

## Life Sciences Technology

### Veracyte, Inc. (VCYT) - BUY

**Price:** **\$14.65**  
Fair Value Estimate: \$25.00  
52-Week Range: \$10.88-\$19.00  
Market Cap (MM): \$311  
Shr.O/S-Diluted (mm): 21.2  
Average Daily Volume: 82,354  
Book Value: \$2.12

FYE: Dec	2014E	2015E	2016E
EPS:	\$(1.23)E	\$(0.80)E	\$(0.20)E
Prior EPS:	\$(1.22)	\$(0.85)	\$(0.10)
P/E:	NA	NA	NA

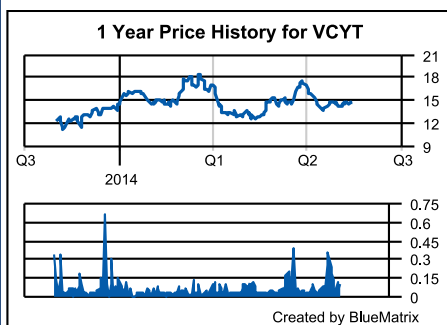
Quarterly EPS:

	2014E	2015E	2016E
Q1	\$(0.32)A	NA	NA
Q2	\$(0.31)A	NA	NA
Q3	\$(0.32)E	NA	NA
Q4	\$(0.28)E	NA	NA

FYE: Dec	2014E	2015E	2016E
Revenue (M):	\$40.0E	\$72.0E	\$115.0E

Quarterly Revenue (M):

	2014E	2015E	2016E
Q1	\$7.5A	NA	NA
Q2	\$8.7A	NA	NA
Q3	\$10.1E	NA	NA
Q4	\$13.7E	NA	NA



**Equity Research**  
**Note**

## 2Q Revenue light; Full year maintained

### INVESTMENT CONCLUSION:

Veracyte reported a light 2Q14 top-line relative to expectations, but the miss was not a result of a fundamental shift in the company's underlying business or demand dynamics. Instead, the softness was due to continued lumpy cash collections. The company reported an acceleration in Afirma test adoption amongst its institutional and academic customers, augmenting its already strong presence in community-based endocrinologists. We expect cash collection to become less of an issue as volumes ramp further and visibility improves amongst patients and payors. Management reiterated full year revenue guidance. We maintain our BUY rating and fair value estimate of \$25 per share.

### KEY POINTS:

- Veracyte reported 2Q14 revenues of \$8.7 million compared to our estimate of \$9.5 million and the Street's \$9.4 million. The discrepancy was the result of lumpy cash collections in the quarter. Veracyte reported sample volumes of 16,458, which trailed our expectations; however, the impact was immaterial because of the higher conversion of FNA sample volumes to GEC tests (reflex rate). Afirma GEC tests ordered during the quarter accelerated to approximately 22.6% of total FNAs, significantly higher than the historical rate of 15%. This increase softened the blow on the bottom-line as the Afirma test is a higher margin product. Veracyte reported 2Q EPS of \$(0.31) relative to our \$(0.30) and consensus' \$(0.33).
- The company maintained full year top-line guidance of \$38-43 million, but it reduced its FNA sample volume expectations to 66,000-73,000 from 76,000-83,000 because of a higher percentage of GEC only tests relative to initial expectations. As a result of the weaker 2Q results and moderated guidance, we now expect 2014 FNA sample volume of 69,031 from 80,525. While total sample volumes received were soft, the GEC test volume was up 50% YoY (18% QoQ). GEC only tests accounted for 7% of total FNA volume - 1150 tests - during 2Q, which is up from 5%, 620 tests, a year ago. These GEC only orders accounted for 31% of total Afirma volume in 2Q14, up from 25% in 2Q13.
- Due to Veracyte's expanding institutional customer base, we now expect lesser outer year FNA sample volumes and a similar reflex rate to 2014. Management announced that it expects to hire 10 additional sales and marketing professionals in 2H14 to further penetrate its institutional and large academic customers and improve its community-based endocrinologist relationships. While these non-academic institutions account for only 25-30% of total annual FNA volumes, they are an attractive sub-segment for VCYT because of their propensity for GEC-only tests. We modestly adjust our 2015 and 2016 EPS estimates, respectively, to \$(0.80) from \$(0.85) and to \$(0.20) from \$(0.10).
- Peer molecular diagnostic companies are trading at 5x revenue; using that multiple, our fair value estimate is \$25 per share on our 2016 forecast. In addition to peer valuations, we proxy like Genoptix and Clariant. Both companies were acquired after developing strong physician networks at approximately 5x revenue.

**Research Analyst Certifications and Important Disclosures**  
**are on pages 2 - 3 of this report**

IMPORTANT DISCLOSURES

Research Analyst Certification

I, Paul Knight, the Primarily Responsible Analyst for this research report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject securities or issuers. No part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views I expressed in this research report.

Janney Montgomery Scott LLC ("Janney") Equity Research Disclosure Legend

Janney Montgomery Scott LLC intends to seek or expects to receive compensation for investment banking services from Veracyte, Inc. in the next three months.

The research analyst is compensated based on, in part, Janney Montgomery Scott's profitability, which includes its investment banking revenues.

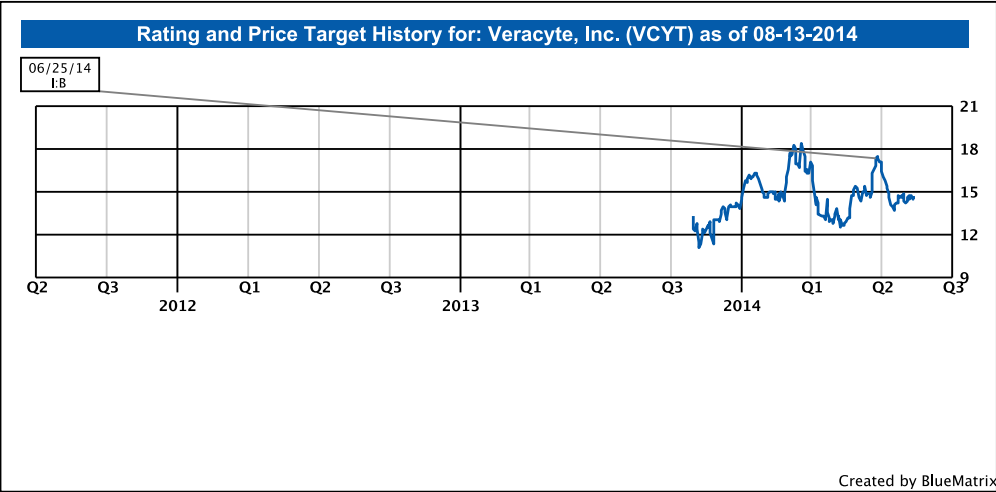
Definition of Ratings

**BUY:** Janney expects that the subject company will appreciate in value. Additionally, we expect that the subject company will outperform comparable companies within its sector.

**NEUTRAL:** Janney believes that the subject company is fairly valued and will perform in line with comparable companies within its sector. Investors may add to current positions on short-term weakness and sell on strength as the valuations or fundamentals become more or less attractive.

**SELL:** Janney expects that the subject company will likely decline in value and will underperform comparable companies within its sector.

Price Charts



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### **Janney Montgomery Scott Ratings Distribution as of 6/30/14**

Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY [B]	207	53.80	53	25.60
NEUTRAL [N]	176	45.70	28	15.90
SELL [S]	2	0.50	0	0.00

**\*Percentages of each rating category where Janney has performed Investment Banking services over the past 12 months.**

#### **Other Disclosures**

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