

Equity Research

August 14, 2014

Price: \$14.65 (08/13/2014)

Price Target: \$22.00

OUTPERFORM (1)

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Key Data

Symbol	NASDAQ: VCYT
52-Week Range:	\$19.00 - 10.88
Market Cap (MM):	\$310.2
Net Debt (MM):	\$(66.3)
Cash/Share:	\$3.37
Enterprise Value (MM):	\$250.9
ROIC:	NA
ROE (LTM):	NA
BV/Share:	\$2.38
Dividend:	NA

FY (Dec)	2013E	2014E	2015E
Revenue (MM)			
Q1	\$4.4A	\$7.5A	\$15.8
Prior Q1	-	-	\$16.1
Q2	\$5.1A	\$8.7A	\$19.0
Prior Q2	-	\$9.2	\$19.1
Q3	\$5.6A	\$10.2	\$21.3
Prior Q3	-	\$10.3	\$20.8
Q4	\$6.8A	\$13.7	\$24.0
Prior Q4	-	-	\$23.4
Year	\$21.9A	\$40.0	\$80.1
Prior Year	-	\$40.7	\$79.4
EV/S	11.5x	6.3x	3.1x

Earnings Per Share

Year	\$(6.15)A	\$(1.19)	\$(0.65)
Prior Year	-	\$(1.16)	\$(0.63)
P/E	NM	NM	NM
Consensus EPS	\$(1.23)	\$(1.29)	\$(0.91)

Consensus source: Thomson Reuters

Earnings Update

Underlying Trends Strong

The Cowen Insight

While Q2 revenue was below consensus and F14 FNA volume guidance was reduced, we believe underlying GEC growth remains robust for reasons described herein. Our rating and price target remains unchanged and we believe that any material weakness in the stock today is likely overdone and represents a buying opportunity.

Guidance & Q2 Performance Summary

Full year revenue guidance of \$38-43MM was reaffirmed but FNA volume guidance was reduced (please see below for details). While Q2 revenue of \$8.7MM (+71% Y/Y) was \$0.7MM below consensus, we note that revenue remains lumpy to the timing of revenue recognition and Veracyte does not provide quarterly revenue guidance.

Some Clarification on FNA Guidance and Customer Mix

Some are disappointed with the “reduced” FNA volume guidance and the seemingly lower GEC penetration rate in physician offices this quarter. Regarding F14 FNA volume guidance, which was reduced from 76-83K to 66-73K, our discussion with management suggests the key driver to the reduction is the changing mix of academic/institutional clients and physician offices, not underlying market weakness or competitive dynamics. We believe that penetration rate of GEC tests at physician offices remains at least in line with historical trends – the reason for the seemingly weaker than expected volume from physician offices is that sales reps spent relatively more time at institutional/academic accounts than at physician offices in Q2.

Encouraging Signs Should Outweigh Any Confusion

The good news is that (a) revenue guidance remains unchanged, (b) GEC volumes were at least as good as management expected, and (c) penetration of academic/institutional accounts, which tend to be inherently higher GEC volume over time, is ahead of expectations. The bad news appears to be that (a) Q2 revenue was a bit light, (b) VCYT is tracking below plan in the physician office setting where FNAs are relevant, and (c) the Q2 revenue miss and guidance change reveal some surprising challenges at this early stage of market penetration. More specifically, it could be argued it is surprising that VCYT faced what appears to have been a resource allocation/prioritization issue in spite of the fact that last year's IPO allowed for expansion of the sales force and with Afirma GEC having only penetrated ~10-15% of the US market. We don't agree – it has always been expected that quarter-to-quarter revenue performance would be lumpy as the sales force expands, new coverage changes occur, and customer mix evolves. Ultimately, conversion of more institutional/academic accounts should be viewed as affirming of the scientific rigor supporting Afirma use and should ultimately lead to easier penetration of non-institutional/academic accounts; also, more institutional/academic accounts should improve overall predictability, revenue recognition, and sales efficiency. These dynamics combined with a young-but-maturing and growing sales force should improve performance over time, especially subsequent to alterations to the company's agreement with Genzyme (announced yesterday) that should improve operating margins over time.

Please see addendum of this report for important disclosures.

