

## Veracyte, Inc.

### Strong Volume and Margins Despite Bad Weather; 2014 Guidance In line with Expectation

- After the market closed Tuesday, Veracyte reported fourth-quarter results and provided 2014 guidance. In sum, results were slightly better than expected (despite the impact of weather); and guidance was essentially in line with expectations. Revenue was \$6.8 million versus our \$6.2 million and consensus of \$6.5 million. Net loss was -\$5.9 million, versus our estimate of -\$6.9 million and consensus of -\$6.7 million.
- The company provided 2014 guidance that was in line with expectations. Revenue is expected to be \$38 million to \$43 million, versus our and consensus of \$40 million. FNA volumes are expected to be 76,000 to 83,000, compared to our prior 79,728 estimate. Our updated model includes revenue of \$40 million and FNA volume of 78,037, with lower volume (driven by weather) offset by higher ASP (driven by better cash collections from private payers than expected) relative to our model.
- The company reported FNA volumes of 14,059 (up 51% and versus our estimate of 13,955). GEC as a percentage of FNA was slightly higher than the company's guidance of 18% to 20%, given strength in academic volumes (which are GEC only); while we believe referrals from academic centers/hospitals in addition to community docs could represent a meaningful opportunity, the company is reluctant to call academic strength a trend as of yet.
- Average ASP (including Medicare payments, which have been consistent at \$3,000 to \$3,500 as well some payers that are paying \$0) was \$2,000, above our estimate of \$1,800, primarily driven by better cash collection, which contributed to higher-than-expected gross margin (49% versus our 43%). Medicare FNA payment rates remain consistent at \$150. An increase in covered lives has allowed the company to collect more quickly (average of 3 to 4 months versus prior 6 to 8 months). The company continues to garner positive private payer coverage decisions now covering over 120 million lives (Cigna announced in December 2013 and EmblemHealth added in February 2014, see exhibit 1 and 2). In addition, three small payer accounts converted to accrual accounting (although this doesn't seem to have impacted financials in the quarter much); while the company converted three payers to accruals, given the strength in cash collected from non-accrued payers, accrued revenue as a percentage of the total declined slightly to 30% from historical average of 33% (historically only Medicare). Guidance does not include incremental assumptions around transition of contracts to accruals, and we continue to view a shift to accrual accounting a source of revenue (realized ASP) upside.

*Veracyte is a diagnostics company that specializes in the field of molecular cytology transforming patient care and aims to save the healthcare system unnecessary costs from overtreatment of diseases.*

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March 19, 2014

Stock Rating: **Outperform**  
Company Profile: **Aggressive Growth**

Symbol: VCYT (NASDAQ)  
Price: \$17.02 (52-Wk.: \$11-\$19)  
Market Value (mil.): \$358  
Fiscal Year End: December  
Long-Term EPS Growth Rate:  
Dividend/Yield: None

	2013A	2014E	2015E
<b>Estimates</b>			
EPS FY	-\$1.22	-\$1.31	-\$0.94
CY		-\$1.31	-\$0.94
Sales (mil.)	12	22	40
<b>Valuation</b>			
FY P/E	NM	NM	NM
CY P/E		NM	NM

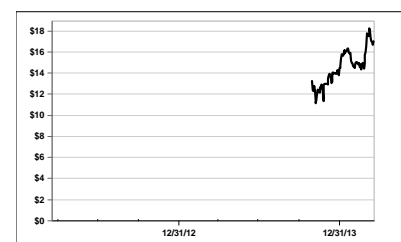
#### Trading Data (FactSet)

Shares Outstanding (mil.)	1
Float (mil.)	10
Average Daily Volume	60,108

#### Financial Data (FactSet)

Long-Term Debt/Total Capital (MRQ)	0.1
Book Value Per Share (MRQ)	-77.1
Enterprise Value (mil.)	4.5
EBITDA (TTM)	0.0
Enterprise Value/EBITDA (TTM)	0.0x
Return on Equity (TTM)	-83.4

