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Reason for report:

EARNINGS

NANOSTRING TECHNOLOGIES

Another Solid Quarter Out of the Gate; 2014 Catalysts

• **Bottom Line:** NSTG delivered its second consecutive top-line beat as a public company. Our forecasts are largely unchanged, and we continue to rate the stock Outperform with a \$15 price target, which represents ~47% upside as of 11/5 market close.

• **Cancer research and biopharma drive strength.** NanoString reported 3Q13 revenue of \$8.4M, above our \$7.9M forecast. Revenue grew 39% y/y. Cancer researchers and biopharma continue to be the key target markets for NanoString's proprietary technology. Consumable pull-through remains solid and is tracking >\$100K on an average annualized basis.

• **nCounter Elements early access program on track.** NSTG's early access program for its new nCounter Elements chemistry remains on track following the introduction at the American Association for Clinical Chemistry (AACC) in 3Q13. The technology allows researchers to independently develop multiplexed genomic assays that can be translated into clinical diagnostics tests. Indeed, 15 users across 3 continents have signed up for the program, and most early adopters have been medical diagnostic companies looking to use the technology to create lab develop tests (LDTs). The addressable market for highly complex labs is ~9,000 labs.

• **nCounter placements ex-U.S.** NSTG initiated a Germany-based decision impact study during the quarter. Ten separate sites are enrolling patients. With prior placements in Spain, we expect to see data from these studies by 2H14.

• **Prosigna commercial launch a 1Q14 event.** We continue to expect the domestic, commercial launch of Prosigna in 1Q14 following the FDA's approval of the assay earlier this year. NSTG has already submitted an application for a z-code to McKesson (OP), which kick-started the process for gaining a favorable coverage decision with Palmetto and Noridian (Medicare administrative contractors).

• **Plenty of visible catalysts in 2014.** We see a number of catalysts for NSTG in 2014 including the aforementioned U.S. launch of Prosigna; favorable coverage decisions; incremental data for decision impact studies; and positive guideline recommendation(s), for examples. We believe this incremental newsflow could build investor awareness about the company.



LEERINK SWANN

HEALTHCARE EQUITY RESEARCH

Key Stats:

(NASDAQ:NSTG)

S&P 600 Health Care Index:	1,208.38
Price:	\$10.20
Price Target:	\$15.00
Methodology:	~3.5x revs for TTM ended Sep 2015e
52 Week High:	\$14.10
52 Week Low:	\$7.01
Shares Outstanding (mil):	14.6
Market Capitalization (mil):	\$148.9
Book Value/Share:	\$2.73
Cash Per Share:	\$3.57
Net Debt to Total Capital:	(27)%
Dividend (ann):	\$0.00
Dividend Yield:	0.0%

*Book Value/Share: estimated**Net Debt to Total Capital: estimated*

Dec Yr	1Q	2Q	3Q	4Q	FY Rev	1Q	2Q	3Q	4Q	FY EPS	P/E
2012A	\$4.5	\$5.9	\$6.0	\$6.5	\$23.0	(\$0.46)	(\$0.49)	(\$0.53)	(\$0.72)	(\$2.21)	NM
2013E - New	\$5.7A	\$7.2A	\$8.4A	\$9.4	\$30.7	(\$0.79)A	(\$0.78)A	(\$0.53)A	(\$0.89)	(\$2.98)	NM
2013E - Old	\$5.7A	\$7.2A	\$7.9	\$9.6	\$30.4	(\$0.79)A	(\$0.78)A	(\$0.66)	(\$0.90)	(\$3.13)	NM
2014E - New	--	--	--	--	\$52.1	--	--	--	--	(\$2.24)	NM
2014E - Old	--	--	--	--	\$52.1	--	--	--	--	(\$2.23)	NM

Source: Company Information and Leerink Swann 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) with an Outperform rating and apply a \$15 price target to it. 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 underappreciated at current levels.

VALUATION

Our 12-month price target for NSTG reflects an enterprise value (using projected levels of debt and cash) that is ~3.5x our revenue forecast for the twelve months ended June 2015. We prefer revenue multiples for companies not yet meaningfully profitable. This multiple is consistent with the life science tools and diagnostics peer group median EV/FTM revenue, which we believe appropriately balances NSTG's greater revenue growth prospects with commercialization risks in diagnostics.