At A Glance

Our Investment Thesis

Through a series of clinical validity, utility, and health economics studies, Veracyte obtained National Comprehensive Cancer Network guideline recommendations as well as several positive payor coverage decisions, including Medicare, United, Aetna, and Humana, covering >125MM lives in the US. We believe Veracyte is well-positioned to gain additional payor coverage and physician adoption over the next several years. Veracyte shares trade at a significant discount of ~40% on a '15-16E EV/sales basis, relative to a peer group that includes ICEL, FLDM, FMI, GHDX, OXFD and MYGN. Given the company's strong management team, the clear unmet need addressed by Afirma, a developing pipeline, a relatively cheap valuation, robust growth over the next several years, and the potential for upside relative to expectations, Veracyte is one of our top 2014 smaller cap picks.

Forthcoming Catalysts

- Insurance coverage decisions
- Conversion to contracted lives from covered lives
- Guideline inclusion
- Pipeline
- Strategic developments
- Quarterly earnings reports

Base Case Assumptions

- FNA and GEC volume growth ahead of expectations
- Total lives under coverage continues to expand
- New product introductions on track
- Some conversions to contracted lives from covered lives in F14

Upside Scenario

- FNA and GEC volume growth well ahead of expectations
- OUS launch starts to gain momentum
- Better than expected ASPs
- Additional guidelines inclusions drive further adoption
- More conversions to contracted lives from covered lives than expected in F14

Downside Scenario

- FNA and GEC volume growth below expectations
- Total covered lives continue to expand, but at a slower pace
- New product launches delayed
- Competition emerges

Price Performance



Source: Bloomberg

Company Description

Veracyte is a molecular cytology-focused diagnostic company that currently markets the Afirma GEC test used to reduce the number of unnecessary thyroid surgeries in patients suspected of having thyroid cancer. Since the initial commercial launch of Afirma GEC test in Jan 2011, Veracyte has processed >50,000 Fine Needle Aspiration (FNA) based cytopathology samples, and >10,000 GECs. Veracyte currently has 3 additional products under development, including Afirma Malignant GEC (launch expected in Q2:14), Idiopathic Pulmonary Fibrosis, and Lung Cancer Diagnostic test.

Analyst Top Picks

	Ticker	Price (08/13/2014)	Price Target	Rating
Illumina	ILMN	\$166.13	\$205.00	Outperform
Thermo Fisher Scientific	TMO	\$121.35	\$135.00	Outperform
Veracyte	VCYT	\$14.65	\$22.00	Outperform

