

November 7, 2011

Stock Rating:
OUTPERFORM

12-18 mo. Price Target \$8.00
GNOM - NASDAQ \$5.05

3-5 Yr. EPS Gr. Rate NM
52-Wk Range \$18.55-\$4.70
Shares Outstanding 33.1M
Float 18.7M
Market Capitalization \$167.0M
Avg. Daily Trading Volume 365,816
Dividend/Div Yield NM/NM
Fiscal Year Ends Dec
Book Value \$3.72
2011E ROE NM
LT Debt \$18.4M
Preferred NM
Common Equity \$63M
Convertible Available No

EPS Diluted	Q1	Q2	Q3	Q4	Year	Mult.
2010A	(51.15)	(13.92)	(21.87)	(0.69)	(13.60)	NM
2011E	(0.48)A	(0.56)A	(0.65)A	(0.66)	(2.36)	NM
Prior (E)	--	--	(0.60)	(0.53)	(2.17)	NM
2012E	--	--	--	--	(1.38)	NM
Prior (E)	--	--	--	--	(1.30)	NM

Revenue (\$/mil)	Q1	Q2	Q3	Q4	Year	Mult.
2010A	0.3	1.1	4.2	3.8	9.4	9.1x
2011E	6.8A	5.9A	4.2A	4.7	21.5	4.0x
Prior (E)	--	--	3.6	8.6	24.9	3.4x
2012E	--	--	--	--	42.0	2.0x
Prior (E)	--	--	--	--	49.9	1.7x

HEALTHCARE/LIFE SCIENCE TOOLS & DIAGNOSTICS

Complete Genomics, Inc.

Near-Term Pain, Long-Term Gain

SUMMARY

GNOM reported 3Q11 results roughly in line with expectations. However, our attention is focused on two key negatives: 1) a sample prep snafu that led to a reduction in the 2011 outlook and 2) the absence of major orders since July. At this point we are willing to attribute both issues to growing pains associated with a young commercial enterprise. We remain confident that the GNOM NGS technology has the clearest path to the \$1,000 genome and the ability to drive a clinical inflection point. 2012 should bring significant milestones, including substantial throughput increases, cost decreases and CLIA certification. We are maintaining our Outperform and reducing our target price to \$8, reflecting slower than expected near-term business ramp.

KEY POINTS

- **3Q results.** Revenue of \$4.2M from the delivery of 700 genomes was roughly in line with expectations. Expenses came in a touch higher than expectations, mostly on higher R&D and COGS cost. COGS were negatively impacted by infrastructural build and inventory fluctuations related to genome shipment timing.
- **Sample prep disruption.** In 3Q, GNOM experienced a hiccup on the path to a fully automated sample prep. As a result, 700 genomes intended for 4Q delivery will now shift to 1Q12. This transiently impacted turnaround time by 20-30 days. Management continues to expect a <60 day sample turnaround in 2012.
- **CLIA the key.** GNOM believes the price elasticity of demand will help attract more translational work with larger orders (>10,000 genomes). CLIA certification should be achieved mid-2012 and is crucial to access this market. New offerings like the cancer and diploid sequencing services are hoped to help this push.
- **Backlog update.** While GNOM added 3,400 genomes to its backlog, only 700 were outside of the two large July contracts. GNOM did add 25 new customers in 3Q, which should help dilute the concentrated revenue base. We model 3,500 backlog additions in 4Q at \$4K/genome.
- **Estimate changes.** Management revised guidance to the delivery of 3,200 to 3,600 genomes in 2011. We have revised our revenue forecast accordingly to \$21.5M on ~3,200 genomes. We are also lowering 2012 and now model revenue of \$42M on 10K genomes.

Stock Price Performance

Company Description

Complete Genomics is a life sciences tools company that has developed and commercialized what is arguably the most powerful DNA sequencing platform in the industry. GNOM operates on a service model, offering its NGS technology as an innovative, end-to-end, outsourced service to provide customers with data that is immediately ready to be used for genome-based research.

