

Equity Research

September 30, 2014

Price: \$9.73 (09/29/2014)

Price Target: \$12.00 (Prior \$22.00)

OUTPERFORM (1)

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Key Data

Symbol	NASDAQ: VCYT
52-Week Range:	\$19.00 - 9.22
Market Cap (MM):	\$209.1
Net Debt (MM):	\$(66.3)
Cash/Share:	\$3.37
Dil. Shares Out (MM):	21.5
Enterprise Value (MM):	\$156.1
ROIC:	NM
ROE (LTM):	NM
BV/Share:	\$2.10
Dividend:	NA

FY (Dec)	2013A	2014E	2015E
Revenue (MM)			
Q1	\$4.4	\$7.5A	\$13.8
Prior Q1	-	-	\$15.8
Q2	\$5.1	\$8.7A	\$16.1
Prior Q2	-	-	\$19.0
Q3	\$5.6	\$9.2	\$18.5
Prior Q3	-	\$10.2	\$21.3
Q4	\$6.8	\$12.7	\$20.6
Prior Q4	-	\$13.7	\$24.0
Year	\$21.9	\$38.0	\$69.0
Prior Year	-	\$40.0	\$80.1
EV/S	7.1x	4.1x	2.3x

Earnings Per Share

Year	\$(6.15)	\$(1.23)	\$(0.82)
Prior Year	-	\$(1.19)	\$(0.65)
Consensus EPS	\$(1.23)	\$(1.31)	\$(0.85)

Consensus source: Thomson Reuters

Company Update

Recapping A Tough Q3, Updating Model, & Outlining The Opportunity From Here

The Cowen Insight

We are revising our VCYT model based on our quarterly review and management commentary. We are lowering our FNA volume and revenue forecast for Q3 primarily to reflect a softer summer season, and for the next several quarters to better reflect some unfavorable dynamics discussed herein. We are reducing our price target to \$12, which still represents a ~15% discount EV/15E sales multiple to peers.

Model Changes

We have made several changes to our revenue model to account for the following dynamics: (1) slower than expected progress with obtaining contracted reimbursements rates with private payors; (2) increased non-diagnostic rate for FNA samples undergoing cytopathology; (3) continued mix shift towards academic/institutional customers; and (4) increased challenges with business predictability. As a result of the aforementioned dynamics, we are cutting our FNA volume and revenue estimates across the board by ~5% and ~10-15% per annum in 2015 and beyond, respectively. Admittedly, our prior revenue estimates were a bit aggressive given the rate at which we had forecast private payors would reimburse the “backlog” of Afirma GEC tests. For Q3, we are reducing our revenue forecast by ~\$1MM to better account for a seasonally weaker summer quarter and some of the aforementioned challenges.

Recent Stock Weakness

While stock performance for almost every small cap Tools and Diagnostics company has materially underperformed the market and Russell 2000 over the past few weeks, Veracyte's stock underperformance has been particularly notable: since reporting Q2 results on August 12, VCYT shares have declined ~35%. We believe there are several factors contributing to this material weakness, chief among which include: (1) moderating expectations for a small cap company that should be robustly beating expectations, particularly with substantial proceeds raised in an IPO last year; (2) an acquisition that likely necessitates the need for additional financing ~1 year earlier; and (3) concerns about the growth trajectory for various reasons detailed herein.

Reducing Price Target And Updated Thoughts On Valuation

Veracyte trades at a material discount (~30-40%) to small cap Tools and Diagnostics peers on a 2015-2016 EV/sales basis. While we acknowledge that recent execution has not been pristine, and it appears the company is targeting a much smaller market opportunity than some peers, we believe that it will be hard to argue the current valuation is expensive. We remain positive on the outlook for Veracyte, but we are cutting our price target to \$12, which still represents a ~15% discount on a EV/15-16 sales basis to peers to better reflect recent revenue/sales force challenges and increasing operating cash burn; the bias should be to the upside. The next potential catalyst for VCYT is the Investor Day in NYC on October 9.

At A Glance

Our Investment Thesis

Through a series of clinical validity, utility and health economics studies, Veracyte has obtained National Comprehensive Cancer Network (NCCN) guideline recommendations as well as several positive payor coverage decisions, including Medicare, United, Aetna, and Humana, covering >135MM lives in the US. While we acknowledge that the GEC test remains on the earlier stages of product adoption, we believe Veracyte is well positioned to gain additional payor coverage and physician adoption over the next several years. VCYT shares trade at a discount of ~50% on a 2015 EV/revenue basis, relative to a peer group that includes ICEL, FLDM, FMI, GHDX, OXFD and MYGN. Given the company's experienced management team, the strong science behind Afirma, the clear unmet need addressed by Afirma, a developing pipeline, a relatively cheap valuation, and the potential for upside relative to expectations, we rate shares Outperform.