Figure 1 Veracyte (VCYT) Earnings Snapshot

Cowen vs. Consensus (\$MM, except EPS)					
	Q2:14E				
	Q2:13A	Cowen	Consensus	Q2:14A	Previous Guidance
Revenue	\$5.1	\$9.2	\$9.4	\$8.7	MAY 8: FY14: \$38-43MM; FNA volumes of 76-83K (reaffirmed)
Gross Margin	36.2%	51.5%	50.0%	54.3%	
Operating Margin	(106.9%)	(68.3%)	NM	(75.6%)	
EPS	(\$7.21)	(\$0.30)	(\$0.33)	(\$0.31)	
Selected Revenue Metrics (\$MM, except EPS)					
	Q2:13A	Q1:14A	Q2:14E	Q2:14A	Comments
FNA	\$1.5	\$2.0	\$2.2	\$2.0	
Reported Growth (Y/Y)	145.2%	53.5%	41.4%	31.3%	FNA revenue was \$0.2MM below our forecast; we believe this is due to more FNA samples coming from academic/institutional clients and fewer from physician offices - these former do not have an associated cytopathology revenue component.
Afirma GEC	\$3.5	\$5.5	\$7.1	\$6.7	
Reported Growth (Y/Y)	90.7%	77.8%	99.0%	88.4%	GEC revenue was \$0.4MM below our forecast; however, we note that GEC revenue remains lumpy quarter-to-quarter due to the timing of revenue recognition.
Income Statement (\$MM, except EPS)					
	Q2:13A	Q1:14A	Q2:14E	Q2:14A	Comments
Revenue	\$5.1	\$7.5	\$9.2	\$8.7	
Reported Growth (Y/Y)	104.4%	70.5%	81.7%	71.2%	Revenue was ~\$0.7MM and ~\$0.5MM below consensus and our forecast, respectively. We note that Veracyte does not provide quarterly revenue guidance and revenue remains lumpy quarter-to-quarter due to the timing of revenue recognition.
Gross Profit	\$1.8	\$3.9	\$4.7	\$4.7	
Margin	36.2%	51.8%	51.5%	54.3%	Gross margin was better than expected. A higher percentage of sales from academic/institutional clients benefited gross margin as these sales do not include lower margin cytopathology revenue.
R&D	\$1.9	\$2.1	\$2.3	\$2.2	
% of sales	37.5%	28.4%	25.0%	25.8%	R&D expense was about in line with our forecast.
Growth Y/Y	13.4%	5.8%	21.0%	17.9%	
SG&A	\$5.4	\$8.3	\$8.7	\$9.0	
% of sales	105.6%	111.3%	94.8%	104.1%	SG&A expense was \$0.3MM above our forecast; we believe this is due to the acceleration of sales force hires.
Growth Y/Y	45.3%	51.4%	63.2%	68.7%	
Operating Profit	(\$5.4)	(\$6.6)	(\$6.3)	(\$6.6)	
Margin	(106.9%)	(87.9%)	(68.3%)	(75.6%)	
Non-Operating Items	\$1.1	\$0.1	\$0.1	\$0.1	
Pre-Tax Income	(\$6.5)	(\$6.7)	(\$6.4)	(\$6.7)	
Taxes	\$0.0	\$0.0	\$0.0	\$0.0	
Rate	0.0%	0.0%	0.0%	0.0%	
Net Income	(\$6.5)	(\$6.7)	(\$6.4)	(\$6.7)	
Margin	(128.1%)	(89.3%)	(69.1%)	(76.7%)	
Earnings Per Share	(\$7.21)	(\$0.32)	(\$0.30)	(\$0.31)	
Growth (Y/Y)	NM	NM	NM	NM	
Share Count (MM)	1	21	21	21	

Source: Company Reports, Thomson One, and Cowen and Company.

Figure 2 Veracyte (VCYT) Revenue Model

(MM, except EPS)	Q1:13	Q2:13	Q3:13	Q4:13	Q1:14	Q2:14	Q3:14E	Q4:14E	Q1:15E	Q2:15E	Q3:15E	Q4:15E	2013	2014E	2015E	2016E	2017E	2018E	5-yr CAGR	Comments
TOTAL REVENUE	\$4.4	\$5.1	\$5.6	\$6.8	\$7.5	\$8.7	\$10.2	\$13.7	\$15.8	\$18.0	\$21.3	\$24.0	\$21.9	\$40.0	\$80.1	\$123.7	\$159.1	\$195.0	54.9%	AUG 12: FY14: \$38-43MM (reaffirmed); FNA volumes 66-73K (was 76-83K)
% Growth - Y/Y	199%	104%	74%	53%	71%	71%	83%	100%	112%	119%	108%	76%	88.2%	82.9%	100.2%	54.3%	28.6%	22.6%		
		15.6%	10.4%	22.2%	9.3%	16.1%	17.8%	33.6%												
% of sales from FNA	30%	30%	28%	28%	27%	23%	23%	19%	19%	17%	17%	16%	29%	23%	17%	17%	16%	14%		
% of sales from GEC	70%	70%	72%	72%	73%	77%	77%	81%	81%	83%	83%	84%	71%	77%	83%	83%	84%	86%		
Medicare Revenue	\$1.6	\$2.0	\$1.9	\$2.2	\$2.4	\$2.9	\$3.1	\$3.7	\$3.8	\$4.0	\$4.6	\$4.8	\$7.7	\$12.0	\$17.2	\$24.2	\$29.0	\$34.8		
% from Medicare	37%	39%	34%	32%	31%	33%	31%	27%	24%	21%	22%	20%	35.0%	29.9%	21.5%	19.6%	18.2%	17.9%		
US CYTOPATHOLOGY REVENUE (FNA)	\$1.3	\$1.5	\$1.6	\$1.9	\$2.0	\$2.0	\$2.4	\$2.6	\$3.0	\$3.2	\$3.5	\$3.8	\$6.3	\$9.0	\$13.6	\$20.5	\$25.4	\$28.0	34.7%	
% Growth	258.5%	145.2%	94.3%	71.8%	53.5%	31.3%	52.4%	37.9%	50.7%	62.6%	47.2%	45.3%	117.3%	43.2%	50.9%	50.3%	23.6%	10.4%		
% of Total Revenue	30.0%	30.0%	28.0%	28.0%	27.0%	23.0%	23.4%	19.3%	19.2%	17.1%	16.5%	16.0%	28.9%	22.6%	17.0%	16.6%	15.9%	14.3%		
GEC REVENUE (AFIRMA)	\$3.1	\$3.5	\$4.0	\$4.9	\$5.5	\$6.7	\$7.8	\$11.0	\$12.8	\$15.8	\$17.7	\$20.2	\$15.6	\$31.0	\$66.5	\$103.2	\$133.7	\$167.1	80.7%	
% Growth	178.9%	90.7%	66.6%	47.3%	77.8%	88.4%	94.5%	123.8%	134.5%	135.7%	126.5%	83.4%	78.5%	99.1%	114.5%	55.1%	29.6%	24.9%		
% of Total Revenue	70.0%	70.0%	72.0%	72.0%	73.0%	77.0%	76.6%	80.7%	80.8%	82.9%	83.5%	84.0%	71.1%	77.4%	83.0%	83.4%	84.1%	85.7%		

