

# Veracyte, Inc. (VCYT)

Overweight

## Veracyte Analyst Day Observations

### CONCLUSION

Veracyte detailed upcoming pulmonology pipeline products, including their Lung Cancer Diagnostic (formally BronchoGen from the Allegro acquisition) and Interstitial Lung Disease test, on-track to launch 2H15 and 2016, respectively. The pulmonary tests target a \$1.2B combined market opportunity. On Afirma, management announced contracts with Cigna and UnitedHealthcare. As a reminder, Cigna and UNH had positive medical policy decisions in place, but in-network status should lead to improved cash flow and incremental physician adoption, in our opinion. All in, we view the inaugural analyst day as positive for Afirma and the pipeline.

- **Afirma Update:** Management announced Cigna and UnitedHealthcare as the first in-network payers, effective end of 2014. While both payers previously considered Afirma medically necessary, the contract should increase cash flow timing. Additionally, given some physicians are reluctant to use out-of-network tests, the contracts should incrementally accelerate doctor adoption, in our opinion.
- **Next Stop, Pulmonology:** Veracyte spent a majority of the analyst day detailing the upcoming pulmonology tests. On the Lung Cancer Diagnostic, Dr. Vachani described difficulties classifying the 20%-50% of indeterminate bronchoscopy results in patients with lung nodules. Like thyroid procedures, a high percentage of these patients undergoing additional screening and procedures are found to be negative by pathology. Initial results from the AEGIS I trial (n: 298) are encouraging as a low risk rule out with a high NPV of 0.93 and an AUC of .78. In terms of next steps, we believe Veracyte's product launch and reimbursement strategy will benefit from outcomes and economics studies. The Interstitial Lung Disease (ILD) test is the second foray into the pulmonology market, utilizing gene expression to detect Idiopathic Pulmonary Fibrosis (IPF). Currently, a majority of ILD patients are incorrectly diagnosed with IPF. Recognizing the preliminary nature of the data presented at the American Thoracic Society earlier this year, Veracyte's assay nevertheless appears like a valuable tool to diagnose IPF. Without good therapy, diagnostics lose considerable value and encouragingly, there are multiple therapies moving through FDA (pirfenidone and nintedanib) that specifically address this patient population. The assay remains on track for a 2016 launch.

### RISKS TO ACHIEVEMENT OF PRICE TARGET

Veracyte risks include GEC adoption, private payer coverage and competition.

### COMPANY DESCRIPTION

Veracyte develops molecular cytology tests; initially focusing on the thyroid FNA market.

PRICE: US\$8.66

TARGET: US\$22.00

4.6x F2016 EV/Rev (net cash/share: \$2.25, s/o: 25.9M)

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Changes	Previous	Current
Rating	—	Overweight
Price Tgt	—	US\$22.00
FY15E Rev (mil)	—	US\$66.7
FY16E Rev (mil)	—	US\$108.7
FY15E EPS	—	US\$(0.98)
FY16E EPS	—	US\$(0.22)

52-Week High / Low	US\$19.00 / US\$8.56
Shares Out (mil)	21.2
Market Cap. (mil)	US\$183.6
Avg Daily Vol (000)	120
Book Value/Share	US\$2.12
Net Cash Per Share	US\$2.50
Debt to Total Capital	10%
Div (ann)	US\$0.00
Fiscal Year End	Dec

### Price Performance - 1 Year



Source: Bloomberg

YEAR	REVENUE (US\$ m)						EARNINGS PER SHARE (US\$)					
	Mar	Jun	Sep	Dec	FY	FY RM	Mar	Jun	Sep	Dec	FY	FY P/E
2014E	7.5A	8.7A	8.7	11.5	36.4	5.0x	(0.32)A	(0.31)A	(0.38)	(0.40)	(1.42)	NM
2015E	13.6	15.8	17.1	20.2	66.7	2.8x	(0.30)	(0.27)	(0.23)	(0.19)	(0.98)	NM
2016E	—	—	—	—	108.7	1.7x	—	—	—	—	(0.22)	NM

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**Veracyte**
**Income Statement**

Fiscal Year End: December 31

(\$ in Thousands)

Updated as of 9/17/2014

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Piper Jaffray &amp; Co.