Forthcoming Catalysts

- October 9 Investor Day
- Insurance coverage decisions
- Conversion to contracted lives from covered lives
- Guideline inclusion
- Pipeline announcements
- Strategic developments
- Quarterly earnings reports

Base Case Assumptions

- FNA and GEC volume growth ahead of expectations
- Total lives under coverage continues to expand
- New product introductions/Allegro on track
- Some conversions to contracted lives from covered lives

Upside Scenario

- FNA and GEC volume growth well ahead of expectations
- OUS launch starts to gain momentum
- Allegro tracks ahead of expectations
- Better than expected ASPs
- Additional guidelines inclusions drive further adoption
- More conversions to contracted lives from covered lives than expected

Downside Scenario

- FNA and GEC volume growth below expectations
- Total covered lives continue to expand, but at a slower pace
- New product launches/Allegro delayed
- Competition emerges

Price Performance



Source: Bloomberg

Company Description

Veracyte is a molecular cytology-focused diagnostics company that currently markets the Afirma GEC test that is used to reduce the number of unnecessary thyroid surgeries in patients suspected of having thyroid cancer. The company launched Afirma Malignancy Classifiers in 2014 and currently has several products under development, including an idiopathic pulmonary fibrosis (IPF) molecular classifier and a pre-operative diagnostic test for lung cancer, obtained through its acquisition of Allegro Diagnostics in September 2014.

Analyst Top Picks

	Ticker	Price (09/29/2014)	Price Target	Rating
Illumina	ILMN	\$165.22	\$205.00	Outperform
Thermo Fisher Scientific	TMO	\$122.00	\$135.00	Outperform

What Has Happened To VCYT In Q3?

Q2 Earnings

Q2 revenue came in \$0.7MM below consensus and FNA volumes were ~2-3K light of our expectations. While revenue tends to remain lumpy Q/Q due to the timing of revenue recognition, FNA volume growth tends to be more consistent; thus, FNA volumes coming in below our forecast was surprising. Management attributed FNA volume weakness to the increasing mix of academic/institutional clients versus physician offices as Veracyte's sales force was seemingly more focused on academic/institutional sales – to be clear, because academic/institutional clients only send in FNAs for GEC testing and not for cytopathology, FNA volumes in the quarter were lighter than expected. FNA volume guidance for 2014 was reduced to 66-73K from 76-83K. We believe many have argued that it is surprising that Veracyte faced what appears to have been a resource allocation/prioritization issue in spite of the fact that last year's IPO allowed for expansion of the sales force, acceleration of sales force hires earlier this year, and Afirma having only penetrated ~10-15% of the US market; thus, we understand the material weakness in VCYT stock over the past several weeks.

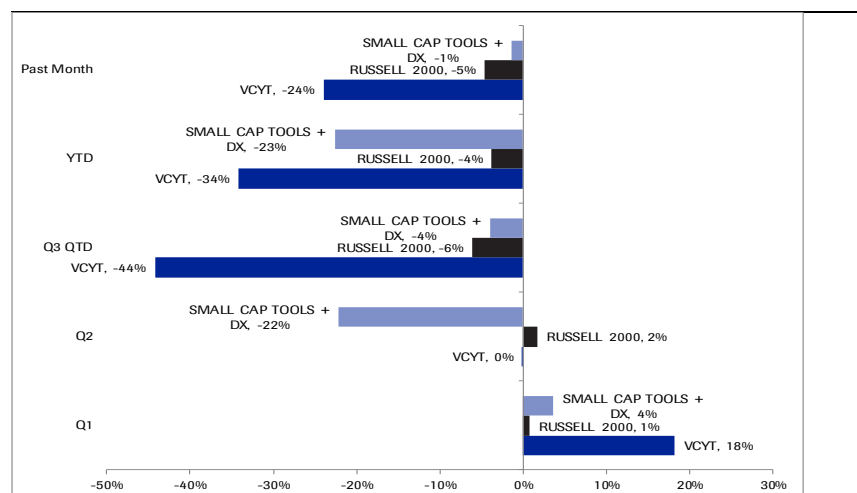
Allegro Acquisition

In Q3, Veracyte announced the acquisition of Allegro Diagnostics, a privately-held company that is focused on developing genomic tests to improve the preoperative diagnosis of lung cancer. For further background and our thoughts on this acquisition, please see our note published in early September ([link to Allegro note](#)).

Stock Performance

VCYT shares have materially underperformed peers over the past several weeks, and now trades ~35% lower since reporting Q2 results. We believe there are numerous factors pressuring shares.

Figure 1 VCYT Relative Share Performance



Source: Thomson One and Cowen and Company; Priced 9/29/14.

Note: Small Cap Tools + Dx Group includes AFFX, FLDIM, FMI, GHDX, ICBL, NSTG, OSUR, OXFD, PACB, QDEL, SQNM, VIVO

What Is Likely Pressuring The Stock?