Source: Company Reports and Cowen and Company.

Figure 3 Veracyte (VCYT) Income Statement

(MM, except EPS)	Q1:13	Q2:13	Q3:13	Q4:13	Q1:14	Q2:14	Q3:14E	Q4:14E	Q1:15E	Q2:15E	Q3:15E	Q4:15E	2013	2014E	2015E	2016E	2017E	2018E	5-yr CAGR	Comments
Net sales	\$4.4	\$5.1	\$5.6	\$6.8	\$7.5	\$8.7	\$10.2	\$13.7	\$15.8	\$19.0	\$21.3	\$24.0	\$21.9	\$40.0	\$80.1	\$123.7	\$159.1	\$195.0	54.9%	AUG 12: FY14: \$38-43MM (reaffirmed); FNA volumes 66-73K (was 76-83K)
Growth	198.8%	104.4%	73.5%	53.4%	70.5%	71.2%	82.7%	99.8%	111.9%	118.9%	100.0%	76.0%	88.2%	82.9%	100.2%	54.3%	28.6%	22.6%		
Cost of sales	\$2.8	\$3.2	\$3.1	\$3.5	\$3.6	\$4.0	\$4.7	\$6.2	\$7.2	\$8.2	\$8.7	\$9.4	\$12.6	\$18.4	\$33.4	\$44.5	\$49.3	\$58.5		
Gross Profit	\$1.6	\$1.8	\$2.5	\$3.4	\$3.9	\$4.7	\$5.6	\$7.5	\$8.7	\$10.8	\$12.5	\$14.7	\$9.3	\$21.6	\$46.7	\$79.1	\$109.8	\$136.5	71.2%	
% of sales	36.7%	36.2%	44.0%	49.2%	51.8%	54.3%	54.4%	54.6%	54.8%	57.0%	59.0%	61.0%	42.4%	54.0%	58.3%	64.0%	69.0%	70.0%		
Growth	NM	NM	98.6%	81.3%	NM	NM	NM	NM	NM	NM	NM	96.6%	NM	NM	NM	69.4%	38.7%	24.4%		
Incremental Margin	47.9%	42.6%	51.6%	63.4%	73.0%	79.6%	67.0%	60.0%	57.5%	59.3%	63.3%	69.4%	51.0%	67.9%	62.6%	74.5%	86.5%	74.4%		
Research & Development	\$2.0	\$1.9	\$2.0	\$1.9	\$2.1	\$2.2	\$2.2	\$2.3	\$2.6	\$2.9	\$3.2	\$3.5	\$7.8	\$8.9	\$12.2	\$17.9	\$22.3	\$26.3	27.5%	
% of sales	45.8%	37.5%	36.3%	27.3%	28.4%	25.8%	22.0%	17.0%	16.5%	15.5%	15.0%	14.5%	35.7%	22.3%	15.3%	14.5%	14.0%	13.5%		
Growth	35.7%	13.4%	17.3%	8.6%	5.8%	17.9%	10.9%	24.2%	22.9%	31.3%	41.8%	50.1%	18.2%	14.5%	36.8%	46.6%	24.2%	18.2%		
Sales, General & Admin.	\$6.5	\$6.4	\$6.5	\$7.3	\$8.3	\$8.0	\$9.7	\$10.6	\$10.8	\$11.2	\$12.4	\$13.8	\$24.6	\$37.6	\$48.0	\$62.2	\$72.1	\$81.6	27.1%	AUG 12: S&M costs to increase Q3 and Q4 (hires and marketing expenses)
% of sales	125.3%	105.6%	116.8%	106.2%	111.3%	104.1%	94.6%	77.9%	67.1%	59.2%	58.2%	57.3%	112.6%	94.0%	59.9%	50.3%	45.3%	41.8%		AUG 12: Genzyme co-promotional fee to be reduced to 15% from 32% of Afirma revenue beginning Jan 1, 2015
Growth	84.3%	45.3%	46.9%	38.2%	51.4%	68.7%	47.9%	46.5%	27.8%	24.6%	28.0%	29.4%	50.6%	52.8%	27.5%	29.5%	16.0%	13.2%		
