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Veracyte, Inc. 1st Quarter 2017 Financial Results
Conference Call Script for Wednesday, May 3, 2017; 4:30 p.m. Eastern Time

Veracyte Participants:

Bonnie H. Anderson, Chief Executive Officer and Chairman of the Board
Keith Kennedy, Chief Financial Officer
Christopher M. Hall, President and Chief Operating Officer

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Operator:

Good afternoon, ladies and gentlemen, and welcome to Veracyte's first quarter 2017 financial results conference call. [Operator instructions]. As a reminder, today's conference call is being recorded. I'd now like to turn the conference over to your host, Ms. Bonnie Anderson, Chief Executive Officer and Chairman of the Board. You may begin.

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Bonnie:

Good afternoon, everyone, and thanks for joining us today for our first quarter 2017 financial results conference call. Joining me today are Keith Kennedy, Chief Financial Officer, and Chris Hall, President and Chief Operating Officer.

Before we begin, Keith will take us through the Safe Harbor Statement.

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Keith:

Good afternoon, everyone.

We'd like to remind you that various statements that we may make during this call will include forward-looking statements as defined under applicable securities laws. Forward-looking statements include statements regarding our future plans, prospects and strategy, financial goals and guidance, product pipeline and other statements that are not historical fact. Management's assumptions, expectations and opinions reflected in those statements are subject to risks and uncertainties that may cause actual results and/or performance to differ materially from any future results, performance or achievements discussed in or implied by such forward-looking statements, and the company can give no assurance they will prove to be correct. Those risks and uncertainties are described in the company's filings with the Securities and Exchange Commission, in addition to today's press release.

Prior to this call, we announced our first quarter 2017 results, which are available on our website, Veracyte.com, by clicking "Menus" on the top-right corner of our website and clicking-through to our "Investors" landing page and then "Press Releases." We also released a financial presentation, which I will reference later in the call when I cover our financial results. You may find the financial presentation in the same "Investors" section, under "Events & Presentations."

I will now turn the call over to Bonnie.

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Bonnie:

Thank you, Keith. And thanks again, everyone, for joining us today. We think this will be a brief call since we just reported our fourth quarter and full-year 2016 results a few weeks ago. However, we're excited about the updates we have to share!

We delivered a solid first quarter, with results in line with our expectations, and we're off to a terrific start in 2017. Our revenue and Afirma GEC volume growth were strong and we made significant progress towards our financial discipline goals. We have great momentum across our business and a lot to be excited about as we head into the second quarter and through the end of the year.

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Looking at our first quarter results, I'll focus on the four metrics that we use to measure success in 2017. They are: Revenue growth, reimbursement expansion, evidence development and financial discipline.

Let's start with Revenue Growth

We continued our strong revenue growth, with Afirma revenue for the quarter of 16.4 million dollars, an increase of 21 percent, compared to 13.6 million dollars during the first quarter of 2016. Because virtually all test volume shifted to accrual-based revenue in Q3 2016, cash-based revenue declined significantly in the first quarter, as expected. Afirma GEC volume, following the typical quarter-over-quarter cadence coming into the new year, was 5,834, a nine percent growth over prior year. This includes a 26 percent year-over-year increase from GEC-only accounts, showing our continued strength in driving this higher-margin segment of our business.

We are well positioned to accelerate growth across both our Afirma and Percepta portfolios with our expanded sales team, which now comprises nearly 50 associates. To further boost our sales efforts, we'll soon launch a series of Afirma-focused marketing campaigns to drive demand and adoption among endocrinologists and pathologists, as well as patients. These campaigns will use an array of traditional and digital communications strategies and tactics and will complement our ongoing physician-education activities.

To further support our accelerated growth, we executed an agreement in February with Quest Diagnostics, which is now poised to offer the Afirma GEC to its large network of physician customers. Through the agreement, which runs through Quest's AmeriPath anatomic pathology business, Quest physician clients can refer patient specimens with indeterminate cytopathology to Veracyte for Afirma testing. We're excited to kick off this agreement and believe it reinforces the Afirma GEC's market-leader status and will help fuel the test's sustained growth looking into the future.

