

**Drew Jones, Analyst**

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Changes	Previous	Current
Rating	--	Overweight(Vol)
Target Price	--	\$14.00
Price:		\$8.66
Fully Diluted Shares Out (mil.):		21.49
52-Week High:		\$19.00
52-Week Low:		\$8.56
Market Cap (mil.):		\$186.1
Fiscal Year End:		Dec
Average Daily Volume:		120,219
Float (mil.):		6.8
Debt/Cap:		8.0
Cash/Shr:		\$3.37
Dividend/Yield:		NA/NA
Book Value/Shr:		\$2.10

EPS	2013A	2014E	2015E
Mar	(\$2.26)A	(\$0.32)A	NE
Jun	(\$2.00)A	(\$0.31)A	NE
Sep	(\$6.59)A	(\$0.36)	NE
Dec	(\$1.42)A	(\$0.40)	NE
FY	(\$6.15)A	(\$1.39)	(\$1.19)
P/E	NM	NM	NM
Rev.	\$21.9M	\$37.8M	\$62.0M

**Veracyte, Inc.** is a molecular diagnostics company that discovers, develops, and commercializes molecular diagnostic solutions that enable physicians to make more informed treatment decisions early.

**Veracyte, Inc.**

VCYT – NASDAQ

**Overweight (Volatile)****Reason for Report:** Company Update**Analyst Day Reaffirms Positive Outlook for GEC; Reiterate OW/Vol \$14 PT****INVESTMENT CONCLUSION:**

We attended VCYT's Analyst Day Thursday and came away with nothing to alter our positive thesis. One key takeaway was the announcement of initial contracts with two large commercial payers for the Afirma GEC test. We didn't get any color on pricing, but we believe there is room for upside to our modeled assumptions (~\$2000 through 2015) as more commercial payers move to in network status. Additionally, we got more color on the pipeline for VCYT's Pulmonology products, which look attractive but are not central to our positive thesis at this point. We maintain our **OW/Vol.** rating and \$14 PT on VCYT.

**KEY POINTS:****Afirma GEC Growth Should Continue**

- VCYT's biggest announcement Thursday was that it has signed contracts to move to in-network status with United Healthcare (UNH-NR) and Cigna (CI-NR). This establishes pricing and serves to lower the out-of-pocket costs to patients for the Afirma GEC, both of which should facilitate wider adoption. We didn't get definitive details on pricing, but we believe there is room for upside to our model pricing assumption of \$2000. We believe pricing for these contracts is somewhere between CMS reimbursement at the low end (\$3200) and list price at the high end (\$4900). Mgmt noted that they are also in talks with other commercial payers for in-network status, which we believe would also help drive adoption.
- Dr. Erik Alexander, professor of endocrinology at Harvard Medical School, provided additional color on his Afirma GEC study. This clinical utility study found that for a sample of 322 nodules with indeterminate FNA biopsy results, surgery was recommended 95% of the time when the nodule was Afirma GEC suspicious and only 2% of the time when the sample was Afirma GEC benign. This underscored his point that not only is Afirma GEC becoming more widely adopted, but its clinical indications are being followed.

**More Color Provided on Lung Product Pipeline**

- VCYT had Dr. Anil Vachani of UPenn's Department of Medicine speak on the clinical need for lung cancer detection and VCYT's recently acquired lung cancer diagnostic (scheduled for 2H15 launch). He sees the largest clinical challenge currently is that the best available test for indeterminate risk patients (>50% of patients), bronchoscopy, doesn't accurately test nodules in the periphery of the lungs where the majority of malignant nodules occur. This leads to 20%-50% non-diagnostic bronchoscopies, where traditionally open-chest diagnostic surgeries have been the choice. These procedures show benign disease 30%-40% of the time, subjecting these patients to potentially severe side effects.

See important disclosures and analyst certification on pages 4 - 5 of this report.