Q2 "Issues" That Have Been Highlighted By Investors

- Q2 revenue and FNA volumes were light of expectations
- Q2 FNA volume weakness was attributed to high mix of academic/institutional centers; investors seemingly don't like this because at this level of market penetration, it arguably doesn't seem like sales to the two customers should be an either/or situation.
- 2014 guidance was reduced for FNA volumes.
- 2014 revenue guidance was maintained but a significant H2 ramp is required to get to the midpoint of revenue guidance. We believe low end of guidance is more realistic when it seems like VCYT should still be beating robustly.
- Company accelerated pace of sales force hiring early this year and this wasn't in guidance - thus, surprisingly weak Q2 performance
- Genzyme contract change - helps economics (32% to 15% of cash received paid to Genzyme) but in context of recent performance, concerns are heightening about internal sales force spend and efficiency
- Reimbursement (conversion to contracted lives) is seemingly not improving as quickly as expected

Allegro Acquisition

- Accelerates operating burn
- Dilutes focus from thyroid
- Reduced cash likely necessitates financing ~1 year early

Model Changes

Subsequent to our quarterly review, we are updating our Veracyte model to better reflect the changing customer mix dynamic; we are reducing our FNA volume forecast by about ~5% per year from 2015 through 2018. For 2014, we are now forecasting ~68K FNA received, which is slightly below the midpoint of guidance updated on the Q2 earnings call (66-73K). Given slower than anticipated conversion of covered lives to contracted lives, an increase in non-diagnostic rate for cytopathology (as disclosed in the 10Q from 5-10% to 8-12%), and generally limited visibility, we are reducing our 2014 revenue forecast to \$38MM from \$40MM (guidance: \$38-43MM). Admittedly, our previous 2015 and 2016 revenue forecasts were a bit aggressive, particularly in light of slower than anticipated reimbursement progress and limited visibility; accordingly, we are cutting our revenue forecasts by ~10-15% in 2015 and beyond. We believe our updated revenue forecast is a much more realistic target for Veracyte. We have not yet modeled any contributions from OUS sales or new products (including Allegro) in our revenue forecast.

Valuation and Price Target

VCYT trades at a material discount (~30-40%) to small cap Tools and Diagnostics peers on a 2015-2016 EV/sales basis. While we acknowledge that recent execution has not been pristine relative to Street expectations, and it appears Veracyte is targeting a much smaller market opportunity than most peers, we believe that it will

be hard to argue the current valuation is expensive. We remain positive on the outlook for Veracyte, but we are cutting our price target to \$12, which still represents a ~15% discount on a EV/'15-16 sales basis to better reflect recent revenue/sales force challenges and increasing operating cash burn.

Figure 2 VCYT Comparable Company Analysis (\$MM, except EPS data)

Company Name	Ticker	Rating	Price	52 Week			Div Yld	MV (MM)	EV (MM)	EV/Sales			
				Low	High					2013	2014E	2015E	2016E
Veracyte Inc	VCYT	1	\$9.55	\$9.60	\$19.00	0.0%		\$203	\$149	6.8x	3.9x	2.2x	1.4x
Cellular Dynamics International Inc	ICEL	1	\$6.52	\$8.14	\$24.11	0.0%		\$157	\$121	10.1x	7.1x	3.2x	2.2x
Fluidigm Corp	FLDM	2	\$25.44	\$21.41	\$49.46	0.0%		\$803	\$903	12.7x	7.8x	6.1x	5.0x
Foundation Medicine Inc	FMI	NR	\$19.23	\$19.51	\$45.00	0.0%		\$604	\$507	18.1x	8.6x	4.6x	2.6x
Oxford Immunotec Global Plc	OXFD	1	\$15.05	\$12.47	\$25.38	0.0%		\$250	\$184	4.8x	3.8x	2.7x	2.2x
Genomic Health Inc	GHDX	2	\$29.15	\$23.90	\$37.24	0.0%		\$921	\$816	3.1x	2.9x	2.6x	2.3x
Myriad Genetics Inc	MYGN	2	\$37.89	\$20.02	\$42.50	0.0%		\$2,775	\$2,588	4.3x	3.3x	3.2x	3.0x
										2013	2014E	2015E	2016E
Median										7.5x	5.4x	3.2x	2.4x
Mean										8.9x	5.6x	3.7x	2.9x
High										18.1x	8.6x	6.1x	5.0x
Low										3.1x	2.9x	2.6x	2.2x
VCYT										6.8x	3.9x	2.2x	1.4x
vs. median										(9%)	(28%)	(33%)	(43%)
vs. mean										(23%)	(30%)	(42%)	(51%)

Source: Company Reports, Thomson One, and Cowen and Company.

