

COMPANY NOTE

Target | Estimate Change

USA | Healthcare | Life Sciences & Diagnostic Tools

August 4, 2011

Jefferies

Complete Genomics (GNOM) Bookings Vitality Encouraging; ASP Declining Faster Than Anticipated

Key Takeaway

GNOM's 2Q11 revenue of \$6M was \$2M below consensus & our forecast, owing to more rapid ASP erosion; unit shipments of 950 genomes exceeded our 925 forecast. We are lowering our 2011 and 2012 revenue forecasts to \$24M and \$50M (from \$36M and \$80M), respectively, primarily to reflect lower ASP assumptions. Our PT moves to \$16 (from \$20) on the adjustments.

Revenue falls short on more rapid ASP erosion. GNOM's 2Q11 revenue of \$5.9M fell short of our \$7.6M forecast. While units shipped (950 genomes) exceeded our 925 genome forecast, ASPs declined more precipitously than we anticipated (\$6,175 vs. our \$8,250).

Near term shipment expectations highly volatile; high profile order commitments validate business model. While GNOM reiterated its commitment to ship >4,000 genomes in 2011 (5x its 2010 experience of >800 genomes), 3Q11 shipment expectations (>600 genomes) fell well below our prior 1,300 forecast. Clearly, we misgauged the behavioral effect of *Illumina's* early-May 2011 list price reductions for its WHG sequencing service offering, as GNOM's 2Q11 firm order commitments (<1,100 genomes) fell short of our 2,100 forecast. However, the effect appears to have been temporary, as GNOM's ability to close two large orders for 2,700 genomes in July 2011 (weighted avg. ASP of \$5,200) suggests recent price reductions have in fact stimulated exponential incremental market demand. Of particular significance is the 1,500 genome order from the Inova Health System, as it signals WGS is becoming relevant in the clinical markets faster than anticipated. As such, our 4Q11 volume forecast (1,800 genomes) remains largely unchanged, giving us confidence in GNOM's trajectory heading into 2012.

Adverse reaction a buying opportunity. Following the substantial weakness this morning, shares of GNOM now imply an equity value of only 2.4x our recalibrated 2013 revenue forecast, which represents a ~35% discount to a blended average of those of other life science product manufacturers and diagnostic service providers. On clear evidence of the viability of GNOM's business model, both from a customer acceptance perspective as well as an economic return perspective, we view current levels as more than adequately discounting execution-related scale-up risks.

Valuation/Risks

Our \$16 PT represents a 10-year horizon in our DCF model and implies an equity value of 4.5x our 2013 revenue forecast. Risks: execution (TATs), ability to evolve technology as fast as instrumentation vendors, threats from new competitive technologies, litigation risks.

USD	Prev.	2010A	Prev.	2011E	Prev.	2012E	Prev.	2013E
Rev. (MM)	--	9.4	36.0	24.0	80.0	50.0	161.0	120.0
Consensus	--	--	(1.95)	(1.76)	(0.78)	(0.89)	0.15	0.07
EPS								
Mar	--	(1.42)	--	(0.48)A	--	--	--	--
Jun	--	(1.10)	(0.48)	(0.56)A	--	--	--	--
Sep	--	(1.05)	(0.38)	(0.55)	--	--	--	--
Dec	--	(0.69)	(0.32)	(0.44)	--	--	--	--
FY Dec	--	(4.14)	(1.63)	(2.04)	(0.80)	(1.23)	0.60	0.25

BUY

Price target \$16.00

(from \$20.00)

Price \$11.46

Financial Summary

Book Value (MM):	\$122.8
Book Value/Share:	\$4.34
Net Debt (MM):	\$(102.6)

Market Data

52 Week Range:	\$18.55 - \$6.60
Total Entprs. Value (MM):	\$195.5
Market Cap. (MM):	\$298.1
Insider Ownership:	38.6%
Institutional Ownership:	23.9%
Shares Out. (MM):	26.0
Float (MM):	8.5
Avg. Daily Vol.:	315,612

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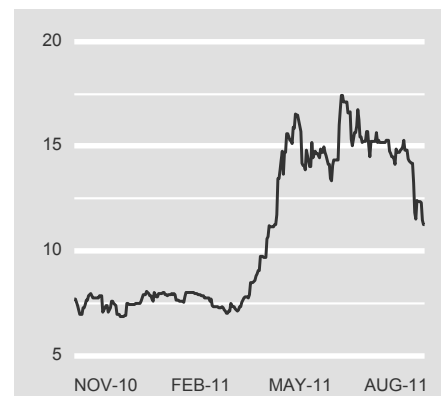
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Price Performance



