

Reason for report:

PROPRIETARY INSIGHTS

NANOSTRING TECHNOLOGIES

Diligence Supports Constructive View; Catalyst Roadmap

• **Bottom Line:** Recent diligence supports our constructive view of NanoString, and we believe the company is on track to accomplish a number of key milestones that should boost investor sentiment for the stock. We provide a roadmap for several catalysts, and we maintain our Outperform rating and \$23 price target. NSTG remains one of our top small-cap picks.

• **Peer-reviewed publications number six; ASCO next up.** NSTG has reached its 1H target of six peer-reviewed publications including two most recently for Prosigna. The first described the late recurrence results from the ABCSG-8 study while the second detailed a multisite analytical validation. Also, two additional manuscripts are undergoing peer-review, and there will be at least one oral presentation and three posters at ASCO.

• **TransATAC study key clinical differentiator in competitive landscape.** As discussed recently (see our [5.14 note](#)), we believe that NSTG's 1Q14 Prosigna commercialization will lead GHDX to increasingly highlight the differences between the two tests. NSTG continues to leverage the TransATAC study as the key clinical differentiator from Oncotype Dx (GHDX [OP]). The ~1,000 sample study concluded that the PAM50 gene signature (Prosigna) provided more prognostic information in endocrine treated patients with HR+ node negative disease than Oncotype Dx, with better differentiation of intermediate- and higher-risk groups.

• **Reimbursement and guidelines are the next key catalysts.** We view a positive coverage decision by Medicare and National Comprehensive Cancer Network (NCCN) guideline inclusion as the most impactful catalysts in 2H14. NSTG hired a reimbursement team that has been in active discussions with major third-party payers, including three Medicare advisory committee meetings to date. Medicare could deem a positive coverage decision for Prosigna as early as 3Q14. The NCCN breast cancer guidelines committee convenes in 4Q14. Inclusion could spur positive coverage decisions if none have been made by this juncture. Nonetheless, we are modeling only \$3.5M in Prosigna revenue in 2014, with most weighted in 2H.

• **nCounter Flex traction a positive signpost; new product intros.** nCounter Flex comprised 40% of instrument placements in 1Q14, which we view as encouraging, since it allows users to run the Prosigna assay and/or develop their own multiplex assays.

Key Stats:

(NASDAQ:NSTG)

S&P 600 Health Care Index:	1,271.82
Price:	\$15.30
Price Target:	\$23.00
Methodology:	~7.5x EV/2015e revenue
52 Week High:	\$22.44
52 Week Low:	\$7.01
Shares Outstanding (mil):	16.9
Market Capitalization (mil):	\$258.6
Book Value/Share:	\$0.28
Cash Per Share:	\$5.07
Net Debt to Total Capital:	0%
Dividend (ann):	\$0.00
Dividend Yield:	0.0%



Dec Yr	1Q	2Q	3Q	4Q	FY Rev	1Q	2Q	3Q	4Q	FY EPS	P/E
2013A	\$5.7	\$7.2	\$8.4	\$10.1	\$31.4	(\$0.79)	(\$0.78)	(\$0.53)	(\$0.60)	(\$2.70)	NM
2014E	\$8.8A	\$10.2	\$12.4	\$15.7	\$47.1	(\$0.68)A	(\$0.77)	(\$0.67)	(\$0.71)	(\$2.83)	NM
2015E	--	--	--	--	\$66.7	--	--	--	--	(\$2.47)	NM
2016E	--	--	--	--	\$91.7	--	--	--	--	(\$1.83)	NM

Source: Company Information and Leerink Partners LLC Research
Revenues in \$millions

EPS ex-extraordinary 1x items, FAS 123 option expense included

INVESTMENT THESIS

We rate Seattle, Washington-based NanoString Technologies (NanoString) Outperform. The company's proprietary technology fills an important role in the research market by enabling mid-density gene analysis in formalin-fixed, paraffin embedded (FFPE) samples. This capability translates readily to oncology diagnostics, in which NanoString's nCounter Analysis System promises to enable complex molecular testing in a decentralized setting. Our Outperform rating reflects a view that NanoString's revenue growth opportunities, in both life science research and clinical diagnostics, are under-appreciated at current levels.