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David Ferreiro, Ph.D.
212-667-8163
David.Ferreiro@opco.com

- **Upgrade Update.** GNOM now has 24 production sequencers delivering 1 genome per day. All 24 systems will be upgraded to produce ~1.5 genomes/day between 4Q11 and 1Q12. Based on the upgrade, capacity will exceed 1,000 genomes per month. Management continues to target mid-2012 for the release of the next-generation system that will initially be capable of 6 genomes/day. Over time this system should evolve to 10 genomes per day. Longer term, GNOM believes the technology could drive throughput up another order of magnitude. Key changes to the systems include the addition of 2 additional cameras (now 4 total) and the move to a much larger chip footprint to take advantage of camera speed. In addition, management indicated the computing facilities can now handle over 1,000 genomes per month. Computing remains highly scalable.

Complete Genomics Quarterly Income Statement (\$MMs except per share data)

	2009	1Q10	2Q10	3Q10	4Q10	2010	1Q11	2Q11	3Q11	4Q1E	2011E
System Sales	0.62	0.34	1.09	4.16	3.80	9.39	6.83	5.87	4.18	4.65	21.53
Total Revenue	0.62	0.34	1.09	4.16	3.80	9.39	6.83	5.87	4.18	4.65	21.53
COGS	5.03	4.08	4.91	6.01	4.90	19.90	6.58	6.12	8.18	7.83	28.71
General and Administrative	4.95	3.10	1.76	2.33	2.15	9.35	2.78	3.47	3.81	3.96	14.01
Sales and Marketing	1.80	1.23	1.31	1.59	1.98	6.11	2.70	3.14	3.46	3.72	13.02
R&D	22.42	6.17	4.93	4.95	5.64	21.69	6.81	8.03	9.55	10.47	34.85
Operating Income	(33.59)	(14.24)	(11.82)	(10.72)	(10.87)	(47.65)	(12.04)	(14.89)	(20.82)	(21.32)	(69.07)
Interest Expense	(3.47)	(0.31)	(0.83)	(0.91)	(0.78)	(2.83)	(0.34)	(0.81)	(0.80)	(0.80)	(2.75)
Other, net	1.10	0.21	0.03	(9.23)	1.39	(7.61)	(0.08)	(0.26)	0.01	0.00	(0.25)
Pre-Tax Income	(35.95)	(14.34)	(12.63)	(20.86)	(10.26)	(58.09)	(12.46)	(15.96)	(21.61)	(22.12)	(72.15)
Taxes	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Tax Rate	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	0.0%
Net Income	(35.95)	(14.34)	(12.63)	(20.86)	(10.26)	(58.09)	(12.46)	(15.96)	(21.61)	(22.12)	(72.15)
Non-GAAP EPS	(\$386.56)	(\$51.15)	(13.92)	(\$21.87)	(\$0.69)	(\$13.60)	(\$0.48)	(\$0.56)	(\$0.65)	(\$0.66)	(\$2.36)
Avg. Shares Out. - Fully Dil.	0.1	0.3	0.9	1.0	14.8	4.3	26.0	28.3	33.1	33.3	30.2
Margin Analysis	2009	1Q10	2Q10	3Q10	4Q10	2010	1Q11	2Q11	3Q11	4Q1E	2011E
COGS	NM	NM	NM	144.4%	128.9%	NM	96.3%	104.4%	195.9%	168.1%	133.4%
Gross Margin	NM	NM	NM	-44.4%	-28.9%	NM	3.7%	-4.4%	-95.9%	-68.1%	-33.4%
General and Administrative	NM	NM	NM	NM	NM	NM	40.7%	59.1%	85.0%	85.0%	65.1%
Sales and Marketing	NM	NM	NM	NM	NM	NM	39.5%	53.5%	110.0%	80.0%	60.5%
R&D	NM	NM	NM	NM	NM	NM	99.6%	136.9%	225.0%	225.0%	161.9%
Operating Margin	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Net Margin	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Growth Analysis	2009	1Q10	2Q10	3Q10	4Q10	2010	1Q11	2Q11E	3Q11	4Q1E	2011E
Revenue	NM	NM	NM	NM	NM	NM	NM	438.6%	0.4%	22.4%	129.3%
COGS	NM	NM	NM	NM	NM	NM	NM	24.7%	36.2%	59.6%	44.3%
Selling and Marketing	NM	NM	NM	NM	NM	NM	NM	96.7%	63.5%	83.8%	50.0%
Selling, General and Administrative	NM	NM	NM	NM	NM	NM	NM	62.9%	92.7%	85.7%	60.7%
Operating Income	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
EPS	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM

Source: Oppenheimer Estimates, Company Reports

Investment Thesis

GNOM has developed a proprietary, innovative sequencing platform including robust bioinformatics tools in order to provide researchers with a complete outsourced human genome sequencing service. Initial data provided by GNOM and early users have demonstrated the company has produced high-quality sequence data, validating the platform. Despite a rapidly expanding installed base of NGS instruments, we believe demand from the research community and later from the clinical community will continue to outpace the total market sequencing capacity, thus creating an important niche for service providers like GNOM.