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To further augment this momentum, we achieved a key milestone toward the launch of our next-generation Afirma test – which we've named the Afirma Genomic Sequencing Classifier. We will refer to the enhanced test from now on as the Afirma GSC. We unveiled data from our pivotal clinical validation study, which will be shared this week during the American Association of Clinical Endocrinology annual meeting. The findings show that by maintaining the high sensitivity of the GEC and further

improving its specificity, the Afirma GSC is expected to identify 30 percent more benign thyroid nodules, allowing us to help nearly 70 percent of benign patients avoid unnecessary surgery as part of thyroid cancer diagnosis. We are thrilled with these results, which we believe will significantly benefit patients, attracting more physicians to adopt the test and furthering our market penetration.

The Afirma GSC uses our novel approach of combining machine learning with whole-genome RNA sequencing to derive clinically useful information from enriched genomic content that previously was undetectable. This includes not only gene expression, which is used in the current test, but also the presence of DNA variants, fusions, copy number variants and other features that may be predictive of thyroid cancer – and can enhance the classifier's ability to distinguish benign from malignant nodules. Our classifier uses machine learning "ensemble" methods in which multiple algorithms – each playing its own role – are used to obtain a better predictive performance than any single algorithm on its own.

This same novel technology platform powers our recently launched Envisia Genomic Classifier, which is used to help distinguish idiopathic pulmonary fibrosis, or IPF, from other interstitial lung diseases – without the need for surgery. We're excited about this groundbreaking work because we're taking the same machine learning methods that are being used in other fields such as financial modeling, social media and self-driving cars and using them in ways that have not been used previously in healthcare. We believe the Afirma GSC will put us a further leap ahead of companies trying to compete in the thyroid cancer space and also provides a robust technology

foundation for continued test innovation and expansion to address additional unmet clinical needs.

We'll begin offering early access to the Afirma GSC to select customers during the next few weeks and expect to be fully transitioned by early next year.

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Our Second Key Success Metric is Reimbursement Expansion

We made significant progress with payers during the quarter for both the Afirma and Percepta classifiers. For Afirma, we announced new positive coverage policies from ten Blues plans and had an additional major win with a positive coverage decision from the Blue Cross Blue Shield Federal Employee Program, which established the test as a medically necessary benefit for its estimated five million members. The Afirma GEC was the only molecular test for use in thyroid cancer diagnosis to receive such a designation and is now covered for nearly 230 million Americans nationwide through their insurance companies, including more than 75 million Blues plan members.

We also expanded the number of health plan members with in-network access to the Afirma GEC to approximately 160 million people nationwide, including more than 30 million Blues plan members. This includes contracts with the Independence and Wellmark Blues plans, which became effective during the first quarter. We remain focused on increasing in-network, contracted lives, as we believe this is an important lever to drive adoption, as well as increase our reimbursement rates.

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We achieved final Medicare coverage and pricing for the Percepta classifier during the quarter through the Palmetto GBA MolDx program. This is a significant milestone that gives us key first-mover advantage, as we believe Percepta is the first genomic test to be covered by Medicare for use in lung cancer screening and diagnosis. These policies will make the Percepta classifier a covered benefit for nearly two thirds of Medicare beneficiaries in the United States, with effective dates between March and May. Pricing for Percepta is in line with our expectations and similar to the Medicare price for our Afirma GEC. Medicare covers approximately half of our target patient population for the Percepta classifier and we're actively working to secure coverage policies from the non-MolDx Medicare administrators, as well as from private insurers.

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Our Third Success Metric is Evidence Development

The AACE annual conference this week will be exciting for us as researchers present data on the development of the next-generation Afirma GSC and also share strong results from the test's pivotal clinical validation study. At the same time, multiple abstracts will be presented demonstrating the current Afirma test's long-term, positive impact on patient care. We're confident that our enhanced test will replace the Afirma GEC as the new standard of care in thyroid cancer diagnosis.

