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Reason for report:

ESTIMATE CHANGE

NANOSTRING TECHNOLOGIES

Reducing Estimates But Increasing Price Target

• **Bottom Line:** We are reducing our revenue and earnings estimates to reflect a more gradual ramp in NSTG's U.S. Prosigna sales. However, we are increasing our price target to \$20 (from \$15) to reflect incremental value created by achieving several catalysts since we established our initial target.

• **Major labs to offer Prosigna nationwide.** NSTG announced last week that major reference labs and cancer centers will offer the company's Prosigna Assay for breast cancer prognosis. ARUP Laboratories, LH (NR), DGX (NR), and two comprehensive cancer centers will offer Prosigna in early 2014. NSTG expects to sign up more cancer centers in the coming months. All of these customers represent new instrument sales rather than reagent rental agreements.

• **Commercial investments planned to support U.S. launch.** NSTG plans to hire 15 field-based oncology sales reps in 1Q14 and phase in further additions based on milestone achievement. The company also intends to build a small team of medical science liaisons and a market access team dedicated to driving reimbursement of Prosigna.

• **Reimbursement, guideline inclusions could be 2H14 events.** NSTG plans to seek Medicare coverage through Palmetto's MoIDx program, which could come as early as 3Q14. MoIDx would provide coverage in states covered by Noridian and Palmetto, which includes CA and NC, homes of the largest molecular diagnostics labs of DGX and LH, respectively. We believe coverage by Palmetto/Noridian would set a precedent that other Medicare Administrative Contractors (MACs) would follow. NSTG plans to apply for inclusion in the National Comprehensive Cancer Network (NCCN) in 1H14, which could convert to guideline inclusion in 2H14.

• **Estimates reduced to reflect more moderate initial Prosigna ramp.** We have moderated our expectations for NSTG's U.S. Prosigna launch for two reasons: 1) we think it prudent to assume sales of kits will be modest in 1H14, as labs will just begin offering the test, and 2) average selling price (ASP) is likely to fall between \$1,500-\$2,000 initially, due to volume discounts and introductory pricing during a period when reimbursement is being established. We had previously modeled \$2,000/test. A lower ASP as well as a greater proportion of cash instrument sales (all 5 of these initial placements are cash sales) motivated a slight reduction in our gross margin forecast.

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	\$5.7A	\$7.2A	\$8.4A	\$9.4	\$30.7	(\$0.79)A	(\$0.78)A	(\$0.53)A	(\$0.89)	(\$2.98)	NM
2014E - New	--	--	--	--	\$44.4	--	--	--	--	(\$2.66)	NM
2014E - Old	--	--	--	--	\$52.1	--	--	--	--	(\$2.24)	NM
2015E - New	--	--	--	--	\$67.7	--	--	--	--	(\$1.93)	NM
2015E - Old	--	--	--	--	\$82.8	--	--	--	--	(\$1.23)	NM

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

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



LEERINK SWANN

HEALTHCARE EQUITY RESEARCH

Key Stats:

(NASDAQ:NSTG)