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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	2010	2011	Mar-12	Jun-12	Sep-12	Dec-12	2012	Mar-13	Jun-13	Sep-13	Dec-13e	2013e	2014e	2015e
Revenue														
Product	\$11,506	\$17,109	\$3,833	\$5,335	\$5,456	\$6,235	\$20,859	\$5,338	\$6,828	\$7,969	\$9,017	\$29,152	\$50,503	\$81,039
Service	224	691	669	608	579	258	2,114	388	390	420	400	1,548	1,625	1,788
Total revenue	11,730	17,800	4,502	5,943	6,035	6,493	22,973	5,676	7,218	8,389	9,417	30,700	52,129	82,826
COGS	9,128	9,777	2,655	3,334	3,086	3,286	12,361	2,882	3,522	3,784	4,897	15,085	21,476	30,130
Gross profit	2,602	8,023	1,847	2,609	2,949	3,207	10,612	2,794	3,696	4,605	4,520	15,615	30,652	52,697
SG&A	8,027	9,529	3,165	3,249	4,382	4,690	15,486	6,126	6,708	7,988	11,866	32,688	44,309	50,524
R&D	7,547	8,990	1,998	3,126	2,650	3,860	11,635	3,059	3,626	3,784	5,085	15,554	21,894	23,064
Operating income (loss)	(12,972)	(10,496)	(3,317)	(3,766)	(4,083)	(5,343)	(16,509)	(6,391)	(6,638)	(7,167)	(12,431)	(32,627)	(35,551)	(20,892)
Interest expense (income)	65	589	307	202	107	167	783	382	486	516	606	1,990	2,407	2,373
Other expense, net	(269)	(153)	61	(9)	75	289	416	486	9	17	0	512	0	0
Pretax income	(12,768)	(10,932)	(3,685)	(3,959)	(4,265)	(5,799)	(17,708)	(7,259)	(7,133)	(7,700)	(13,037)	(35,129)	(37,958)	(23,265)
Taxes	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Net income	(\$12,768)	(\$10,932)	(\$3,685)	(\$3,959)	(\$4,265)	(\$5,799)	(\$17,708)	(\$7,259)	(\$7,133)	(\$7,700)	(\$13,037)	(\$35,129)	(\$37,958)	(\$23,265)
Basic shares outstanding			8,018	8,018	8,018	8,018	8,018	9,195	9,201	14,616	14,666	11,919	16,791	18,991
Diluted shares outstanding			8,018	8,018	8,018	8,018	8,018	9,195	9,201	14,616	14,666	11,919	16,791	18,991
EPS diluted			(\$0.46)	(\$0.49)	(\$0.53)	(\$0.72)	(\$2.21)	(\$0.79)	(\$0.78) (1)	(\$0.53)	(\$0.89)	(\$2.98)	(\$2.24)	(\$1.23)
<i>EPS growth</i>														
Sales growth		51.7%					29.1%	26.1%	21.5%	39.0%	45.0%	33.6%	69.8%	58.9%
Gross margin	22.2%	45.1%	41.0%	43.9%	48.9%	49.4%	46.2%	49.2%	51.2%	54.9%	48.0%	50.9%	58.8%	63.6%
SG&A % of revenue	68.4%	53.5%	70.3%	54.7%	72.6%	72.2%	67.4%	107.9%	92.9%	95.2%	126.0%	106.5%	85.0%	61.0%
R&D % of revenue	64.3%	50.5%	44.4%	52.6%	43.9%	59.5%	50.6%	53.9%	50.2%	45.1%	54.0%	50.7%	42.0%	27.8%
Operating margin	(110.6%)	(59.0%)	(73.7%)	(63.4%)	(67.7%)	(82.3%)	(71.9%)	(112.6%)	(92.0%)	(85.4%)	(132.0%)	(106.3%)	(68.2%)	(25.2%)
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	\$972	\$1,454	\$815	\$573	\$579	(\$20)	\$1,947	\$464	\$437	\$459	\$446	\$1,806	\$1,658	\$2,210
EBITDA	(\$12,000)	(\$9,042)	(\$2,502)	(\$3,193)	(\$3,504)	(\$5,363)	(\$14,562)	(\$5,927)	(\$6,201)	(\$6,708)	(\$11,984)	(\$30,820)	(\$33,893)	(\$18,682)
Free cash flow														
Operarating cash flow	(\$10,965)	(\$10,692)	(\$2,630)	(\$4,113)	(\$3,859)	(\$4,206)	(\$14,808)	(\$9,009)	(\$5,233)	(\$6,000)		(\$32,519)	(\$37,741)	(\$20,826)
CapX	(1,932)	(2,688)	(133)	(91)	(87)	(117)	(428)	(136)	(118)	(120)		(1,169)	(5,184)	(5,833)
Free cash flow	(\$12,897)	(\$13,380)	(\$2,763)	(\$4,204)	(\$3,946)	(\$4,323)	(\$15,236)	(\$9,145)	(\$5,351)	(\$6,120)		(\$33,687)	(\$42,925)	(\$26,658)
Guidance														
Total revenue												\$30.0M - \$31.5M		\$29.5M - \$31.5M
Gross Margin												50-53%		48-51%
Segment revenue														
Life Science Tools	\$11,730	\$17,800					\$22,973	\$5,676	\$7,018	\$8,089	\$8,817	\$29,600	\$37,329	\$52,486
Diagnostics	0	0					0	0	200	300	600	1,100	14,800	30,340
Total revenue	\$11,730	\$17,800					\$22,973	\$5,676	\$7,218	\$8,389	\$9,417	\$30,700	\$52,129	\$82,826

