

Veracyte, Inc.

Blue Skies Ahead With Signing of First Blue Cross Payer; Solid Volume Despite Bad Weather

- On Thursday, May 8, Veracyte reported first-quarter results that despite bad weather were slightly above expectations, driven by strong institutional adoption (Afirma-enabled business model) and positive coverage decisions (most notably Premera Blue Cross). While Veracyte performs fine needle aspirate (FNA) cytology in addition to its gene expression classifier (GEC) assay via a partnership with Thyroid Cytopathology Partners (TCP), Veracyte also supports labs (mostly academic centers) that perform FNA analysis in-house and want to outsource molecular GEC analysis to Veracyte, via the Afirma-enabled business model.
- Revenue was \$7.5 million, above our and Street estimate of \$7.1 million. Net loss per share was \$0.32, compared with our and the Street estimate of \$0.31. Revenue guidance was unchanged at \$38 million to \$43 million, and FNA guidance was unchanged at 76,000 to 83,000. The company raised guidance for the Afirma GEC as a percent of FNA's to 20% to 22%, up from 18% to 20%, as a result of strong adoption from institutional clients that use an Afirma-enabled business model (perform FNA in house and only order GEC tests).
- Veracyte continues to garner rapid payer coverage (more than 125 million covered lives) with the addition of Premera Blue Cross, the first Blue Cross payer to cover the Afirma GEC test (we believe more to follow throughout the year), as well as Health Net, and Optima Health. Also, in June, the American Thyroid Association meets to discuss updating guideline—potentially including molecular assays for use in treating patients with indeterminate FNAs, which would help Veracyte gain physician and payer adoption.
- Stock Thoughts and Valuation.** The stock is trading at 2.8 times enterprise value to sales on 2015 estimates and has pulled back 34% from its 52-week high. We believe at current levels, the stock is an attractive buying opportunity given our expectations for 75%-plus revenue growth over the next few years and upside bias to estimates. Veracyte currently has limited competition and is obtaining coverage quickly for the Afirma GEC (it announced Premera Blue Cross—perhaps more Blue plans will follow suit), which brings a clear cost savings to the system by reducing unnecessary surgeries. Thus, we maintain our Outperform rating.
- Revenue Detail.** We estimate that reported revenue of \$7.5 million consisted of \$2.0 million cyto (FNA) and \$5.5 million from Afirma GEC. Given the 22% of FNAs that had the Afirma GEC test performed, we estimated a realized ASP for the Afirma GEC to be \$1,952 with volumes of 2,814 tests (up 61%). Reported FNA volume of 14,373 was negatively affected by weather by 6% to 10%. Excluding weather, FNA volume would have been closer to 15,000 or more.

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.

Amanda Murphy, CFA
+1 312 364 8951
amurphy@williamblair.com

JP McKim
+1 312 364 8991
jpmckim@williamblair.com

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

Symbol: VCYT (NASDAQ)
Price: \$12.58 (52-Wk.: \$11-\$19)
Market Value (mil.): \$266
Fiscal Year End: December
Long-Term EPS Growth Rate:
Dividend/Yield: None

	2013A	2014E	2015E
Estimates			
EPS FY	\$-1.22	\$-1.36	\$-1.15
CY		\$-1.36	\$-1.15
Sales (mil.)	22	40	71
Valuation			
FY P/E	NM	NM	NM
CY P/E		NM	NM

Trading Data (FactSet)	
Shares Outstanding (mil.)	14
Float (mil.)	10
Average Daily Volume	45,586

Financial Data (FactSet)	
Long-Term Debt/Total Capital (MRQ)	0.0
Book Value Per Share (MRQ)	2.7
Return on Equity (TTM)	-83.4