S&P 600 Health Care Index: **1,249.65**
Price: **\$16.24**

Price Target: \$20.00 from \$15.00

Methodology: 6.5x EV/15E revenues

52 Week High: \$18.09

52 Week Low: \$7.01

Shares Outstanding (mil): 14.6

Market Capitalization (mil): \$237.1

Book Value/Share: \$2.73

Cash Per Share: \$3.57

Net Debt to Total Capital: 0%

Dividend (ann): \$0.00

Dividend Yield: 0.0%

Book Value/Share: estimated

Net Debt to Total Capital: estimated





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 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 ~6.5x 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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	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	\$42,808	\$65,874
Service	224	691	669	608	579	258	2,114	338	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	44,433	67,662
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	21,125	28,126
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	23,309	39,536
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	44,433	50,746
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	21,328	23,005
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)	(42,453)	(34,215)
Interest expense (income)	65	589	307	202	107	167	783	382	486	516	606	1,990	2,404	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)	(44,857)	(36,589)
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)	(\$44,857)	(\$36,589)
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)	(\$2.66)	(\$1.93)
<i>EPS growth</i>														
Sales growth		51.7%					29.1%	26.1%	21.5%	39.0%	45.0%	33.6%	44.7%	52.3%
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%	52.5%	58.4%
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%	100.0%	75.0%
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%	48.0%	34.0%
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%)	(95.5%)	(50.6%)
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	\$1,414	\$1,797
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)	(\$41,039)	(\$32,419)
Free cash flow														
Operarating cash flow	(\$10,965)	(\$10,692)	(\$2,630)	(\$4,113)	(\$3,859)	(\$4,206)	(\$14,808)	(\$9,009)	(\$5,233)	(\$7,241)		(\$33,760)	(\$44,353)	(\$33,880)
CapX	(1,932)	(2,688)	(133)	(91)	(87)	(117)	(428)	(136)	(118)	(246)		(1,295)	(3,409)	(3,534)
Free cash flow	(\$12,897)	(\$13,380)	(\$2,763)	(\$4,204)	(\$3,946)	(\$4,323)	(\$15,236)	(\$9,145)	(\$5,351)	(\$7,487)		(\$35,054)	(\$47,763)	(\$37,415)
Guidance														
Total revenue												\$30.0M - \$31.5M		
Gross Margin												50-53%		
Segment revenue														
Life Science Tools	\$11,730	\$17,800					\$22,973	\$5,676	\$7,015	\$8,063	\$8,817	\$29,571	\$37,293	\$52,437
Diagnostics	0	0					0	0	203	326	600	1,129	7,140	15,225
Total revenue	\$11,730	\$17,800					\$22,973	\$5,676	\$7,218	\$8,389	\$9,417	\$30,700	\$44,433	\$67,662

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



Disclosures Appendix

Analyst Certification

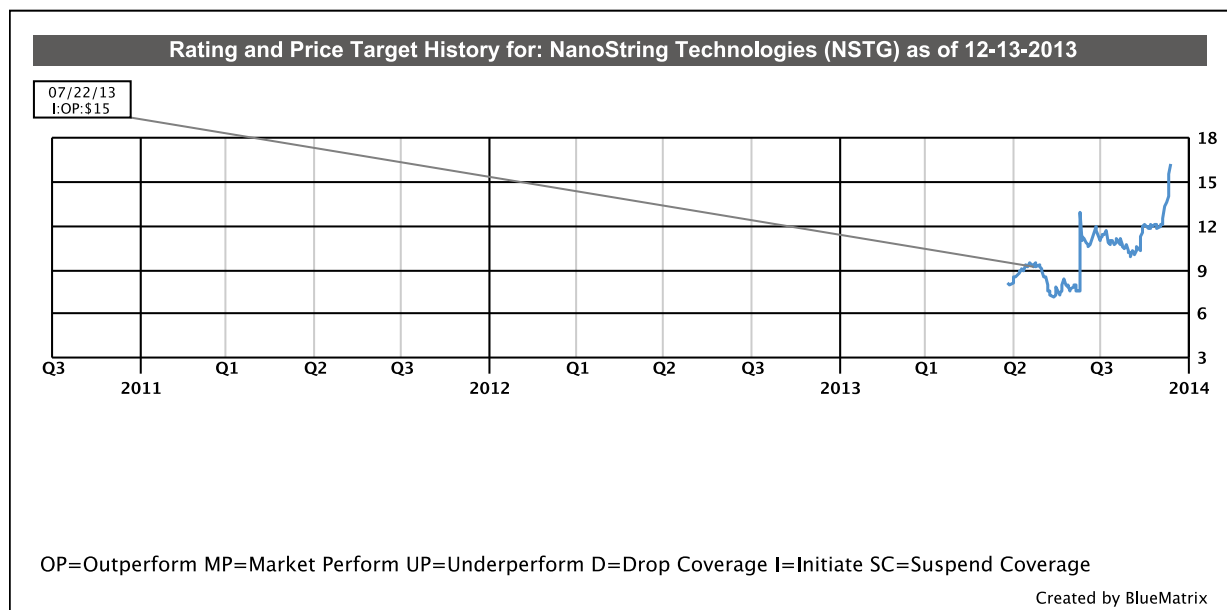
I, Dan Leonard, certify that the views expressed in this report accurately reflect my views and that no part of my compensation was, is, or will be directly related to the specific recommendation or views contained in this report.

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

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