

NanoString Technologies Inc  
Form 10-Q  
May 15, 2014  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended March 31, 2014**

**OR**

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File: Number 001-35980**

**NANOSTRING TECHNOLOGIES, INC.**

**(Exact name of registrant as specified in its charter)**

**Delaware**  
**(State or other jurisdiction of**  
**incorporation or organization)**  
**530 Fairview Avenue North, Suite 2000**  
**Seattle, Washington 98109**  
**(Address of principal executive offices)**  
**(206) 378-6266**  
**(Registrant's telephone number, including area code)**

**20-0094687**  
**(I.R.S. Employer**  
**Identification No.)**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

The number of shares of registrant's common stock outstanding as of May 12, 2014 was 18,064,577



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**NANOSTRING TECHNOLOGIES, INC.**  
**QUARTERLY REPORT ON FORM 10-Q**  
**FOR THE QUARTER ENDED MARCH 31, 2014**

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**Table of Contents****PART 1. FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements****NanoString Technologies, Inc.****Condensed Consolidated Balance Sheets***(in thousands, except par value)***(Unaudited)**

	<b>March 31, 2014</b>	<b>December 31, 2013</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 28,973	\$ 9,941
Short-term investments	56,837	32,715
Accounts receivable, net	7,429	8,331
Inventory	7,522	6,750
Prepaid expenses and other	3,567	2,999
Total current assets	104,328	60,736
Restricted cash	142	201
Deferred offering costs		29
Property and equipment, net	3,118	3,065
Other assets	205	341
Total assets	\$ 107,793	\$ 64,372
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Accounts payable	\$ 2,619	\$ 3,354
Accrued liabilities	5,437	7,088
Deferred revenue, current portion	1,292	1,462
Deferred rent, current portion	605	590
Long-term debt, current portion	6,772	6,136
Total current liabilities	16,725	18,630
Deferred revenue, net of current portion	756	803
Deferred rent, net of current portion	1,168	1,313
Long-term debt, net of current portion	10,533	12,157
Total liabilities	29,182	32,903

Commitment and contingencies

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Stockholders' equity:		
Preferred stock, \$0.0001 par value, 15,000 shares authorized; none issued		
Common stock, \$0.0001 par value, 150,000 shares authorized; 18,053 and 14,620 shares issued and outstanding, respectively	2	1
Additional paid-in-capital	216,854	158,278
Other comprehensive income	9	22
Accumulated deficit	(138,254)	(126,832)
<b>Total stockholders' equity</b>	<b>78,611</b>	<b>31,469</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 107,793</b>	<b>\$ 64,372</b>

The accompanying notes are an integral part of these condensed consolidated financial statements.

**Table of Contents****NanoString Technologies, Inc.****Condensed Consolidated Statements of Operations***(in thousands, except per share amounts)***(Unaudited)**

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
Revenue	\$ 8,751	\$ 5,676
Costs and expenses:		
Cost of revenue	4,325	2,882
Research and development	4,732	3,059
Selling, general and administrative	10,674	6,126
Total costs and expenses	19,731	12,067
Loss from operations	(10,980)	(6,391)
Other income (expense):		
Interest income	64	3
Interest expense	(536)	(385)
Other expense	30	(4)
Revaluation of preferred stock warrant liability		(482)
Total other expense	(442)	(868)
Net loss	(11,422)	(7,259)
Accretion of mandatorily redeemable convertible preferred stock		(2,342)
Net loss attributable to common stockholders	\$ (11,422)	\$ (9,601)
Net loss per share - basic and diluted	\$ (0.68)	\$ (17.88)
Shares used in computing basic and diluted net loss per share	16,917	537

The accompanying notes are an integral part of these condensed consolidated financial statements.

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**NanoString Technologies, Inc.**

**Condensed Consolidated Statements of Comprehensive Loss**

*(in thousands)*

**(Unaudited)**

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
Net loss	\$ (11,422)	\$ (7,259)
Unrealized loss on short-term investments	(13)	
<b>Comprehensive loss</b>	<b>\$ (11,435)</b>	<b>\$ (7,259)</b>

The accompanying notes are an integral part of these condensed consolidated financial statements.



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## NanoString Technologies, Inc.

## Condensed Consolidated Statements of Cash Flows

*(in thousands)*

(Unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
<b>Operating activities</b>		
Net loss	\$ (11,422)	\$ (7,259)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	396	464
Amortization of debt discount	51	51
Stock-based compensation	1,039	231
Revaluation of preferred stock warrant liability		482
Net amortization of premium on short-term investments	(173)	
Interest accrued on long-term notes	88	79
Loss on disposal of property and equipment		1
Gain on sale of investments	(2)	
Changes in operating assets and liabilities		
Accounts receivable	902	(1,034)
Inventory	(772)	43
Prepaid expenses and other	(568)	(842)
Other assets	136	9
Accounts payable	(735)	(62)
Accrued liabilities	(1,651)	(1,201)
Deferred revenue	(217)	211
Deferred rent	(130)	(183)
Net cash used in operating activities	(13,058)	(9,010)
<b>Investing activities</b>		
Purchases of property and equipment	(446)	(136)
Decrease in restricted cash	59	
Proceeds from maturity of short-term investments	5,671	
Purchase of short-term investments	(29,631)	
Net cash used in investing activities	(24,347)	(136)
<b>Financing activities</b>		
Net proceeds from public offering	57,016	
Proceeds from employee stock purchase plan	442	

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Repayment of long-term debt	(1,129)	(55)
Deferred offering costs		(1,019)
Proceeds from exercise of stock options	108	322
Net cash provided by (used in) financing activities	56,437	(752)
Net increase (decrease) in cash and cash equivalents	19,032	(9,898)
<b>Cash and cash equivalents</b>		
Beginning of period	9,941	21,692
End of period	\$ 28,973	\$ 11,794

The accompanying notes are an integral part of these condensed consolidated financial statements.

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**NanoString Technologies, Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**1. Description of Business**

NanoString Technologies, Inc. (the Company) was incorporated in the state of Delaware on June 20, 2003. The Company's headquarters is located in Seattle, Washington. The Company's technology enables direct detection, identification and quantification of individual target molecules in a biological sample by attaching a unique color coded fluorescent reporter to each target molecule of interest. The Company markets its proprietary nCounter Analysis System, consisting of instruments and consumables, including its Prosigna Breast Cancer Assay, to academic, government and biopharmaceutical and clinical laboratories.

The Company has incurred losses to date and expects to incur additional losses in the foreseeable future. The Company continues to devote the majority of its resources to the growth of its business in accordance with its business plan. The Company's activities have been financed primarily through the sale of equity securities and incurrence of indebtedness, and to a lesser extent, capital leases and other borrowings.

***Reverse Stock Split***

On June 12, 2013, the Company effected a 1-for-32 reverse stock split of its common stock and preferred stock. All share and per share information has been retroactively adjusted to reflect this reverse stock split.

***Public Equity Offering***

In January 2014, the Company completed an underwritten public offering of 2,972,972 shares of common stock for total gross proceeds of \$55.0 million. In February 2014, the underwriters partially exercised an overallotment option, purchasing 345,945 additional shares from the Company for additional gross proceeds of \$6.4 million. After underwriters' fees and commissions and other expenses of the offering, the Company's aggregate net proceeds were approximately \$57.0 million.

**2. Basis of Presentation and Summary of Significant Accounting Policies**

***Basis of Presentation***

The accompanying unaudited condensed consolidated financial statements reflect the accounts of the Company and its wholly-owned subsidiaries, NanoString Technologies International, Inc., NanoString Technologies Asia Pacific Limited, NanoString Technologies Singapore Pte. Limited, NanoString Technologies Europe Limited, NanoString Technologies Germany GmbH and NanoString Technologies SAS. The unaudited condensed consolidated balance sheet at December 31, 2013 has been derived from the audited consolidated financial statements at that date but does not include all of the information and disclosures required by U.S. GAAP for annual financial statements. These unaudited condensed consolidated financial statements and notes should be read in conjunction with the Company's audited consolidated financial statements and accompanying notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (SEC) and generally accepted accounting principles in the United States of America (U.S. GAAP) for

unaudited condensed consolidated financial information. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. The accompanying unaudited condensed consolidated financial statements reflect all adjustments consisting of normal recurring adjustments which, in the opinion of management, are necessary for a fair statement of the Company's financial position and results of its operations, as of and for the periods presented.

Unless indicated otherwise, all amounts presented in financial tables are presented in thousands, except for per share and par value amounts.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The results of the Company's operations for the three month period ended March 31, 2014 are not necessarily indicative of the results to be expected for the full year or for any other period.

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**Table of Contents*****Revenue Recognition***

The Company recognizes revenue when (1) persuasive evidence of an arrangement exists, (2) delivery has occurred or services have been rendered, (3) the price to the customer is fixed or determinable and (4) collectability is reasonably assured. The Company generates revenue from the sale of products and services. The Company's products consist of its proprietary nCounter Analysis System and related consumables. Services consist of extended warranties and service fees for assay processing. A delivered product or service is considered to be a separate unit of accounting when it has value to the customer on a stand-alone basis. Products or services have value on a stand-alone basis if they are sold separately by any vendor or the customer could resell the delivered product.

Systems product revenue is recognized upon installation and calibration in geographic regions where such services are only available from the Company's specialized technicians. In these regions, systems and related installation and calibration are considered to be one unit of accounting, as systems are required to be professionally installed and calibrated before use. In certain geographic regions, installation and calibration services are available from other vendors, and in such regions they are considered separate revenue elements. For systems sold for use primarily to run Prosigna assays, training must be provided prior to system revenue recognition. Consumables are considered to be separate units of accounting as they are sold separately. Consumables product revenue is recognized upon shipment.

Service revenue is recognized when earned, which is generally upon the rendering of the related services. Service agreements and service fees for assay processing are each considered separate units of accounting as they are sold separately. The Company offers service agreements on its nCounter Analysis System for periods ranging from 12 to 36 months after the end of the standard 12-month warranty period. Service agreements are generally separately priced. Revenue from service agreements is deferred and recognized in income on a straight-line basis over the service period.

For arrangements with multiple deliverables, the Company allocates the agreement consideration at the inception of the agreement to the deliverables based upon their relative selling prices. To date, selling prices have been established by reference to vendor specific objective evidence based on stand-alone sales transactions for each deliverable. Vendor specific objective evidence is considered to have been established when a substantial majority of individual sales transactions within the previous 12 month period fall within a reasonably narrow range, which the Company has defined to be plus or minus 15% of the median sales price of actual stand-alone sales transactions. The Company uses its best estimate of selling price for individual deliverables when vendor specific objective evidence or third-party evidence is unavailable. Allocated revenue is only recognized for each deliverable when the revenue recognition criteria have been met.

***Recent Accounting Pronouncements***

As an emerging growth company, the Jumpstart Our Business Startups Act allows the Company to delay adoption of new or revised accounting pronouncements applicable to public companies until such pronouncements are made applicable to private companies.

The Company has reviewed recent accounting pronouncements and concluded that they are either not applicable to the business, or that no material effect is expected on the condensed consolidated financial statements as a result of future adoption.

**3. Net Loss Per Share**

Net loss attributable to common stockholders per share is computed by dividing the net loss allocable to common stockholders by the weighted average number of shares of common stock outstanding. Outstanding stock options and

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warrants have not been included in the calculation of the diluted net loss attributable to common stockholders per share because to do so would be anti-dilutive. Accordingly, the numerator and the denominator used in computing both basic and diluted net loss per share for each period are the same.

The following outstanding options and warrants were excluded from the computation of basic and diluted net loss per share for the three month periods presented because their effect would have been anti-dilutive (in thousands):

	<b>2014</b>	<b>2013</b>
Stock options	3,169	
Stock options (as converted)		1,806
Convertible preferred stock (as converted)		8,631
Convertible preferred stock warrants (as converted)		607
Common stock warrants	618	

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Financial instruments that potentially expose the Company to concentrations of credit risk consist principally of cash and cash equivalents, short-term investments and accounts receivable. Cash is invested in accordance with the Company's investment policy, which includes guidelines intended to minimize and diversify credit risk. Most of the Company's investments are not federally insured. The Company has credit risk related to the collectability of its accounts receivable. The Company performs initial and ongoing evaluations of its customers' financial position and generally extends credit on account without collateral. The Company has not experienced any significant credit losses to date as a result of credit risk concentration.

The Company had one customer that individually represented more than 10% of total revenue during the three months ended March 31, 2014 and none during the three months ended March 31, 2013. In addition, the Company had one customer that represented more than 10% of total accounts receivable as of March 31, 2014 and none as of December 31, 2013.