	2013A				2014E				2015E				Annual				
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	2012A	2013A	2014E	2015E	2016E
	Qtr 1 A	Qtr 2 A	Qtr 3 A	Qtr 4 A	Qtr 1 A	Qtr 2 A	Qtr 3 E	Qtr 4 E	Qtr 1 E	Qtr 2 E	Qtr 3 E	Qtr 4 E					
Product Revenue	4,384	5,068	5,594	6,838	7,476	8,677	8,731	11,502	13,562	15,832	17,057	20,218	11,628	21,884	36,386	66,669	108,714
<b>Total Revenue</b>	<b>4,384</b>	<b>5,068</b>	<b>5,594</b>	<b>6,838</b>	<b>7,476</b>	<b>8,677</b>	<b>8,731</b>	<b>11,502</b>	<b>13,562</b>	<b>15,832</b>	<b>17,057</b>	<b>20,218</b>	<b>11,628</b>	<b>21,884</b>	<b>36,386</b>	<b>66,669</b>	<b>108,714</b>
Cost of Goods Sold	2,773	3,231	3,132	3,471	3,607	3,966	4,529	5,797	7,001	7,967	8,480	9,789	7,584	12,607	17,898	33,238	47,312
<b>Gross Profit</b>	<b>1,611</b>	<b>1,837</b>	<b>2,462</b>	<b>3,367</b>	<b>3,869</b>	<b>4,711</b>	<b>4,202</b>	<b>5,705</b>	<b>6,561</b>	<b>7,865</b>	<b>8,576</b>	<b>10,429</b>	<b>4,044</b>	<b>9,277</b>	<b>18,488</b>	<b>33,431</b>	<b>61,402</b>
Operating Expenses:																	
Research & Development	2,010	1,902	2,028	1,870	2,126	2,243	2,619	2,876	2,848	3,008	3,070	3,235	6,608	7,810	9,864	12,161	13,167
Sales & Marketing	2,703	2,615	3,291	3,931	4,336	5,101	6,112	7,821	6,374	6,808	6,986	7,668	8,447	12,540	23,370	27,835	35,333
General & Administrative	2,791	2,737	3,244	3,328	3,982	3,928	4,104	4,141	4,204	4,275	4,264	4,448	7,918	12,100	16,154	17,191	18,564
Total Operating Expense	7,504	7,254	8,563	9,129	10,444	11,272	12,835	14,838	13,426	14,091	14,320	15,351	22,973	32,450	49,389	57,188	67,064
<b>Operating Income (Loss)</b>	<b>(5,893)</b>	<b>(5,417)</b>	<b>(6,101)</b>	<b>(5,762)</b>	<b>(6,575)</b>	<b>(6,561)</b>	<b>(8,632)</b>	<b>(9,132)</b>	<b>(6,866)</b>	<b>(6,226)</b>	<b>(5,743)</b>	<b>(4,922)</b>	<b>(18,929)</b>	<b>(23,173)</b>	<b>(30,901)</b>	<b>(23,757)</b>	<b>(5,662)</b>
Interest Income (Expense)	0	(5)	(126)	(97)	(111)	(113)	32	(7)	(31)	(48)	(62)	17	2	(228)	(199)	(124)	(28)
Other Income (Expense)	(1,002)	(1,068)	(76)	(33)	12	19	0	0	0	0	0	0	278	(2,179)	31	0	0
<b>Pretax Income (Loss)</b>	<b>(6,895)</b>	<b>(6,490)</b>	<b>(6,303)</b>	<b>(5,892)</b>	<b>(6,674)</b>	<b>(6,655)</b>	<b>(8,600)</b>	<b>(9,140)</b>	<b>(6,897)</b>	<b>(6,273)</b>	<b>(5,806)</b>	<b>(4,905)</b>	<b>(18,649)</b>	<b>(25,580)</b>	<b>(31,069)</b>	<b>(23,881)</b>	<b>(5,690)</b>
Provision for Income Taxes	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
<b>Net Income (Loss) - Reported</b>	<b>(6,895)</b>	<b>(6,490)</b>	<b>(6,303)</b>	<b>(5,892)</b>	<b>(6,674)</b>	<b>(6,655)</b>	<b>(8,600)</b>	<b>(9,140)</b>	<b>(6,897)</b>	<b>(6,273)</b>	<b>(5,806)</b>	<b>(4,905)</b>	<b>(18,649)</b>	<b>(25,580)</b>	<b>(31,069)</b>	<b>(23,881)</b>	<b>(5,690)</b>
