

Reason for report:
EARNINGS

NANOSTRING TECHNOLOGIES

2014 Catalysts Remain on Track

• **Bottom Line:** NanoString delivered its third consecutive top-line beat as a public company. We are increasing our 2014 revenue forecast. NSTG remains one of our top small-cap picks, and we continue to rate the stock Outperform. We increase our price target to \$23 (from \$20) to reflect our increased forecasts.

• **Cancer research and biopharma drive strength.** NanoString reported 4Q13 revenue of \$10.1M, ~8% above our \$9.4M forecast. Revenue grew robustly at 56% y/y, with the change in growth rate accelerating for the second consecutive quarter. Gross margin of 52.4% also came in better than our 48.0% estimate. Instrument revenue of \$5.3M more than doubled y/y, and was motivated by cancer and biopharma research in addition to clinical labs following the FDA's 4Q13 clearance of the Prosigna breast cancer risk assessment test. Consumable revenue was lighter than our model given the sales force was focused on instrument sales during the quarter, notably the new dual-mode nCounter Dx system. We've modestly reduced our 2014E consumable revenue to \$110k/box from \$120k/box.

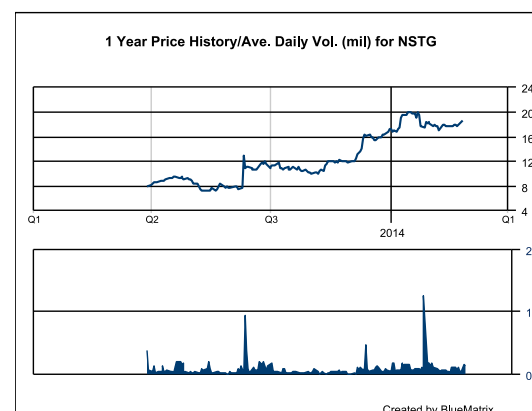
• **Catalysts on track for 2014.** NSTG has a number of initiatives underway that should improve its market penetration during the year. McKesson (OP) has assigned a Z-Code to Prosigna, which should facilitate the process of gaining a positive coverage decision from Medicare. The company will likely have six peer-reviewed publications to include with its reimbursement dossier; a decision could occur as early as 3Q14. The publications should also help strengthen NSTG's case for the inclusion of Prosigna in the National Comprehensive Cancer Network (NCCN) guidelines, which would be a 4Q14 event. On the product front, we're looking for a 4Q14 launch of the third generation nCounter benchtop system, in addition to new research applications on the nCounter system during 2H14.

• **Prosigna rollout underway along with decision impact studies.** While LabCorp (NR) is already marketing Prosigna, NSTG has completed the validation process with DGX (NR) and ARUP. The latter two are likely to begin sales in late March. In the meantime, the company continues to build out its commercial and reimbursement teams; as expected, ramp of Prosigna sales should be modest during 2014. NSTG completed enrollment for its decision impact study in Germany, and plans to initiate another in the EU this year. The results of the decision impact study in Spain provide another potential mid-year catalyst.

• **Raising forecasts.** We are increasing our 2014 revenue forecasts to assume continued momentum from NSTG's strong instrument sales.

Key Stats: (NASDAQ:NSTG)

S&P 600 Health Care Index:	1,318.88
Price:	\$18.41
Price Target:	\$23.00 from \$20.00
Methodology:	~7.5x EV/ 2015e revenue
52 Week High:	\$20.79
52 Week Low:	\$7.01
Shares Outstanding (mil):	14.6
Market Capitalization (mil):	\$268.8
Book Value/Share:	\$0.15
Cash Per Share:	\$2.92
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	\$8.6	\$10.6	\$12.7	\$15.1	\$47.0	(\$0.73)	(\$0.70)	(\$0.66)	(\$0.66)	(\$2.76)	NM
2014E - Old	--	--	--	--	\$44.4	--	--	--	--	(\$2.66)	NM
2015E - New	--	--	--	--	\$66.7	--	--	--	--	(\$2.37)	NM
2015E - Old	--	--	--	--	\$67.7	--	--	--	--	(\$1.93)	NM
2016E	--	--	--	--	\$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 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 ~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