The Company is also subject to supply chain risks related to the outsourcing of the manufacturing and production of its instruments to sole suppliers. Although there are a limited number of manufacturers for instruments of this type, the Company believes that other suppliers could provide similar products on comparable terms. A change in suppliers, however, could cause a delay in manufacturing and a possible loss of sales, which would adversely affect operating results.

**5. Short-term Investments**

Short-term investments consisted of available-for-sale securities as follows (in thousands):

Type of security as of March 31, 2014	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
U.S. government-related debt securities	\$ 1,550	\$ 1	\$	\$ 1,551
Corporate debt securities	55,278	26	(18)	55,286
<b>Total available-for-sale securities</b>	<b>\$ 56,828</b>	<b>\$ 27</b>	<b>\$ (18)</b>	<b>\$ 56,837</b>

Type of security as of December 31, 2013	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
U.S. government-related debt securities	\$ 1,565	\$ 1	\$	\$ 1,566
Corporate debt securities	31,128	24	(3)	31,149
<b>Total available-for-sale securities</b>	<b>\$ 32,693</b>	<b>\$ 25</b>	<b>\$ (3)</b>	<b>\$ 32,715</b>

The fair values of available-for-sale securities by contractual maturity were as follows (in thousands):

Contractual maturity	March 31, 2014	December 31, 2013
Maturing in one year or less	\$ 53,286	\$ 26,725
Maturing after one year through three years	3,551	5,990
<b>Total available-for-sale securities</b>	<b>\$ 56,837</b>	<b>\$ 32,715</b>

Realized gains and losses are determined based on the specific identification method and are reported in other income in the condensed consolidated statements of operations. Gross realized gains on sales of available-for-sale securities were approximately \$1,900 and \$0 for the three months ended March 31, 2014 and 2013, respectively. There were no realized losses on sales of available-for-sale securities for the three months ended March 31, 2014 and 2013.

## 6. Fair Value Measurements

The Company establishes the fair value of its assets and liabilities using the price that would be received to sell an asset or paid to transfer a financial liability in an orderly transaction between market participants at the measurement date. A fair value hierarchy is used to measure fair value. The three levels of the fair value hierarchy are as follows:

Level 1 Quoted prices in active markets for identical assets and liabilities.



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Level 2 Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.

Level 3 Valuations derived from valuation techniques in which one or more significant inputs and significant value drivers are unobservable.

The recorded amounts of certain financial instruments, including cash, accounts receivable, prepaid expenses and other, accounts payable and accrued liabilities, approximate fair value due to their relatively short-term maturities. The recorded amount of the Company's long-term debt approximates fair value because the related interest rates approximate rates currently available to the Company.

The Company's available-for-sale securities by level within the fair value hierarchy were as follows (in thousands):

	Level 1	Level 2	Level 3	Total
As of March 31, 2014				
Cash equivalents:				
Money market fund	\$ 28,567	\$	\$	\$ 28,567
Short-term investments:				
U.S. government-related debt securities		1,551		1,551
Corporate debt securities		55,286		55,286
Total	\$ 28,567	\$ 56,837	\$	\$ 85,404
As of December 31, 2013				
Cash equivalents:				
Money market fund	\$ 8,454	\$	\$	\$ 8,454
Short-term investments:				
U.S. government-related debt securities		1,566		1,566
Corporate debt securities		31,149		31,149
Total	\$ 8,454	\$ 32,715	\$	\$ 41,169

**7. Inventory**

Inventory consisted of the following as of the date indicated (in thousands):

	March 31, 2014	December 31, 2013
Raw materials	\$ 1,605	\$ 2,164
Work in process	1,957	2,198
Finished goods	3,960	2,388
	\$ 7,522	\$ 6,750

**8. Reserve for Product Warranties**

The Company generally provides a one-year warranty on its nCounter Analysis Systems and establishes an accrual based on historical product failure rates and actual warranty costs incurred. Warranty expense is recorded as a component of cost of revenue in the condensed consolidated statements of operations.

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The following information reconciles changes in the Company's warranty reserve and related costs (in thousands):

Warranty reserve, December 31, 2013	\$ 358
Cost of warranty claims	(28)
Warranty accrual	80
Warranty reserve, March 31, 2014	\$ 410

**9. Commitments and Contingencies**

From time to time, the Company may become involved in litigation relating to claims arising from the ordinary course of business. Management believes that there are no claims or actions pending against the Company currently, the ultimate disposition of which would have a material adverse effect on the Company's consolidated results of operation, financial condition or cash flows.

**10. Information about Geographic Areas**

The Company operates as a single reportable segment and primarily enables customers to perform both research and clinical testing on its nCounter Analysis System. The Company has one sales force that sells these systems to both research and clinical testing labs, and has launched its first product, nCounter Elements GPRs, that can be used for both research and diagnostic testing.

The following table is based on the geographic location of distributors or end users who purchased products and services. For sales to distributors, their geographic location may be different from the geographic locations of the ultimate end user. Revenue by geography was as follows (in thousands):

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2014</b>	<b>2013</b>
North America	\$ 5,989	\$ 4,477
Europe & Middle East	1,763	616
Asia Pacific	999	583
Total revenue	\$ 8,751	\$ 5,676

Total revenue in the United States was \$5.3 million and \$3.7 million for the three month periods ended March 31, 2014 and 2013, respectively.

The Company's assets are primarily located in the United States and not allocated to any specific geographic region. Substantially all of the Company's long-lived assets are located in the United States.

**11. Subsequent Events**

In April 2014, the Company entered into a term loan agreement with a new lender to refinance its existing credit facility and potentially incur up to an aggregate of \$45.0 million in term loan borrowings or up to an aggregate of approximately \$52.0 million if it elects to exercise in full an option to defer payment of a portion of the interest that would accrue on the borrowings under the term loan agreement. The Company has committed to borrow no less than \$30.0 million under the agreement, from which it will repay the outstanding balance under its existing credit facility plus the related \$1.0 million end of term payment and a \$0.3 million make-whole premium. The Company expects to record a total charge of \$1.4 million related to the repayment. All borrowings under this new term loan agreement will accrue interest at 12.5% annually, of which 3.5% can be deferred and paid at the end of the six-year term. The Company will make interest-only payments for the first five years. The Company has the option to prepay the term loans, in whole or in part, at any time subject to payment of a redemption fee. This new term loan agreement contains customary conditions to borrowings, events of default and negative covenants, including covenants that could limit the Company's ability to, among other things, incur additional indebtedness, liens or other encumbrances, make dividends or other distributions; buy, sell or transfer assets; engage in any new line of business; and enter into certain transactions with affiliates. The new term loan agreement also includes liquidity and revenue-based financial covenants. The Company's obligations under the new term loan agreement are collateralized by substantially all of its assets.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**  
***Forward-Looking Statements***

This section should be read in conjunction with our unaudited condensed consolidated financial statements and related notes included in Part I, Item 1 of this report. This discussion contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements are identified by words such as believe, anticipate, expect, intend, plan, will, may, seek and other similar expressions. You should read these statements carefully because they discuss future expectations, contain projections of future results of operations or financial condition, or state other forward-looking information. These statements relate to our future plans, objectives, expectations, intentions and financial performance and the assumptions that underlie these statements. These forward-looking statements include, but are not limited to:

our ability to successfully commercialize Prosigna, our first product for which we have obtained a CE mark in the European Union and, in September 2013, received 510(k) clearance from the U.S. Food and Drug Administration, or FDA;

the implementation of our business model and strategic plans for our business;

the regulatory regime and our ability to secure regulatory clearance or approval for the clinical use of our products, domestically and internationally;

our strategic relationships, including with patent holders of our technologies, manufacturers and distributors of our products, and third parties who conduct our clinical studies;

our intellectual property position;

our expectations regarding the market size and growth potential for our businesses;

any estimates regarding expenses, future revenues, capital requirements, and stock performance; and

our ability to sustain and manage growth, including our ability to develop new products and enter new markets.

These forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those anticipated in the forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed in this report in Part II, Item 1A Risk Factors, and elsewhere in this report. These statements, like all statements in this report, speak only as of their date, and we undertake no obligation to update or revise these statements in light of future developments. In this report, we, our, us, NanoString, and the Company refer to NanoString Technologies, Inc.

## Overview

We develop, manufacture and sell robust, intuitive products that unlock scientifically valuable and clinically actionable genomic information from minute amounts of tissue. Our nCounter Analysis System directly profiles hundreds of molecules simultaneously using a novel barcoding technology that is powerful enough for use in research, yet simple enough for use in clinical laboratories worldwide. We market systems and related consumables to researchers in academic, government, and biopharmaceutical laboratories for use in understanding fundamental biology and the molecular basis of disease and to clinical laboratories and medical centers for diagnostic use. We have an installed base of more than 200 systems, which our customers have used to publish more than 400 peer-reviewed papers. As researchers discover how genomic information can be used to improve clinical decision-making, these discoveries can be translated and validated as diagnostic tests based on our nCounter Elements General Purpose Reagents, or GPRs. In certain situations, we intend to translate their discoveries into *in vitro* diagnostic assays. For example, in September 2013, we received 510(k) clearance from the U.S. Food and Drug Administration, or FDA, to market in the United States a version of our first molecular diagnostic product, the Prosigna Breast Cancer Assay, or Prosigna, providing an assessment of a patient's risk of recurrence for breast cancer.

We derive a substantial majority of our revenue from the sale of our products, which consist of our nCounter instruments and related proprietary consumables, which we call CodeSets, nCounter Elements GPRs and Master Kits, and our Prosigna *in vitro* diagnostic kits. We also derive revenue from processing fees related to proof-of-principle studies we conduct for potential customers and extended service contracts for our nCounter Analysis Systems.

We use third-party contract manufacturers to produce the two instruments comprising the nCounter Analysis System. We manufacture consumables at our Seattle, Washington facility. This operating model is designed to be capital efficient and to scale efficiently as our product volumes grow. We focus a substantial portion of our resources on researching and developing new technologies and products. We sell our products through our own sales force in the United States, Canada, Singapore, Israel and certain European countries. We sell through distributors in other parts of the world.

Our total revenue has increased to \$8.8 million for the three months ended March 31, 2014 from \$5.7 million for the first three months of 2013. Historically, we have generated a substantial majority of our revenue from sales to customers in North America; however, we expect sales in other regions to increase over time. We have never been profitable and had net losses of \$11.4 million and \$7.3 million for the three months ended March 31, 2014 and 2013, respectively, and as of March 31, 2014 our accumulated deficit was \$138.3 million.

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In January 2014, we completed an underwritten public offering of 2,972,972 shares of common stock for total gross proceeds of \$55.0 million. In February 2014, the underwriters partially exercised an over-allotment option, purchasing 345,945 additional shares from us for additional gross proceeds of \$6.4 million. After underwriters' fees and commissions and other expenses of the offering, our aggregate net proceeds were approximately \$57 million.

**Results of Operations*****Revenue; Cost of Revenue; Gross Profit; Gross Margin***

Our product revenues consist of sales of our nCounter Analysis System and related consumables, including Prosigna *in vitro* diagnostic kits. Service revenue consists of fees associated with extended service agreements and conducting proof-of-principle studies. Our customer base is primarily composed of academic institutions, government laboratories, biopharmaceutical companies and clinical laboratories that perform analyses or testing using our nCounter Analysis System and purchase related consumables.

The following table reflects product and service revenue by geography based on the billing address of our customers. North America consists of the United States, Canada and Mexico; and Asia Pacific includes Japan, China, South Korea, Singapore, Malaysia and Australia.

	<b>Three Months Ended March 31,</b>		
	<b>2014</b>	<b>2013</b>	<b>% Change</b>
	<b>(In thousands)</b>		
North America	\$ 5,989	\$ 4,477	34%
Europe & Middle East	1,763	616	186
Asia Pacific	999	583	71
Total	\$ 8,751	\$ 5,676	54

Cost of revenue consists primarily of costs incurred in the production process, including costs of purchasing instruments from third-party contract manufacturers, consumable component materials and assembly labor and overhead, installation, warranty, service and packaging and delivery costs. In addition, cost of revenue includes royalty costs for licensed technologies included in our products, provisions for slow-moving and obsolete inventory and stock-based compensation expense. We provide a one-year warranty on each nCounter Analysis System sold and establish a reserve for warranty repairs based on historical warranty repair costs incurred.