Notes:
Source: Company reports and Leerink Swann estimates
(1) Excludes accretion of mandatorily redeemable convertible preferred stock and change in fair value of preferred stock warrant liability

NanoString (NSTG)

Balance Sheet (\$ thousands)	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13e	Sep-13	Dec-13e
Assets								
Cash, equivalents, and short-term investments	\$13,783	\$9,412	\$5,361	\$21,692	\$11,794	\$10,755	\$52,214	\$39,190
Accounts receivable	2,613	3,702	4,111	3,322	4,356	4,779	6,792	5,929
Inventory	3,742	4,098	3,905	5,380	5,337	5,627	5,716	6,440
Other	<u>2,201</u>	<u>1,531</u>	<u>2,984</u>	<u>1,320</u>	<u>2,162</u>	<u>2,533</u>	<u>2,820</u>	<u>3,246</u>
Total current assets	22,339	18,743	16,361	31,714	23,649	23,694	67,542	54,805
Property and equipment, net	4,843	4,445	4,040	3,674	3,346	3,028	3,223	3,571
Goodwill	0	0	0	0	0	0	0	0
Other intangibles	0	0	0	0	0	0	0	0
Other	<u>331</u>	<u>383</u>	<u>378</u>	<u>2,018</u>	<u>2,580</u>	<u>3,768</u>	<u>528</u>	<u>528</u>
Total assets	\$27,513	\$23,571	\$20,779	\$37,406	\$29,575	\$30,490	\$71,293	\$58,904
Liabilities and shareholders' equity								
Notes payable and current maturities of long-term debt	\$0	\$0	\$0	\$2,789	\$4,021	\$2,675	\$4,405	\$2,717
Accounts payable	2,174	1,571	2,259	2,865	1,839	2,727	2,874	3,388
Accruals and other	<u>3,709</u>	<u>4,066</u>	<u>5,306</u>	<u>6,123</u>	<u>5,539</u>	<u>7,385</u>	<u>8,209</u>	<u>7,935</u>
Total current liabilities	5,883	5,637	7,565	11,777	11,399	12,787	15,488	14,040
Long-term debt	7,478	7,447	7,413	9,970	8,814	15,047	13,808	15,394
Other	<u>3,230</u>	<u>3,052</u>	<u>2,866</u>	<u>2,265</u>	<u>6,206</u>	<u>4,686</u>	<u>2,106</u>	<u>2,106</u>
Total liabilities	\$16,591	\$16,136	\$17,844	\$24,012	\$26,419	\$32,520	\$31,402	\$31,540
Shareholders' equity	\$10,922	\$7,435	\$2,935	\$13,394	\$3,156	(\$2,030)	\$39,891	\$27,365
Total liabilities, shareholders' equity, and minority interest	\$27,513	\$23,571	\$20,779	\$37,406	\$29,575	\$30,490	\$71,293	\$58,904