Key Questions

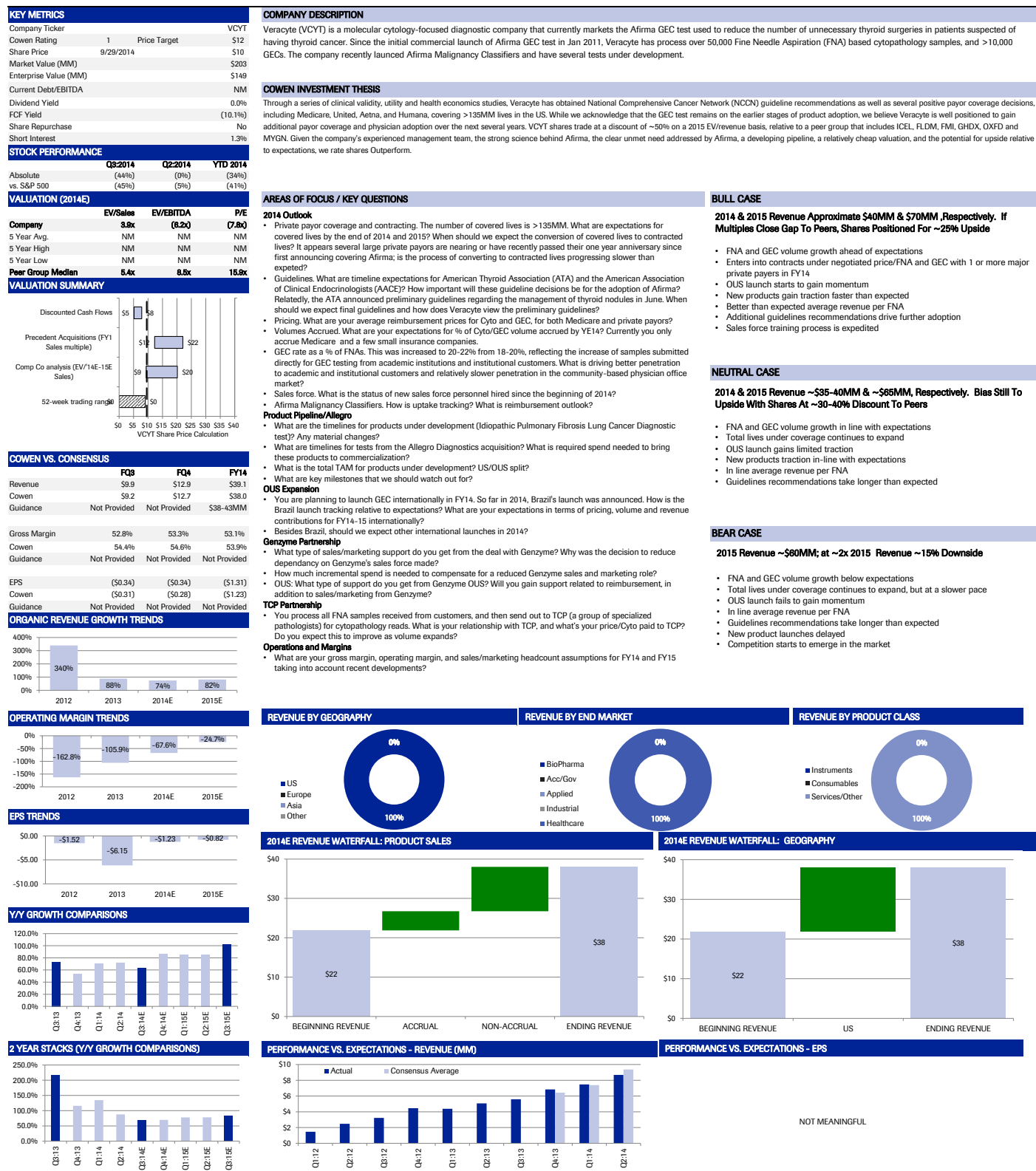
- When will covered lives be converted to contracted lives for Afirma GEC? A few large payors are nearing or passed the one year period since first obtaining covered lives.
- What percentage of revenue are accrual accounts now?
- What is the status of new sales force personnel hired since the beginning of 2014?
- How much incremental spend is needed to compensate for a reduced Genzyme sales and marketing role?
- What is the focus going forward between academic/institutional and community-based physician office accounts? Why does it appear sales force success at these channels are a bit "mutually exclusive"?
- Timing on guideline inclusions?
- What are financial expectations (revenue and operating expense) related to Allegro?
- Any incremental competitive concerns in thyroid or lung?
- What is the focus of the upcoming Analyst Day (October 9th in NYC)?