Revenue, cost of revenue, gross profit and gross margin were as follows:

	<b>Three Months Ended March 31,</b>		
	<b>2014</b>	<b>2013</b>	<b>% Change</b>
	<b>(In thousands)</b>		

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Product revenue:			
Instruments	\$ 3,448	\$ 1,639	110%
Consumables	4,786	3,699	29
<i>In vitro</i> diagnostic kits	61		
Service revenue	456	338	35
Total revenue	8,751	5,676	54
Cost of revenue	4,325	2,882	50
Gross profit	\$ 4,426	\$ 2,794	58
Gross margin	51%	49%	



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Instruments revenue increased significantly due to an increase in the number of instruments sold. The increase in consumables revenue was driven by growth in our installed base of instruments. The increase in service revenue was primarily related to an increase in the number of instruments covered by service agreements.

The increase in cost of revenue was related to the increased volume of both instruments and consumables sold. Gross margin improved due to cost efficiencies associated with increased consumables production volume and several large custom consumable orders with unusually low per unit manufacturing costs. These improvements were partially offset by a shift in product mix toward instruments.

***Research and Development Expense***

Research and development expenses consist primarily of salaries and benefits, occupancy, laboratory supplies, consulting fees and related costs, costs associated with licensing molecular diagnostics rights and clinical study expenses (including the cost of tissue samples) to support the regulatory approval or clearance of diagnostic products. We have made substantial investments in research and development since our inception. Our research and development efforts have focused primarily on the tasks required to enhance our technologies and to support development and commercialization of new and existing products and applications. We believe that our continued investment in research and development is essential to our long-term competitive position and expect these expenses to increase in future periods.

Given the relatively small size of our research and development staff and the limited number of active projects at any given time, we have found that, to date, it has been effective for us to manage our research and development activities on a departmental basis. Accordingly, we do not require employees to report their time by project nor do we allocate our research and development costs to individual projects. Research and development expense by functional area was as follows:

	<b>Three Months Ended March 31,</b>		
	<b>2014</b>	<b>2013</b>	<b>% Change</b>
	<b>(In thousands)</b>		
Core nCounter platform technology	\$ 1,828	\$ 612	199%
Manufacturing process development	489	378	29
Research products and applications	861	736	17
Diagnostic product development	1,181	938	26
Facility allocation	373	395	(6)
Total	\$ 4,732	\$ 3,059	55

The increases in research and development expense reflected an increase in personnel-related expenses primarily to support the advancement of our nCounter technology. In addition, there was an increase in engineering costs for development of the next generation of our nCounter system.

***Selling, General and Administrative Expense***

Selling, general and administrative expense consists primarily of costs for our sales and marketing, finance, legal, human resources, information technology, business development and general management functions, as well as professional services, such as legal, consulting and accounting services. We expect selling, general and administrative expense to increase in future periods as the number of sales, technical support and marketing and administrative personnel grows and we continue to introduce new products, broaden our customer base and grow our business. In particular, the continued commercialization of Prosigna requires us to establish a dedicated oncology diagnostics sales force which will increase selling and marketing expenses significantly. We also expect legal, accounting and compliance costs to increase as our business grows.

Selling, general and administrative expense was as follows:

	<b>Three Months Ended</b>		
	<b>March 31,</b>		
	<b>2014</b>	<b>2013</b>	<b>% Change</b>
	<b>(In thousands)</b>		
Selling, general and administrative expense	\$ 10,674	\$ 6,126	74%

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The increase for the period was primarily attributable to increased staffing and personnel-related costs to support sales and marketing and administration; increased external marketing and other consulting costs related to the commercial launch of Prosigna; and increased corporate professional fees and other public company costs.

***Other Income (Expense), Net***

Other income (expense) was as follows:

	<b>Three Months Ended</b>		
	<b>March 31,</b>		
	<b>2014</b>	<b>2013</b>	<b>% Change</b>
	<b>(In thousands)</b>		
Interest income	\$ 64	\$ 3	2033%
Interest expense	(536)	(385)	39
Other income (expense)	30	(4)	(850)
Revaluation of preferred stock warrant liability		(482)	(100)
<b>Total other expense, net</b>	<b>\$ (442)</b>	<b>\$ (868)</b>	<b>(49)</b>

The increase in interest expense was driven by increased borrowing under our existing credit facility during 2014 from \$12.8 million as of March 31, 2013 to \$17.3 million as of March 31, 2014.

The revaluation of the preferred stock warrant liability for the three month period ended March 31, 2013 resulted from a re-measurement of the fair value of preferred stock warrants using the Black-Scholes option pricing model, which was primarily impacted by a decrease in the valuation of the underlying stock. Upon closing of our initial public offering in July 2013, all outstanding preferred stock was automatically converted into common stock, and the warrants to purchase preferred stock converted into warrants to purchase common stock. As a result, the preferred stock warrant liability was reclassified to stockholders' equity.

**Liquidity and Capital Resources**

As of March 31, 2014, we had cash, cash equivalents and short-term investments totaling \$85.8 million. We believe our existing cash, cash equivalents and short-term investments will be sufficient to meet our working capital and capital expenditure needs for at least the next 12 months. However, we may need to raise additional capital to expand the commercialization of our products, fund our operations and further our research and development activities. Our future funding requirements will depend on many factors, including: market acceptance of our products; the cost and timing of establishing additional sales, marketing and distribution capabilities; the cost of our research and development activities; the cost and timing of regulatory clearances or approvals; the effect of competing technological and market developments; and the extent to which we acquire or invest in businesses, products and technologies, although we currently have no commitments or agreements relating to any of these types of transactions.

If we require additional funds in the future, we may not be able to obtain such funds on acceptable terms, or at all. If we raise additional funds by issuing equity or equity-linked securities, our stockholders may experience dilution. Debt financing, if available, may involve covenants restricting our operations or our ability to incur additional debt. Any debt or additional equity financing that we raise may contain terms that are not favorable to us or our stockholders. If we raise additional funds through collaboration and licensing arrangements with third parties, it may be necessary to

relinquish some rights to our technologies or our products, or grant licenses on terms that are not favorable to us. If we are unable to raise adequate funds, we may have to liquidate some or all of our assets, or delay, reduce the scope of or eliminate some or all of our development programs. If we do not have, or are not able to obtain, sufficient funds, we may have to delay development or commercialization of our products or license to third parties the rights to commercialize products or technologies that we would otherwise seek to commercialize. We also may have to reduce marketing, customer support or other resources devoted to our products or cease operations.

### ***Sources and Uses of Funds***

Since inception, we have financed our operations primarily through the sale of equity securities and, to a lesser extent, from borrowings.

In March 2012, we entered into a loan and security agreement, pursuant to which we have incurred \$18.0 million in term loan borrowings, all of which accrue interest at a rate of 8.89%. Through January 2014, we paid interest only on such term loan borrowings. Following the expiration of the interest only payment period, we are now paying principal and interest in 30 equal monthly installments, and are required to pay an end of term payment equal to 5.5% of the amount borrowed, or \$990,000, at maturity in July 2016. We may at our option prepay all of the term loan borrowings by paying the lender, among other things, all principal and accrued interest, the end of term payment plus a premium of up to 3% of the amount borrowed. In addition, from time to time we can also incur revolver borrowings of up to the lesser of \$2.0 million or a borrowing base tied to the amount of eligible accounts receivable. Interest on revolver borrowings accrues at a floating rate equal to the prime rate plus 3.70% (subject to a floor of 6.95%) and is payable monthly. We are also required to pay a fee of 0.075% per month on the unused portion of the revolver borrowings.

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In April 2014, we entered into a term loan agreement with a new lender to refinance our existing credit facility and potentially incur up to an aggregate of \$45.0 million in term loan borrowings or up to an aggregate of approximately \$52.0 million if we elect to exercise in full an option to defer payment of a portion of the interest that would accrue on the borrowings under the term loan agreement. We have committed to borrow no less than \$30.0 million under the agreement, from which we will repay the outstanding balance under our existing credit facility plus a related end of term payment and a make-whole premium. All borrowings under this new term loan agreement will accrue interest at 12.5% annually, of which 3.5% can be deferred and paid at the end of the six-year term. We have the option to prepay the term loans, in whole or in part, at any time subject to payment of a redemption fee. This new term loan agreement contains customary conditions to borrowings, events of default and negative covenants, including covenants that could limit our ability to, among other things, incur additional indebtedness, liens or other encumbrances, make dividends or other distributions; buy, sell or transfer assets; engage in any new line of business; and enter into certain transactions with affiliates. The new term loan agreement also includes liquidity and revenue-based financial covenants. Our obligations under the new term loan agreement are collateralized by substantially all of our assets.

Our principal uses of cash are funding our operations, satisfaction of our obligations under our debt instruments, and other working capital requirements. Over the past several years, our revenue has increased significantly from year to year and, as a result, our cash flows from customer collections have increased. However, our operating expenses have also increased as we have invested in growing our existing research business and in developing Prosigna and preparing it for commercialization. As a result, our cash used in operating activities has either remained relatively constant or increased. We expect our operating cash requirements to increase in the future as we (1) increase sales and marketing activities to expand the installed base of our nCounter Analysis Systems among research customers and clinical laboratories, (2) commercialize, and conduct studies to expand the clinical utility of, Prosigna, and (3) develop new applications, chemistry and instruments for our nCounter platform.

***Historical Cash Flow Trends***

The following table shows a summary of our cash flows for the periods indicated:

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
	<b>(In thousands)</b>	
Cash used in operating activities	\$ (13,058)	\$ (9,010)
Cash used in investing activities	(24,347)	(136)
Cash provided by (used in) financing activities	56,437	(752)

***Operating Cash Flows***

We derive operating cash flows from cash collected from the sale of our products and services. These cash flows received are outweighed by our use of cash for operating expenses to support the growth of our business. As a result, we have historically experienced negative cash flows from operating activities as we have expanded our business in the United States and other markets and this will likely continue for the foreseeable future.

Net cash used in operating activities for the three months ended March 31, 2014 consisted of our net loss of \$11.4 million and \$3.0 million of cash used for working capital purposes. These uses were partially offset by \$1.8 million of net non-cash expense items, such as depreciation and amortization, amortization of premium on short-term investments and stock-based compensation.

Net cash used in operating activities for the three months ended March 31, 2013 consisted of our net loss of \$7.3 million and \$3.1 million of cash used for working capital purposes. These uses were partially offset by \$1.3 million of non-cash expense items, such as depreciation and amortization, stock-based compensation, revaluation of preferred stock warrant liability and amortization of debt discounts and issuance cost.

*Investing Cash Flows*

Our most significant investing activities for the three months ended March 31, 2014 were related to the purchase and sale of short-term investments. Because we manage our cash usage with respect to our total cash, cash equivalents and short-term investments, we do not consider these cash flows to be important to an understanding of our liquidity and capital resources.

In the three months ended March 31, 2014 and 2013, we purchased \$0.4 million and \$0.1 million, respectively, of property and equipment required to support the growth and expansion of our operations.

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*Financing Cash Flows*

Historically, we have funded our operations through the issuance of equity securities and the incurrence of indebtedness.

Net cash provided by financing activities for the three months ended March 31, 2014 consisted of net proceeds of \$57.0 million from our public offering of common stock, Employee Stock Purchase Plan proceeds of \$0.4 million and \$0.1 million of proceeds from the exercise of stock options. These proceeds were partially offset by repayments of borrowings of \$1.1 million.

Net cash used in financing activities for the three months ended March 31, 2013 included payments for initial public offering costs of \$1.0 million and repayments of borrowing of \$0.1 million, which were partially offset by proceeds from exercise of stock options of \$0.3 million.

***Critical Accounting Policies and Significant Estimates***

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements which have been prepared in accordance with U.S. generally accepted accounting principles, or GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities and related disclosure of contingent assets and liabilities, revenue and expenses at the date of the financial statements. Generally, we base our estimates on historical experience and on various other assumptions in accordance with GAAP that we believe to be reasonable under the circumstances. Actual results may differ from these estimates.

Critical accounting policies and estimates are those that we consider the most important to the portrayal of our financial condition and results of operations because they require our most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Our critical accounting policies and estimates include those related to:

revenue recognition;

stock-based compensation;

inventory valuation;

fair value measurements; and

income taxes.

There have been no material changes in our critical accounting policies and estimates in the preparation of our condensed consolidated financial statements during the three months ended March 31, 2014 compared to those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the SEC on March 27, 2014.

***Recent Accounting Pronouncements***

As an emerging growth company the JOBS Act allows us to delay adoption of new or revised accounting pronouncements applicable to public companies until such pronouncements are made applicable to private companies. As a result, our financial statements may not be comparable to the financial statements of issuers who are required to comply with the effective dates for new or revised accounting standards that are applicable to public companies.

We have reviewed recent accounting pronouncements and concluded that they are either not applicable to our business, or that no material effect is expected on our consolidated financial statements as a result of future adoption.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

We are exposed to various market risks, including changes in interest rates and foreign currency exchange rates. Market risk is the potential loss arising from adverse changes in market rates and prices. Prices for our products are largely denominated in U.S. dollars and, as a result, we do not face significant risk with respect to foreign currency exchange rates.

