

COMPANY NOTE

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November 8, 2011

Jefferies

Complete Genomics (GNOM) Encouraging Backlog Development; 4Q11 Outlook Hit by Temporary Disruption

Key Takeaway

GNOM's 3Q11 revenue of \$4.2M was ~\$500K (+14%) above consensus and eclipsed our \$3.2M forecast on better than expected genome unit shipments (~750 genomes vs. our 605). We are trimming our 2011 and 2012 revenue forecasts to \$21M (from \$24M) and \$40M (from \$50M), respectively, on a more conservative volume ramp outlook owing to environmental uncertainties. Our price target moves to \$12 (from \$16) on lower cash flow forecasts.

Encouraging 3Q11 backlog development; 4Q11 shipment outlook hit by temporary internal disruption. GNOM trimmed the mid-point of its 2011 unit shipment outlook to ~3,400 genomes (vs. >4,000 units previously), as disruptions related to the installation of new automated sample prep processes in late-3Q11 / early-4Q11 will cause ~700 genomes previously anticipated for 4Q11 to be shipped in 1Q12. Such an outlook implies ~1,050 (mid-point) genome shipments in 4Q11 (+50% sequentially). However, GNOM's new order pipeline continued to ramp nicely as it formally booked ~3,400 genomes (vs. our 3,000) in 3Q11, which drove a >100% sequential increase in its order backlog to ~4,800 genomes (vs. ~2,200 in 2Q11).

Revised intermediate-term profitability outlook. GNOM's 3Q11 operating expenses spiked 15% sequentially, to \$16.8M (vs. our \$14.7M), reflecting stepped-up R&D and commercial expense outlays in support of a swelling new business pipeline, levels that appear likely to persist. Our revised forecasts and PT now assume GNOM is able to achieve operating income break-even on \$150M of annualized revenue (vs. ~\$100M previously).

Relief rally overdue; valuations appear attractive. Shares of GNOM currently imply an equity value of only 2.5 times our recalibrated 2013 revenue forecast, which represents a ~33% discount to a blended average of those of other life science product manufacturers and diagnostics service providers. Such levels appear to reflect little appreciation for the viability of GNOM's business model, accelerating new order bookings trajectory, or future growth opportunities in clinical settings (CLIA certification slated for mid-2012), in our view. As such, we view current levels as more than adequately discounting execution-related scale-up risks.

Valuation/Risks

Our \$12 PT represents a 10-year discount horizon to our DCF model and implies an equity value of 3.0x our 2014 revenue forecast. Risks: execution (TATs), ability to evolve technology as fast as competitors, ability to achieve self-funding status, litigation.

USD	Prev.	2010A	Prev.	2011E	Prev.	2012E	Prev.	2013E
Rev. (MM)	--	9.4	24.0	21.4	50.0	40.0	120.0	85.0
Consensus	--	--	(1.76)	(2.11)	(0.89)	(1.61)	0.07	(0.53)
EPS								
Mar	--	(1.42)	--	(0.48)A	--	--	--	--
Jun	--	(1.10)	--	(0.56)A	--	--	--	--
Sep	--	(1.05)	(0.55)	(0.65)A	--	--	--	--
Dec	--	(0.69)	(0.44)	(0.63)	--	--	--	--
FY Dec	--	(4.14)	(2.04)	(2.35)	(1.23)	(2.05)	0.25	(0.95)

BUY

Price target \$12.00

(from \$16.00)

Price \$5.05

Financial Summary

Book Value (MM):	\$102.6
Book Value/Share:	\$3.10
Net Debt (MM):	(\$81.5)

Market Data

52 Week Range:	\$18.55 - \$4.70
Total Entprs. Value (MM):	\$85.7
Market Cap. (MM):	\$167.2
Insider Ownership:	38.1%
Institutional Ownership:	23.9%
Shares Out. (MM):	33.1
Float (MM):	10.2
Avg. Daily Vol.:	365,000

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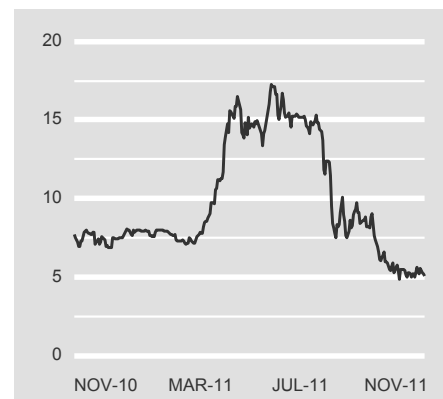
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Price Performance



Complete Genomics**Quarterly results versus expectations, 3Q11**

(\$ in millions, except per share)