Dan Leonard, 212-277-6116
dan.leonard@leerink.com

	2011	2012	Mar-13	Jun-13	Sep-13	Dec-13	2013	Mar-14e	Jun-14e	Sep-14e	Dec-14e	2014e	2015e	2016e
Revenue														
Product	\$17,109	\$20,859	\$5,338	\$6,828	\$7,969	\$9,683	\$29,818	\$8,221	\$10,169	\$12,243	\$14,677	\$45,310	\$64,846	\$89,676
Service	691	2,114	338	390	420	437	1,585	355	410	441	459	1,664	1,831	2,014
Total revenue	17,800	22,973	5,676	7,218	8,389	10,120	31,403	8,576	10,578	12,684	15,136	46,974	66,677	91,690
COGS	9,777	12,361	2,882	3,522	3,784	4,821	15,009	3,824	4,673	5,445	6,286	20,228	26,723	34,698
Gross profit	8,023	10,612	2,794	3,696	4,605	5,299	16,394	4,752	5,906	7,239	8,850	26,746	39,953	56,992
SG&A	9,529	15,486	6,126	6,708	7,988	9,090	29,912	11,149	12,694	12,684	13,622	50,149	56,675	62,349
R&D	8,990	11,635	3,059	3,626	3,784	4,510	14,979	4,717	5,078	5,708	6,357	21,859	23,337	23,839
Operating income (loss)	(10,496)	(16,509)	(6,391)	(6,638)	(7,167)	(8,301)	(28,497)	(11,114)	(11,866)	(11,153)	(11,129)	(45,263)	(40,059)	(29,197)
Interest expense (income)	589	783	382	486	516	490	1,874	600	591	595	600	2,386	2,445	2,836
Other expense, net	(153)	416	486	9	17	36	548	0	0	0	0	0	0	0
Pretax income	(10,932)	(17,708)	(7,259)	(7,133)	(7,700)	(8,827)	(30,919)	(11,714)	(12,457)	(11,748)	(11,729)	(47,648)	(42,503)	(32,032)
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)	(\$11,714)	(\$12,457)	(\$11,748)	(\$11,729)	(\$47,648)	(\$42,503)	(\$32,032)
Basic shares outstanding		8,018	9,195	9,201	14,616	14,617	11,907	15,961	17,690	17,740	17,790	17,295	17,915	18,115
Diluted shares outstanding		8,018	9,195	9,201	14,616	14,617	11,907	15,961	17,690	17,740	17,790	17,295	17,915	18,115
EPS diluted		(\$2.21)	(\$0.79)	(\$0.78) (1)	(\$0.53)	(\$0.60)	(\$2.70)	(\$0.73)	(\$0.70)	(\$0.66)	(\$0.66)	(\$2.76)	(\$2.37)	(\$1.77)
EPS growth														
Sales growth	51.7%	29.1%	26.1%	21.5%	39.0%	55.9%	36.7%	51.1%	46.6%	51.2%	49.6%	49.6%	41.9%	37.5%
Gross margin	45.1%	46.2%	49.2%	51.2%	54.9%	52.4%	52.2%	55.4%	55.8%	57.1%	58.5%	56.9%	59.9%	61.3%
SG&A % of revenue	53.5%	67.4%	107.9%	92.9%	95.2%	89.8%	95.3%	130.0%	120.0%	100.0%	90.0%	106.8%	85.0%	68.0%
R&D % of revenue	50.5%	50.6%	53.9%	50.2%	45.1%	44.6%	47.7%	55.0%	48.0%	45.0%	42.0%	46.5%	35.0%	26.0%
Operating margin	(59.0%)	(71.9%)	(112.6%)	(92.0%)	(85.4%)	(82.0%)	(90.7%)	(129.6%)	(112.2%)	(87.9%)	(73.5%)	(96.4%)	(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	\$419	\$1,779	\$308	\$339	\$408	\$440	\$1,496	\$1,945	\$2,690
EBITDA	(\$9,042)	(\$14,562)	(\$5,927)	(\$6,201)	(\$6,708)	(\$7,882)	(\$26,718)	(\$10,806)	(\$11,527)	(\$10,745)	(\$10,689)	(\$43,767)	(\$38,113)	(\$26,506)
Free cash flow														
Operating cash flow	(\$10,692)	(\$14,808)	(\$9,009)	(\$5,233)	(\$7,241)		(\$27,483)					(\$46,199)	(\$39,648)	(\$28,884)
CapX	(2,688)	(428)	(136)	(118)	(246)		(886)					(4,301)	(3,980)	(5,752)
Free cash flow	(\$13,380)	(\$15,236)	(\$9,145)	(\$5,351)	(\$7,487)		(\$28,369)					(\$50,500)	(\$43,627)	(\$34,636)
Guidance														
Total revenue												\$45 - \$50M		
Gross Margin												55% - 58%		
Net loss												\$40 - \$50M		
Segment revenue														
Life Science Tools	\$17,800	\$22,973	\$5,676	\$7,015	\$8,063	\$9,105	\$29,859					\$39,834	\$51,452	\$64,040
Diagnostics	0	0	0	203	326	1,015	1,544					7,140	15,225	27,650
Total revenue	\$17,800	\$22,973	\$5,676	\$7,218	\$8,389	\$10,120	\$31,403					\$46,974	\$66,677	\$91,690