***Interest Rate Risk***

Generally, our exposure to market risk has been primarily limited to interest income sensitivity, which is affected by changes in the general level of U.S. interest rates, particularly because the majority of our investments are in short-term debt securities. The primary objective of our investment activities is to preserve principal while at the same time maximizing the income we receive without significantly increasing risk. To minimize risk, we maintain our portfolio of cash, cash equivalents and short-term investments in a variety of interest-bearing instruments, which have included U.S. government and agency securities, high-grade U.S. corporate bonds and money market funds. Declines in interest rates, however, would reduce future investment income. A 1% decline in interest rates, occurring on April 1, 2014 and sustained throughout the period ended March 31, 2015, would not be material.

As of March 31, 2014, the principal and accrued interest outstanding under our term borrowings was \$17.3 million. The interest rates on our term borrowings under our credit facility are fixed. If overall interest rates had increased by 10% during the periods presented, our interest expense would not have been affected.



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### ***Foreign Currency Exchange Risk***

As we expand internationally our results of operations and cash flows will become increasingly subject to fluctuations due to changes in foreign currency exchange rates. Historically, a majority of our revenue has been denominated in U.S. dollars, although we sell our products and services in local currency outside of the United States, principally the Euro. Our expenses are generally denominated in the currencies in which our operations are located, which is primarily in the United States. The effect of a 10% adverse change in exchange rates on foreign denominated cash, receivables and payables would not have been material for the periods presented. As our operations in countries outside of the United States grow, our results of operations and cash flows will be subject to fluctuations due to changes in foreign currency exchange rates, which could harm our business in the future. To date, we have not entered into any material foreign currency hedging contracts although we may do so in the future.

### ***Inflation Risk***

We do not believe that inflation has had a material effect on our business, financial condition or results of operations. If our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could adversely affect our business, financial condition and results of operations.

## **Item 4. Controls and Procedures**

(a) *Evaluation of disclosure controls and procedures.* Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, have evaluated our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) prior to the filing of this quarterly report. Based on that evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that, as of the end of the period covered by this quarterly report, our disclosure controls and procedures were, in design and operation, effective.

(b) *Changes in internal control over financial reporting.* There were no changes in our internal control over financial reporting during the quarter ended March 31, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### ***Inherent limitation on the effectiveness of internal control.***

The effectiveness of any system of internal control over financial reporting, including ours, is subject to inherent limitations, including the exercise of judgment in designing, implementing, operating, and evaluating the controls and procedures, and the inability to eliminate misconduct completely. Accordingly, any system of internal control over financial reporting, including ours, no matter how well designed and operated, can only provide reasonable, not absolute assurances. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. We intend to continue to monitor and upgrade our internal controls as necessary or appropriate for our business, but cannot assure you that such improvements will be sufficient to provide us with effective internal control over financial reporting.

## **PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

We are not engaged in any material legal proceedings. However, in the normal course of business, we may from time to time be named as a party to legal claims, actions and complaints, including matters involving employment, intellectual property or others.

**Item 1A. Risk Factors**

*You should carefully consider the following risk factors, in addition to the other information contained in this report, including the section of this report captioned Management's Discussion and Analysis of Financial Condition and Results of Operations and our financial statements and related notes. If any of the events described in the following risk factors and the risks described elsewhere in this report occurs, our business, operating results and financial condition could be seriously harmed. This report on Form 10-Q also contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of factors that are described below and elsewhere in this report.*

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### **Risks Related to our Business and Strategy**

***We have incurred losses since we were formed and expect to incur losses in the future. We cannot be certain that we will achieve or sustain profitability.***

We have incurred losses since we were formed and expect to incur losses in the future. We incurred net losses of \$11.4 million and \$7.3 million for the three months ended March 31, 2014 and 2013, respectively. As of March 31, 2014, we had an accumulated deficit of \$138.3 million. We expect that our losses will continue for at least the next several years as we will be required to invest significant additional funds toward development and commercialization of our technology. We also expect that our selling, general and administrative expenses will continue to increase due to the additional costs associated with establishing a dedicated oncology sales force and the increased administrative costs associated with being a public company. Our ability to achieve or sustain profitability is based on numerous factors, many of which are beyond our control, including the market acceptance of our products, future product development and our market penetration and margins. We may never be able to generate sufficient revenue to achieve or sustain profitability.

***Our financial results may vary significantly from quarter to quarter which may adversely affect our stock price.***

Investors should consider our business and prospects in light of the risks and difficulties we expect to encounter in the new, uncertain and rapidly evolving markets in which we compete. Because these markets are new and evolving, predicting their future growth and size is difficult. We expect that our visibility into future sales of our products, including volumes, prices and product mix between instruments and consumables, will continue to be limited and could result in unexpected fluctuations in our quarterly and annual operating results.

Numerous other factors, many of which are outside our control, may cause or contribute to significant fluctuations in our quarterly and annual operating results. These fluctuations may make financial planning and forecasting difficult. In addition, these fluctuations may result in unanticipated changes in our available cash, which could negatively affect our business and prospects. Factors that may contribute to fluctuations in our operating results include many of the risks described in this section. In addition, one or more of such factors may cause our revenue or operating expenses in one period to be disproportionately higher or lower relative to the others. Our products involve a significant capital commitment by our customers and accordingly involve a lengthy sales cycle. We may expend significant effort in attempting to make a particular sale, which may be deferred by the customer or never occur. Accordingly, comparing our operating results on a period-to-period basis may not be meaningful, and investors should not rely on our past results as an indication of our future performance. If such fluctuations occur or if our operating results deviate from our expectations or the expectations of securities analysts, our stock price may be adversely affected.

***If we do not achieve, sustain or successfully manage our anticipated growth, our business and growth prospects will be harmed.***

We have experienced significant revenue growth in a short period of time. We may not achieve similar growth rates in future periods. Investors should not rely on our operating results for any prior periods as an indication of our future operating performance. If we are unable to maintain adequate revenue growth, our financial results could suffer and our stock price could decline. Furthermore, growth will place significant strains on our management and our operational and financial systems and processes. For example, commercialization of the Prosigna Breast Cancer Assay, or Prosigna, in Europe and the United States and development and commercialization of this test and other diagnostic products worldwide are key elements of our growth strategy and will require us to hire and retain additional sales and marketing, regulatory, manufacturing and quality assurance personnel. If we do not successfully forecast the timing of regulatory clearance or approval for product marketing in additional jurisdictions and subsequent demand

for our diagnostic products or manage our anticipated expenses accordingly, our operating results will be harmed.

***If Prosigna fails to achieve and sustain sufficient market acceptance, we will not generate expected revenue, and our prospects may be harmed.***

Commercialization of Prosigna in Europe, the United States and the other jurisdictions in which we intend to pursue regulatory approval is a key element of our strategy. Currently, most oncologists seeking sophisticated gene expression analysis for diagnosing and profiling breast cancer in their patients, ship tissue samples to a limited number of centralized laboratories typically located in the United States. We may experience reluctance, or refusal, on the part of physicians to order, and third-party payors to pay for, Prosigna if the results of our research and clinical studies, and our sales and marketing activities relating to communication of these results, do not convey to physicians, third-party payors and patients that Prosigna provides equivalent or better prognostic information. In addition, breast cancer treatment guidelines recommend that chemotherapy be considered in many cases, in combination with other patient factors. Accordingly, physicians may be reluctant to order a test, such as Prosigna, that may suggest recommending against chemotherapy. Furthermore, our diagnostic tests are performed by pathologists in local laboratories, rather than by a vendor in a remote centralized laboratory, which requires us to educate pathologists regarding the benefits of this business model and oncologists regarding the reliability and consistency of results generated locally.

These hurdles may make it difficult to convince health care providers that tests using our technologies are appropriate options for cancer diagnostics, may be equivalent or superior to available tests, and may be at least as cost effective as alternative technologies. Furthermore, we may encounter significant difficulty in gaining inclusion in breast cancer treatment guidelines, obtaining patient reimbursement from public and private payors, and gaining broad market acceptance of Prosigna. If we fail to successfully commercialize Prosigna, we may never receive a return on the significant investments in sales and marketing, regulatory, manufacturing and quality assurance personnel we have made, and further investments we intend to make, which would adversely affect our growth prospects, operating results and financial condition.

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***Our future success is dependent upon our ability to expand our customer base and introduce new applications.***

Our current customer base is primarily composed of academic institutions, government laboratories and biopharmaceutical companies that perform analyses using our nCounter Analysis System for research use only. Our success will depend, in part, upon our ability to increase our market penetration among these customers and to expand our market by developing and marketing new research applications, developing a lower cost instrument that would be attractive to more researchers, and introducing diagnostic products into clinical laboratories after obtaining regulatory authorization. For example, we must convince physicians and third-party payors that our diagnostic products, such as Prosigna, are cost effective in obtaining prognostic information that can inform treatment decisions and that our nCounter Analysis System could enable an equivalent or superior approach that lessens reliance on centralized laboratories. Furthermore, we expect that increasing the installed base of our nCounter Analysis Systems will drive demand for our relatively high margin consumable products. If we are not able to successfully increase our installed base of nCounter Analysis Systems, sales of our consumable products and our margins may not meet expectations. Attracting new customers and introducing new applications requires substantial time and expense. Any failure to expand our existing customer base, or launch new applications, would adversely affect our ability to improve our operating results.

***Our research business depends on levels of research and development spending by academic and governmental research institutions and biopharmaceutical companies, a reduction in which could limit demand for our products and adversely affect our business and operating results.***

In the near term, we expect that our revenue will be derived primarily from sales of our nCounter Analysis Systems to academic institutions, governmental laboratories and biopharmaceutical companies worldwide for research applications. The demand for our products will depend in part upon the research and development budgets of these customers, which are impacted by factors beyond our control, such as:

changes in government programs that provide funding to research institutions and companies;

macroeconomic conditions and the political climate;

changes in the regulatory environment;

differences in budgetary cycles;

market-driven pressures to consolidate operations and reduce costs; and

market acceptance of relatively new technologies, such as ours.

In addition, academic, governmental and other research institutions that fund research and development activities may be subject to stringent budgetary constraints that could result in spending reductions, reduced allocations or budget cutbacks, which could jeopardize the ability of these customers to purchase our products. Our operating results may fluctuate substantially due to reductions and delays in research and development expenditures by these customers.

Any decrease in our customers' budgets or expenditures, or in the size, scope or frequency of capital or operating expenditures, could materially and adversely affect our business, operating results and financial condition.

***Our sales cycle is lengthy and variable, which makes it difficult for us to forecast revenue and other operating results.***

Our sales process involves numerous interactions with multiple individuals within an organization, and often includes in-depth analysis by potential customers of our products, performance of proof-of-principle studies, preparation of extensive documentation and a lengthy review process. As a result of these factors, the large capital investment required in purchasing our instruments and the budget cycles of our customers, the time from initial contact with a customer to our receipt of a purchase order can vary significantly and be up to 12 months or longer. Given the length and uncertainty of our sales cycle, we have in the past experienced, and likely will in the future experience, fluctuations in our instrument sales on a period-to-period basis. In addition, any failure to meet customer expectations could result in customers choosing to retain their existing systems or to purchase systems other than ours.

***Our reliance on distributors for sales of our products outside of the United States could limit or prevent us from selling our products in foreign markets and impact our revenue.***

We have established exclusive distribution agreements for our nCounter Analysis System and related consumable products within parts of Europe, the Middle East, Asia Pacific and South America. We intend to continue to grow our business internationally, and to do so we must attract additional distributors and retain existing distributors to maximize the commercial opportunity for our products. There is no guarantee that we will be successful in attracting or retaining desirable sales and distribution partners or that we will be able to enter into such arrangements on favorable terms. Distributors may not commit the necessary resources to market and sell our products to the level of our expectations or may choose to favor marketing the products of our competitors. If current or future distributors do not perform adequately, or we are unable to enter into effective arrangements with distributors in particular geographic areas, we may not realize long-term international revenue growth.