Additionally, Dr. Vachani gave color on a clinical validation study for VCYT's acquired lung diagnostic. The results were promising, showing that the test had a sensitivity of 87% and specificity of 50% in classifying non-diagnostic nodules as cancerous. Encouragingly, the study showed that VCYT's test had robustness across all stages of cancer and for differing lesion size. A final takeaway was that 42% of the patients who had negative genetic tests retroactively, could have been saved invasive procedures if the test had been done beforehand.

- VCYT's final practitioner speaking was Dr. Fernando Martinez of the University of Michigan Health System, who spoke on Idiopathic Pulmonary Fibrosis, the deadly (< 30% 5-year survival rate) disease that is the focus of VCYT's second lung test in development. His studies had found that diagnosis for IPF is very inconsistent between the 3 doctor groups (pulmonologist, radiologist, pathologist) and that its most widely used diagnostic, the CT scan, found only 50%-70% of cases diagnosed as IPF were actually IPF, mainly because of the difficult nature of classifying the disease from other similar lung diseases and clinicians' tendency to err on the side of caution. VCYT's diagnostic for IPF is still in development (expected 2016 launch), but Dr. Martinez did note that he would be excited to use the genes included so far on VCYT's test as a diagnostic, which we believe shows more potential for the test than we initially believed.

# Veracyte Inc. Income Statement

(in 000s except per share data)