Figure 3 Veracyte (VCYT) Quarterly Snapshot

Cowen vs. Consensus (\$MM, except EPS)				
		Q3:14E		
	Q3:13A	Cowen	Consensus	Guidance
Revenue	\$5.6	\$9.2	\$9.9	AUG 12: FY14: \$38-43MM (reaffirmed); FNA volumes 66-73K (was 76-83K)
Gross Margin	44.0%	54.4%	52.8%	
Operating Margin	(109.1%)	(72.0%)	NM	
EPS	(\$6.59)	(\$0.31)	(\$0.34)	
Selected Revenue Metrics (\$MM, except EPS)				
	Q3:13A	Q2:14A	Q3:14E	Comments
FNA Volume	12,417	16,458	16,608	We are forecasting FNA volume to increase slightly Q/Q. Seasonality (summer vacations) should negatively impact volume, but we expect underlying trends to remain relatively robust.
Reported Growth (Y/Y)	76.1%	32.5%	33.8%	
GEC Volume	2,508	3,654	3,703	We are forecasting GEC volume to increase slightly Q/Q. Seasonality (summer vacations) should negatively impact volume. We expect GEC volume to grow faster than FNA volume as uptake at academic and institutional clients has been better than the uptake at community-based physician channel (the former only sends FNA samples for GEC testing, not cytopathology).
Reported Growth (Y/Y)	97.9%	50.0%	47.6%	
Income Statement (\$MM, except EPS)				
	Q3:13A	Q2:14A	Q3:14E	Comments
Revenue	\$5.6	\$8.7	\$9.2	We are reducing our revenue forecast to better account for seasonality (summer vacations), to reflect a more conservative rate of conversion for "backlog" revenue, and to account for a higher rate of non-diagnostic cytopathology tests (as disclosed in the 10Q). We note that quarter to quarter revenue tends to be lumpy due to the timing of revenue recognition.
Reported Growth (Y/Y)	73.5%	71.2%	63.7%	
Gross Profit	\$2.5	\$4.7	\$5.0	We expect underlying COGS per test to decrease. Reported gross margin isn't meaningful as Veracyte incurs costs as tests are performed but revenue on tests may be recognized in a different period.
Margin	44.0%	54.3%	54.4%	
R&D	\$2.0	\$2.2	\$2.4	We are expecting R&D expense to increase slightly Q/Q, partly driven by the acquisition of Allegro.
% of sales	36.3%	25.8%	26.0%	
Growth Y/Y	17.3%	17.9%	17.4%	
SG&A	\$6.5	\$9.0	\$9.2	We expect SG&A expense to increase \$500K Q/Q to reflect additional expenses related to Allegro and sales force hires.
% of sales	116.8%	104.1%	100.4%	
Growth Y/Y	46.9%	68.7%	40.7%	
Operating Profit	(\$6.1)	(\$6.6)	(\$6.6)	
Margin	(109.1%)	(75.6%)	(72.0%)	
Non-Operating Items	\$0.2	\$0.1	\$0.1	
Pre-Tax Income	(\$6.3)	(\$6.7)	(\$6.7)	
Taxes	\$0.0	\$0.0	\$0.0	
Rate	0.0%	0.0%	0.0%	
Net Income	(\$6.3)	(\$6.7)	(\$6.7)	
Margin	(112.7%)	(76.7%)	(72.7%)	
Earnings Per Share	(\$6.59)	(\$0.31)	(\$0.31)	
Growth (Y/Y)	NM	NM	NM	
Share Count (MM)	1	21	21	

Source: Company Reports, Thomson One, and Cowen and Company.

Figure 4 Veracyte (VCYT) Tearsheet



Source: Company Reports, Thomson One, and Cowen and Company.

Figure 5 Veracyte (VCYT) Revenue Model

(MM, except EPS)	Q1:13	Q2:13	Q3:13	Q4:13	Q1:14	Q2:14	Q3:14E	Q4:14E	Q1:15E	Q2:15E	Q3:15E	Q4:15E	2013	2014E	2015E	2016E	2017E	2018E	5-yr CAGR	Comments
Revenue	\$4.4	\$5.1	\$5.8	\$8.8	\$7.5	\$8.7	\$9.2	\$12.7	\$13.8	\$18.1	\$18.5	\$20.8	\$21.9	\$38.0	\$68.0	\$107.0	\$130.7	\$150.8		AUG 12: FY14: \$38-43MM (reaffirmed); FNA volumes 66-73K (was 76-83K)
Growth - Y/Y	199%	104%	74%	53%	71%	71%	64%	86%	85%	85%	102%	62%	88%	74%	82%	55%	22%	15%		
Growth - Q/Q	(2%)	16%	10%	22%	9%	16%	6%	39%	9%	16%	15%	12%								
Accrual Revenue																				
% of total	34%	36%	30%	30%	32%	30%	33%	31%	30%	29%	26%	27%	32%	31%	28%	25%	27%	28%		
Non-Medicare	\$0.0	\$0.0	\$0.0	\$0.0	\$0.2	\$0.2	\$0.3	\$0.5	\$0.5	\$0.8	\$1.0	\$1.2	\$0.0	\$1.2	\$3.4	\$3.1	\$5.2	\$7.4		
% of total	0%	0%	0%	0%	3%	3%	3%	4%	4%	5%	5%	6%	0%	3%	5%	3%	4%	5%		
Medicare	\$1.5	\$1.8	\$1.7	\$2.0	\$2.2	\$2.4	\$2.7	\$3.4	\$3.6	\$3.9	\$3.9	\$4.4	\$7.0	\$10.7	\$15.8	\$24.1	\$29.7	\$34.1		
% Medicare (all accrued) of total	34%	36%	30%	30%	29%	27%	30%	27%	26%	24%	21%	21%	32%	28%	23%	23%	23%	23%		
Non-Accrual Revenue																				
% of total	66%	64%	70%	70%	68%	70%	67%	69%	70%	71%	74%	73%	68%	69%	72%	75%	73%	72%		
% of Backlog Converted	17%	14%	13%	13%	12%	13%	10%	12%	11%	11%	12%	12%		64%	55%	55%	47%	40%		
Volumes																				
Total FNA Volumes	10,757	12,424	12,417	14,059	14,373	16,458	16,808	20,751	21,775	23,978	24,257	27,190	40,657	68,190	97,190	127,795	154,431	177,598		AUG 13: 66-73K (was 76-83K)
Physician Based Community Channel	10,251	11,790	11,784	13,328	13,511	15,339	15,437	19,326	20,267	22,242	22,384	25,123	47,153	63,613	90,015	117,020	140,423	161,487		
Cytopathology Only Volumes	8,792	9,988	9,909	11,247	11,197	12,804	12,905	16,156	16,923	18,572	18,690	20,978	39,936	53,063	75,163	97,711	117,254	134,842		
Cytopathology + GEC	1,459	1,802	1,875	2,081	2,314	2,535	2,532	3,169	3,344	3,670	3,693	4,145	7,217	10,550	14,852	19,308	23,170	26,645		
Academic, Institutional Channel GEC	506	634	633	731	862	1,119	1,171	1,425	1,509	1,734	1,874	2,067	2,504	4,578	7,184	10,775	14,008	16,109		
Total GEC	1,965	2,438	2,508	2,812	3,176	3,654	3,703	4,595	4,852	5,404	5,567	6,212	9,721	15,128	22,038	30,084	37,178	42,754		

Source: Company Reports and Cowen and Company.