Price Target Calculation

We value GNOM by a discounted cash flow (DCF) analysis. Our \$8.00 target price (down from \$16.00) assumes a WACC of 11.3% and a terminal growth rate of 2.0% on an estimated free cash flow of \$73M in 2022.

Key Risks to Price Target

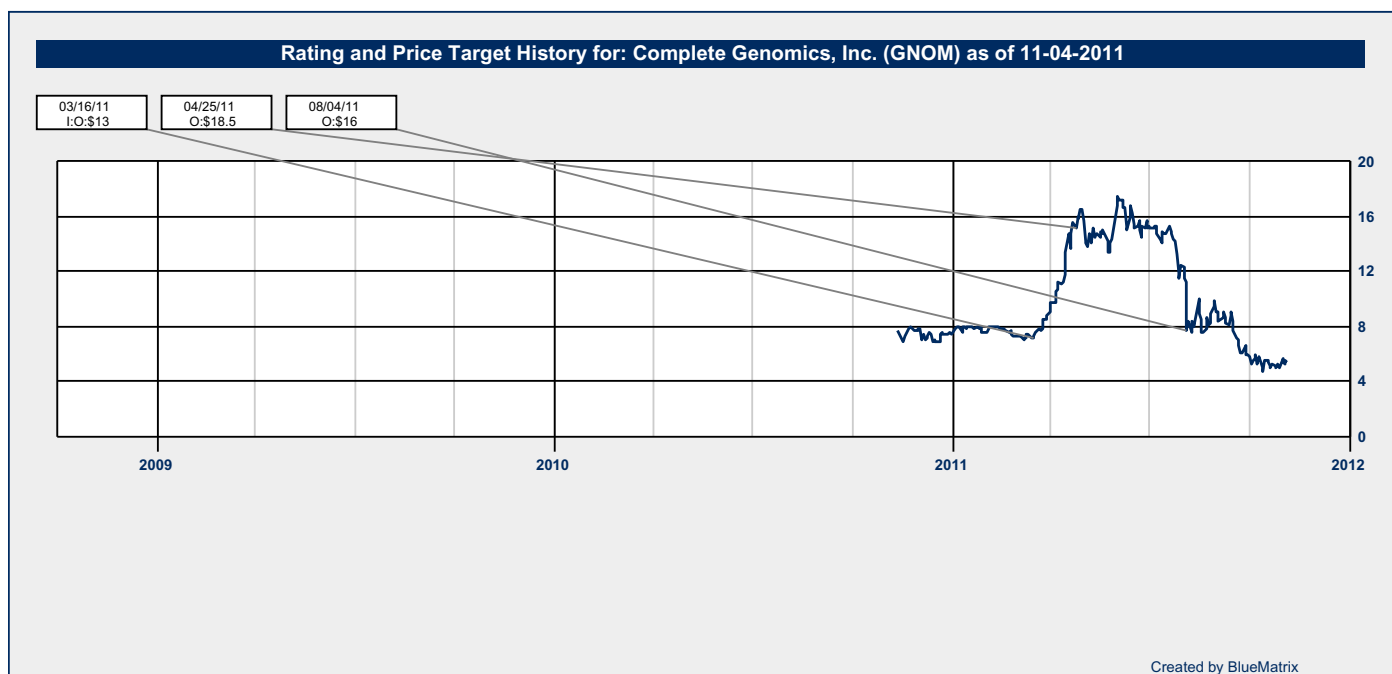
These include: 1) competition from the high-throughput NGS installed base, 2) uncertainty over research funding, 3) technology obsolescence, 4) competition from other service providers, 5) the clinical market perhaps taking time to develop and 6) financing risk.

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Rating	Count	IB Serv/Past 12 Mos.		Count	Percent
		Percent	Count		
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PERFORM [P]	256	43.10	83	32.42	
UNDERPERFORM [U]	9	1.50	3	33.33	

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