	Prior year	Forecast	Reported	vs Growth		vs Expectations	
				Actual	Percent	Actual	Percent
Net sales	\$4.2	\$3.2	\$4.2	\$0.0	0%	\$1.0	32%
Cost of revenue	<u>\$6.0</u>	<u>\$6.1</u>	<u>\$8.2</u>	<u>\$2.2</u>	36%	<u>\$2.1</u>	35%
Gross profit	(\$1.8)	(\$2.9)	(\$4.0)	(\$2.2)	117%	(\$1.1)	39%
Research and Development	\$5.0	\$7.9	\$9.5	\$4.6	93%	\$1.6	21%
Commercial expenses	\$1.6	\$3.0	\$3.5	\$1.9	117%	\$0.5	15%
G&A expenses	<u>\$2.3</u>	<u>\$3.8</u>	<u>\$3.8</u>	<u>\$1.5</u>	<u>64%</u>	<u>(\$0.0)</u>	<u>(1%)</u>
Operating income	(\$10.7)	(\$17.6)	(\$20.8)	(\$10.1)	94%	(\$3.2)	18%
Interest expense	\$0.9	\$0.8	\$0.8	(\$0.1)	(12%)	\$0.0	3%
Interest income	\$8.8	(\$0.3)	(\$0.0)	nmf	nmf	nmf	nmf
Other income, net	<u>\$0.4</u>	<u>\$0.0</u>	<u>\$0.0</u>	<u>nmf</u>	<u>nmf</u>	<u>nmf</u>	<u>nmf</u>
Income before taxes	(\$20.9)	(\$18.1)	(\$21.6)	(\$0.7)	4%	(\$3.5)	19%
Income tax	<u>\$0.0</u>	<u>\$0.0</u>	<u>\$0.0</u>	<u>nmf</u>	<u>nmf</u>	<u>nmf</u>	<u>nmf</u>
Net income	(\$20.9)	(\$18.1)	(\$21.6)	(\$0.7)	4%	(\$3.5)	19%
Basic shares outstanding	19.81	32.66	33.08				
Diluted shares outstanding	19.81	32.66	33.08				
Basic E.P.S.	(\$1.05)	(\$0.55)	(\$0.65)				
Diluted E.P.S.	(\$1.05)	(\$0.55)	(\$0.65)				
Margin Analysis							
Gross margin	(44.4%)	(90.8%)	(95.9%)				
Research and Development	119.1%	249.5%	228.5%				
Commercial expenses	38.2%	94.5%	82.7%				
G&A expenses	<u>56.0%</u>	<u>120.7%</u>	<u>91.2%</u>				
Operating margin	(258%)	(556%)	(498%)				
Income before taxes	(501%)	(570%)	(517%)				
Income tax	<u>0%</u>	<u>0%</u>	<u>0%</u>				
Net margin	(501%)	(570%)	(517%)				

Source: Jefferies estimates, company data.

GNOM's Historical and Projected Quarterly Income Statement

(\$ in millions, except per share)