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***If we are unable to obtain additional regulatory clearances or approvals to market Prosigna in additional countries or if regulatory limitations are placed on our diagnostic products our business and growth will be harmed. In addition, if we do not obtain additional regulatory clearances or approvals to market products other than Prosigna for diagnostic purposes, we will be limited to marketing such products for research use only.***

We have received regulatory clearance in the United States under a 510(k) for a version of our first diagnostic product, Prosigna, providing an assessment of a patient's risk of recurrence for breast cancer, and we have obtained a CE mark for Prosigna which permits us to market that assay for diagnostic purposes in Europe. We do not have regulatory clearance or approval to market any other product for diagnostic purposes or to market Prosigna for diagnostic purposes in any other market, other than Israel. Other than with respect to Prosigna in such jurisdictions, we are limited to marketing our products for research use only, which means that we cannot make any diagnostic or clinical claims. We intend to seek regulatory authorizations in other jurisdictions to market Prosigna for diagnostic purposes; however, we cannot assure investors that we will be successful in doing so. Similarly, if we do not obtain additional regulatory clearances or approvals to market future products or future indications for diagnostic purposes, if unexpected regulatory limitations are placed on our products or if we fail to successfully commercialize such products, the market potential for our diagnostic products would be constrained, and our business and growth prospects would be adversely affected.

***As part of our current business model, we will seek to enter into strategic collaborations and licensing arrangements with third parties to develop diagnostic tests.***

We have relied, and expect to continue to rely, on strategic collaborations and licensing agreements with third parties for discoveries based on which we develop diagnostic tests. For example, we licensed the rights to intellectual property that forms the basis of Prosigna from Bioclassifier, LLC, which was founded by several of our research customers engaged in translational research. We intend to enter into more such arrangements with our research customers and other researchers, including biopharmaceutical companies, for future diagnostic products. However, there is no assurance that we will be successful in doing so. In particular, our customers are not obligated to collaborate with us or license technology to us, and they may choose to develop diagnostic products themselves or collaborate with our competitors. Establishing collaborations and licensing arrangements is difficult and time-consuming. Discussions may not lead to collaborations or licenses on favorable terms, if at all. To the extent we agree to work exclusively with a party in a given area, our opportunities to collaborate with others could be limited. Potential collaborators or licensors may elect not to work with us based upon their assessment of our financial, regulatory or intellectual property position. Even if we establish new relationships, they may never result in the successful development or commercialization of future tests.

***New diagnostic product development involves a lengthy and complex process, and we may be unable to commercialize on a timely basis, or at all, any of the tests we develop.***

Few research and development projects result in successful commercial products, and success in early clinical studies often is not replicated in later studies. For example, even though the results of our clinical studies that used samples from the Arimidex, Tamoxifen, Alone or in Combination, or ATAC, study and the Austrian Breast & Colorectal Cancer Study Group 8, or ABCSG8, study of postmenopausal women with HR+ early stage breast cancer were favorable, there is no guarantee that any future studies will be successful. At any point, we may abandon development of a product candidate or we may be required to expend considerable resources repeating clinical studies, which would adversely impact potential revenue and our expenses. In addition, any delay in product development would provide others with additional time to commercialize competing products before we do, which in turn may adversely affect our growth prospects and operating results.

***Our research and development efforts will be hindered if we are not able to contract with third parties for access to archival tissue samples.***

Under standard clinical practice, tumor biopsies removed from patients are preserved and stored in formalin-fixed paraffin embedded, or FFPE, format. We rely on our ability to secure access to these archived FFPE tumor biopsy samples, as well as information pertaining to the clinical outcomes of the patients from which they were derived for our clinical development activities. Others compete with us for access to these samples. Additionally, the process of negotiating access to archived samples is lengthy because it typically involves numerous parties and approval levels to resolve complex issues such as usage rights, institutional review board approval, privacy rights, publication rights, intellectual property ownership and research parameters. If we are not able to negotiate access to archived tumor tissue samples with hospitals, clinical partners, pharmaceutical companies, or companies developing therapeutics on a timely basis, or at all, or if other laboratories or our competitors secure access to these samples before us, our ability to research, develop and commercialize future products will be limited or delayed.

***The life sciences research and diagnostic markets are highly competitive. If we fail to compete effectively, our business and operating results will suffer.***

We face significant competition in the life sciences research and diagnostics markets. We currently compete with both established and early stage life sciences research companies that design, manufacture and market instruments and consumables for gene expression analysis, single-cell analysis, polymerase chain reaction, or PCR, digital PCR, other nucleic acid detection and



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additional applications. These companies use well established laboratory techniques such as microarrays or quantitative PCR, or qPCR, as well as newer technologies such as next generation sequencing. We believe our principal competitors in the life sciences research market are Affymetrix, Agilent Technologies, Bio-Rad, Exiqon, Fluidigm, HTG Molecular Diagnostics, Illumina, Life Technologies (acquired by Thermo Fisher Scientific), Luminex, Perkin Elmer, Qiagen and Roche Applied Science. In addition, there are a number of new market entrants in the process of developing novel technologies for the life sciences market, including companies such as RainDance Technologies and Wafergen Bio-Systems.

We also compete with commercial diagnostics companies. We believe our principal competitor in the breast cancer diagnostics market is Genomic Health, which provides gene expression analysis at its central laboratory in Redwood City, California and currently commands a substantial majority of the market. We also face competition from companies such as Agendia, Clariant (a GE Healthcare company), Genoptix (a division of Novartis) and bioMérieux, which also offer services by means of centralized laboratories that profile gene or protein expression in breast cancer. In Europe, we also face regional competition from smaller companies such as Sividon Diagnostics, maker of EndoPredict, a distributed test for breast cancer recurrence, and other independent laboratories.

Most of our current competitors are either publicly traded, or are divisions of publicly-traded companies, and enjoy a number of competitive advantages over us, including:

greater name and brand recognition, financial and human resources;

broader product lines;

larger sales forces and more established distributor networks;

substantial intellectual property portfolios;

larger and more established customer bases and relationships; and

better established, larger scale, and lower cost manufacturing capabilities.

We believe that the principal competitive factors in all of our target markets include:

cost of capital equipment;

cost of consumables and supplies;

reputation among customers;

innovation in product offerings;

flexibility and ease-of-use;

accuracy and reproducibility of results; and

compatibility with existing laboratory processes, tools and methods.

We believe that additional competitive factors specific to the diagnostics market include:

breadth of clinical decisions that can be influenced by information generated by tests;

volume, quality, and strength of clinical and analytical validation data;

availability of reimbursement for testing services; and

economic benefit accrued to customers based on testing services enabled by products.

We cannot assure investors that our products will compete favorably or that we will be successful in the face of increasing competition from new products and technologies introduced by our existing competitors or new companies entering our markets. In addition, we cannot assure investors that our competitors do not have or will not develop products or technologies that currently or in the future will enable them to produce competitive products with greater capabilities or at lower costs than ours. Any failure to compete effectively could materially and adversely affect our business, financial condition and operating results.

***We have limited experience in marketing and selling our products, and if we are unable to successfully commercialize our products, our business may be adversely affected.***

We have limited experience marketing and selling our products into clinical laboratories. Our nCounter Dx Analysis System was introduced for sale in the clinical laboratory market in Europe and Israel in February 2013, and in the United States in November 2013. We sell our products through our own sales force in North America and through a combination of our own sales force and distributors in Europe, Middle East, Asia Pacific and South America. Many members of our original sales force were hired and our distributors were selected based on experience selling to research customers and not necessarily to clinical laboratories. If we are unable to market and sell our products effectively to clinical laboratories, our ability to sell diagnostic products, including Prosigna, will be adversely affected.

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Our future sales of Prosigna will depend in large part on our ability to successfully establish an oncology sales force and to increase the scope of our marketing efforts. Because we have limited experience in marketing and selling our products in the diagnostics market, our ability to forecast demand, the infrastructure required to support such demand and the sales cycle to diagnostics customers is unproven. If we do not build an efficient and effective sales force targeting this market, our business and operating results will be adversely affected.

***We may not be able to develop new products, enhance the capabilities of our systems to keep pace with rapidly changing technology and customer requirements or successfully manage the transition to new product offerings, any of which could have a material adverse effect on our business and operating results.***

Our success depends on our ability to develop new products and applications for our technology in existing and new markets, while improving the performance and cost-effectiveness of our systems. New technologies, techniques or products could emerge that might offer better combinations of price and performance than our current or future products and systems. Existing markets for our products, including gene expression analysis, single-cell analysis and copy number variation, as well as potential markets for our diagnostic product candidates, are characterized by rapid technological change and innovation. Competitors may be able to respond more quickly and effectively than we can to new or changing opportunities, technologies, standards or customer requirements. We anticipate that we will face increased competition in the future as existing companies and competitors develop new or improved products and as new companies enter the market with new technologies. It is critical to our success that we anticipate changes in technology and customer requirements and to successfully introduce new, enhanced and competitive technologies to meet our customers and prospective customers' needs on a timely and cost-effective basis. If we do not successfully innovate and introduce new technology into our product lines, our business and operating results will be adversely impacted.

Additionally, we must carefully manage the introduction of new products. If customers believe that such products will offer enhanced features or be sold for a more attractive price, they may delay purchases until such products are available. We may also have excess or obsolete inventory of older products as we transition to new products and our experience in managing product transitions is very limited. If we do not effectively manage the transitions to new product offerings, our revenues, results of operations and business will be adversely affected.

***New market opportunities may not develop as quickly as we expect, limiting our ability to successfully market and sell our products.***

The market for our products is new and evolving. Accordingly, we expect the application of our technologies to emerging opportunities will take several years to develop and mature and we cannot be certain that these market opportunities will develop as we expect. For example, in September 2013, we launched a single cell gene expression application for our nCounter Analysis System, which applies our technology to, amongst other things, improve single cell analytic workflow for gene expression analysis, and in July 2013, we launched nCounter Elements, a new digital molecular barcoding chemistry that allows users to design their own customized assays using standard sets of barcodes provided by us. The future growth of the market for these products depends on many factors beyond our control, including recognition and acceptance of our applications by the scientific community and the growth, prevalence and costs of competing methods of genomic analysis. If the markets for nCounter Elements, single cell analysis or others do not develop as we expect, our business may be adversely affected. In addition, we commercially launched Prosigna in Europe and Israel in February 2013 and we intend to offer Prosigna in other countries outside of the United States. Genomic testing for breast cancer is not widely available outside of the United States and the market for such tests is new. The future growth of the market for genomic breast cancer testing will depend on physicians' acceptance of such testing and the availability of reimbursement for such tests. Our success in these new markets will depend to a large extent on our ability to successfully market, sell and establish reimbursement for

products using our technologies. If we are not able to successfully market and sell our products or to achieve the revenue or margins we expect, our operating results may be harmed and we may not recover our product development and marketing expenditures.

***We are dependent on single source suppliers for some of the components and materials used in our products, and the loss of any of these suppliers could harm our business.***

We rely on Precision System Science, Co., Ltd of Chiba, Japan, to build our nCounter Prep Station and Korvis LLC of Corvallis, Oregon, to build our nCounter Digital Analyzer. Each of these contract manufacturers are sole suppliers. Since our contracts with these instrument suppliers do not commit them to carry inventory or make available any particular quantities, they may give other customers' needs higher priority than ours, and we may not be able to obtain adequate supplies in a timely manner or on commercially reasonable terms. We also rely on sole suppliers for various components we use to manufacture our consumable products. We periodically forecast our needs for such components and enter into standard purchase orders with them. If we were to lose such suppliers, there can be no assurance that we will be able to identify or enter into agreements with alternative suppliers on a timely basis on acceptable terms, if at all. If we should encounter delays or difficulties in securing the quality and quantity of materials we require for our products our supply chain would be interrupted which would adversely affect sales. If any of these events occur, our business and operating results could be harmed.

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***We may experience manufacturing problems or delays that could limit our growth or adversely affect our operating results***

Our consumable products are manufactured at our Seattle facility using complex processes, sophisticated equipment and strict adherence to specifications and quality systems procedures. Any unforeseen manufacturing problems, such as contamination of our facility, equipment malfunction, or failure to strictly follow procedures or meet specifications, could result in delays or shortfalls in production of our consumable products. Identifying and resolving the cause of any such manufacturing issues could require substantial time and resources. If we are unable to keep up with demand for our products by successfully manufacturing and shipping our products in a timely manner, our revenue could be impaired, market acceptance for our products could be adversely affected and our customers might instead purchase our competitors' products.

In addition, the introduction of new products may require the development of new manufacturing processes and procedures. While all of our codesets are produced using the same basic processes, significant variations may be required to meet product specifications. Developing such a process can be very time consuming, and any unexpected difficulty in doing so could delay the introduction of a product.