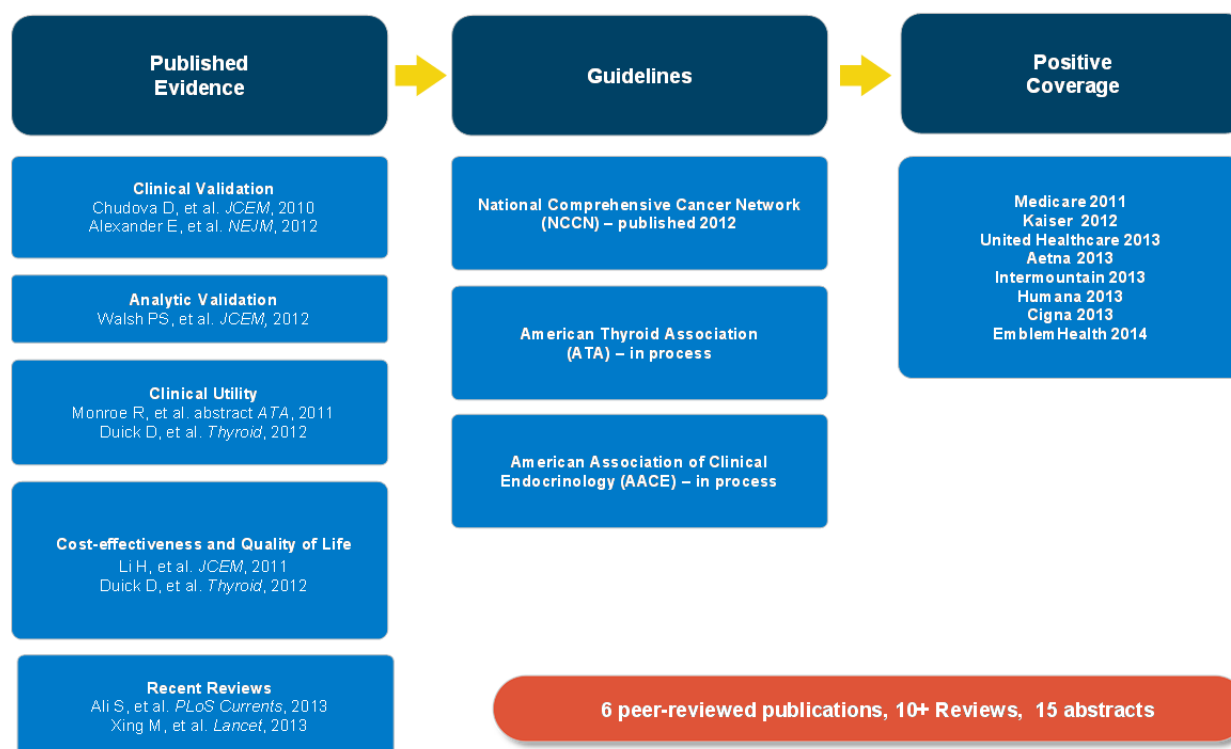
#### Two-Year Price Performance Chart



Sources: FactSet, William Blair & Company estimates

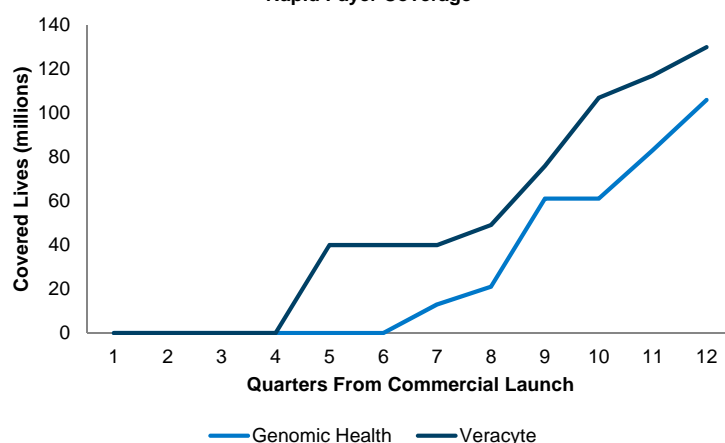
- R&D expense of \$1.9 million was below our estimate of \$2.3 million and slightly above last year at \$1.7 million. Selling and marketing as a percentage of revenue was in line with our estimate of 58%. Veracyte should benefit from the Genzyme co-promotion fee stepping down to 32% in March 2014, though cash burn will increase, as the delayed cash payments through the IPO process ended in November. Net loss was \$5.9 million versus our \$6.9 estimate, driven by higher revenue, gross margin, and lower-than-expected R&D. Please see our full variance analysis at the end of our note.
- On an enterprise value-to-sales basis, the stock is trading at 7 times our 2014 sales estimated of \$40 million and 4 times our 2015 sales estimates of \$71 million. We are encouraged by the positive private payer coverage decisions bringing patients in network, which should help drive further adoption (see exhibit 2) and the on-schedule launch of Afirma Malignancy Classifiers in the second quarter (though pricing to be announced later). We believe Veracyte should continue to obtain positive coverage decisions, which should eventually lead into contracts and the ability to accrue those payers' patients. Thus, we maintain our Outperform rating.
- **Model Updates.** Our estimate for 2014 revenue remains unchanged at \$40 million, though the underlying revenue build changed slightly with less volume and higher realized ASP. FNA volume of 78,037 is down from 79,728, mostly driven by bad weather in the first quarter. We expect FNA pricing to remain at \$150, compared to our prior estimate of down 15%, to \$130. Gross margin of 51% is up from our prior estimate of 46%, driven by higher realized ASP for both GEC and FNA. We continue to expect total operating expenses to be \$48 million. Net loss of \$28 million is better than our prior estimate of \$30 million, driven by better gross margins. For the full year 2015, we estimate revenue of \$71 million and net loss of \$21 million