Figure 6 Veracyte (VCYT) Income Statement

(MM, except EPS)	Q1:13	Q2:13	Q3:13	Q4:13	Q1:14	Q2:14	Q3:14E	Q4:14E	Q1:15E	Q2:15E	Q3:15E	Q4:15E	2013	2014E	2015E	2016E	2017E	2018E	5-yr CAGR	Comments	
Net sales	\$4.4	\$5.1	\$5.6	\$6.8	\$7.5	\$8.7	\$9.2	\$12.7	\$18.8	\$16.1	\$18.5	\$20.6	\$21.9	\$38.0	\$68.0	\$107.0	\$190.7	\$190.6	47.1%	AUG 12: FY14: \$38-43MM (reaffirmed); FNA volumes 66-73K (was 76-83K)	
Growth	198.8%	104.4%	73.5%	53.4%	70.5%	71.2%	63.7%	86.0%	85.2%	85.4%	101.8%	62.1%	88.2%	73.8%	81.5%	55.0%	22.1%	15.3%			
Cost of sales	\$2.8	\$3.2	\$3.1	\$3.5	\$3.6	\$4.0	\$4.2	\$5.8	\$6.3	\$6.9	\$7.6	\$8.0	\$12.6	\$17.5	\$28.8	\$38.5	\$40.5	\$45.2			
Gross Profit	\$1.6	\$1.8	\$2.5	\$3.4	\$3.9	\$4.7	\$5.0	\$6.9	\$7.8	\$9.2	\$10.9	\$12.6	\$9.3	\$20.5	\$40.2	\$68.5	\$90.2	\$105.4	62.6%		
% of sales	36.7%	36.2%	44.0%	49.2%	51.8%	54.3%	54.4%	54.6%	54.8%	57.0%	59.0%	61.0%	42.4%	53.9%	58.3%	64.0%	69.0%	70.0%			
Growth	NM	NM	98.6%	81.3%	NM	NM	NM	NM	96.1%	94.7%	NM	81.1%	NM	NM	96.2%	70.2%	31.7%	16.9%			
Incremental Margin	47.9%	42.6%	51.6%	63.4%	73.0%	79.6%	70.7%	60.8%	58.4%	60.2%	63.5%	71.3%	51.0%	69.5%	63.6%	74.4%	91.6%	76.6%			
Research & Development	\$2.0	\$1.9	\$2.0	\$1.9	\$2.1	\$2.2	\$2.4	\$2.7	\$2.7	\$2.9	\$3.0	\$3.3	\$7.8	\$9.4	\$11.9	\$16.5	\$18.3	\$20.3	21.1%		
% of sales	45.8%	37.5%	36.3%	27.3%	28.4%	25.8%	26.0%	21.0%	19.5%	18.0%	16.5%	16.0%	35.7%	24.8%	17.3%	14.5%	14.0%	13.5%			
Growth	35.7%	13.4%	17.3%	8.6%	5.8%	17.9%	17.4%	42.9%	27.0%	29.1%	28.1%	23.5%	18.2%	20.6%	26.8%	29.9%	17.9%	11.1%			
Sales, General & Admin.	\$6.5	\$6.4	\$6.5	\$7.3	\$8.3	\$9.0	\$9.2	\$10.2	\$10.8	\$11.2	\$11.5	\$12.0	\$24.6	\$36.8	\$45.3	\$59.9	\$68.0	\$73.0	24.9%	AUG 12: S&M costs to increase Q3 and Q4 (hires and marketing expenses)	
% of sales	125.3%	105.6%	116.8%	106.2%	111.3%	104.1%	100.4%	80.6%	77.8%	69.3%	61.9%	58.0%	112.6%	96.7%	65.7%	56.0%	52.0%	48.5%		AUG 12: Genzyme co-promotional fee to be reduced to 15% from 32% of	
Growth	84.3%	45.3%	46.9%	38.2%	51.4%	68.7%	40.7%	41.2%	29.5%	23.6%	24.6%	16.6%	50.6%	48.3%	23.2%	32.2%	13.4%	7.5%		Afirma revenue beginning Jan 1, 2015	
Total Operating Expenses	\$7.5	\$7.3	\$8.6	\$9.1	\$10.4	\$11.3	\$11.8	\$12.9	\$18.5	\$14.1	\$14.5	\$15.3	\$32.4	\$46.2	\$57.3	\$75.4	\$86.3	\$89.4	23.5%	SEP 4: Small S&M team for Allegro in 2015, ramp a bit more in 2016, peak 2017	
% of sales	171.1%	143.1%	153.1%	133.5%	139.7%	129.9%	126.4%	101.6%	97.3%	87.3%	78.4%	74.0%	148.3%	121.5%	83.0%	70.5%	66.0%	62.0%			
Growth	68.2%	35.3%	38.6%	30.9%	39.2%	55.4%	35.2%	41.5%	29.0%	24.7%	25.3%	18.0%	41.3%	42.4%	23.9%	31.7%	14.3%	8.3%			
EBITDA	(\$6.7)	(\$5.2)	(\$5.8)	(\$5.5)	(\$6.9)	(\$6.2)	(\$6.2)	(\$5.5)	(\$5.4)	(\$4.4)	(\$3.1)	(\$2.2)	(\$22.2)	(\$24.1)	(\$15.0)	(\$4.9)	\$6.2	\$14.8			
% of sales	(129.9%)	(102.4%)	(103.9%)	(80.1%)	(84.4%)	(71.0%)	(67.6%)	(43.0%)	(38.5%)	(27.2%)	(16.7%)	(10.5%)	(101.3%)	(63.5%)	(21.8%)	(4.5%)	4.8%	9.7%			
Growth	39.7%	16.6%	22.0%	11.0%	10.8%	18.8%	6.5%	(0.1%)	(14.7%)	(28.9%)	(50.0%)	(60.3%)	NM	NM	NM	NM	NM	NM			
Depreciation and Amortization	\$0.2	\$0.2	\$0.3	\$0.3	\$0.3	\$0.4	\$0.4	\$0.5	\$0.5	\$0.5	\$0.5	\$0.5	\$1.0	\$1.8	\$2.0	\$2.1	\$2.3	\$2.5			