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

NanoString (NSTG)

Balance Sheet (\$ thousands)	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14e	Jun-14e	Sep-14e	Dec-14e
Assets								
Cash, equivalents, and short-term investments	\$11,794	\$10,755	\$52,214	\$42,656	\$81,867	\$70,018	\$56,764	\$44,127
Accounts receivable	4,356	4,779	6,792	8,331	5,856	7,243	8,721	10,455
Inventory	5,337	5,627	5,716	6,750	5,448	6,657	7,758	8,955
Other	<u>2,162</u>	<u>2,533</u>	<u>2,820</u>	<u>2,999</u>	<u>3,289</u>	<u>4,068</u>	<u>4,897</u>	<u>5,871</u>
Total current assets	23,649	23,694	67,542	60,736	96,460	87,986	78,140	69,408
Property and equipment, net	3,346	3,028	3,223	3,065	4,111	4,519	5,441	5,871
Goodwill	0	0	0	0	0	0	0	0
Other intangibles	0	0	0	0	0	0	0	0
Other	<u>2,580</u>	<u>3,768</u>	<u>528</u>	<u>571</u>	<u>571</u>	<u>571</u>	<u>571</u>	<u>571</u>
Total assets	\$29,575	\$30,490	\$71,293	\$64,372	\$101,141	\$93,077	\$84,152	\$75,849
Liabilities and shareholders' equity								
Notes payable and current maturities of long-term debt	\$4,021	\$2,675	\$4,405	\$6,136	\$2,730	\$2,717	\$2,705	\$2,695
Accounts payable	1,839	2,727	2,874	3,354	1,659	3,867	4,304	4,921
Accruals and other	<u>5,539</u>	<u>7,385</u>	<u>8,209</u>	<u>9,140</u>	<u>7,235</u>	<u>8,949</u>	<u>10,774</u>	<u>12,916</u>
Total current liabilities	11,399	12,787	15,488	18,630	11,623	15,532	17,783	20,531
Long-term debt	8,814	15,047	13,808	12,157	15,468	15,395	15,328	15,269
Other	<u>6,206</u>	<u>4,686</u>	<u>2,106</u>	<u>2,116</u>	<u>2,116</u>	<u>2,116</u>	<u>2,116</u>	<u>2,116</u>
Total liabilities	\$26,419	\$32,520	\$31,402	\$32,903	\$29,208	\$33,043	\$35,227	\$37,916
Shareholders' equity	\$3,156	(\$2,030)	\$39,891	\$31,469	\$71,934	\$60,034	\$48,925	\$37,933
Total liabilities, shareholders' equity, and minority interest	\$29,575	\$30,490	\$71,293	\$64,372	\$101,141	\$93,077	\$84,152	\$75,849

Notes:

Source: Company reports and Leerink Partners estimates

Disclosures Appendix

Analyst Certification

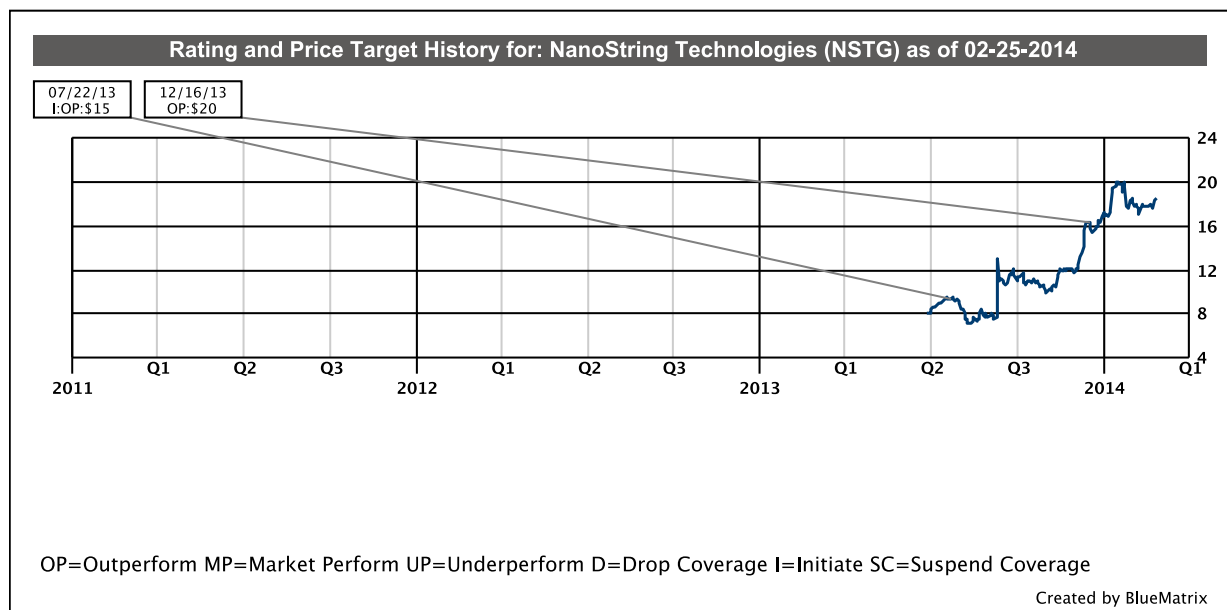
I, Dan Leonard, certify that the views expressed in this report accurately reflect my views and that no part of my compensation was, is, or will be directly related to the specific recommendation or views contained in this report.

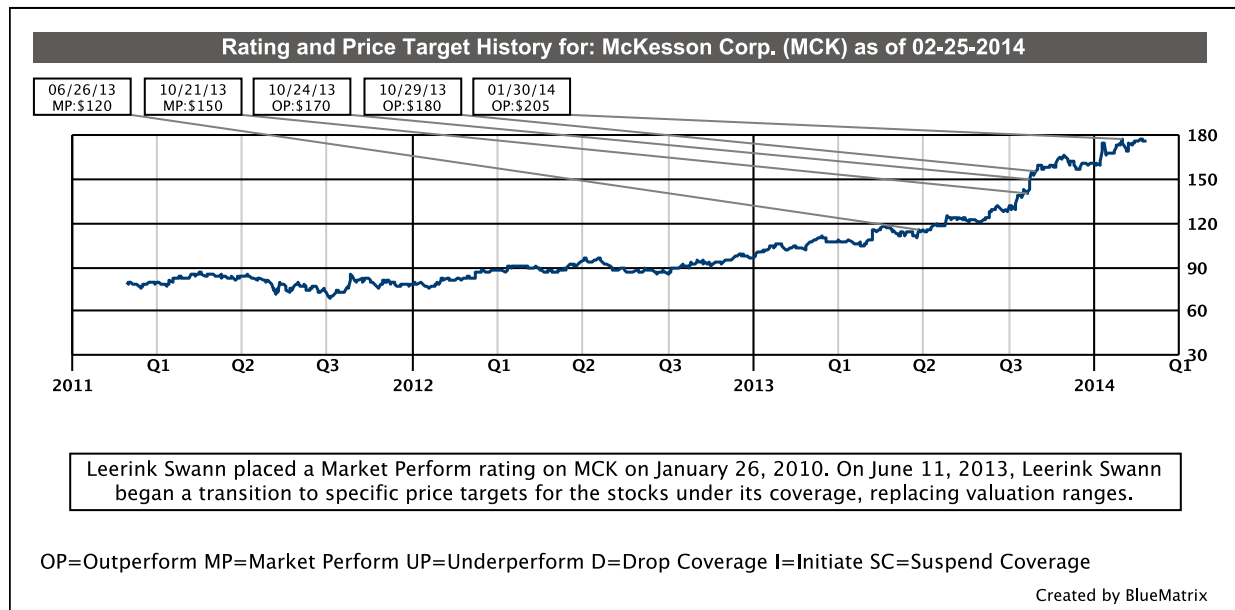
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Distribution of Ratings/Investment Banking Services (IB) as of 12/31/13				
Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY [OP]	118	64.50	30	25.00
HOLD [MP]	65	35.50	2	3.00
SELL [UP]	0	0.00	0	0.00