***If our Seattle facility becomes unavailable or inoperable, we will be unable to continue manufacturing our consumables or process sales orders, and our business will be harmed.***

We manufacture our consumable products in our facility in Seattle, Washington. In addition, our Seattle facility is the center for order processing, receipt of our prep station and digital analyzer manufactured by third-party contract manufacturers and shipping products to customers. Our facility and the equipment we use to manufacture our consumable products would be costly, and would require substantial lead time, to repair or replace. Seattle is situated near active earthquake fault lines. The facility may be harmed or rendered inoperable by natural or man-made disasters, including earthquakes and power outages, which may render it difficult or impossible for us to produce our tests for some period of time. The inability to manufacture consumables or to ship products to customers for even a short period of time may result in the loss of customers or harm our reputation, and we may be unable to regain those customers in the future. Although we possess insurance for damage to our property and the disruption of our business, this insurance, and in particular earthquake insurance, which is limited, may not be sufficient to cover all of our potential losses and may not continue to be available to us on acceptable terms, if at all.

***We expect to generate a substantial portion of our revenue internationally and are subject to various risks relating to our international activities which could adversely affect our operating results.***

For the three months ended March 31, 2014 and 2013, approximately 32% and 21% of our revenue was generated from sales to customers located outside of North America. We believe that a significant percentage of our future revenue will come from international sources as we expand our overseas operations and develop opportunities in additional areas. Engaging in international business involves a number of difficulties and risks, including:

required compliance with existing and changing foreign regulatory requirements and laws;

required compliance with anti-bribery laws, such as the U.S. Foreign Corrupt Practices Act and U.K. Bribery Act, data privacy requirements, labor laws and anti-competition regulations;

export or import restrictions;

various reimbursement and insurance regimes;

laws and business practices favoring local companies;

longer payment cycles and difficulties in enforcing agreements and collecting receivables through certain foreign legal systems;

political and economic instability;

potentially adverse tax consequences, tariffs, customs charges, bureaucratic requirements and other trade barriers;

difficulties and costs of staffing and managing foreign operations; and

difficulties protecting or procuring intellectual property rights.

As we expand internationally our results of operations and cash flows will become increasingly subject to fluctuations due to changes in foreign currency exchange rates. Historically, most of our revenue has been denominated in U.S. dollars, although we have sold our products and services in local currency outside of the United States, principally the Euro. Our expenses are generally denominated in the currencies in which our operations are located, which is primarily in the United States. As our operations in countries outside of the United States grow, our results of operations and cash flows will be subject to fluctuations due to changes in foreign currency exchange rates, which could harm our business in the future. For example, if the value of the U.S. dollar increases relative to foreign currencies, in the absence of a corresponding change in local currency prices, our revenue could be adversely affected as we convert revenue from local currencies to U.S. dollars. If we dedicate significant resources to our international operations and are unable to manage these risks effectively, our business, operating results and prospects will suffer.

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***Our ability to use net operating losses to offset future taxable income may be subject to certain limitations.***

As of December 31, 2013, we had federal net operating loss carryforwards, or NOLs, to offset future taxable income of approximately \$92.6 million, which expire in various years beginning in 2023, if not utilized. A lack of future taxable income would adversely affect our ability to utilize these NOLs. In addition, under Section 382 of the Internal Revenue Code, a corporation that undergoes an ownership change is subject to limitations on its ability to utilize its NOLs to offset future taxable income. We may have already experienced one or more ownership changes. Depending on the timing of any future utilization of our carryforwards, we may be limited as to the amount that can be utilized each year as a result of such previous ownership changes. However, we do not believe such limitations will cause our NOL and credit carryforwards to expire unutilized. In addition, future changes in our stock ownership as well as other changes that may be outside of our control, could result in additional ownership changes under Section 382 of the Internal Revenue Code. Our NOLs may also be impaired under similar provisions of state law. We have recorded a full valuation allowance related to our NOLs and other deferred tax assets due to the uncertainty of the ultimate realization of the future benefits of those assets.

***Provisions of our debt instruments may restrict our ability to pursue our business strategies.***

Our term loan agreement requires us, and any debt instruments we may enter into in the future may require us, to comply with various covenants that limit our ability to, among other things:

dispose of assets;

complete mergers or acquisitions;

incur indebtedness;

encumber assets;

pay dividends or make other distributions to holders of our capital stock;

make specified investments; engage in any new line of business; and

engage in certain transactions with our affiliates.

These restrictions could inhibit our ability to pursue our business strategies. In addition, we are subject to financial covenants based on total revenue and minimum cash balances. If we default under our term loan agreement, and such event of default is not cured or waived, the lenders could terminate commitments to lend and cause all amounts outstanding with respect to the debt to be due and payable immediately, which in turn could result in cross defaults under other debt instruments. Our assets and cash flow may not be sufficient to fully repay borrowings under all of our outstanding debt instruments if some or all of these instruments are accelerated upon a default. We may incur additional indebtedness in the future. The debt instruments governing such indebtedness could contain provisions that

are as, or more, restrictive than our existing debt instruments. If we are unable to repay, refinance or restructure our indebtedness when payment is due, the lenders could proceed against the collateral granted to them to secure such indebtedness or force us into bankruptcy or liquidation.

*Our future capital needs are uncertain and we may need to raise additional funds in the future.*

We believe that our existing cash and cash equivalents, including the funds raised in our January 2014 public offering, together with funds available under our term loan agreement, will be sufficient to meet our anticipated cash requirements for at least the next 12 months. However, we may need to raise substantial additional capital to:

expand the commercialization of our products;

fund our operations; and

further our research and development.

Our future funding requirements will depend on many factors, including:

market acceptance of our products;

the cost and timing of establishing additional sales, marketing and distribution capabilities;

the cost of our research and development activities;

the cost and timing of regulatory clearances or approvals;

the effect of competing technological and market developments; and

the extent to which we acquire or invest in businesses, products and technologies, including new licensing arrangements for new products.



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We cannot assure you that we will be able to obtain additional funds on acceptable terms, or at all. If we raise additional funds by issuing equity or equity-linked securities, our stockholders may experience dilution. Additional debt financing, if available, may involve additional covenants restricting our operations or our ability to incur additional debt. Any debt or additional equity financing that we raise may contain terms that are not favorable to us or our stockholders. If we raise additional funds through collaboration and licensing arrangements with third parties, it may be necessary to relinquish some rights to our technologies or our products, or grant licenses on terms that are not favorable to us. If we do not have, or are not able to obtain, sufficient funds, we may have to delay development or commercialization of our products or license to third parties the rights to commercialize products or technologies that we would otherwise seek to commercialize. We also may have to reduce marketing, customer support or other resources devoted to our products or cease operations. Any of these factors could harm our operating results.

### ***Acquisitions or joint ventures could disrupt our business, cause dilution to our stockholders and otherwise harm our business.***

We may acquire other businesses, products or technologies as well as pursue strategic alliances, joint ventures, technology licenses or investments in complementary businesses. We have not made any acquisitions to date, and our ability to do so successfully is unproven. Any of these transactions could be material to our financial condition and operating results and expose us to many risks, including:

disruption in our relationships with customers, distributors or suppliers as a result of such a transaction;

unanticipated liabilities related to acquired companies;

difficulties integrating acquired personnel, technologies and operations into our existing business;

diversion of management time and focus from operating our business to acquisition integration challenges;

increases in our expenses and reductions in our cash available for operations and other uses; and

possible write-offs or impairment charges relating to acquired businesses.

Foreign acquisitions involve unique risks in addition to those mentioned above, including those related to integration of operations across different cultures and languages, currency risks and the particular economic, political and regulatory risks associated with specific countries.

Also, the anticipated benefit of any acquisition may not materialize. Future acquisitions or dispositions could result in potentially dilutive issuances of our equity securities, the incurrence of debt, contingent liabilities or amortization expenses or write-offs of goodwill, any of which could harm our financial condition. We cannot predict the number, timing or size of future joint ventures or acquisitions, or the effect that any such transactions might have on our operating results.

***If we are unable to recruit, train and retain key personnel, we may not achieve our goals.***

Our future success depends on our ability to recruit, train, retain and motivate key personnel, including our senior management, research and development, manufacturing and sales and marketing personnel. Competition for qualified personnel is intense, particularly in the Seattle, Washington area. Our growth depends, in particular, on attracting, retaining and motivating highly-trained sales personnel with the necessary scientific background and ability to understand our systems at a technical level to effectively identify and sell to potential new customers. In particular, the commercial launch of Prosigna requires us to establish a dedicated oncology sales force to fully optimize the breast cancer diagnostic market opportunity. We do not maintain fixed term employment contracts or key man life insurance with any of our employees. Because of the complex and technical nature of our products and the dynamic market in which we compete, any failure to attract, train, retain and motivate qualified personnel could materially harm our operating results and growth prospects.

***Undetected errors or defects in our products could harm our reputation, decrease market acceptance of our products or expose us to product liability claims.***

Our products may contain undetected errors or defects when first introduced or as new versions are released. Disruptions or other performance problems with our products may damage our customers' businesses and could harm our reputation. If that occurs, we may incur significant costs, the attention of our key personnel could be diverted, or other significant customer relations problems may arise. We may also be subject to warranty and liability claims for damages related to errors or defects in our products. A material liability claim or other occurrence that harms our reputation or decreases market acceptance of our products could adversely impact our business and operating results.

The sale and use of products or services based on our technologies, or activities related to our research and clinical studies, could lead to the filing of product liability claims if someone were to allege that one of our products contained a design or manufacturing defect which resulted in the failure to adequately perform the analysis for which it was designed. A product liability claim could result in substantial damages and be costly and time consuming to defend, either of which could materially harm our business or financial condition. We cannot assure investors that our product liability insurance would adequately protect our assets from the financial impact of defending a product liability claim. Any product liability claim brought against us, with or without merit, could increase our product liability insurance rates or prevent us from securing insurance coverage in the future.

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*We face risks related to handling of hazardous materials and other regulations governing environmental safety.*

Our operations are subject to complex and stringent environmental, health, safety and other governmental laws and regulations that both public officials and private individuals may seek to enforce. Our activities that are subject to these regulations include, among other things, our use of hazardous materials and the generation, transportation and storage of waste. We could discover that we or an acquired business is not in material compliance with these regulations. Existing laws and regulations may also be revised or reinterpreted, or new laws and regulations may become applicable to us, whether retroactively or prospectively, that may have a negative effect on our business and results of operations. It is also impossible to eliminate completely the risk of accidental environmental contamination or injury to individuals. In such an event, we could be liable for any damages that result, which could adversely affect our business.

**Risks Related to Government Regulation and Diagnostic Product Reimbursement**

*Our research use only products for the research market could become subject to regulation as medical devices by the FDA or other regulatory agencies in the future which could increase our costs and delay our commercialization efforts, thereby materially and adversely affecting our business and results of operations.*

In the United States, most of our products are currently labeled and sold for research use only, or RUO, and not for the diagnosis or treatment of disease, and are sold to pharmaceutical and biotechnology companies, academic institutions and research laboratories. Because such products are not intended for use in clinical practice in diagnostics, and the products cannot include clinical or diagnostic claims, they are not subject to regulation by the FDA as medical devices. In particular, while the FDA regulations require that RUO products be labeled, For Research Use Only. Not for use in diagnostic procedures, the regulations do not subject such products to the FDA's pre- and post-market controls for medical devices. In November 2013, the FDA issued a final guidance on RUO products, which, among other things, reaffirmed that a company may not make clinical or diagnostic claims about an RUO product. Although not suggested in the final RUO guidance, if in the future the FDA modifies its approach to regulating our products labeled for research use only, it could reduce our revenue or increase our costs and adversely affect our business, prospects, results of operations or financial condition. In the event that the FDA requires marketing authorization of our RUO products in the future, there can be no assurance that the FDA will ultimately grant any clearance or approval requested by us in a timely manner, or at all.

In addition, we sell dual-use instruments with software that have both FDA-cleared functions and research functions, for which FDA approval or clearance is not required. Dual-use instruments are subject to FDA regulation since they are intended, at least in part, for use by customers performing clinical diagnostic testing. There is a risk that the FDA could take enforcement action against a manufacturer for distributing dual-use instruments if the FDA determines that approval or clearance was required for those functions for which FDA approval or clearance has not been obtained, and the instruments are being sold off-label. There is also a risk that the FDA could broaden its current regulatory enforcement of dual-use instruments through additional FDA oversight.

*Our GPRs may be used by clinical laboratories to create Laboratory Developed Tests, which could in the future be the subject of additional FDA regulation as medical devices, which could materially and adversely affect our business and results of operations.*

Recently, we launched nCounter Elements, a new digital molecular barcoding chemistry that allows users to design their own customized assays using standard sets of barcodes provided by us with the laboratories' choice of oligonucleotide probes. In July 2013, we listed nCounter Elements as General Purpose Reagents with the FDA. GPRs are classified as Class I medical devices, and may be used in conjunction with appropriate analyte specific reagents

and other general purpose reagents to create diagnostic test procedures or test systems.