Total Operating Expenses	\$7.5	\$7.3	\$8.6	\$9.1	\$10.4	\$11.3	\$11.9	\$13.0	\$13.2	\$14.2	\$15.6	\$17.2	\$32.4	\$46.6	\$80.2	\$80.1	\$94.3	\$107.9	27.2%	
% of sales	171.1%	143.1%	153.1%	133.5%	139.7%	129.9%	116.6%	94.9%	83.6%	74.7%	73.2%	71.8%	148.3%	116.4%	75.2%	64.8%	59.3%	55.3%		
Growth	68.2%	35.3%	38.6%	30.9%	39.2%	55.4%	39.1%	41.9%	26.8%	25.9%	30.6%	33.1%	41.3%	43.6%	29.3%	33.0%	17.8%	14.4%		
EBITDA	(\$6.7)	(\$5.2)	(\$5.8)	(\$5.8)	(\$8.9)	(\$8.2)	(\$5.8)	(\$4.9)	(\$9.8)	(\$2.9)	(\$2.2)	(\$1.8)	(\$22.2)	(\$23.1)	(\$10.8)	\$4.7	\$22.7	\$37.5		
% of sales	(129.9%)	(102.4%)	(103.9%)	(80.1%)	(84.4%)	(71.0%)	(56.3%)	(35.9%)	(23.8%)	(13.5%)	(10.4%)	(7.4%)	(101.3%)	(57.8%)	(12.9%)	3.8%	14.2%	19.2%		
Growth	39.7%	16.6%	22.0%	11.0%	10.8%	18.8%	(1.0%)	(10.6%)	(40.4%)	(58.4%)	(61.5%)	(63.6%)	NM	NM	NM	NM	NM	65.5%		
Depreciation and Amortization	\$0.2	\$0.2	\$0.3	\$0.3	\$0.3	\$0.4	\$0.6	\$0.6	\$0.8	\$0.8	\$0.8	\$0.8	\$1.0	\$1.9	\$3.2	\$5.6	\$7.3	\$8.9		
Operating Profit	(\$5.6)	(\$5.4)	(\$5.1)	(\$5.4)	(\$8.6)	(\$8.6)	(\$6.4)	(\$5.5)	(\$4.6)	(\$3.4)	(\$3.0)	(\$2.6)	(\$23.2)	(\$25.0)	(\$13.6)	(\$0.9)	\$15.4	\$26.6		
% of sales	(134.4%)	(106.9%)	(109.1%)	(84.3%)	(87.9%)	(75.9%)	(62.2%)	(40.3%)	(28.8%)	(17.7%)	(14.2%)	(10.8%)	(105.9%)	(62.4%)	(16.9%)	(0.8%)	9.7%	14.7%		
Growth	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	85.7%		
Incremental Margin	(56.4%)	(30.6%)	(49.1%)	(27.1%)	(22.1%)	(31.7%)	(5.4%)	3.9%	24.1%	31.0%	30.2%	28.1%	(41.4%)	(10.0%)	28.6%	28.9%	46.2%	36.7%		
Other non-Operating Expense	\$1.0	\$1.1	\$0.1	\$0.0	(\$0.0)	(\$0.0)	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$2.2	(\$0.0)	\$0.0	\$0.0	\$0.0	\$0.0		
Net Interest Expense	(\$0.0)	\$0.0	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.2	\$0.4	\$0.3	\$0.0	\$0.0	\$0.0		
Earnings Before Taxes	(\$6.9)	(\$5.5)	(\$5.3)	(\$5.9)	(\$8.7)	(\$8.7)	(\$6.4)	(\$5.6)	(\$4.6)	(\$3.4)	(\$3.1)	(\$2.7)	(\$25.6)	(\$25.3)	(\$13.8)	(\$0.9)	\$15.4	\$26.6		
Margin	(157.2%)	(128.1%)	(112.7%)	(86.2%)	(89.3%)	(76.7%)	(62.8%)	(40.8%)	(29.2%)	(18.1%)	(14.5%)	(11.0%)	(116.9%)	(63.3%)	(17.2%)	(0.8%)	9.7%	14.7%		