	Historical results										Projections				
	2010					2011					2012				
	Mar-10	Jun-10	Sep-10	Dec-10	Total	Mar-11	Jun-11	Sep-11	Dec-11	Total	Mar-12	Jun-12	Sep-12	Dec-12	Total
Net sales	\$0.3	\$1.1	\$4.2	\$3.8	\$9.4	\$6.8	\$5.9	\$4.2	\$4.5	\$21.4	\$7.5	\$9.0	\$11.0	\$12.5	\$40.0
Cost of revenue	\$4.1	\$4.9	\$6.0	\$4.9	\$19.9	\$6.6	\$6.1	\$8.2	\$8.0	\$28.9	\$8.4	\$8.7	\$9.2	\$9.9	\$36.2
Gross profit	(\$3.7)	(\$3.8)	(\$1.8)	(\$1.1)	(\$10.5)	\$0.3	(\$0.3)	(\$4.0)	(\$3.5)	(\$7.5)	(\$0.9)	\$0.3	\$1.9	\$2.6	\$3.8
Research and Development	\$6.2	\$4.9	\$5.0	\$5.6	\$21.7	\$6.8	\$8.0	\$9.5	\$9.5	\$33.8	\$9.0	\$9.5	\$10.0	\$10.5	\$39.0
Commercial expenses	\$1.2	\$1.3	\$1.6	\$2.0	\$6.1	\$2.7	\$3.1	\$3.5	\$3.5	\$12.8	\$4.1	\$4.7	\$5.2	\$5.9	\$20.0
G&A expenses	\$3.1	\$1.8	\$2.3	\$2.2	\$9.3	\$2.8	\$3.5	\$3.8	\$3.8	\$13.9	\$3.5	\$3.6	\$3.6	\$3.7	\$14.5
Operating income	(\$14.2)	(\$11.8)	(\$10.7)	(\$10.9)	(\$47.7)	(\$12.0)	(\$14.9)	(\$20.8)	(\$20.3)	(\$68.1)	(\$17.6)	(\$17.5)	(\$17.0)	(\$17.6)	(\$69.7)
Interest expense	\$0.3	\$0.8	\$0.9	\$0.8	\$2.8	\$0.3	\$0.8	\$0.8	\$0.8	\$2.7	\$0.9	\$0.9	\$0.9	\$0.9	\$3.6
Interest income	(\$0.2)	(\$0.0)	\$8.8	(\$1.4)	\$7.2	\$0.1	\$0.3	(\$0.0)	(\$0.3)	\$0.1	(\$0.2)	(\$0.2)	(\$0.1)	(\$0.1)	(\$0.6)
Other income, net	\$0.0	\$0.0	\$0.4	\$0.0	\$0.4	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Income before taxes	(\$14.3)	(\$12.6)	(\$20.9)	(\$10.3)	(\$58.1)	(\$12.5)	(\$16.0)	(\$21.6)	(\$20.8)	(\$70.9)	(\$18.3)	(\$18.2)	(\$17.8)	(\$18.4)	(\$72.7)
Income tax	\$0.0	\$0.0	\$0.0	\$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	(\$14.3)	(\$12.6)	(\$20.9)	(\$10.3)	(\$58.1)	(\$12.5)	(\$16.0)	(\$21.6)	(\$20.8)	(\$70.9)	(\$18.3)	(\$18.2)	(\$17.8)	(\$18.4)	(\$72.7)
Basic shares outstanding	10.1	11.5	19.8	14.8	14.0	26.0	28.3	33.1	33.2	30.1	33.4	33.6	33.7	41.4	35.5
Diluted shares outstanding	10.1	11.5	19.8	14.8	14.0	26.0	28.3	33.1	33.2	30.1	33.4	33.6	33.7	41.4	35.5
Basic E.P.S.	(\$1.42)	(\$1.10)	(\$1.05)	(\$0.69)	(\$4.14)	(\$0.48)	(\$0.56)	(\$0.65)	(\$0.63)	(\$2.35)	(\$0.55)	(\$0.54)	(\$0.53)	(\$0.44)	(\$2.05)
Diluted E.P.S.	(\$1.42)	(\$1.10)	(\$1.05)	(\$0.69)	(\$4.14)	(\$0.48)	(\$0.56)	(\$0.65)	(\$0.63)	(\$2.35)	(\$0.55)	(\$0.54)	(\$0.53)	(\$0.44)	(\$2.05)
EBITDA	(\$12.9)	(\$10.1)	(\$8.2)	(\$8.4)	(\$39.6)	(\$9.5)	(\$12.1)	(\$17.4)	(\$17.0)	(\$56.1)	(\$14.2)	(\$14.0)	(\$13.4)	(\$13.9)	(\$55.5)
Margin Analysis															
Gross margin	(1,113.4%)	(350.7%)	(44.4%)	(28.9%)	(111.9%)	3.7%	(4.4%)	(95.9%)	(77.9%)	(35.2%)	(12.5%)	3.5%	17.0%	20.5%	9.5%
Research and Development	1,836.0%	452.5%	119.1%	148.3%	231.0%	99.6%	136.9%	228.5%	210.2%	158.3%	121.0%	105.0%	91.0%	84.0%	97.6%
Commercial expenses	364.9%	120.6%	38.2%	52.1%	65.1%	39.5%	53.5%	82.7%	77.8%	59.8%	55.0%	52.5%	47.5%	47.5%	50.0%
G&A expenses	922.3%	161.9%	56.0%	56.6%	99.5%	40.7%	59.1%	91.2%	85.3%	65.0%	47.5%	40.0%	32.5%	30.0%	36.2%
Operating margin	(4,236.6%)	(1,085.7%)	(257.7%)	(285.9%)	(507.5%)	(176.2%)	(253.9%)	(498.3%)	(451.2%)	(318.4%)	(236.0%)	(194.0%)	(154.0%)	(141.0%)	(174.3%)
Income before taxes	(4,266.7%)	(1,159.9%)	(501.3%)	(269.9%)	(618.7%)	(182.4%)	(272.1%)	(517.3%)	(462.6%)	(331.4%)	(245.2%)	(202.1%)	(161.0%)	(147.6%)	(181.8%)
Income tax	0.0%	0.0%	0.0%	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 margin	(4,266.7%)	(1,159.9%)	(501.3%)	(269.9%)	(618.7%)	(182.4%)	(272.1%)	(517.3%)	(462.6%)	(331.4%)	(245.2%)	(202.1%)	(161.0%)	(147.6%)	(181.8%)
Growth Analysis															
Net sales						1,933.6%	438.6%	0.4%	18.4%	127.7%	9.0%	53.9%	164.0%	176.9%	87.0%
Cost of revenue						61.4%	24.7%	36.2%	63.4%	45.2%	27.4%	42.3%	11.9%	23.7%	25.1%
Gross profit						(106.7%)	(93.3%)	117.0%	219.0%	(28.4%)	(471.1%)	(222.9%)	(146.8%)	(172.8%)	(150.7%)
Research and Development						10.4%	62.9%	92.7%	67.8%	56.0%	32.4%	18.1%	5.1%	10.6%	15.2%
Commercial expenses						120.2%	139.0%	117.2%	76.7%	109.3%	51.8%	51.0%	51.6%	69.2%	56.3%
G&A expenses						(10.3%)	96.7%	63.5%	78.4%	48.7%	27.3%	4.1%	(5.9%)	(2.7%)	4.1%
Operating income						(15.4%)	25.9%	94.2%	86.8%	42.8%	46.1%	17.6%	(18.4%)	(13.5%)	2.3%
Income before taxes						(13.1%)	26.3%	3.6%	102.9%	22.0%	46.6%	14.3%	(17.8%)	(11.7%)	2.5%
Net income						(13.1%)	26.3%	3.6%	102.9%	22.0%	46.6%	14.3%	(17.8%)	(11.7%)	2.5%
Diluted E.P.S.						(66.3%)	(48.8%)	(38.0%)	(9.5%)	(43.2%)	14.0%	(3.7%)	(19.4%)	(29.1%)	(13.0%)