A clinical laboratory can use GPRs to create what is called a Laboratory Developed Test. Laboratory Developed Tests are diagnostic tests that are developed and performed by a laboratory and include genetic tests and other tests for rare conditions. In June 2013, the Commissioner of the FDA stated that the FDA intends to further regulate Laboratory Developed Tests; however, it is unclear whether, when and to what extent the FDA will do so. Restrictions on Laboratory Developed Tests by the FDA could restrict the demand for our products, including nCounter Elements. Additionally, compliance with additional regulatory burdens could be time consuming and costly. If the FDA regulates Laboratory Developed Tests or further defines or limits the acceptability of the raw materials used to make Laboratory Developed Tests, such regulation could adversely affect our prospects, results of operations and financial condition.

***Approval and/or clearance by the FDA and foreign regulatory authorities for our diagnostic tests will take significant time and require significant research, development and clinical study expenditures and ultimately may not succeed.***

Before we begin to label and market our products for use as clinical diagnostics in the United States, thereby subjecting them to FDA regulation as medical devices, unless an exemption applies, we are required to obtain either prior 510(k) clearance or prior pre-market approval, or PMA, from the FDA. In September 2013, we received FDA 510(k) clearance for Prosigna as a prognostic indicator for distant recurrence-free survival at 10 years in post-menopausal women with Stage I/II lymph node-negative or Stage II lymph node-positive (1-3 positive nodes) hormone receptor-positive breast cancer who have undergone surgery in conjunction with locoregional treatment and consistent with standard of care. In the future we plan to submit a separate application for approval of Prosigna to report intrinsic subtype and we expect that this application will require a PMA supported by additional clinical studies.

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We intend to pursue additional intended uses for Prosigna, which may require more burdensome regulatory processes than the 510(k) clearance process, including PMAs. Even if granted, a 510(k) clearance or PMA approval for any future product would likely place substantial restrictions on how our device is marketed or sold, and the FDA will continue to place considerable restrictions on our products, including, but not limited to, quality system regulations, registering manufacturing facilities, listing the products with the FDA, and complying with labeling, marketing, complaint handling, adverse event and medical device reporting requirements and corrections and removals. Obtaining FDA clearance or approval for diagnostics can be expensive and uncertain, and generally takes from several months to several years, and generally requires detailed and comprehensive scientific and clinical data. Notwithstanding the expense, these efforts may never result in FDA approval or clearance. Even if we were to obtain regulatory approval or clearance, it may not be for the uses we believe are important or commercially attractive, in which case we would not be permitted to market our product for those uses.

Sales of our diagnostic products outside the United States are subject to foreign regulatory requirements governing clinical studies, vigilance reporting, marketing approval, manufacturing, product licensing, pricing and reimbursement. These regulatory requirements vary greatly from country to country. As a result, the time required to obtain approvals outside the United States may differ from that required to obtain FDA approval, and we may not be able to obtain foreign regulatory approvals on a timely basis or at all. Approval by the FDA does not ensure approval by regulatory authorities in other countries, and approval by one foreign regulatory authority does not ensure approval by regulatory authorities in other countries or by the FDA, and foreign regulatory authorities could require additional testing. In addition, FDA regulates exports of medical devices. Failure to comply with these regulatory requirements or to obtain required approvals could impair our ability to commercialize our diagnostic products outside of the United States.

***We expect to rely on third parties in conducting any future studies of our diagnostic products that may be required by the FDA or other regulatory authorities, and those third parties may not perform satisfactorily.***

We do not have the ability to independently conduct the clinical studies or other studies that may be required to obtain FDA and other regulatory clearance or approval for our diagnostic products, including Prosigna. Accordingly, we expect to rely on third parties, such as medical institutions, clinical investigators and consultants, to conduct such studies. Our reliance on these third parties for clinical development activities will reduce our control over these activities. These third-party contractors may not complete activities on schedule or conduct studies in accordance with regulatory requirements or our study design. Our reliance on third parties that we do not control will not relieve us of any applicable requirement to prepare, and ensure compliance with, various procedures required under good clinical practices. If these third parties do not successfully carry out their contractual duties or regulatory obligations or meet expected deadlines, if the third parties need to be replaced or if the quality or accuracy of the data they obtain is compromised due to their failure to adhere to our clinical protocols or regulatory requirements or for other reasons, our studies may be extended, delayed, suspended or terminated, and we may not be able to obtain regulatory approval for our diagnostic products.

***We are subject to ongoing and extensive regulatory requirements, and our failure to comply with these requirements could substantially harm our business.***

Following our obtaining CE Mark in the EU and receipt of FDA 510(k) clearance in September 2013 for Prosigna, we are subject to ongoing ISO and FDA obligations and continued regulatory oversight and review, including routine inspections by EU Notified Bodies and by the FDA of our manufacturing facilities and compliance with requirements such as ISO 13485 and quality system regulations, which establish extensive requirements for quality assurance and control as well as manufacturing procedures; requirements pertaining to the registration of our manufacturing facilities and the listing of our devices with the FDA; continued complaint, adverse event and malfunction reporting;

corrections and removals reporting; and labeling and promotional requirements. The promotional claims we can make for Prosigna are limited to the cleared indication. For instance, in the United States the following special conditions for use are listed in the intended use: Prosigna is not intended for diagnosis, to predict or detect response to therapy or to help select the optimal therapy for patients. We may also be subject to additional FDA post-marketing obligations or requirements by the FDA to change our current product classifications which would impose additional regulatory obligations on us. If we are not able to maintain regulatory compliance, we may not be permitted to market our diagnostic products and/or may be subject to enforcement by EU Competent Authorities and the FDA such as the issuance of warning or untitled letters, fines, injunctions, and civil penalties; recall or seizure of products; operating restrictions; and criminal prosecution. In addition, we may be subject to similar regulatory regimes of foreign jurisdictions as we continue to commercialize our products in new markets. Adverse Notified Body, EU Competent Authority or FDA action in any of these areas could significantly increase our expenses and limit our revenue and profitability.

***If Medicare and other third-party payors in the United States and foreign countries do not approve reimbursement for diagnostic tests enabled by our technology, the commercial success of our diagnostic products would be compromised.***

Successful commercialization of our diagnostic products depends, in large part, on the availability of adequate reimbursement for testing services that our diagnostic products enable from government insurance plans, managed care organizations and private insurance plans. There is significant uncertainty surrounding third-party reimbursement for the use of tests that incorporate new technology, such as Prosigna. If we are unable to obtain positive policy decisions from third-party payors approving reimbursement for our tests at adequate levels, the commercial success of our products would be compromised and our

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revenue would be significantly limited. Even if we do obtain reimbursement for our tests, Medicare, Medicaid and private and other payors may withdraw their coverage policies, cancel their contracts with us at any time, review and adjust the rate of reimbursement, require co-payments from patients or stop paying for our tests, which would reduce revenue for testing services based on our technology, and indirectly, demand for diagnostic products. In addition, insurers, including managed care organizations as well as government payors such as Medicare and Medicaid, have increased their efforts to control the cost, utilization and delivery of healthcare services, which may include decreased coverage or reduced reimbursement. From time to time, Congress has considered and implemented changes to the Medicare fee schedules in conjunction with budgetary legislation, and pricing and payment terms, including the possible requirement of a patient co-payment for Medicare beneficiaries for tests covered by Medicare, and are subject to change at any time. Reductions in the reimbursement rate of third-party payors have occurred and may occur in the future. Reductions in the prices at which testing services based on our technology are reimbursed could have a negative impact on our revenue.

In many countries outside of the United States, various coverage, pricing and reimbursement approvals are required. We expect that it will take several years to establish broad coverage and reimbursement for testing services based on our products with payors in countries outside of the United States, and our efforts may not be successful.

***We may be subject, directly or indirectly, to federal and state healthcare fraud and abuse laws and other federal and state laws applicable to our marketing practices. If we are unable to comply, or have not complied, with such laws, we could face substantial penalties.***

As we begin commercializing Prosigna and any other potential diagnostic products in the United States, our operations will be directly, or indirectly through our customers, subject to various federal and state fraud and abuse laws, including, without limitation, the federal and state anti-kickback statutes and state and federal marketing compliance laws and gift bans. These laws may impact, among other things, our proposed sales and marketing and education programs and require us to implement additional internal systems for tracking certain marketing expenditures and reporting them to government authorities. In addition, we may be subject to patient privacy regulation by both the federal government and the states in which we conduct our business. The laws that may affect our ability to operate include:

the federal Anti-kickback Law and state anti-kickback prohibitions;

the federal physician self-referral prohibition, commonly known as the Stark Law, and the state equivalents;

the federal Health Insurance Portability and Accountability Act of 1996, as amended;

the Medicare civil money penalty and exclusion requirements;

the federal False Claims Act civil and criminal penalties and state equivalents; and

state physician gift bans and marketing expenditure laws.

If our operations are found to be in violation of any of the laws described above or any other governmental regulations that apply to us, we may be subject to penalties, including civil and criminal penalties, damages, fines and the curtailment or restructuring of our operations, any of which could adversely affect our ability to operate our business and our results of operations.

***Healthcare policy changes, including legislation reforming the United States healthcare system, may have a material adverse effect on our financial condition and results of operations.***

The Patient Protection and Affordable Care Act, as amended by the Health Care and Education Affordability Reconciliation Act, collectively, the PPACA, enacted in March 2010, makes changes that are expected to significantly impact the pharmaceutical and medical device industries and clinical laboratories. Beginning in 2013, each medical device manufacturer must pay a sales tax in an amount equal to 2.3% of the price for which such manufacturer sells its medical devices. The new tax applies to our listed medical device products, which include the nCounter Dx Analysis System, Prosigna in vitro diagnostic kits and nCounter Elements GPRs. The PPACA also mandates a reduction in payments for clinical laboratory services paid under the Medicare Clinical Laboratory Fee Schedule of 1.75% for the years 2011 through 2015 and a productivity adjustment to the Clinical Laboratory Fee Schedule. These or any future proposed or mandated reductions in payments may apply to some or all of the clinical laboratory tests that our customers use our technology to deliver to Medicare beneficiaries, and may indirectly reduce demand for our products.

Other significant measures contained in the PPACA include coordination and promotion of research on comparative clinical effectiveness of different technologies and procedures, initiatives to revise Medicare payment methodologies, such as bundling of payments across the continuum of care by providers and physicians, and initiatives to promote quality indicators in payment methodologies. The PPACA also includes significant new fraud and abuse measures, including required disclosures of financial arrangements with physician customers, lower thresholds for violations and increasing potential penalties for such violations. In addition, the PPACA establishes an Independent Payment Advisory Board, or IPAB, to reduce the per capita rate of growth in Medicare spending. The IPAB has broad discretion to propose policies to reduce health care expenditures, which may have a negative impact on payment rates for services, including our tests. The IPAB proposals may impact payments for clinical laboratory services that our customers use our technology to deliver beginning in 2016 and for hospital services beginning in 2020, and may indirectly reduce demand for our products.



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In addition to the PPACA, the effect of which cannot presently be quantified, various healthcare reform proposals have also emerged from federal and state governments. Changes in healthcare policy, such as the creation of broad test utilization limits for diagnostic products in general or requirements that Medicare patients pay for portions of clinical laboratory tests or services received, could substantially impact the sales of our tests, increase costs and divert management's attention from our business. Such co-payments by Medicare beneficiaries for laboratory services were discussed as possible cost savings for the Medicare program as part of the debt ceiling budget discussions in mid-2011 and may be enacted in the future. In addition, sales of our tests outside of the United States will subject us to foreign regulatory requirements, which may also change over time.

We cannot predict whether future healthcare initiatives will be implemented at the federal or state level or in countries outside of the United States in which we may do business, or the effect any future legislation or regulation will have on us. The taxes imposed by the new federal legislation and the expansion in government's effect on the United States healthcare industry may result in decreased profits to us, lower reimbursements by payors for our products or reduced medical procedure volumes, all of which may adversely affect our business, financial condition and results of operations.

## **Risks Related to Intellectual Property**

*If we are unable to protect our intellectual property effectively, our business would be harmed.*

We rely on patent protection as well as trademark, copyright, trade secret and other intellectual property rights protection and contractual restrictions to protect our proprietary technologies, all of which provide limited protection and may not adequately protect our rights or permit us to gain or keep any competitive advantage. As of March 31, 2014, we owned or exclusively licensed [seven] issued U.S. patents and approximately [23] pending U.S. patent applications, including provisional and non-provisional filings. We also owned or licensed approximately [73] pending and granted counterpart applications worldwide, including [22] country-specific validations of [four] European patents. If we fail to protect our intellectual property, third parties may be able to compete more effectively against us and we may incur substantial litigation costs in our attempts to recover or restrict use of our intellectual property.