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 Consulting LLC, an affiliate of Leerink Partners, is a provider of evidence-based strategy and consulting to the healthcare industry.

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Leerink Partners LLC makes a market in NanoString Technologies.

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

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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Leerink Partners LLC Equity Research			
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Director of Equity Research	John L. Sullivan, CFA	(617) 918-4875	john.sullivan@leerink.com
Associate Director of Research	Alice C. Avanian, CFA	(617) 918-4544	alice.avanian@leerink.com
Healthcare Strategy	John L. Sullivan, CFA	(617) 918-4875	john.sullivan@leerink.com
	Alice C. Avanian, CFA	(617) 918-4544	alice.avanian@leerink.com
Biotechnology	Howard Liang, Ph.D.	(617) 918-4857	howard.liang@leerink.com
	Joseph P. Schwartz	(617) 918-4575	joseph.schwartz@leerink.com
	Marko Kozul, M.D.	(415) 905-7221	marko.kozul@leerink.com
	Michael Schmidt, Ph.D.	(617) 918-4588	michael.schmidt@leerink.com
	Jonathan Chang, Ph.D.	(617) 918-4015	jonathan.chang@leerink.com
	Irene Lau	(415) 905-7256	irene.lau@leerink.com
	Paul Matteis	(617) 918-4585	paul.matteis@leerink.com
	Gena Wang, Ph.D., CFA	(212) 277-6073	gena.wang@leerink.com
	Richard Goss	(617) 918-4059	richard.goss@leerink.com
Life Science Tools and Diagnostics	Dan Leonard	(212) 277-6116	dan.leonard@leerink.com
	Justin Bowers, CFA	(212) 277-6066	justin.bowers@leerink.com
Pharmaceuticals/Major	Seamus Fernandez	(617) 918-4011	seamus.fernandez@leerink.com
	Ario Arabi	(617) 918-4568	ario.arabi@leerink.com
Specialty Pharmaceuticals, Generics	Jason M. Gerberry, JD	(617) 918-4549	jason.gerberry@leerink.com
	Christopher W. Kuehnle, JD	(617) 918-4851	chris.kuehnle@leerink.com
Medical Devices, Cardiology & Orthopedics	Danielle Antalffy	(212) 277-6044	danielle.antalffy@leerink.com
	Richard Newitter	(212) 277-6088	richard.newitter@leerink.com
	Robert Marcus, CFA	(212) 277-6084	robert.marcus@leerink.com
	Ravi Misra	(212) 277-6049	ravi.misra@leerink.com
Healthcare Services	Ana Gupte, Ph.D.	(212) 277-6040	ana.gupte@leerink.com
Healthcare Technology & Distribution	David Larsen, CFA	(617) 918-4502	david.larsen@leerink.com
	Christopher Abbott	(617) 918-4010	chris.abbott@leerink.com
Sr. Editor/Supervisory Analyst Supervisory Analysts	Mary Ellen Eagan, CFA	(617) 918-4837	maryellen.eagan@leerink.com
	Robert Egan		bob.egan@leerink.com
	Amy N. Sonne		amy.sonne@leerink.com

New York
299 Park Avenue, 21st floor
New York, NY 10171
(888) 778-1653

Boston
One Federal Street, 37th Floor
Boston, MA 02110
(800) 808-7525

San Francisco
201 Spear Street, 16th Floor
San Francisco, CA 94105
(800) 778-1164