VALUATION

Our 12-month price target of \$23 for NSTG reflects an enterprise value (using projected levels of debt and cash) that is ~7.5x our 2015 revenue forecast. We prefer revenue multiples for companies not yet meaningfully profitable. This multiple is a premium to the life science tools and diagnostics peer group median EV/FTM revenue of ~4x, which we believe appropriately reflects NSTG's greater growth prospects.

RISKS TO VALUATION

Risks to our price target for NSTG include, but are not limited to: Prosigna commercialization uncertainty in both the U.S. and Europe, competition, and tightening research budgets. While we model the company raising equity in 2014 to help fund operations, its ability to tap the equity markets or obtain additional funding may be a potential uncertainty.

NanoString (NSTG)
Income Statement

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	2011	2012	Mar-13	Jun-13	Sep-13	Dec-13	2013	Mar-14	Jun-14e	Sep-14e	Dec-14e	2014e	2015e	2016e
Revenue														
Product/service	\$17,800	\$22,973	\$5,676	\$7,218	\$8,389	\$10,120	\$31,403	\$8,751	\$10,239	\$12,403	\$15,673	\$47,066	\$66,723	\$91,682
Other revenue	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total revenue	17,800	22,973	5,676	7,218	8,389	10,120	31,403	8,751	10,239	12,403	15,673	47,066	66,723	91,682
COGS	<u>9,777</u>	<u>12,361</u>	<u>2,882</u>	<u>3,522</u>	<u>3,784</u>	<u>4,821</u>	<u>15,009</u>	<u>4,325</u>	<u>4,718</u>	<u>5,319</u>	<u>6,528</u>	<u>20,889</u>	<u>26,744</u>	<u>34,695</u>
Gross profit	8,023	10,612	2,794	3,696	4,605	5,299	16,394	4,426	5,521	7,084	9,145	26,176	39,979	56,988
SG&A	9,529	15,486	6,126	6,708	7,988	9,090	29,912	10,674	12,286	12,403	14,106	49,469	56,714	62,344
R&D	<u>8,990</u>	<u>11,635</u>	<u>3,059</u>	<u>3,626</u>	<u>3,784</u>	<u>4,510</u>	<u>14,979</u>	<u>4,732</u>	<u>4,915</u>	<u>5,581</u>	<u>6,583</u>	<u>21,811</u>	<u>23,353</u>	<u>23,837</u>
Operating income (loss)	(10,496)	(16,509)	(6,391)	(6,638)	(7,167)	(8,301)	(28,497)	(10,980)	(11,680)	(10,900)	(11,543)	(45,103)	(40,089)	(29,194)
Interest expense (income)	589	783	382	486	516	490	1,874	472	1,430	570	574	3,046	2,333	2,620
Other expense, net	<u>(153)</u>	<u>416</u>	<u>486</u>	<u>9</u>	<u>17</u>	<u>36</u>	<u>548</u>	<u>(30)</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>(30)</u>	<u>0</u>	<u>0</u>
Pretax income	(10,932)	(17,708)	(7,259)	(7,133)	(7,700)	(8,827)	(30,919)	(11,422)	(13,110)	(11,471)	(12,117)	(48,119)	(42,422)	(31,813)
