

## NANOSTRING TECHNOLOGIES

### Due Diligence Highlights Many Growth Drivers

• **Bottom Line:** Following recent due diligence, we have a better understanding of NSTG's many growth drivers. We continue to rate NSTG's stock Outperform with a \$15 price target (+26% from yesterday's close).

• **Diagnostics projected to be bigger driver of growth going forward; expect to hear more on menu.** We believe the diagnostics market, currently 4% of revenue, will become a bigger driver of NSTG's growth going forward (we project 36% of revenue in 2015). The company launched its nCounter Dx system in the U.S. last week. We believe the menu of nCounter will be a point of increasing emphasis going forward, something we alluded to in our [note last week](#). A larger menu gives labs more reasons to buy the nCounter and could reduce the amount of instrument amortization loaded onto each Prosigna test. The company's sales efforts are off to a good start. NSTG garnered more leads during the first day of the Association for Molecular Pathology (AMP) annual meeting last week than it did during the entirety of the American Society of Human Genetics (ASHG) annual meeting in late October.

• **Prosigna economics can be compelling for the customer.** We think NSTG's ability to enable reference and academic labs, as well as integrated delivery networks (IDNs), to participate in the economics of the invasive breast cancer prognostic market will be a compelling value proposition. If a lab charges \$3,500 for the test and pays \$2,000 to NSTG for the kit, it can pay back the cost of its nCounter Dx instrument (\$285k list) in two years assuming ~150 tests/yr. The key to this math is the assumption that the marginal costs for running the test are low, excluding the kit price. The test only requires 15 min of hands on time and wouldn't require the build out of any additional lab space. We imagine NSTG could have some flexibility on the economics in the early days until the reimbursement situation for Prosigna is settled, which could occur as soon as next year.

• **Life science growth driven by international and biopharma.** Seventy-five percent of NSTG's sales growth in 3Q was driven by international sales, highlighted by strength in China. More broadly, NSTG is reaping the fruits of efforts to expand its international distribution network (13 distributors today, up from 2 a year ago). The other driver of its life science research business is biopharma. The company's biopharma customer base has nearly 2x the consumables pull through of its academic customer base, and the company highlighted a \$1M order in 3Q from a single biopharma customer (which wasn't all recognized as revenue in 3Q).

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	--	--	--	--	\$52.1	--	--	--	--	(\$2.24)	NM
2015E	--	--	--	--	\$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:

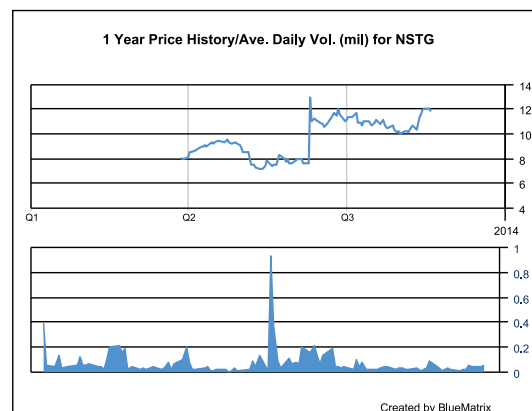
(NASDAQ:NSTG)

<b>S&amp;P 600 Health Care Index:</b>	<b>1,241.62</b>
<b>Price:</b>	<b>\$11.86</b>
Price Target:	\$15.00
Methodology:	~3.3x EV/Sept-15E TTM revs
52 Week High:	\$14.10
52 Week Low:	\$7.01
Shares Outstanding (mil):	14.6
Market Capitalization (mil):	\$173.2
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*