Operating Profit	(\$6.9)	(\$5.4)	(\$6.1)	(\$5.8)	(\$6.9)	(\$6.6)	(\$6.6)	(\$6.0)	(\$5.9)	(\$4.9)	(\$3.6)	(\$2.7)	(\$23.2)	(\$25.7)	(\$17.0)	(\$7.0)	\$3.9	\$12.0			
% of sales	(134.4%)	(106.9%)	(109.1%)	(84.3%)	(87.9%)	(75.9%)	(72.0%)	(47.0%)	(42.5%)	(30.3%)	(19.4%)	(13.0%)	(105.9%)	(67.6%)	(24.7%)	(6.5%)	3.0%	8.0%			
Growth	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM			
Incremental Margin	(56.4%)	(30.6%)	(49.1%)	(27.1%)	(22.1%)	(31.7%)	(13.8%)	(3.6%)	10.9%	22.7%	32.1%	41.8%	(41.4%)	(15.7%)	28.0%	26.5%	45.9%	40.8%			
Other non-Operating Expense	\$1.0	\$1.1	\$0.1	\$0.0	(\$0.0)	(\$0.0)	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$2.2	(\$0.0)	\$0.0	\$0.0	\$0.0	\$0.0			
Net Interest Expense	(\$0.0)	\$0.0	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.2	\$0.4	\$0.3	\$0.0	\$0.0	\$0.0			
Earnings Before Taxes	(\$6.9)	(\$6.5)	(\$6.3)	(\$5.9)	(\$6.7)	(\$6.7)	(\$6.7)	(\$6.0)	(\$6.0)	(\$5.7)	(\$2.7)	(\$2.7)	(\$26.6)	(\$26.0)	(\$17.3)	(\$7.0)	\$3.9	\$12.0			
Margin	(157.2%)	(128.1%)	(112.7%)	(86.2%)	(89.3%)	(76.7%)	(72.7%)	(47.5%)	(43.0%)	(30.8%)	(19.8%)	(13.3%)	(116.9%)	(68.5%)	(25.1%)	(6.5%)	3.0%	8.0%			
Growth	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM			
Income Taxes	\$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	\$0.0	\$1.5	\$4.7			
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%	0.0%	0.0%	0.0%	0.0%	39.0%	39.0%			
Net income	(\$6.9)	(\$6.5)	(\$6.3)	(\$5.9)	(\$6.7)	(\$6.7)	(\$6.7)	(\$6.0)	(\$6.0)	(\$5.7)	(\$2.7)	(\$2.7)	(\$26.6)	(\$26.0)	(\$17.3)	(\$7.0)	\$2.4	\$7.4			
Margin	(157.2%)	(128.1%)	(112.7%)	(86.2%)	(89.3%)	(76.7%)	(72.7%)	(47.5%)	(43.0%)	(30.8%)	(19.8%)	(13.3%)	(116.9%)	(68.5%)	(25.1%)	(6.5%)	1.8%	4.9%			
Growth	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM			
Earnings Per Share	(\$8.23)	(\$7.21)	(\$6.59)	(\$6.42)	(\$9.32)	(\$9.31)	(\$9.31)	(\$9.26)	(\$9.26)	(\$9.23)	(\$9.17)	(\$9.13)	(\$8.15)	(\$1.23)	(\$0.82)	(\$0.33)	\$0.11	\$0.36			
Shares Outstanding	1	1	1	14	21	21	21	21	21	21	21	21	4	21	21	21	21	21			
Growth	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM			
VERACYTE - CONSENSUS ESTIMATES																					
\$MM, ex. per share data	Q1:13	Q2:13	Q3:13	Q4:13	Q1:14	Q2:14	Q3:14E	Q4:14E	Q1:15E	Q2:15E	Q3:15E	Q4:15E	2013	2014E	2015E	2016E	2017E	2018E			
Revenue				\$6.4	\$7.4	\$8.4	\$9.9	\$12.9	\$14.7	\$17.4	\$19.2	\$22.1	\$21.5	\$38.1	\$72.0	\$113.4	\$198.1	\$198.0			
Growth								101.6%	98.6%	85.1%	93.9%	71.3%		81.9%	84.1%	57.5%	40.3%	22.0%			
Gross Margin				44.3%	50.9%	50.0%	52.8%	53.9%	51.6%	53.4%	54.7%	56.3%	40.7%	53.1%	58.8%	60.9%	60.9%	60.0%	70.0%		
Actual/ Cowen				49.2%	51.8%	54.3%	54.4%	54.6%	54.8%	57.0%	59.0%	61.0%	42.4%	53.9%	58.3%	64.0%	69.0%	69.0%			
Operating Margin				N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A			
Actual/ Cowen				(84.3%)	(87.9%)	(75.9%)	(72.0%)	(47.0%)	(42.5%)	(30.3%)	(19.4%)	(13.0%)	(105.9%)	(67.6%)	(24.7%)	(6.5%)	3.0%				
EPS				(\$0.38)	(\$0.30)	(\$0.38)	(\$0.34)	(\$0.34)	(\$0.28)	(\$0.22)	(\$0.19)	(\$0.16)	(\$1.83)	(\$1.21)	(\$0.85)	(\$0.17)	\$0.44				
Actual/ Cowen				(50.42)	(50.32)	(50.31)	(50.31)	(50.26)	(50.26)	(50.23)	(50.17)	(50.13)	(56.15)	(51.23)	(50.82)	(50.33)	50.11				