Complete Genomics**Quarterly results versus expectations, 2Q11**

(\$ in millions, except per share)

	Prior	Forecast	Reported	vs Growth		vs Expectations	
				Actual	Percent	Actual	Percent
Net sales	\$1.1	\$7.6	\$5.9	\$4.8	438.6%	(\$1.8)	(23.2%)
Cost of revenue	<u>\$4.9</u>	<u>\$7.5</u>	<u>\$6.1</u>	<u>\$1.2</u>	24.7%	<u>(\$1.4)</u>	(18.7%)
Gross profit	(\$3.8)	\$0.1	(\$0.3)	\$3.6	(93.3%)	(\$0.4)	(347.7%)
Research and Development	\$4.9	\$7.0	\$8.0	\$3.1	62.9%	\$1.0	14.7%
Commercial expenses	\$1.3	\$3.3	\$3.1	\$1.8	139.0%	(\$0.1)	(4.4%)
G&A expenses	<u>\$1.8</u>	<u>\$2.7</u>	<u>\$3.5</u>	<u>\$1.7</u>	<u>96.7%</u>	<u>\$0.8</u>	<u>30.8%</u>
Operating income	(\$11.8)	(\$12.8)	(\$14.9)	(\$3.1)	25.9%	(\$2.1)	16.1%
Interest expense	\$0.8	\$0.8	\$0.8	(\$0.0)	(2.8%)	\$0.0	3.3%
Interest income	(\$0.0)	(\$0.2)	\$0.3	nmf	nmf	nmf	nmf
Other income, net	<u>\$0.0</u>	<u>\$0.0</u>	<u>\$0.0</u>	<u>nmf</u>	<u>nmf</u>	<u>nmf</u>	<u>nmf</u>
Income before taxes	(\$12.6)	(\$13.4)	(\$16.0)	(\$3.3)	26.3%	(\$2.5)	18.7%
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	(\$12.6)	(\$13.4)	(\$16.0)	(\$3.3)	26.3%	(\$2.5)	18.7%
Basic shares outstanding	11.46	28.22	28.29				
Diluted shares outstanding	11.46	28.22	28.29				
Basic E.P.S.	(\$1.10)	(\$0.48)	(\$0.56)				
Diluted E.P.S.	(\$1.10)	(\$0.48)	(\$0.56)				
EBITDA	(\$10.1)	(\$10.2)	(\$12.2)				
Margin Analysis							
Gross margin	(350.7%)	1.4%	(4.4%)				
Research and Development	452.5%	91.7%	136.9%				
Commercial expenses	120.6%	43.0%	53.5%				
G&A expenses	161.9%	34.7%	59.1%				
Operating margin	(1085.7%)	(168.0%)	(253.9%)				
Income before taxes	(1159.9%)	(176.1%)	(272.1%)				
Income tax	0.0%	0.0%	0.0%				
Net margin	(1159.9%)	(176.1%)	(272.1%)				

