

Reason for report:

**EARNINGS**

## NANOSTRING TECHNOLOGIES

### Story Intact; Maintain Outperform and \$23 PT

• **Bottom Line:** NanoString delivered another good quarter, and our forecasts are little changed. NSTG remains one of our top small-cap picks, and we continue to rate the stock Outperform. We maintain our price target (PT) of \$23.

• **Solid revenue growth during the quarter.** NSTG reported 1Q14 revenue of \$8.8M, ~2% above our forecast. Revenue grew 54% y/y. Instrument sales were the key growth driver during the quarter, up 110% y/y, followed by service (+35% y/y), and codesets and reagents (+29% y/y). Gross margin of 51% came in below our 55% estimate due to various mix factors. Annualized consumable revenue pull-through was \$100K. NSTG maintained its full-year guidance across all key metrics, including revenue of \$45M to \$50M and gross margin of 55% to 58%, although the latter is likely to come in at the lower end of the range following 1Q.

• **Installed base continues to grow.** NSTG's instrument revenue more than doubled y/y for the second consecutive quarter. The company's installed base is now 50% higher than it was at this time last year, aided by the late 2013 launch of the nCounter Dx system. The nCounter Dx with multi-mode FLEX configuration comprised ~40% of placements during 1Q:14. The FLEX model allows laboratories to run the Prosigna breast cancer assay, and also operate in research only mode. Thus, we believe many of these new placements will drive increased Prosigna sales.

• **Prosigna launch imminent for several labs.** Following LH and ARUP's 1Q launch, several other clinical labs are preparing to launch Prosigna, including DGX, three major cancer centers, and three additional clinical labs in the U.S. Furthermore, as of April 1, NSTG has 15 Prosigna sales representatives in the field with additional market access professionals. The latter will help with gaining payer reimbursement.

• **Peer review support for Prosigna expanded.** NSTG has increased the number of papers to build a case for Prosigna reimbursement and guidelines inclusion to six.

• **Forecasts little changed.** Our new forecasts capture the impact of NSTG's 1Q:14 results as well as modest changes to our opex and interest rate assumptions.

#### Key Stats:

(NASDAQ:NSTG)

<b>S&amp;P 600 Health Care Index:</b>	<b>1,214.38</b>
<b>Price:</b>	<b>\$14.26</b>
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):	\$241.0
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 - New	<b>\$8.8A</b>	<b>\$10.2</b>	<b>\$12.4</b>	<b>\$15.7</b>	<b>\$47.1</b>	<b>(\$0.68)A</b>	<b>(\$0.77)</b>	<b>(\$0.67)</b>	<b>(\$0.71)</b>	<b>(\$2.83)</b>	<b>NM</b>
2014E - Old	\$8.6	\$10.6	\$12.7	\$15.1	\$47.0	(\$0.73)	(\$0.70)	(\$0.66)	(\$0.66)	(\$2.76)	NM
2015E - New	--	--	--	--	<b>\$66.7</b>	--	--	--	--	<b>(\$2.47)</b>	<b>NM</b>
2015E - Old	--	--	--	--	\$66.7	--	--	--	--	(\$2.37)	NM
2016E - New	--	--	--	--	<b>\$91.7</b>	--	--	--	--	<b>(\$1.83)</b>	<b>NM</b>
2016E - Old	--	--	--	--	\$91.7	--	--	--	--	(\$1.77)	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	0	0	0	0	0	0	0	0	0	0	0	0	0	0
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	9,777	12,361	2,882	3,522	3,784	4,821	15,009	4,325	4,718	5,319	6,528	20,889	26,744	34,695
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	8,990	11,635	3,059	3,626	3,784	4,510	14,979	4,732	4,915	5,581	6,583	21,811	23,353	23,837
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	(153)	416	486	9	17	36	548	(30)	0	0	0	(30)	0	0
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	0	0	0	0	0	0	0	0	0	0	0	0	0	0
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)
EPS growth														
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)	(\$9,451)				(\$40,762)	(\$39,364)	(\$28,475)
CapX	(2,688)	(428)	(136)	(118)	(246)	(259)	(759)	(250)				(4,626)	(4,020)	(5,830)
Free cash flow	(\$13,380)	(\$15,236)	(\$9,145)	(\$5,351)	(\$7,487)	(\$10,122)	(\$32,105)	(\$9,701)				(\$45,388)	(\$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	0	0	0	0	41	140	181	61	350	1,050	2,100	3,561	13,125	26,250
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

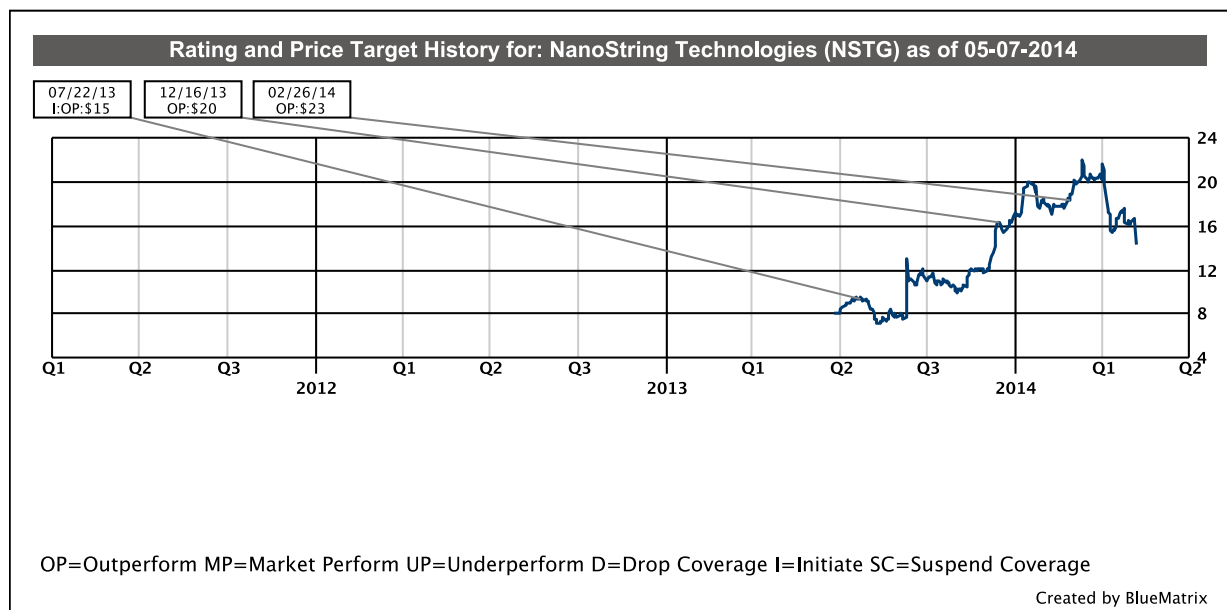
I, Dan Leonard, certify that the views expressed in this report accurately reflect my views and that no part of my compensation was, is, or will be directly related to the specific recommendation or views contained in this report.

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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.**

**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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