Growth	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	85.7%		
Income Taxes	\$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	\$11.2		
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%	39.0%	39.0%		
Net Income	(\$6.9)	(\$5.5)	(\$5.3)	(\$5.9)	(\$8.7)	(\$8.7)	(\$6.4)	(\$5.6)	(\$4.6)	(\$3.4)	(\$3.1)	(\$2.7)	(\$25.6)	(\$25.3)	(\$13.8)	(\$0.9)	\$6.4	\$17.5		
Margin	(157.2%)	(128.1%)	(112.7%)	(86.2%)	(89.3%)	(76.7%)	(62.8%)	(40.8%)	(29.2%)	(18.1%)	(14.5%)	(11.0%)	(116.9%)	(63.3%)	(17.2%)	(0.8%)	5.9%	8.9%		
Growth	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	85.7%		
Earnings Per Share	(\$8.23)	\$7.21	(\$6.58)	(\$0.42)	(\$0.32)	(\$0.31)	(\$0.30)	(\$0.26)	(\$0.22)	(\$0.18)	(\$0.15)	(\$0.12)	(\$6.15)	\$1.19	(\$0.65)	(\$0.04)	\$0.44	\$0.82		
Shares Outstanding	1	1	1	14	21	21	21	21	21	21	21	21	4	21	21	21	21	21		
Growth	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	85.7%		
VERACYTE - CONSENSUS ESTIMATES																				
\$MM, ex. per share data	Q1:13	Q2:13	Q3:13	Q4:13	Q1:14	Q2:14	Q3:14E	Q4:14E	Q1:15E	Q2:15E	Q3:15E	Q4:15E	2013	2014E	2015E	2016E	2017E	2018E		
Revenue	\$8.4				\$7.4	\$8.4	\$10.2	\$13.4	\$16.1	\$18.7	\$20.3	\$23.2	\$21.5	\$40.4	\$78.7	\$117.1	\$148.5	\$171.1		
Growth								108.3%	117.6%	99.7%	99.8%	72.9%		88.0%	89.6%	52.7%	27.7%	14.4%		
<i>Actual/Cowen</i>				\$6.8	\$7.5	\$8.7	\$10.2	\$13.7	\$15.8	\$19.0	\$21.3	\$24.0	\$21.9	\$40.0	\$80.1	\$123.7	\$159.1	\$195.0		
Gross Margin				44.3%	50.9%	50.0%	50.7%	52.0%	53.2%	56.3%	56.3%	60.9%	40.7%	51.1%	57.0%	61.3%	66.0%	70.0%		
<i>Actual/Cowen</i>				49.2%	51.8%	54.3%	54.4%	54.6%	54.8%	57.0%	59.0%	61.0%	42.4%	54.0%	58.3%	64.0%	69.0%			
Operating Margin				N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A		
<i>Actual/Cowen</i>				(84.3%)	(87.9%)	(75.6%)	(62.2%)	(40.3%)	(28.8%)	(17.7%)	(14.2%)	(10.8%)	(105.9%)	(62.4%)	(16.9%)	(0.8%)	9.7%			
EPS				(\$0.38)	(\$0.30)	(\$0.33)	(\$0.33)	(\$0.31)	(\$0.27)	(\$0.22)	(\$0.18)	(\$0.14)	(\$1.53)	(\$1.29)	(\$0.91)	(\$0.19)	\$0.43			
<i>Actual/Cowen</i>				(50.42)	(50.32)	(50.31)	(50.30)	(50.26)	(50.22)	(50.16)	(50.15)	(50.12)	(56.15)	(51.19)	(50.65)	(50.04)	\$0.44			

