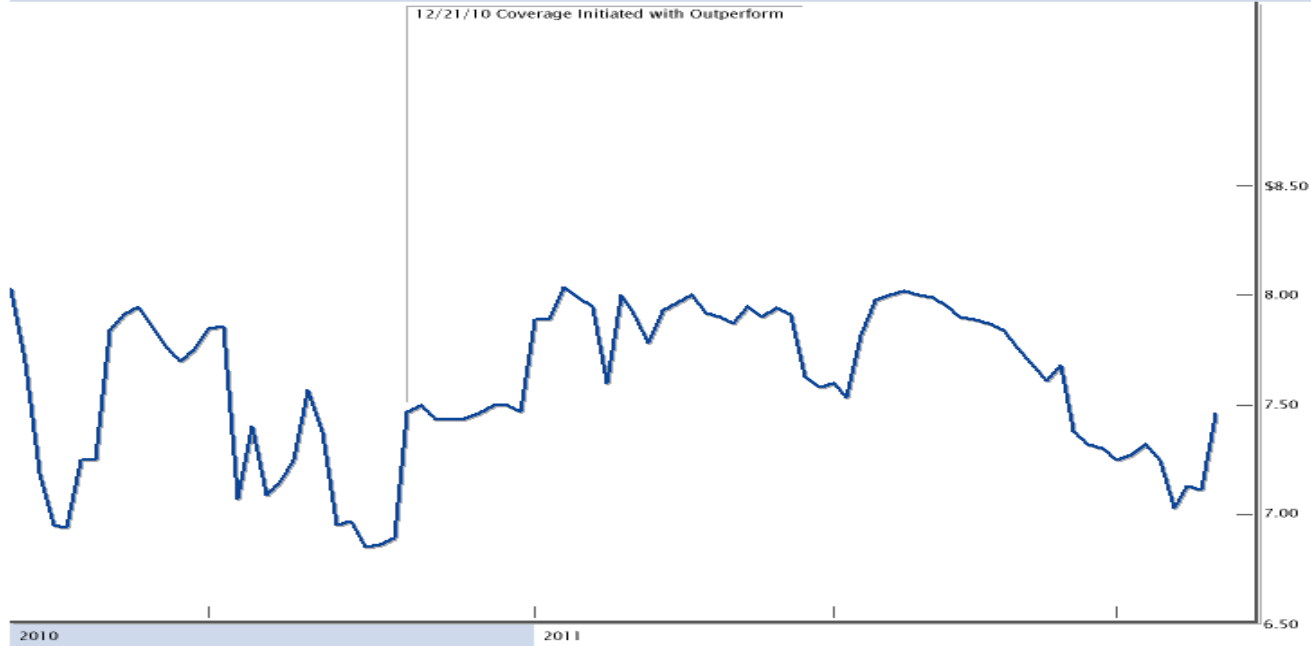
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Cowen and Company Price and Ratings History

Complete Genomics - GNOM



Pricing data provided by Reuters America. Chart as of 3/10/11 in USD.