Taxes	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Net income	(\$10,932)	(\$17,708)	(\$7,259)	(\$7,133)	(\$7,700)	(\$8,827)	(\$30,919)	(\$11,422)	(\$13,110)	(\$11,471)	(\$12,117)	(\$48,119)	(\$42,422)	(\$31,813)
Basic shares outstanding		8,018	9,195	9,201	14,616	14,617	11,907	16,917	16,967	17,017	17,067	16,992	17,192	17,392
Diluted shares outstanding		8,018	9,195	9,201	14,616	14,617	11,907	16,917	16,967	17,017	17,067	16,992	17,192	17,392
EPS diluted		(\$2.21)	(\$0.79)	(\$0.78) (1)	(\$0.53)	(\$0.60)	(\$2.70)	(\$0.68)	(\$0.77)	(\$0.67)	(\$0.71)	(\$2.83)	(\$2.47)	(\$1.83)
<i>EPS growth</i>														
Sales growth	51.7%	29.1%	26.1%	21.5%	39.0%	55.9%	36.7%	54.2%	41.8%	47.9%	54.9%	49.9%	41.8%	37.4%
Gross margin	45.1%	46.2%	49.2%	51.2%	54.9%	52.4%	52.2%	50.6%	53.9%	57.1%	58.3%	55.6%	59.9%	62.2%
SG&A % of revenue	53.5%	67.4%	107.9%	92.9%	95.2%	89.8%	95.3%	122.0%	120.0%	100.0%	90.0%	105.1%	85.0%	68.0%
R&D % of revenue	50.5%	50.6%	53.9%	50.2%	45.1%	44.6%	47.7%	54.1%	48.0%	45.0%	42.0%	46.3%	35.0%	26.0%
Operating margin	(59.0%)	(71.9%)	(112.6%)	(92.0%)	(85.4%)	(82.0%)	(90.7%)	(125.5%)	(114.1%)	(87.9%)	(73.7%)	(95.8%)	(60.1%)	(31.8%)
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%
D&A	\$1,454	\$1,947	\$464	\$437	\$459	\$417	\$1,777	\$396	\$341	\$413	\$470	\$1,621	\$2,002	\$2,750
EBITDA	(\$9,042)	(\$14,562)	(\$5,927)	(\$6,201)	(\$6,708)	(\$7,884)	(\$26,720)	(\$10,584)	(\$11,339)	(\$10,487)	(\$11,073)	(\$43,483)	(\$38,087)	(\$26,443)
Free cash flow														
Operarating cash flow	(\$10,692)	(\$14,808)	(\$9,009)	(\$5,233)	(\$7,241)	(\$9,863)	(\$31,346)	(\$13,058)				(\$44,369)	(\$39,364)	(\$28,475)
CapX	<u>(2,688)</u>	<u>(428)</u>	<u>(136)</u>	<u>(118)</u>	<u>(246)</u>	<u>(259)</u>	<u>(759)</u>	<u>(446)</u>				<u>(4,822)</u>	<u>(4,020)</u>	<u>(5,830)</u>
Free cash flow	(\$13,380)	(\$15,236)	(\$9,145)	(\$5,351)	(\$7,487)	(\$10,122)	(\$32,105)	(\$13,504)				(\$49,191)	(\$43,385)	(\$34,305)
Guidance														
Total revenue												\$45 - \$50M		
Gross Margin												55% - 58%		
Net loss												\$40 - \$50M		
Segment revenue														
Life Science Tools	\$17,800	\$22,973	\$5,676	\$7,218	\$8,348	\$9,980	\$31,222	\$8,690	\$9,889	\$11,353	\$13,573	\$43,505	\$53,598	\$65,432
IVD Kits	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>41</u>	<u>140</u>	<u>181</u>	<u>61</u>	<u>350</u>	<u>1,050</u>	<u>2,100</u>	<u>3,561</u>	<u>13,125</u>	<u>26,250</u>
Total revenue	\$17,800	\$22,973	\$5,676	\$7,218	\$8,389	\$10,120	\$31,403	\$8,751	\$10,239	\$12,403	\$15,673	\$47,066	\$66,723	\$91,682