Non-Recurring Items	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
<b>Net Income (Loss) - Ongoing</b>	<b>(6,895)</b>	<b>(6,490)</b>	<b>(6,303)</b>	<b>(5,892)</b>	<b>(6,674)</b>	<b>(6,655)</b>	<b>(8,600)</b>	<b>(9,140)</b>	<b>(6,897)</b>	<b>(6,273)</b>	<b>(5,806)</b>	<b>(4,905)</b>	<b>(18,649)</b>	<b>(25,580)</b>	<b>(31,069)</b>	<b>(23,881)</b>	<b>(5,690)</b>
<b>Diluted EPS (Reported)</b>	<b>(\$9.04)</b>	<b>(\$7.53)</b>	<b>(\$6.59)</b>	<b>(\$0.42)</b>	<b>(\$0.32)</b>	<b>(\$0.31)</b>	<b>(\$0.38)</b>	<b>(\$0.40)</b>	<b>(\$0.30)</b>	<b>(\$0.27)</b>	<b>(\$0.23)</b>	<b>(\$0.19)</b>	<b>(\$28.66)</b>	<b>(\$6.19)</b>	<b>(\$1.42)</b>	<b>(\$0.98)</b>	<b>(\$0.22)</b>
<b>Diluted EPS (Ongoing, Inc. SBC)</b>	<b>(\$9.04)</b>	<b>(\$7.53)</b>	<b>(\$6.59)</b>	<b>(\$0.42)</b>	<b>(\$0.32)</b>	<b>(\$0.31)</b>	<b>(\$0.38)</b>	<b>(\$0.40)</b>	<b>(\$0.30)</b>	<b>(\$0.27)</b>	<b>(\$0.23)</b>	<b>(\$0.19)</b>	<b>(\$28.66)</b>	<b>(\$6.19)</b>	<b>(\$1.42)</b>	<b>(\$0.98)</b>	<b>(\$0.22)</b>
Avg. Share Outstanding, Diluted	763	862	956	13,944	21,148	21,237	22,502	22,802	23,002	23,202	25,390	25,490	650	4,131	21,922	24,271	25,740
<b>Expense Variables:</b>																	
Cost of Goods Sold (Product)	63.3%	63.8%	56.0%	50.8%	48.2%	45.7%	51.9%	50.4%	51.6%	50.3%	49.7%	48.4%	65.2%	57.6%	49.2%	49.9%	43.5%
Cost of Goods Sold (Royalties/License)	NM	NM	NM	NM	NM	NM	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	NM	NM	NM	NM	NM
Research & Development	45.8%	37.5%	36.3%	27.3%	28.4%	25.8%	30.0%	25.0%	21.0%	19.0%	18.0%	16.0%	56.8%	35.7%	27.1%	18.2%	12.1%
Sales & Marketing	61.7%	51.6%	58.8%	57.5%	58.0%	58.8%	70.0%	68.0%	47.0%	43.0%	41.0%	37.9%	NM	35.7%	27.1%	18.2%	12.1%
General & Administrative	63.7%	54.0%	58.0%	48.7%	53.3%	45.3%	47.0%	36.0%	31.0%	27.0%	25.0%	22.0%	68.1%	55.3%	44.4%	25.8%	17.1%
Total Operating Expenses	171.2%	143.1%	153.1%	133.5%	139.7%	129.9%	147.0%	129.0%	99.0%	89.0%	84.0%	75.9%	197.6%	148.3%	135.7%	85.8%	61.7%
Effective Interest Rate, Debt	0.0%	0.0%	0.0%	0.0%	2.2%	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%	0.0%	0.3%	0.4%	0.2%	0.0%
Ongoing Tax 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%	0.0%
<b>Margin Analysis:</b>																	
Gross Margin (Product Sales)	36.7%	36.2%	44.0%	49.2%	51.8%	54.3%	48.1%	49.6%	48.4%	49.7%	50.3%	51.6%	34.8%	42.4%	50.8%	50.1%	56.5%
Operating Margin	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Pretax Margin	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Net Income Margin	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