Two-Year Price Performance Chart



Sources: FactSet, William Blair & Company estimates

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- **Market Expansion.** We estimate Veracyte has grown its current addressable market by \$94 million, via launch of the Afirma Malignancy Classifiers (more details to come next week at AACE) and expansion into Brazil (Fleury Medicine agreement reached May 2). Roughly 100,000 FNAs are performed each year in Brazil, which equates to roughly 85,000 patients and a potential market opportunity of \$50 million (85,000 patients multiplied by 21% indeterminate multiplied by assumed \$2,800 ASP).
- The Afirma Malignancy Classifier will be priced at \$975 and separate BRAF test at \$475; combined, they are a \$44 million market opportunity. About 5% of cytopathology performed on FNA samples are malignant, yielding an estimated 23,000 patients in the United States available for the Afirma Malignancy Classifier or a \$22 million market opportunity. In addition to those patients, of the Afirma GEC results that are suspicious, which we estimate to be 47,000 patients a year in the United States, would be eligible for a BRAF test yielding a market opportunity of \$22 million.
- **Margin Detail.** Gross margin of 52% was above our expectation of 49% as a result of the 22% GEC of FNAs, compared with our 20% estimate, which carry higher margin than the FNAs. Research and development was \$2.1 million versus our estimate of \$2.3 million, the year-over-year increase from \$2.0 million is a result of increased personnel. Sales and marketing expenses of \$4.3 million was above our estimate of \$4.1 million due to increased reps and Genzyme fee. General and administrative expense was \$4.0 million compared with our estimate of \$3.6 million as a result of increased stock-based compensation and fees from of being a public company.
- **Model Update.** For 2014, our revenue estimate of \$40 million and gross margin estimate of 51% are unchanged. Given the additional sales reps added in the quarter (now at about 18 Veracyte reps), we increased our sales and marketing expense estimate to \$20.1 million, from \$19.3 million. We also increased are general and administrative expense estimate to \$17.8 million, from our prior estimate of \$16.7 million because of higher-than-expected first-quarter results. We lowered our research and development estimate to \$11.4 million from \$12.2 million. We now estimate a net loss of \$1.36, down from our previous estimate of \$1.31. For 2015, we estimate revenue of \$71.2 million and net loss per share of \$1.15, compared with our previous estimates of revenue of \$71.1 million and net loss per share of \$0.94.

Exhibits are included on the following pages.

Veracyte, Inc. First-Quarter Variance Analysis (\$ in thousands, fiscal year ends December)						
	1Q 2014 Actual	1Q 2013 Actual	Year/Year %Change	1Q 2014 Estimate	Year/Year %Change	Actual-Est.
Revenue	\$7,476	\$4,384	70.5%	\$7,123	-38.5%	\$353.0
Cost of Revenue	\$3,607	\$2,773	30.1%	\$3,633	-23.7%	-\$25.8
Gross Profit	\$3,869	\$1,611	140.2%	\$3,490	-53.9%	\$378.7
Research & Development	\$2,126	\$2,010	5.8%	\$2,279	-11.8%	-\$153.4
Sales & Marketing	\$4,336	\$2,703	60.4%	\$4,076	-33.7%	\$259.8
General & Administrative	\$3,982	\$2,791	42.7%	\$3,633	-23.2%	\$349.2
Operating Income/Loss	-\$6,575	-\$5,893	11.6%	-\$6,498	-9.3%	-\$77.0
Interest	-\$111	\$1	-20467.0%	-\$119	-100.5%	\$7.8
Other income (expense)	\$12	-\$1,003	-101.2%	\$0	NM	\$12.0
Net Income/Loss	-\$6,674	-\$6,895	-3.2%	-\$6,617	4.2%	-\$57.1
W. Avg. Shares (Diluted)	21,148	763	2671.7%	21,354	-96.4%	-206
EPS	-\$0.32	-\$9.04	-96.5%	-\$0.31	2816.4%	-\$0.01
Margin Analysis						<i>BPS</i>
Gross Margin	51.8%	36.7%	15.0%	49.0%	-12.3%	275
Research & Development	28.4%	45.8%	-17.4%	32.0%	13.8%	-356
Sales & Marketing	58.0%	61.7%	-3.7%	57.2%	4.4%	77
General & Administrative	53.3%	63.7%	-10.4%	51.0%	12.7%	226
Operating Income/Loss	-87.9%	-134.4%	46.5%	-91.2%	-43.2%	328
Net Income/Loss	-89.3%	-157.3%	68.0%	-92.9%	-64.4%	362
Other Indicators						
FNA Samples	14,373	10,770	33.5%	14,647	36.0%	-274
GEC Percent of FNA	22%	18%	20.6%	20%	-1.8%	2%
GEC Tests	3,162	1,965	60.9%	2,929	49.1%	233