Source: Jefferies estimates, company data.

Company Description

Complete Genomics offers proprietary human genome sequencing technology, advanced informatics and data management software to academic and biopharmaceutical researchers as an end-to-end outsourced service solution that is capable of delivering research-ready genomic data at a significantly lower cost.

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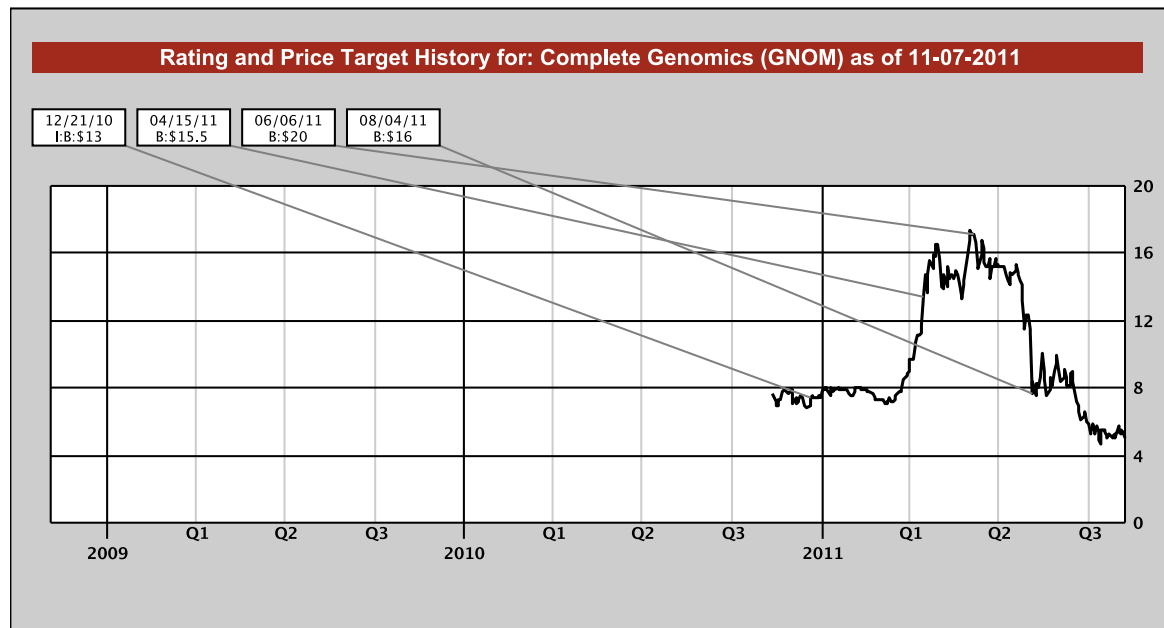
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Other Companies Mentioned in This Report

- Complete Genomics (GNOM: \$5.05, BUY)



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			Count	Percent
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