<b>YoY Growth Rates:</b>																	
Product Revenue	198.6%	104.4%	73.5%	53.4%	70.5%	71.2%	56.1%	68.2%	81.4%	82.5%	95.4%	75.8%	NM	88.2%	66.3%	83.2%	63.1%
Net Income (Ongoing)	62.3%	40.3%	27.6%	21.8%	-3.2%	2.5%	36.4%	55.1%	3.3%	-5.7%	-32.5%	-46.3%	NM	37.2%	21.5%	-23.1%	-76.2%
EPS (Ongoing)	32.6%	6.3%	-12.0%	-94.2%	-96.5%	-95.8%	-94.2%	-5.1%	-5.0%	-13.7%	-40.2%	-52.0%	NM	-78.4%	-77.1%	-30.6%	-77.5%
<b>Other Data:</b>																	
Days Sales Outstanding	NM	71.4	46.6	61.0	58.1	60.2	53.7	46.8	49.3	43.5	42.4	38.0	NM	19.1	18.2	11.8	10.3
EBITDA Per Share	(\$7.34)	(\$5.99)	(\$6.01)	(\$0.40)	(\$0.30)	(\$0.30)	(\$0.37)	(\$0.39)	(\$0.29)	(\$0.26)	(\$0.22)	(\$0.18)	(\$27.68)	(\$5.34)	(\$1.36)	(\$0.93)	(\$0.18)
Free Cash Flow Per Share	(\$8.09)	(\$3.85)	(\$5.39)	(\$0.25)	(\$0.32)	(\$0.31)	(\$0.34)	(\$0.43)	(\$0.29)	(\$0.26)	(\$0.22)	(\$0.19)	(\$29.05)	(\$4.92)	(\$1.42)	(\$0.95)	(\$0.37)
Net Debt (Cash) Per Share	(\$9.42)	(\$18.54)	(\$11.17)	(\$4.76)	(\$2.81)	(\$2.50)	(\$1.66)	(\$1.22)	(\$0.93)	(\$0.67)	(\$1.85)	(\$1.66)	(\$21.72)	(\$16.12)	(\$2.22)	(\$2.61)	(\$2.25)
<b>S&amp;M Expenses</b>																	
% of Revenue Shared With Genzyme	40%	40%	40%	40%	37%	32%	32%	32%	15%	15%	15%	15%	50%	40%	33%	15%	15%
Genzyme Promotion Expense	1,754	2,027	2,238	2,735	2,791	2,733	2,794	3,681	2,034	2,375	2,551	3,017	5,814	8,754	11,999	9,977	16,030
Genzyme Fee Amortized	(625)	(625)	(625)	(625)	(625)	(625)	(625)	(625)	(625)	(625)	(625)	(625)	(2,500)	(2,500)	(2,500)	(2,500)	-
Core S&M Expense	1,574	1,213	1,678	1,821	2,170	2,368	3,318	4,141	4,340	4,433	4,435	4,650	5,133	6,286	11,996	17,858	19,303
Total S&M Expense	2,703	2,615	3,291	3,931	4,336	5,101	6,112	7,821	6,374	6,808	6,986	7,668	8,447	12,540	23,370	27,835	35,333
Core S&M Expense % of Revenue	36%	24%	30%	27%	29%	27%	38%	36%	32%	28%	26%	23%	44%	29%	33%	27%	18%

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R: Resuming Coverage  
T: Transferring Coverage  
D: Discontinuing Coverage  
S: Suspending Coverage  
OW: Overweight  
N: Neutral  
UW: Underweight  
NA: Not Available  
UR: Under Review

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Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
<b>BUY [OW]</b>	370	60.96	93	25.14
<b>HOLD [N]</b>	226	37.23	24	10.62
<b>SELL [UW]</b>	11	1.81	0	0.00

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**Analyst Certification — William R. Quirk, CFA, Sr Research Analyst**  
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