**Exhibit 1**  
**Published Evidence Drives Guidelines and Positive Coverage**



Sources: Company reports and William Blair & Company, L.L.C. estimates

**Exhibit 2**  
**Rapid Payer Coverage**



Sources: William Blair & Company, L.L.C. estimates

Veracyte, Inc. Fourth-Quarter Variance Analysis (\$ in thousands, fiscal year ends December)						
	4Q 2013 Actual	4Q 2012 Actual	Year/Year %Change	4Q 2013 Estimate	Year/Year %Change	Actual-Est.
Revenue	\$6,838	\$4,457	53.4%	\$6,180	-27.9%	\$658.3
Cost of Revenue	\$3,471	\$2,600	33.5%	\$3,522	-26.2%	-\$51.4
Gross Profit	\$3,367	\$1,857	81.3%	\$2,657	-30.1%	\$709.7
Research & Development	\$1,870	\$1,721	8.6%	\$2,286	-24.7%	-\$416.5
Sales & Marketing	\$3,931	\$3,055	28.7%	\$3,602	-15.2%	\$329.1
General & Administrative	\$3,328	\$2,197	51.5%	\$3,584	-38.7%	-\$256.2
Operating Income/Loss	-\$5,762	-\$5,116	12.6%	-\$6,815	-24.9%	\$1,053.3
Interest	-\$97	\$1	-12616.1%	-\$124	-100.6%	\$27.4
Other income (expense)	-\$33	\$278	-111.9%	\$0	NM	-\$33.0
Net Income/Loss	-\$5,892	-\$4,837	21.8%	-\$6,940	-30.3%	\$1,047.7
W. Avg. Shares (Diluted)	13,944	665	1995.9%	23,301	-97.1%	-9,357
<b>EPS</b>	<b>-\$0.42</b>	<b>-\$7.27</b>	<b>-94.2%</b>	<b>-\$0.30</b>	<b>2341.2%</b>	<b>-\$0.12</b>
<b>Margin Analysis</b>						<i>BPS</i>
Gross Margin	49.2%	41.7%	7.6%	43.0%	-1.3%	624
Research & Development	27.3%	38.6%	-11.3%	37.0%	1.6%	-965
Sales & Marketing	57.5%	68.5%	-11.1%	58.3%	10.3%	-80
General & Administrative	48.7%	49.3%	-0.6%	58.0%	-8.7%	-933
Operating Income/Loss	-84.3%	-114.8%	30.5%	-110.3%	-4.5%	2602
Net Income/Loss	-86.2%	-108.5%	22.4%	-112.3%	3.8%	2613
<b>Other Indicators</b>						
FNA Samples	14,059	9,303	51.1%	13,955	50.0%	105
GEC Percent of FNA	20%	20%	0.0%	19%	1.0%	1%