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

	FY 2011	FY 2012	Q1'13	Q2'13	Q3'13	Q4'13	FY 2013	Q1'14E	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	\$7,476	\$9,599	\$9,823	\$13,114	\$40,012	\$71,171	\$115,356
Cost of Services:	\$2,925	\$7,584	\$2,773	\$3,231	\$3,132	\$3,471	\$12,607	\$3,607	\$4,800	\$4,813	\$6,295	\$19,514	\$28,233	\$39,465
Gross Profit	-\$281	\$4,044	\$1,611	\$1,836	\$2,462	\$3,367	\$9,277	\$3,869	\$4,800	\$5,010	\$6,819	\$20,498	\$42,938	\$75,891
Operating expenses:														
Research and development	\$6,680	\$6,608	\$2,010	\$1,902	\$2,028	\$1,870	\$7,810	\$2,126	\$2,592	\$3,045	\$3,672	\$11,435	\$16,042	\$18,863
Total Selling & Marketing	\$2,934	\$8,447	\$2,703	\$2,615	\$3,291	\$3,931	\$12,540	\$4,336	\$4,789	\$4,817	\$6,163	\$20,105	\$31,859	\$45,583
General & Administrative	\$5,371	\$7,918	\$2,791	\$2,737	\$3,244	\$3,328	\$12,100	\$3,982	\$4,416	\$4,420	\$4,983	\$17,801	\$20,622	\$22,495
Total Operating Expenses	\$14,985	\$22,973	\$7,504	\$7,254	\$8,563	\$9,129	\$32,450	\$10,444	\$11,796	\$12,282	\$14,818	\$49,341	\$68,522	\$86,941
Operating Income	-\$15,265	-\$18,929	-\$5,893	-\$5,418	-\$6,101	-\$5,762	-\$23,173	-\$6,575	-\$6,997	-\$7,272	-\$7,999	-\$28,843	-\$25,584	-\$11,051
Interest Income (Expense)	\$2	\$2	\$1	-\$5	-\$126	-\$97	-\$228	-\$111	-\$121	-\$122	-\$123	-\$477	-\$389	-\$197
Other Expense	\$819	\$278	-\$1,003	-\$1,068	-\$76	-\$33	-\$2,180	\$12	\$0	\$0	\$0	\$12	\$0	\$0
Net Income/Loss	-\$14,445	-\$18,649	-\$6,895	-\$6,491	-\$6,303	-\$5,892	-\$25,580	-\$6,674	-\$7,117	-\$7,395	-\$8,122	-\$29,308	-\$25,973	-\$11,248
EPS basic	-\$6.23	-\$7.17	-\$0.33	-\$0.31	-\$0.30	-\$0.28	-\$1.23	-\$0.32	-\$0.33	-\$0.34	-\$0.37	-\$1.36	-\$1.15	-\$0.48
EPS fully diluted	-\$0.72	-\$0.89	-\$0.33	-\$0.31	-\$0.30	-\$0.28	-\$1.22	-\$0.32	-\$0.33	-\$0.34	-\$0.37	-\$1.36	-\$1.15	-\$0.48
W.Avg Shares Outstanding basic	2,320	2,601	20,690	20,690	20,690	20,897	20,742	21,148	21,360	21,573	21,789	21,468	22,619	23,710
W.Avg Shares Outstanding diluted	19,992	20,841	20,843	20,943	21,043	21,143	20,993	21,148	21,360	21,573	21,789	21,468	22,619	23,710
Margin Analysis:														
Gross Margin	-11%	35%	37%	36%	44%	49%	42%	52%	50%	51%	52%	51%	60%	66%
Total Operating Expenses	-567%	-198%	-171%	-143%	-153%	-134%	-150%	-140%	-123%	-125%	-113%	-125%	-97%	-76%
Research and development	253%	57%	46%	38%	36%	27%	37%	28%	27%	31%	28%	29%	23%	17%
Selling & Marketing	111%	73%	62%	52%	59%	57%	57%	58%	50%	49%	47%	51%	45%	40%
General & Administrative	203%	68%	64%	54%	58%	49%	56%	53%	46%	45%	38%	46%	30%	20%
EBIT	-577%	-163%	-134%	-107%	-109%	-84%	-109%	-88%	-73%	-74%	-61%	-74%	-38%	-10%
Tax Rate	NM													
Net Income/Loss	-546%	-160%	-157%	-128%	-113%	-86%	-121%	-89%	-74%	-75%	-62%	-75%	-38%	-11%
Growth Metrics:														
Total Revenue Growth	NM	340%	199%	104%	74%	53%	88%	71%	89%	76%	92%	83%	78%	62%
Gross Profit	NM	-1541%	653%	150%	99%	81%	129%	140%	161%	103%	103%	121%	109%	77%
Total Operating Expenses	NM	53%	68%	35%	39%	31%	41%	39%	63%	43%	62%	52%	39%	27%
Research and development	NM	NM	36%	13%	17%	9%	18%	6%	36%	50%	96%	46%	40%	18%
Selling & Marketing	NM	NM	122%	43%	40%	29%	48%	60%	83%	46%	57%	60%	58%	43%
General & Administrative	NM	NM	58%	48%	54%	52%	53%	43%	61%	36%	50%	47%	16%	9%
EBIT	NM	-24%	-39%	-17%	-24%	-13%	-22%	-12%	-29%	-19%	-39%	-24%	11%	57%
Net Income/Loss	NM	-29%	-62%	-40%	-28%	-22%	-37%	3%	-10%	-17%	-38%	-15%	11%	57%
EPS	NM	86%	81%	83%	84%	85%	-36%	5%	-6%	-13%	-32%	-12%	16%	59%
Shares Outstanding	NM	4%	0%	0%	0%	0%	697%	0%	1%	1%	1%	4%	5%	5%