Looking at our Afirma efforts more broadly, to date, we have accrued over 1,000 samples from thyroid-nodule patients as part of our 49-site ENHANCE trial. This bio-repository includes comprehensive cytology, genomic, histopathology and clinical data

and is – to our knowledge – the largest database of its kind in the world. This is important because it gives us immediate access to a huge amount of data that will advance our ongoing research and development efforts in thyroid cancer. These are data that would take potential competitors years and millions of dollars – along with expertise they may not have – to develop.

For the Percepta classifier, we continue to build the clinical evidence that will fuel the test's adoption and reimbursement. Later this month, external investigators will present study findings at the American Thoracic Society annual meeting, advancing our efforts to establish the Percepta classifier as a new standard in lung cancer screening and diagnosis. Additionally, a key cost-effectiveness study for the test has been accepted by a leading pulmonology journal and we look forward to its publication in the near future.

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We are following the same reimbursement approach for the Envisia classifier that we have successfully used for our Afirma and Percepta tests, in which we build the clinical evidence to demonstrate our tests' value and positive impact on patient care. To this end, four Envisia-focused abstracts will be presented at the ATS meeting this month demonstrating the test's clinical performance and utility. These data will help feed the pipeline of published evidence that we plan to include in the packet we will submit for Medicare coverage.

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Lastly, Our Fourth Success Metric is Financial Discipline

Our cash burn for the first quarter of 2017 was 8.3 million dollars, marking a 28 percent improvement over the prior year. This continues our strong financial discipline as we set our sights on sustained profitable growth and maintaining our prediction of achieving cash flow breakeven by the end of 2018.

I'll now turn the call over to Keith to review our financial results for the first quarter.

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Keith:

Thank you, Bonnie. Good afternoon, everyone. As I mentioned earlier, in addition to our earnings release, you may find our **financial presentation** on our website at www.veracyte.com under "Investors" and then "Events & Presentations." I plan to speak about our first quarter 2017 results and will reference the relevant pages in the financial presentation as I cover the highlights.

Turning to page 2 of the presentation. The **Financial Highlights** for the first quarter 2017, as compared to the first quarter of 2016, are as follows:

- Revenue of $16.4 million increased 21%;
- Afirma GEC reported volume of 5,834 tests increased 9%;
- Total operating expenses of $23.9 million increased 3%;
- Net loss of $8.2 million improved 18%;
- Net loss per share of 24 cents improved 33%;

- Cash burn, defined as net cash used in operating activities and net capital expenditures, of $8.3 million improved 28%; and
- We ended the quarter with $51.5 million in cash.

The next three slides in the financial presentation depict quarterly revenue trends:

- For the first quarter of 2017, on average we accrued between $2,300 and $2,400 for the Afirma GEC tests that met our revenue recognition standard, which was between 90 and 95 percent of the reported Afirma GEC test volume.
- Over the eight quarters ended March 31, 2017, we generated between $2.1 to $2.7 million in revenue per quarter from providing cytopathology services as part of our Afirma solution;
- Prior to July 1st 2016, we accrued less than 50 percent of the billed Afirma test volume per fiscal period. Starting in the quarter ended September 30th 2016, we had sufficient cash collection history to reasonably estimate the amount of revenue to accrue upon test delivery. Thus, we began accruing substantially all GEC test volume in Q3 2016 that met our revenue recognition criteria.

    - Page four of the presentation depicts the quarterly trend for accrued revenue and the year-over-year change. Accrued revenue was $15.1 million or 92% of our revenue this quarter, an 84% increase over prior year;
    - Moving to page five, cash revenue was $1.3 million or 8% of our first quarter revenue, a 76% decline over prior year. We receive the majority of our cash-based revenue from Afirma tests performed prior to July 1st 2016.