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	\$3.2	\$8.1	\$24.0	\$10.6	\$11.7	\$12.2	\$15.4	\$50.0
Cost of revenue	\$4.1	\$4.9	\$6.0	\$4.9	\$19.9	\$6.6	\$6.1	\$6.1	\$6.6	\$25.4	\$6.8	\$7.0	\$6.8	\$7.7	\$28.4
Gross profit	(\$3.7)	(\$3.8)	(\$1.8)	(\$1.1)	(\$10.5)	\$0.3	(\$0.3)	(\$2.9)	\$1.5	(\$1.4)	\$3.8	\$4.7	\$5.4	\$7.7	\$21.6
Research and Development	\$6.2	\$4.9	\$5.0	\$5.6	\$21.7	\$6.8	\$8.0	\$7.9	\$7.8	\$30.6	\$6.4	\$6.5	\$6.7	\$7.7	\$27.2
Commercial expenses	\$1.2	\$1.3	\$1.6	\$2.0	\$6.1	\$2.7	\$3.1	\$3.0	\$3.5	\$12.3	\$3.7	\$3.8	\$4.0	\$4.6	\$16.1
G&A expenses	\$3.1	\$1.8	\$2.3	\$2.2	\$9.3	\$2.8	\$3.5	\$3.8	\$4.1	\$14.2	\$4.0	\$4.1	\$4.0	\$4.2	\$16.3
Operating income	(\$14.2)	(\$11.8)	(\$10.7)	(\$10.9)	(\$47.7)	(\$12.0)	(\$14.9)	(\$17.6)	(\$13.9)	(\$58.5)	(\$10.2)	(\$9.7)	(\$9.3)	(\$8.9)	(\$38.1)
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	(\$0.3)	(\$0.3)	(\$0.2)	(\$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)	(\$18.1)	(\$14.4)	(\$60.9)	(\$10.9)	(\$10.4)	(\$10.0)	(\$9.7)	(\$41.0)
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)	(\$18.1)	(\$14.4)	(\$60.9)	(\$10.9)	(\$10.4)	(\$10.0)	(\$9.7)	(\$41.0)
Basic shares outstanding	10.1	11.5	19.8	14.8	14.0	26.0	28.3	32.7	32.8	29.9	33.0	33.1	33.3	33.5	33.2
Diluted shares outstanding	10.1	11.5	19.8	14.8	14.0	26.0	28.3	32.7	32.8	29.9	33.0	33.1	33.3	33.5	33.2
Basic E.P.S.	(\$1.42)	(\$1.10)	(\$1.05)	(\$0.69)	(\$4.14)	(\$0.48)	(\$0.56)	(\$0.55)	(\$0.44)	(\$2.04)	(\$0.33)	(\$0.31)	(\$0.30)	(\$0.29)	(\$1.23)
Diluted E.P.S.	(\$1.42)	(\$1.10)	(\$1.05)	(\$0.69)	(\$4.14)	(\$0.48)	(\$0.56)	(\$0.55)	(\$0.44)	(\$2.04)	(\$0.33)	(\$0.31)	(\$0.30)	(\$0.29)	(\$1.23)
EBITDA	(\$12.9)	(\$10.1)	(\$8.2)	(\$8.4)	(\$39.6)	(\$9.5)	(\$12.2)	(\$14.6)	(\$10.2)	(\$46.5)	(\$6.3)	(\$5.5)	(\$5.0)	(\$4.4)	(\$21.2)
Margin Analysis															
Gross margin	(1113.4%)	(350.7%)	(44.4%)	(28.9%)	(111.9%)	3.7%	(4.4%)	(90.8%)	18.5%	(5.8%)	36.0%	40.0%	44.0%	50.0%	43.2%
Research and Development	1836.0%	452.5%	119.1%	148.3%	231.0%	99.6%	136.9%	249.5%	96.4%	127.5%	60.0%	55.0%	55.0%	50.0%	54.5%
Commercial expenses	364.9%	120.6%	38.2%	52.1%	65.1%	39.5%	53.5%	94.5%	43.2%	51.5%	35.0%	32.5%	32.5%	30.0%	32.3%
G&A expenses	922.3%	161.9%	56.0%	56.6%	99.5%	40.7%	59.1%	120.7%	50.5%	59.1%	37.5%	35.0%	32.5%	27.5%	32.6%
Operating margin	(4236.6%)	(1085.7%)	(257.7%)	(285.9%)	(507.5%)	(176.2%)	(253.9%)	(555.5%)	(171.7%)	(243.9%)	(96.5%)	(82.5%)	(76.0%)	(57.5%)	(76.2%)
Income before taxes	(4266.7%)	(1159.9%)	(501.3%)	(269.9%)	(618.7%)	(182.4%)	(272.1%)	(570.0%)	(178.0%)	(254.2%)	(103.0%)	(88.7%)	(82.2%)	(62.6%)	(82.1%)
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	(4266.7%)	(1159.9%)	(501.3%)	(269.9%)	(618.7%)	(182.4%)	(272.1%)	(570.0%)	(178.0%)	(254.2%)	(103.0%)	(88.7%)	(82.2%)	(62.6%)	(82.1%)
Growth Analysis															
Net sales						1933.6%	438.6%	(23.7%)	113.0%	155.3%	55.0%	100.0%	285.0%	90.5%	108.5%
Cost of revenue						61.4%	24.7%	0.8%	34.7%	27.5%	3.0%	15.0%	13.0%	16.8%	11.9%
Gross profit						(106.7%)	(93.3%)	56.1%	(235.9%)	(86.7%)	1419.0%	(1925.7%)	(286.6%)	416.2%	(1651.0%)
Research and Development						10.4%	62.9%	59.9%	38.4%	40.9%	(6.7%)	(19.6%)	(15.1%)	(1.2%)	(10.9%)
Commercial expenses						120.2%	139.0%	88.6%	76.7%	101.9%	37.3%	21.5%	32.4%	32.3%	30.6%
G&A expenses						(10.3%)	96.7%	64.4%	90.0%	51.6%	42.9%	18.4%	3.7%	3.7%	15.0%
Operating income						(15.4%)	25.9%	64.4%	27.9%	22.7%	(15.1%)	(35.0%)	(47.3%)	(36.2%)	(34.9%)
Income before taxes						(13.1%)	26.3%	(13.3%)	40.5%	4.9%	(12.5%)	(34.8%)	(44.5%)	(33.0%)	(32.7%)
Net income						(13.1%)	26.3%	(13.3%)	40.5%	4.9%	(12.5%)	(34.8%)	(44.5%)	(33.0%)	(32.7%)
Diluted E.P.S.						(66.3%)	(48.8%)	(47.4%)	(36.5%)	(50.8%)	(31.1%)	(44.3%)	(45.6%)	(34.3%)	(39.4%)