Source: Company Reports, Thomson One, and Cowen and Company.

Valuation Methodology And Risks

Valuation Methodology

Life Science & Diagnostic Tools:

Price targets are based on several methodologies which may include: analysis of market risk, growth rate, revenue stream, discounted cash flows (DCF), EBITDA, EPS, cash flow (CF), free cash flow (FCF), EV/EBITDA, P/E, PE/growth, P/CF, P/FCF, premium (discount) / average group EV/EBITDA, premium (discount) / average group P/E, sum of the parts, net asset value, dividend returns, and return on equity (ROE) over the next 12 months.

Investment Risks

Life Science & Diagnostic Tools:

Risks to the Medical and Life Science Tools sector may include: reduction or delay in research and development budgets and government funding, reduced or delayed purchasing from health care / hospital customers, increased or extended regulatory hurdles or processes for regulated products, increased dependence on volatile emerging markets for revenues and profitability, and general macroeconomic challenges.

Risks To The Price Target

Risks include but are not limited to: difficulty in expanding payer coverage and entering into payer contracts; reimbursement prices lower than expected; delays or weaker than expected clinical data in support of new products; competition from other potential molecular diagnostic players; weaker than expected uptake in international markets; Genzyme partnership could become "relatively" expensive; and delivering on margin / profitability targets.

Addendum

Stocks Mentioned In Important Disclosures

Ticker	Company Name
ILMN	Illumina
TMO	Thermo Fisher Scientific
VCYT	Veracyte

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Cowen and Company Rating System effective May 25, 2013

Outperform (1): The stock is expected to achieve a total positive return of at least 15% over the next 12 months

Market Perform (2): The stock is expected to have a total return that falls between the parameters of an Outperform and Underperform over the next 12 months

Underperform (3): Stock is expected to achieve a total negative return of at least 10% over the next 12 months

Assumption: The expected total return calculation includes anticipated dividend yield

Cowen and Company Rating System until May 25, 2013

Outperform (1): Stock expected to outperform the S&P 500

Neutral (2): Stock expected to perform in line with the S&P 500

Underperform (3): Stock expected to underperform the S&P 500

Assumptions: Time horizon is 12 months; S&P 500 is flat over forecast period

Cowen Securities, formerly known as Dahlman Rose & Company, Rating System until May 25, 2013

Buy – The fundamentals/valuations of the subject company are improving and the investment return is expected to be 5 to 15 percentage points higher than the general market return

Sell – The fundamentals/valuations of the subject company are deteriorating and the investment return is expected to be 5 to 15 percentage points lower than the general market return

Hold – The fundamentals/valuations of the subject company are neither improving nor deteriorating and the investment return is expected to be in line with the general market return

Cowen And Company Rating Definitions

Distribution of Ratings/Investment Banking Services (IB) as of 06/30/14

Rating	Count	Ratings Distribution	Count	IB Services/Past 12 Months
Buy (a)	417	58.57%	94	22.54%
Hold (b)	279	39.19%	7	2.51%
Sell (c)	16	2.25%	0	0.00%

(a) Corresponds to "Outperform" rated stocks as defined in Cowen and Company, LLC's rating definitions. (b) Corresponds to "Market Perform" as defined in Cowen and Company, LLC's ratings definitions. (c) Corresponds to "Underperform" as defined in Cowen and Company, LLC's ratings definitions.

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Veracyte Rating History as of 08/13/2014

powered by: BlueMatrix



Illumina Rating History as of 08/13/2014

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Thermo Fisher Scientific Rating History as of 08/13/2014

powered by: BlueMatrix



Initiated Coverage - 2/2/2009 - Outperform Rating

Legend for Price Chart:

I = Initiation | 1 = Outperform | 2 = Market Perform | 3 = Underperform | UR = Price Target Under Review | T = Terminated Coverage | \$xx = Price Target | NA = Not Available | S=Suspended

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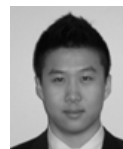
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