William Blair & Company, L.L.C.

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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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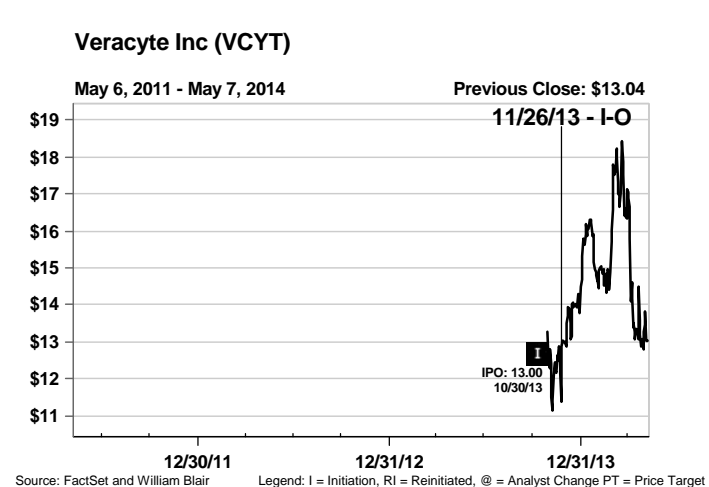
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DOW JONES: 16,550.97

S&P 500: 1,875.63

NASDAQ: 4,051.50



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Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	66	Outperform (Buy)	14
Market Perform (Hold)	31	Market Perform (Hold)	2
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