Fiscal Year Ends Dec. 31

	FY 2011	FY 2012A	Mar-13 1Q13A	June-13 2Q13A	Sep-13 3Q13A	Dec-13 4Q13A	FY 2013A	Mar-14 1Q14A	June-14 2Q14A	Sep-14 3Q14E	Dec-14 4Q14E	FY 2014E	FY 2015E
<b>Total Revenues</b>	<b>\$ 2,645</b>	<b>\$ 11,628</b>	<b>\$ 4,384</b>	<b>\$ 5,068</b>	<b>\$ 5,594</b>	<b>\$ 6,838</b>	<b>\$ 21,884</b>	<b>\$ 7,476</b>	<b>\$ 8,677</b>	<b>\$ 9,063</b>	<b>\$ 12,599</b>	<b>\$ 37,816</b>	<b>\$ 62,030</b>
Cost of Product Revenues	2,925	7,584	2,773	3,231	3,132	3,471	12,607	3,607	3,966	3,988	5,418	16,979	24,812
Gross Profit	(280)	4,044	1,611	1,837	2,462	3,367	9,277	3,869	4,711	5,076	7,182	20,837	37,218
Operating Expenses													
Research and Development	6,680	6,608	2,010	1,902	2,028	1,870	7,810	2,126	2,243	2,719	3,150	10,238	16,133
Selling & Marketing	2,934	8,447	2,703	2,615	3,291	3,931	12,540	4,336	5,101	5,619	6,930	21,986	25,393
General & Administrative	5,372	7,918	2,791	2,737	3,244	3,328	12,100	3,982	3,928	4,532	5,670	18,111	21,555
Non-Recurring Expenses	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Operating Expenses	14,986	22,973	7,504	7,254	8,563	9,129	32,450	10,444	11,272	12,870	15,749	50,335	63,081
Operating Income (Loss)	(15,266)	(18,929)	(5,893)	(5,417)	(6,101)	(5,762)	(23,173)	(6,575)	(6,561)	(7,795)	(8,568)	(29,498)	(25,863)
EBITDA	(14,655)	(18,223)	(5,696)	(5,186)	(5,812)	(5,480)	(22,174)	(6,311)	(6,284)	(7,518)	(8,291)	(28,403)	(25,863)
Interest Income (Expense), net	-	-	-	(5)	(126)	(97)	(228)	(111)	(113)	-	-	(224)	-
Other Income (Expense), net	821	280	(1,002)	(1,068)	(76)	(33)	(2,179)	12	19	-	-	31	-
Income Before Taxes	(14,445)	(18,649)	(6,895)	(6,490)	(6,303)	(5,892)	(25,580)	(6,674)	(6,655)	(7,795)	(8,568)	(29,691)	(25,863)
Tax Expense (Break)	-	-	-	-	-	-	-	-	-	-	-	-	-
Net Income	\$ (14,445)	\$ (18,649)	\$ (6,895)	\$ (6,490)	\$ (6,303)	\$ (5,892)	\$ (25,580)	\$ (6,674)	\$ (6,655)	\$ (7,795)	\$ (8,568)	\$ (29,691)	\$ (25,863)
Reported EPS	\$ (24.90)	\$ (7.17)	\$ (2.26)	\$ (2.00)	\$ (6.59)	\$ (1.42)	\$ (6.15)	\$ (0.32)	\$ (0.31)	\$ (0.36)	\$ (0.40)	\$ (1.39)	\$ (1.19)
<b>Pro Forma EPS</b>	<b>\$ (24.90)</b>	<b>\$ (7.17)</b>	<b>\$ (2.26)</b>	<b>\$ (2.00)</b>	<b>\$ (6.59)</b>	<b>\$ (1.42)</b>	<b>\$ (6.15)</b>	<b>\$ (0.32)</b>	<b>\$ (0.31)</b>	<b>\$ (0.36)</b>	<b>\$ (0.40)</b>	<b>\$ (1.39)</b>	<b>\$ (1.19)</b>
Fully Diluted Shares Outstanding	580	2,601	3,052	3,251	956	4,159	4,159	21,148	21,237	21,490	21,540	21,354	21,665
<u>Margin Analysis</u>													
Gross Profit	-10.6%	34.8%	36.7%	36.2%	44.0%	49.2%	42.4%	51.8%	54.3%	56.0%	57.0%	55.1%	60.0%
Research and Development	252.6%	56.8%	45.8%	37.5%	36.3%	27.3%	35.7%	28.4%	25.8%	30.0%	25.0%	27.1%	26.0%
Selling & Marketing	110.9%	72.6%	61.7%	51.6%	58.8%	57.5%	57.3%	58.0%	58.8%	62.0%	55.0%	58.1%	40.9%
General & Administrative	203.1%	68.1%	63.7%	54.0%	58.0%	48.7%	55.3%	53.3%	45.3%	50.0%	45.0%	47.9%	34.7%
Operating Income	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
EBITDA	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Income Before Taxes	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
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%
Net Income	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
<u>Growth Analysis</u>													
Revenues	---	339.6%	198.6%	104.4%	73.5%	53.4%	88.2%	70.5%	71.2%	62.0%	84.3%	72.8%	64.0%
Gross Profit	---	NM	652.8%	150.6%	98.5%	81.3%	129.4%	140.2%	156.5%	106.2%	113.3%	124.6%	78.6%
Research & Development	---	-1.1%	35.7%	13.4%	17.3%	8.7%	18.2%	5.8%	17.9%	34.1%	68.4%	31.1%	57.6%
Sales & Marketing	---	187.9%	122.5%	42.9%	40.2%	28.7%	48.5%	60.4%	95.1%	70.7%	76.3%	75.3%	15.5%
General & Administrative	---	47.4%	58.0%	47.8%	54.3%	51.5%	52.8%	42.7%	43.5%	39.7%	70.4%	49.7%	19.0%
Operating Income	---	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Pretax Income	---	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Net Income	---	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Reported EPS	---	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM

\* Pro forma EPS excludes non-recurring expenses and stock-based compensation.

Source: Company reports and Stephens Inc. estimates.

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## COMPANIES MENTIONED

Cigna Corporation (CI - \$89.98)  
United Health Group (UNH -\$84.94)