*Net Debt to Total Capital: estimated*





## INVESTMENT THESIS

We rate Seattle, Washington-based NanoString Technologies (NanoString) Outperform 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 ~3.3x our revenue forecast for the twelve months ended Sept 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														
<b>Product</b>	<b>\$11,506</b>	<b>\$17,109</b>	<b>\$3,833</b>	<b>\$5,335</b>	<b>\$5,456</b>	<b>\$6,235</b>	<b>\$20,859</b>	<b>\$5,338</b>	<b>\$6,828</b>	<b>\$7,969</b>	<b>\$9,017</b>	<b>\$29,152</b>	<b>\$50,503</b>	<b>\$81,039</b>
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	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
<b>Operating income (loss)</b>	<b>(12,972)</b>	<b>(10,496)</b>	<b>(3,317)</b>	<b>(3,766)</b>	<b>(4,083)</b>	<b>(5,343)</b>	<b>(16,509)</b>	<b>(6,391)</b>	<b>(6,638)</b>	<b>(7,167)</b>	<b>(12,431)</b>	<b>(32,627)</b>	<b>(35,551)</b>	<b>(20,892)</b>
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
<b>EPS diluted</b>			<b>(\$0.46)</b>	<b>(\$0.49)</b>	<b>(\$0.53)</b>	<b>(\$0.72)</b>	<b>(\$2.21)</b>	<b>(\$0.79)</b>	<b>(\$0.78) (1)</b>	<b>(\$0.53)</b>	<b>(\$0.89)</b>	<b>(\$2.98)</b>	<b>(\$2.24)</b>	<b>(\$1.23)</b>
<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%
<b>Operating margin</b>	<b>(110.6%)</b>	<b>(59.0%)</b>	<b>(73.7%)</b>	<b>(63.4%)</b>	<b>(67.7%)</b>	<b>(82.3%)</b>	<b>(71.9%)</b>	<b>(112.6%)</b>	<b>(92.0%)</b>	<b>(85.4%)</b>	<b>(132.0%)</b>	<b>(106.3%)</b>	<b>(68.2%)</b>	<b>(25.2%)</b>
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
<b>EBITDA</b>	<b>(\$12,000)</b>	<b>(\$9,042)</b>	<b>(\$2,502)</b>	<b>(\$3,193)</b>	<b>(\$3,504)</b>	<b>(\$5,363)</b>	<b>(\$14,562)</b>	<b>(\$5,927)</b>	<b>(\$6,201)</b>	<b>(\$6,708)</b>	<b>(\$11,984)</b>	<b>(\$30,820)</b>	<b>(\$33,893)</b>	<b>(\$18,682)</b>
<b>Free cash flow</b>														
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)	(\$37,741)	(\$20,826)
CapX	(1,932)	(2,688)	(133)	(91)	(87)	(117)	(428)	(136)	(118)	(246)		(1,295)	(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)	(\$7,487)		(\$35,054)	(\$42,925)	(\$26,658)
<b>Guidance</b>														
Total revenue												\$30.0M - \$31.5M		
Gross Margin												50-53%		
<b>Segment revenue</b>														
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	203	326	600	1,129	14,800	30,340
Total revenue	\$11,730	\$17,800					\$22,973	\$5,676	\$7,221	\$8,415	\$9,417	\$30,729	\$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)**

<b>Balance Sheet (\$ thousands)</b>	<b>Mar-12</b>	<b>Jun-12</b>	<b>Sep-12</b>	<b>Dec-12</b>	<b>Mar-13</b>	<b>Jun-13e</b>	<b>Sep-13</b>	<b>Dec-13e</b>
<b>Assets</b>								
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
<b>Liabilities and shareholders' equity</b>								
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

Notes:

Source: Company reports and Leerink Swann estimates



## Disclosures Appendix

### Analyst Certification

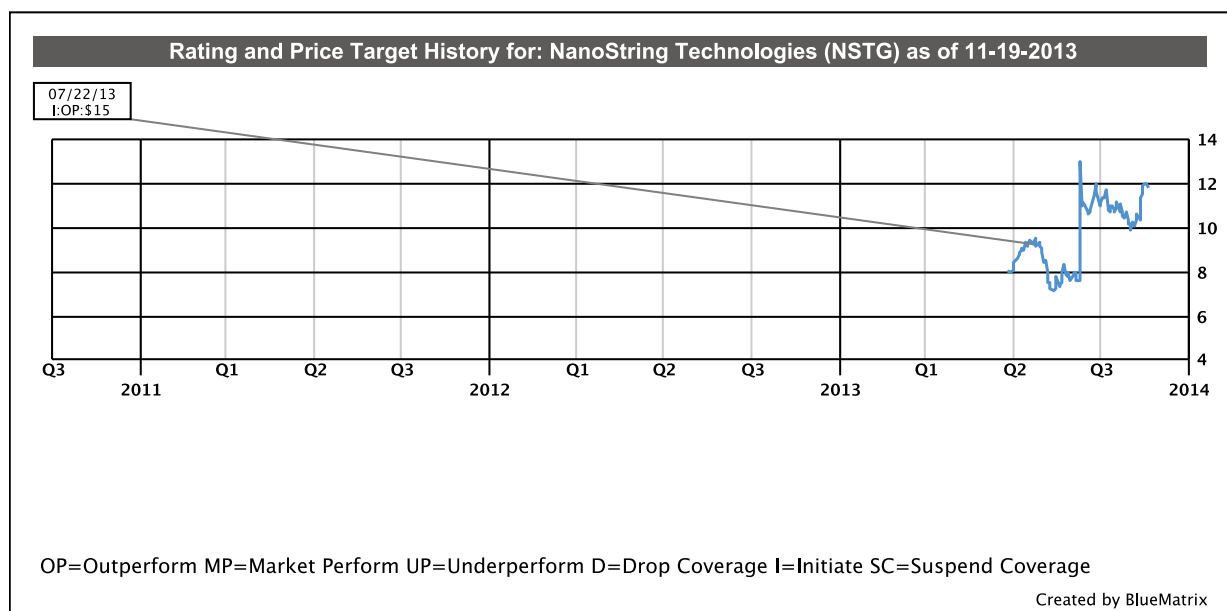
I, Dan Leonard, certify that the views expressed in this report accurately reflect my views and that no part of my compensation was, is, or will be directly related to the specific recommendation or views contained in this report.

### Valuation

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### Risks to Valuation

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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

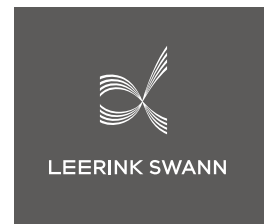
## Explanation of Ratings

**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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