Disclosures Appendix

Analyst Certification

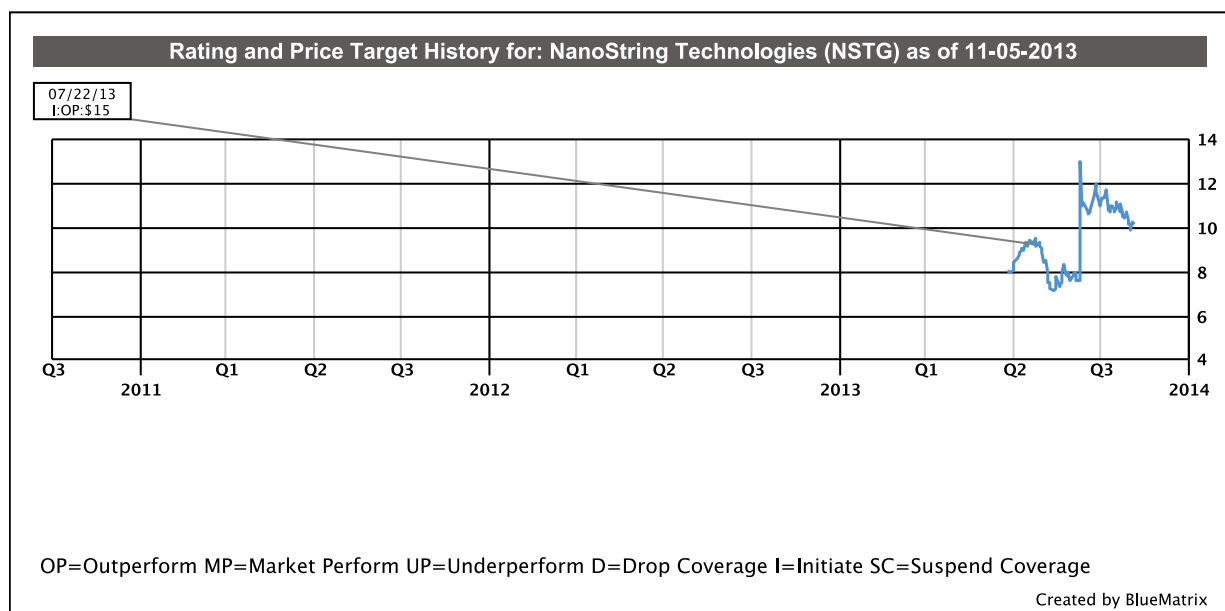
I, Dan Leonard, certify that the views expressed in this report accurately reflect my views and that no part of my compensation was, is, or will be directly related to the specific recommendation or views contained in this report.

Valuation

Our 12-month price target for NSTG reflects an enterprise value (using projected levels of debt and cash) that is ~3.5x our revenue forecast for the twelve months ended June 2015. We prefer revenue multiples for companies not yet meaningfully profitable. This multiple is consistent with the life science tools and diagnostics peer group median EV/FTM revenue, which we believe appropriately balances NSTG's greater revenue growth prospects with commercialization risks in diagnostics.

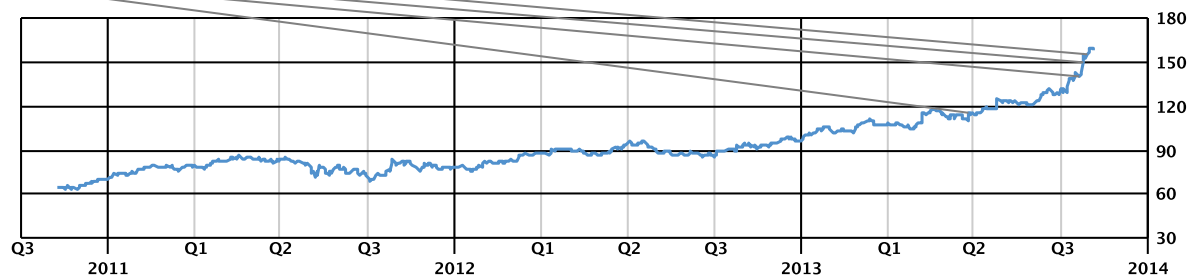
Risks to Valuation

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.



**Rating and Price Target History for: McKesson Corp. (MCK) as of 11-05-2013**

06/26/13 MP:\$120	10/21/13 MP:\$150	10/24/13 OP:\$170	10/29/13 OP:\$180
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Leerink Swann placed a Market Perform rating on MCK on January 26, 2010. 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

Created by BlueMatrix



Distribution of Ratings/Investment Banking Services (IB) as of 09/30/13				
Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY [OP]	111	64.90	27	24.00
HOLD [MP]	60	35.10	0	0.00
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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Leerink Swann Consulting LLC, an affiliate of Leerink Swann LLC, is a provider of evidence-based strategy and consulting to the healthcare industry.

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



Leerink Swann LLC makes a market in NanoString Technologies.

Leerink Swann LLC is willing to sell to, or buy from, clients the common stock of McKesson Corp. on a principal basis.

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

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