## APPENDIX A

### ANALYST CERTIFICATION

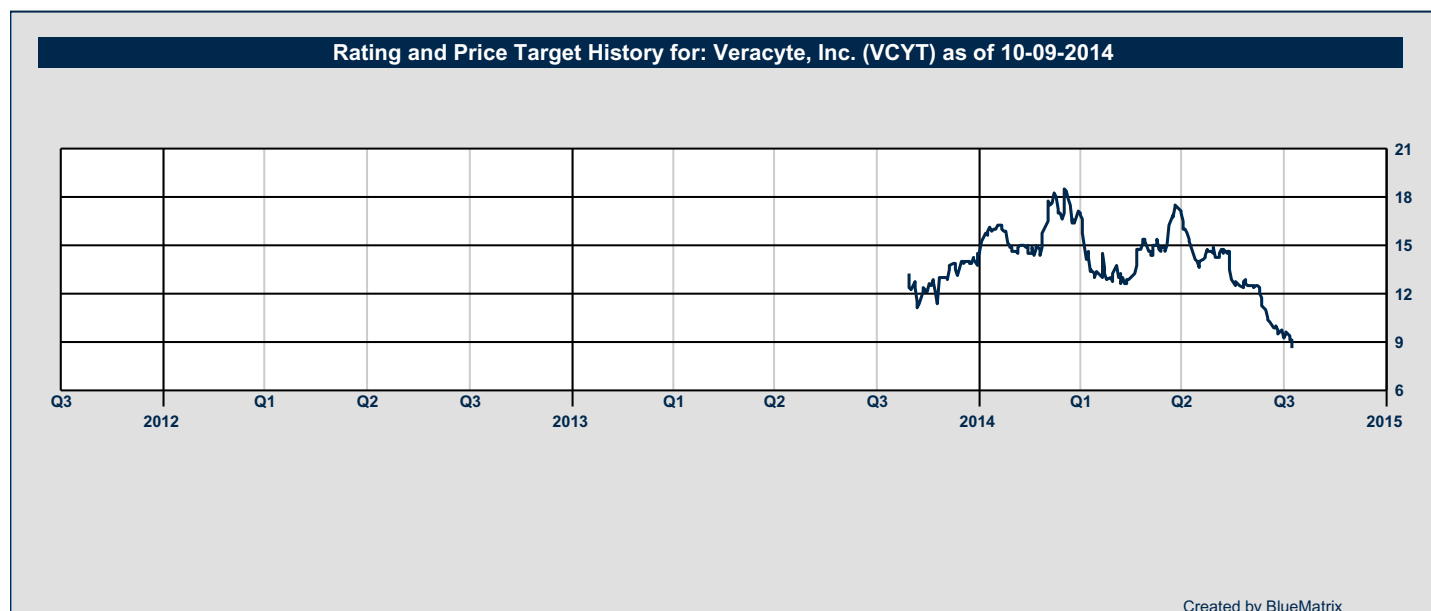
The analyst primarily responsible for the preparation of the content of this report certifies that (i) all views expressed in this report accurately reflect the analyst's personal views about the subject company and securities, and (ii) no part of the analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by the analyst in this report.

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Stephens Inc. maintains a market in the common stock of Veracyte, Inc. as of the date of this report and may act as principal in these transactions.

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



### Valuation Methodology for Veracyte, Inc.

We value VCYT on a blended basis using comparable companies analysis and a market share discounted cash flow analysis.

### Risks to Achievement of Target Price for Veracyte, Inc.

Key risks for investors to note when evaluating shares of VCYT include 1) reimbursement risk, 2) share loss due to competition, 3) potential for channel conflict between customers, and 4) potentially dilutive products in the pipeline.

### Ratings Definitions

OVERWEIGHT (O) - The stock's total return is expected to be greater than the total return of the company's industry sector, on a risk-adjusted basis, over the next 12 months. EQUAL-WEIGHT (E) - The stock's total return is expected to be equivalent to the total return of the company's industry sector, on a risk-adjusted basis, over the next 12 months. UNDERWEIGHT (U) - The stock's total return is expected to be less than the total return of the company's industry sector, on a risk-adjusted basis, over the next 12 months. VOLATILE (V) - The stock's price volatility is potentially higher than that of the company's industry sector. The company stock ratings may reflect the analyst's subjective assessment of risk factors that could impact the company's business.

## Distribution of Stephens Inc. Ratings

Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY [OW]	259	58.33	57	22.01
HOLD [EW]	180	40.54	19	10.56
SELL [UW]	5	1.13	0	0.00

## OTHER DISCLOSURES

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