**Veracyte, Inc. Projected Income Statement (2011 to 2016E)**

	FY 2011	FY 2012	Q1'13	2013 Q2'13	Q3'13	Q4'13	FY 2013E	Q1'14E	2014 Q2'14E	Q3'14E	Q4'14E	FY 2014E	FY 2015E	FY 2016E
Revenue:	\$2,645	\$11,628	\$4,385	\$5,067	\$5,594	\$6,838	\$21,884	\$7,123	\$10,131	\$10,300	\$12,516	\$40,070	\$71,061	\$115,594
Cost of Services:	\$2,925	\$7,584	\$2,773	\$3,231	\$3,132	\$3,471	\$12,607	\$3,633	\$5,065	\$5,047	\$6,007	\$19,753	\$28,101	\$39,532
Gross Profit	-\$281	\$4,044	\$1,611	\$1,836	\$2,462	\$3,367	\$9,277	\$3,490	\$5,065	\$5,253	\$6,508	\$20,317	\$42,960	\$76,061
Operating expenses:														
Research and development	\$6,680	\$6,608	\$2,010	\$1,902	\$2,028	\$1,870	\$7,810	\$2,279	\$2,837	\$3,296	\$3,755	\$12,167	\$16,645	\$20,057
Total Selling & Marketing	\$2,934	\$8,447	\$2,703	\$2,615	\$3,291	\$3,931	\$12,540	\$4,076	\$4,582	\$4,875	\$5,728	\$19,262	\$30,665	\$44,518
General & Administrative	\$5,371	\$7,918	\$2,791	\$2,737	\$3,244	\$3,328	\$12,100	\$3,633	\$4,052	\$4,429	\$4,631	\$16,745	\$16,645	\$16,995
Total Operating Expenses	\$14,985	\$22,973	\$7,504	\$7,254	\$8,563	\$9,129	\$32,450	\$9,988	\$11,471	\$12,601	\$14,113	\$48,174	\$63,956	\$81,570
Operating Income	-\$15,265	-\$18,929	-\$5,893	-\$5,418	-\$6,101	-\$5,762	-\$23,173	-\$6,498	-\$6,406	-\$7,348	-\$7,605	-\$27,857	-\$20,996	-\$5,509
Interest Income (Expense)	\$2	\$2	\$1	-\$5	-\$126	-\$97	-\$228	-\$119	-\$121	-\$122	-\$123	-\$484	-\$387	-\$194
Other Expense	\$819	\$278	-\$1,003	-\$1,068	-\$76	-\$33	-\$2,180	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Net Income/Loss	-\$14,445	-\$18,649	-\$6,895	-\$6,491	-\$6,303	-\$5,892	-\$25,580	-\$6,617	-\$6,526	-\$7,470	-\$7,728	-\$28,341	-\$21,383	-\$5,703
EPS basic	-\$6.23	-\$7.17	-\$0.33	-\$0.31	-\$0.30	-\$0.28	-\$1.23	-\$0.31	-\$0.31	-\$0.35	-\$0.36	-\$1.32	-\$0.95	-\$0.24
EPS fully diluted	-\$0.72	-\$0.89	-\$0.33	-\$0.31	-\$0.30	-\$0.28	-\$1.22	-\$0.31	-\$0.30	-\$0.34	-\$0.35	-\$1.31	-\$0.94	-\$0.24
W.Avg Shares Outstanding basic	2,320	2,601	20,690	20,690	20,690	20,897	20,742	21,106	21,317	21,530	21,745	21,424	22,573	23,662
W.Avg Shares Outstanding diluted	19,992	20,841	20,843	20,943	21,043	21,143	20,993	21,354	21,568	21,784	22,001	21,677	22,839	23,941
<b>Margin Analysis:</b>														
Gross Margin	-11%	35%	37%	36%	44%	49%	42%	49%	50%	51%	52%	51%	60%	66%
Total Operating Expenses	-567%	-198%	-171%	-143%	-153%	-134%	-150%	-140%	-113%	-122%	-113%	-122%	-91%	-71%
Research and development	253%	57%	46%	38%	36%	27%	37%	32%	28%	32%	30%	31%	24%	18%
Selling & Marketing	111%	73%	62%	52%	59%	57%	57%	57%	45%	47%	46%	49%	43%	39%
General & Administrative	203%	68%	64%	54%	58%	49%	56%	51%	40%	43%	37%	43%	24%	15%
EBIT	-577%	-163%	-134%	-107%	-109%	-84%	-109%	-91%	-63%	-71%	-61%	-72%	-32%	-6%
Tax Rate	NM													
Net Income/Loss	-546%	-160%	-157%	-128%	-113%	-86%	-121%	-93%	-64%	-73%	-62%	-73%	-32%	-6%
<b>Growth Metrics:</b>														
Total Revenue Growth	NM	340%	199%	104%	74%	53%	88%	62%	100%	84%	83%	83%	77%	63%
Gross Profit	NM	-1541%	653%	150%	99%	81%	129%	117%	176%	113%	93%	119%	111%	77%
Total Operating Expenses	NM	53%	68%	35%	39%	31%	41%	33%	58%	47%	55%	48%	33%	28%
Research and development	NM	NM	36%	13%	17%	9%	18%	13%	49%	63%	101%	56%	37%	20%
Selling & Marketing	NM	NM	122%	43%	40%	29%	48%	51%	75%	48%	46%	54%	59%	45%
General & Administrative	NM	NM	58%	48%	54%	52%	53%	30%	48%	37%	39%	38%	-1%	2%
EBIT	NM	-24%	-39%	-17%	-24%	-13%	-22%	-10%	-18%	-20%	-32%	-20%	25%	74%
Net Income/Loss	NM	-29%	-62%	-40%	-28%	-22%	-37%	4%	-1%	-19%	-31%	-11%	25%	73%
EPS	NM	86%	81%	83%	84%	85%	-36%	6%	2%	-14%	-26%	-7%	28%	74%
Shares Outstanding	NM	4%	0%	0%	0%	0%	697%	1%	1%	1%	1%	3%	5%	5%