- We collected $16.2 million in cash in the first quarter and, based on our cash collection history, we expect the trend shown on page five to continue such that we collect substantially all revenue for tests performed prior to the third quarter of 2016 by June 30th this year.

- Stepping back for a second, this is my first full quarter as CFO. Given the growth in our business, I thought it might be helpful to 'level-set' or explain how I think about the high-level building blocks of our revenue model. To illustrate my point, I am going to explain the four factors that I would use to explain our revenue model to someone that didn't know our business. Note, this is not an exact build of our first quarter 2017 revenue, but an illustrative example and I will use the mid-point of ranges previously mentioned or from our SEC filings.

    - First, volume. To illustrate my point, assume that we report five thousand eight hundred (5,800) Afirma GECs in one quarter and assume that 92.5 percent or five thousand, four hundred (5,400) of these Afirma GECs have both sufficient RNA from which to render a benign or suspicious result and an expectation of cash collection;
    - Second, accrued revenue. Multiply five thousand four hundred (5,400) accrued GECs by the mid-point of the average accrual rate, or $2,350, to arrive at 12.7 million dollars in accrued GEC revenue;
    - Third, add the portion of the Afirma solution derived from cytopathology services or 2.4 million dollars; and,
    - Fourth, and finally, add estimated cash-based revenue, or $1.3 million in my example, to arrive at 16.4 million dollars in quarterly revenue.

Now, turning to slide number 6, you can see that cost of revenue since the first quarter 2016, in absolute dollars, ranged from $6.3 million to $6.5 million. Over this period, we made significant improvements in our sample collection costs and in labor efficiencies that contributed to the stability in the dollars spent. We also moved into our new corporate facility in the first quarter of 2016 and we incurred some expenses in that period associated with the move.

Volume and revenue are key drivers of our gross margin, quote unquote. The increase in gross margins in the third quarter of 2016 reflect the increase in our accrued revenue.

On slide 7, we further breakdown the components of our operating expenses and show the percentage of revenue for each category. As Bonnie mentioned, we are investing in our salesforce and marketing campaigns to support the anticipated growth in our business.

Slides 8 through 10 cover the trends in our net loss, cash burn and cash position. I would remind our investors that we generally pay-out our corporate incentive compensation plan in the first quarter.

I will now turn the call back over to Bonnie for closing remarks.

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Bonnie:

Thanks, Keith.

To wrap up, we're extremely pleased with our first-quarter accomplishments and believe we are positioned to deliver great results in 2017. During the quarter, we put a

number of pieces in place to accelerate growth, including 11 additional Blues plans now covering the Afirma test, our Quest agreement, which is signed and ready to launch and the advancement of our next-generation GEC. We secured Percepta coverage and pricing for Medicare patients and can now accelerate commercial adoption. We're on track to achieve our business goals for the year and reiterate our 2017 annual revenue guidance of 76 to 84 million dollars and annual cash burn of 25 to 27 million dollars.

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Moreover, we're forging new ground in the genomic diagnostics field. In an era when science and technology advances are fueling a relentless thirst for more data about people's health, we provide clinically *useful* results – that are backed by rigorous evidence and enable physicians to make different patient-care decisions. Our powerful combination of machine learning expertise and deep clinical and genomic knowledge is enabling us to bring new solutions to bear as we ask the right clinical questions to inform meaningful changes to patient care. We're creating a new standard of genomic truth and resolving the critical problem of diagnostic uncertainty – by providing ANSWERS without the need for risky, costly and often-unnecessary surgery. This is the Age of Evidence and we are clearly leading in it.

Thank you for your time and attention today. I'd now like to ask the operator to open the call up for questions.

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Operator:

Q&A session

[Operator instructions]

I will now turn the call back to Bonnie Anderson, Chief Executive Officer and Chairman of the Board, for closing remarks.

Bonnie:

Thank you all for joining us today. We appreciate your ongoing support and look forward to updating you our progress in the future.

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Operator:

This concludes today’s conference call. Thank you for your participation. You may now disconnect.