Notes:

Source: Company reports and Leerink Partners estimates

(1) Excludes accretion of mandatorily redeemable convertible preferred stock and change in fair value of preferred stock warrant liability

Disclosures Appendix

Analyst Certification

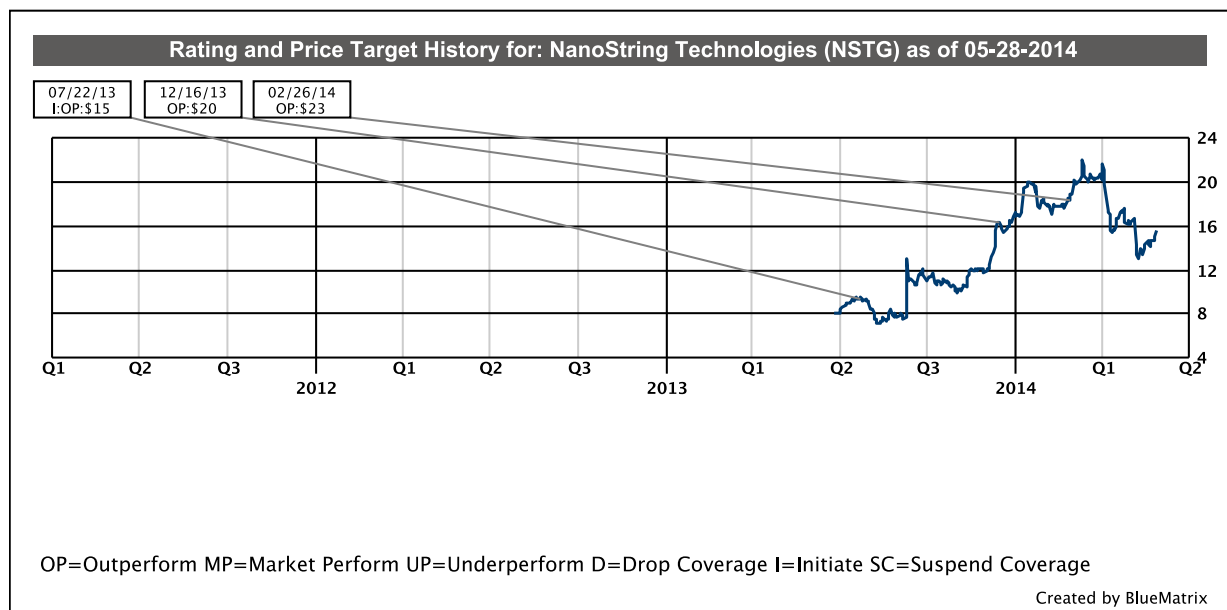
I, Dan Leonard, certify that the views expressed in this report accurately reflect my views and that no part of my compensation was, is, or will be directly related to the specific recommendation or views contained in this report.

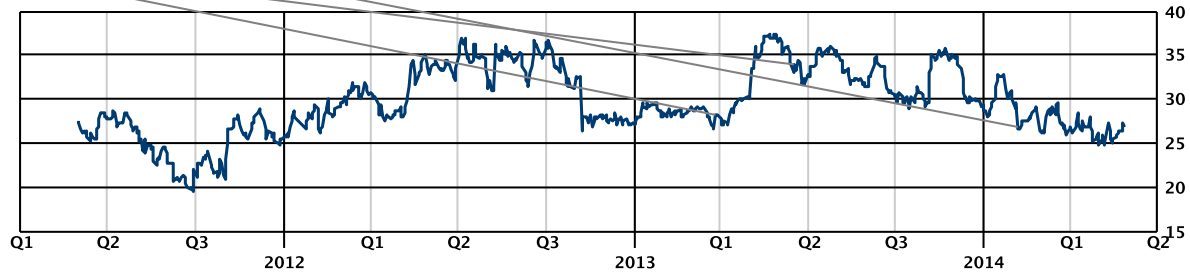
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Risks to Valuation

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Rating and Price Target History for: Genomic Health, Inc. (GHDX) as of 05-28-201403/27/13
OP06/18/13
OP:\$4102/05/14
OP:\$37

Leerink Swann placed a Market Perform rating on GHDX on January 17, 2008. On June 11, 2013, Leerink Swann began a transition to specific price targets for the stocks under its coverage, replacing valuation ranges.

OP=Outperform MP=Market Perform UP=Underperform D=Drop Coverage I=Initiate SC=Suspend Coverage

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Distribution of Ratings/Investment Banking Services (IB) as of 03/31/14				
Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY [OP]	131	68.23	46	35.11
HOLD [MP]	61	31.77	3	4.92
SELL [UP]	0	0.00	0	0.00

Explanation of Ratings

Outperform (Buy): We expect this stock to outperform its benchmark over the next 12 months.

Market Perform (Hold/Neutral): We expect this stock to perform in line with its benchmark over the next 12 months.

Underperform (Sell): We expect this stock to underperform its benchmark over the next 12 months. The degree of outperformance or underperformance required to warrant an Outperform or an Underperform rating should be commensurate with the risk profile of the company.

For the purposes of these definitions the relevant benchmark will be the S&P 600® Health Care Index for issuers with a market capitalization of less than \$2 billion and the S&P 500® Health Care Index for issuers with a market capitalization over \$2 billion.

Important Disclosures

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In the past 12 months, the Firm has received compensation for providing investment banking services to NanoString Technologies .

Leerink Partners LLC makes a market in NanoString Technologies and Genomic Health, Inc.

Leerink Partners LLC has acted as a co-manager for a public offering of NanoString Technologies in the past 12 months.

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