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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In May 2011, Jefferies & Company acted as a Joint Bookrunner in connection with a follow on offering of equity for Complete Genomics, Inc. In November 2010, Jefferies & Company acted as a Joint Bookrunner on the Initial Public Offering for Complete Genomics, Inc.

Jefferies makes a market in Complete Genomics.

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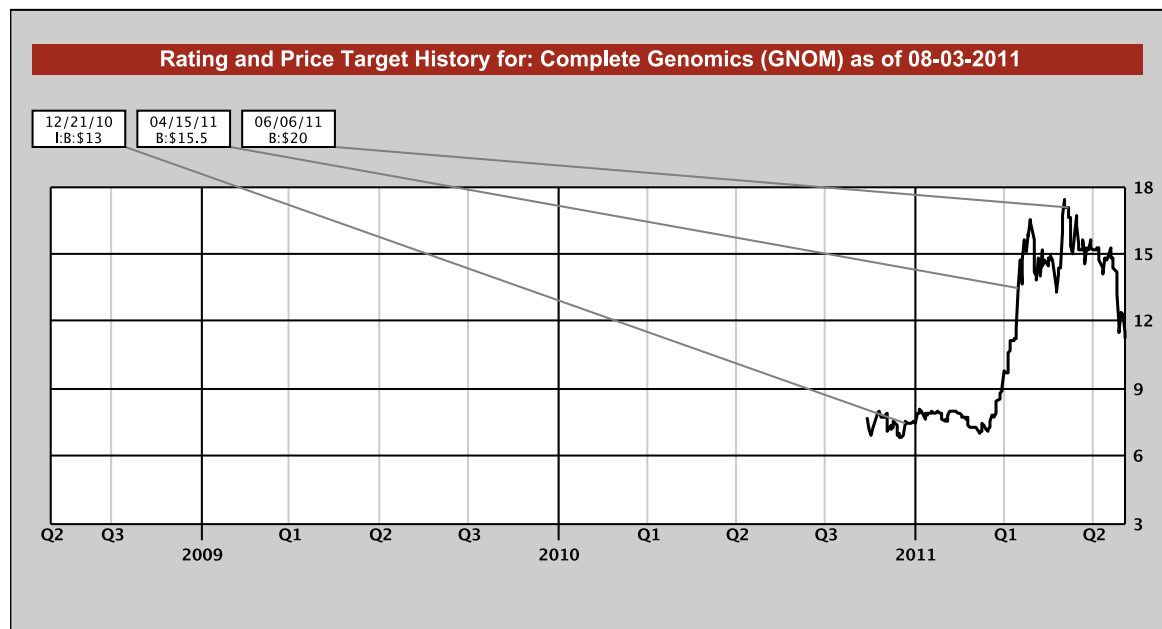
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Other Companies Mentioned in This Report

- Complete Genomics (GNOM: \$11.46, BUY)



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			Count	Percent
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