Source: Company Reports, Thomson One, and Cowen and Company.

Valuation Methodology And Risks

Valuation Methodology

Life Science & Diagnostic Tools:

Price targets are based on several methodologies which may include: analysis of market risk, growth rate, revenue stream, discounted cash flows (DCF), EBITDA, EPS, cash flow (CF), free cash flow (FCF), EV/EBITDA, P/E, PE/growth, P/CF, P/FCF, premium (discount) / average group EV/EBITDA, premium (discount) / average group P/E, sum of the parts, net asset value, dividend returns, and return on equity (ROE) over the next 12 months.

Investment Risks

Life Science & Diagnostic Tools:

Risks to the Medical and Life Science Tools sector may include: reduction or delay in research and development budgets and government funding, reduced or delayed purchasing from health care / hospital customers, increased or extended regulatory hurdles or processes for regulated products, increased dependence on volatile emerging markets for revenues and profitability, and general macroeconomic challenges.

Risks To The Price Target

Risks include but are not limited to: difficulty in expanding payer coverage and entering into payer contracts; reimbursement prices lower than expected; delays or weaker than expected clinical data in support of new products; competition from other potential molecular diagnostic players; weaker than expected uptake in international markets; Genzyme partnership could become "relatively" expensive; and delivering on margin / profitability targets.

Addendum

Analyst Certification

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Cowen and Company Rating System effective May 25, 2013

Outperform (1): The stock is expected to achieve a total positive return of at least 15% over the next 12 months

Market Perform (2): The stock is expected to have a total return that falls between the parameters of an Outperform and Underperform over the next 12 months

Underperform (3): Stock is expected to achieve a total negative return of at least 10% over the next 12 months

Assumption: The expected total return calculation includes anticipated dividend yield

Cowen and Company Rating System until May 25, 2013

Outperform (1): Stock expected to outperform the S&P 500

Neutral (2): Stock expected to perform in line with the S&P 500

Underperform (3): Stock expected to underperform the S&P 500

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

Cowen Securities, formerly known as Dahlman Rose & Company, Rating System until May 25, 2013

Buy – The fundamentals/valuations of the subject company are improving and the investment return is expected to be 5 to 15 percentage points higher than the general market return

Sell – The fundamentals/valuations of the subject company are deteriorating and the investment return is expected to be 5 to 15 percentage points lower than the general market return

Hold – The fundamentals/valuations of the subject company are neither improving nor deteriorating and the investment return is expected to be in line with the general market return

Cowen And Company Rating Definitions

Distribution of Ratings/Investment Banking Services (IB) as of 06/30/14

Rating	Count	Ratings Distribution	Count	IB Services/Past 12 Months
Buy (a)	417	58.57%	94	22.54%
Hold (b)	279	39.19%	7	2.51%
Sell (c)	16	2.25%	0	0.00%

(a) Corresponds to "Outperform" rated stocks as defined in Cowen and Company, LLC's rating definitions. (b) Corresponds to "Market Perform" as defined in Cowen and Company, LLC's ratings definitions. (c) Corresponds to "Underperform" as defined in Cowen and Company, LLC's ratings definitions.

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