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William Blair is a market maker in the security of Veracyte, Inc. and may have a long or short position.

William Blair intends to seek investment banking compensation in the next three months from Veracyte, Inc.

Within the past 12 months William Blair has provided or is providing investment banking services to or has an investment services relationship with Veracyte, Inc.

Additional information is available upon request.

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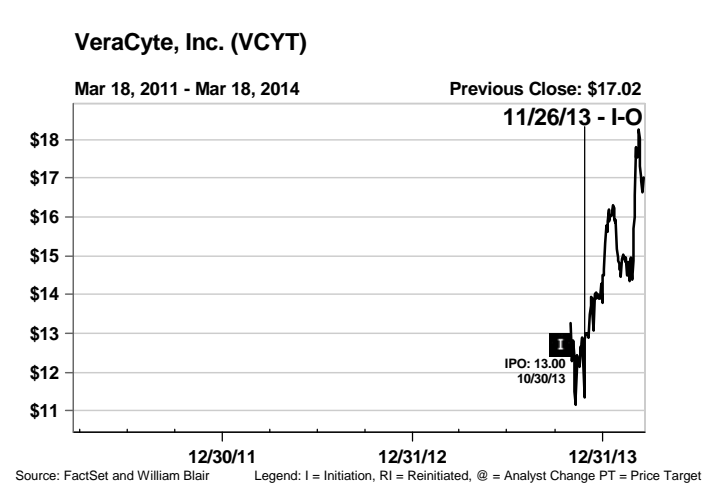
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DOW JONES: 16,336.19

S&P 500: 1,872.25

NASDAQ: 4,333.31



### Current Rating Distribution (as of 02/28/14)

Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	64	Outperform (Buy)	13
Market Perform (Hold)	33	Market Perform (Hold)	2
Underperform (Sell)	1	Underperform (Sell)	0

\*Percentage of companies in each rating category that are investment banking clients, defined as companies for which William Blair has received compensation for investment banking services within the past 12 months.

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