We cannot assure investors that any of our currently pending or future patent applications will result in issued patents, and we cannot predict how long it will take for such patents to be issued. Further, we cannot assure investors that other parties will not challenge any patents issued to us or that courts or regulatory agencies will hold our patents to be valid or enforceable. We cannot guarantee investors that we will be successful in defending challenges made against our patents and patent applications. Any successful third-party challenge to our patents could result in the third party or the unenforceability or invalidity of such patents.

The patent positions of life sciences companies can be highly uncertain and involve complex legal and factual questions for which important legal principles remain unresolved. No consistent policy regarding the breadth of claims allowed in such companies' patents has emerged to date in the United States. Furthermore, in the biotechnology field, courts frequently render opinions that may affect the patentability of certain inventions or discoveries, including opinions that may affect the patentability of methods for analyzing or comparing DNA.

In particular, the patent positions of companies engaged in development and commercialization of genomic diagnostic tests, like Prosigna, are particularly uncertain. Various courts, including the U.S. Supreme Court, have recently rendered decisions that impact the scope of patentability of certain inventions or discoveries relating to genomic diagnostics. Specifically these decisions stand for the proposition that patent claims that recite laws of nature (for example, the relationships between gene expression levels and the likelihood of risk of recurrence of cancer) are not

themselves patentable unless those patent claims have sufficient additional features that provide practical assurance that the processes are genuine inventive applications of those laws rather than patent drafting efforts designed to monopolize the law of nature itself. What constitutes a sufficient additional feature is uncertain. Accordingly, this evolving case law in the United States may adversely impact our ability to obtain new patents and may facilitate third-party challenges to our existing owned and licensed patents. One of our main areas of intellectual property, namely patents we license directed to the use of gene expression markers as part of genomic diagnostic tests, may be affected by these decisions.

The laws of some non-U.S. countries do not protect intellectual property rights to the same extent as the laws of the United States, and many companies have encountered significant problems in protecting and defending such rights in foreign jurisdictions. The legal systems of certain countries, particularly certain developing countries, do not favor the enforcement of patents and other intellectual property protection, particularly those relating to biotechnology, which could make it difficult for us to stop the infringement of our patents. Proceedings to enforce our patent rights in foreign jurisdictions could result in substantial cost and divert our efforts and attention from other aspects of our business.

Changes in either the patent laws or in interpretations of patent laws in the United States or other countries may diminish the value of our intellectual property. We cannot predict the breadth of claims that may be allowed or enforced in our patents or in third-party patents. For example:

We might not have been the first to make the inventions covered by each of our pending patent applications.

We might not have been the first to file patent applications for these inventions.

Others may independently develop similar or alternative products and technologies or duplicate any of our products and technologies.

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It is possible that our pending patent applications will not result in issued patents, and even if they issue as patents, they may not provide a basis for commercially viable products, may not provide us with any competitive advantages, or may be challenged and invalidated by third parties.

We may not develop additional proprietary products and technologies that are patentable.

The patents of others may have an adverse effect on our business.

We apply for patents covering our products and technologies and uses thereof, as we deem appropriate. However, we may fail to apply for patents on important products and technologies in a timely fashion or at all.

In addition to pursuing patents on our technology, we take steps to protect our intellectual property and proprietary technology by entering into confidentiality agreements and intellectual property assignment agreements with our employees, consultants, corporate partners and, when needed, our advisors. Such agreements may not be enforceable or may not provide meaningful protection for our trade secrets or other proprietary information in the event of unauthorized use or disclosure or other breaches of the agreements, and we may not be able to prevent such unauthorized disclosure. Monitoring unauthorized disclosure is difficult, and we do not know whether the steps we have taken to prevent such disclosure are, or will be, adequate. If we were to enforce a claim that a third party had illegally obtained and was using our trade secrets, it would be expensive and time consuming, and the outcome would be unpredictable. In addition, courts outside the United States may be less willing to protect trade secrets.

In addition, competitors could purchase our products and attempt to replicate some or all of the competitive advantages we derive from our development efforts, willfully infringe our intellectual property rights, design around our protected technology or develop their own competitive technologies that fall outside of our intellectual property rights. If our intellectual property is not adequately protected so as to protect our market against competitors' products and methods, our competitive position could be adversely affected, as could our business.

We have not yet registered certain of our trademarks, including Prosigna, in all of our potential markets. If we apply to register these trademarks, our applications may not be allowed for registration, and our registered trademarks may not be maintained or enforced. In addition, opposition or cancellation proceedings may be filed against our trademark applications and registrations, and our trademarks may not survive such proceedings. If we do not secure registrations for our trademarks, we may encounter more difficulty in enforcing them against third parties than we otherwise would.

To the extent our intellectual property, including licensed intellectual property, offers inadequate protection, or is found to be invalid or unenforceable, we would be exposed to a greater risk of direct competition. If our intellectual property does not provide adequate protection against our competitors' products, our competitive position could be adversely affected, as could our business. Both the patent application process and the process of managing patent disputes can be time consuming and expensive.

***We depend on certain technologies that are licensed to us. We do not control these technologies and any loss of our rights to them could prevent us from selling our products.***

We rely on licenses in order to be able to use various proprietary technologies that are material to our business, including our core digital molecular barcoding technology licensed from the Institute for Systems Biology and

technology relating to Prosigna licensed from Bioclassifier, LLC. We do not own the patents that underlie these licenses. Our rights to use these technologies and employ the inventions claimed in the licensed patents are subject to the continuation of and compliance with the terms of those licenses.

In some cases, we do not control the prosecution, maintenance, or filing of the patents to which we hold licenses, or the enforcement of these patents against third parties. Some of our patents and patent applications were either acquired from another company who acquired those patents and patent applications from yet another company, or are licensed from a third party. Thus, these patents and patent applications are not written by us or our attorneys, and we did not have control over the drafting and prosecution. The former patent owners and our licensors might not have given the same attention to the drafting and prosecution of these patents and applications as we would have if we had been the owners of the patents and applications and had control over the drafting and prosecution. We cannot be certain that drafting or prosecution of the licensed patents and patent applications by the licensors have been or will be conducted in compliance with applicable laws and regulations or will result in valid and enforceable patents and other intellectual property rights.

Enforcement of our licensed patents or defense of any claims asserting the invalidity of these patents is often subject to the control or cooperation of our licensors. Certain of our licenses contain provisions that allow the licensor to terminate the license upon specific conditions. Our rights under the licenses are subject to our continued compliance with the terms of the license, including the payment of royalties due under the license. Because of the complexity of our products and the patents we have licensed, determining the scope of the license and related royalty obligation can be difficult and can lead to disputes between us and the licensor. An unfavorable resolution of such a dispute could lead to an increase in the royalties payable pursuant to the license or termination of the license. If a licensor believed we were not paying the royalties due under the license or were otherwise not in compliance with the terms of the license, the licensor might attempt to revoke the license. If such an attempt were successful, we might be barred from producing and selling some or all of our products.

In addition, certain of the patents we have licensed relate to technology that was developed with U.S. government grants. Federal regulations impose certain domestic manufacturing requirements with respect to some of our products embodying these patents.

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*We may be involved in lawsuits to protect or enforce our patents and proprietary rights, to determine the scope, coverage and validity of others' proprietary rights, or to defend against third-party claims of intellectual property infringement, any of which could be time-intensive and costly and may adversely impact our business or stock price.*

We have received notices of claims of infringement and misappropriation or misuse of other parties' proprietary rights in the past and may from time to time receive additional notices. Some of these claims may lead to litigation. We cannot assure investors that we will prevail in such actions, or that other actions alleging misappropriation or misuse by us of third-party trade secrets, infringement by us of third-party patents and trademarks or other rights, or the validity of our patents, trademarks or other rights, will not be asserted or prosecuted against us.

Litigation may be necessary for us to enforce our patent and proprietary rights or to determine the scope, coverage and validity of the proprietary rights of others. Litigation could result in substantial legal fees and could adversely affect the scope of our patent protection. The outcome of any litigation or other proceeding is inherently uncertain and might not be favorable to us, and we might not be able to obtain licenses to technology that we require. Even if such licenses are obtainable, they may not be available at a reasonable cost. We could therefore incur substantial costs related to royalty payments for licenses obtained from third parties, which could negatively affect our gross margins. Further, we could encounter delays in product introductions, or interruptions in product sales, as we develop alternative methods or products. In addition, if we resort to legal proceedings to enforce our intellectual property rights or to determine the validity, scope and coverage of the intellectual property or other proprietary rights of others, the proceedings could be burdensome and expensive, even if we were to prevail. Any litigation that may be necessary in the future could result in substantial costs and diversion of resources and could have a material adverse effect on our business, operating results or financial condition.

As we move into new markets and applications for our products, incumbent participants in such markets may assert their patents and other proprietary rights against us as a means of slowing our entry into such markets or as a means to extract substantial license and royalty payments from us. Our competitors and others may now and in the future have significantly larger and more mature patent portfolios than we currently have. In addition, future litigation may involve patent holding companies or other adverse patent owners who have no relevant product revenue and against whom our own patents may provide little or no deterrence or protection. Therefore, our commercial success may depend in part on our non-infringement of the patents or proprietary rights of third parties. We are aware of a third party, Genomic Health, Inc., that has issued patents and pending patent applications in the United States, Europe and other jurisdictions that claim methods of using certain genes that are included in Prosigna. We believe that Prosigna does not infringe any valid issued claim. Numerous significant intellectual property issues have been litigated, and will likely continue to be litigated, between existing and new participants in our existing and targeted markets and competitors may assert that our products infringe their intellectual property rights as part of a business strategy to impede our successful entry into those markets. Third parties may assert that we are employing their proprietary technology without authorization. In addition, our competitors and others may have patents or may in the future obtain patents and claim that use of our products infringes these patents. We could incur substantial costs and divert the attention of our management and technical personnel in defending against any of these claims. Parties making claims against us may be able to obtain injunctive or other relief, which could block our ability to develop, commercialize and sell products, and could result in the award of substantial damages against us. In the event of a successful claim of infringement against us, we may be required to pay damages and obtain one or more licenses from third parties, or be prohibited from selling certain products. We may not be able to obtain these licenses at a reasonable cost, if at all. We could therefore incur substantial costs related to royalty payments for licenses obtained from third parties, which could negatively affect our gross margins. In addition, we could encounter delays in product introductions while we attempt to develop alternative methods or products to avoid infringing third-party patents or proprietary rights. Defense of any lawsuit or failure to obtain any of these licenses on favorable terms could prevent us from commercializing products,

and the prohibition of sale of any of our products could materially affect our ability to grow and gain market acceptance for our products.

Furthermore, because of the substantial amount of discovery required in connection with intellectual property litigation, there is a risk that some of our confidential information could be compromised by disclosure during this type of litigation. In addition, during the course of this kind of litigation, there could be public announcements of the results of hearings, motions or other interim proceedings or developments. If securities analysts or investors perceive these results to be negative, it could have a substantial adverse effect on the price of our common stock.

In addition, our agreements with some of our suppliers, distributors, customers and other entities with whom we do business require us to defend or indemnify these parties to the extent they become involved in infringement claims against us, including the claims described above. We could also voluntarily agree to defend or indemnify third parties in instances where we are not obligated to do so if we determine it would be important to our business relationships. If we are required or agree to defend or indemnify any of these third parties in connection with any infringement claims, we could incur significant costs and expenses that could adversely affect our business, operating results, or financial condition.

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***We may be subject to damages resulting from claims that we or our employees have wrongfully used or disclosed alleged trade secrets of our employees former employers.***

Many of our employees were previously employed at universities or other life sciences companies, including our competitors or potential competitors. Although no claims against us are currently pending, we may be subject to claims that these employees or we have inadvertently or otherwise used or disclosed trade secrets or other proprietary information of their former employers. Litigation may be necessary to defend against these claims. If we fail in defending such claims, in addition to paying monetary damages, we may lose valuable intellectual property rights. A loss of key research personnel work product could hamper or prevent our ability to commercialize certain potential products, which could severely harm our business. Even if we are successful in defending against these claims, litigation could result in substantial costs and be a distraction to management.

***Our products contain third-party open source software components, and failure to comply with the terms of the underlying open source software licenses could restrict our ability to sell our products.***

Our products contain software tools licensed by third-party authors under open source licenses. Use and distribution of open source software may entail greater risks than use of third-party commercial software, as open source licensors generally do not provide warranties or other contractual protections regarding infringement claims or the quality of the code. Some open source licenses contain requirements that we make available source code for modifications or derivative works we create based upon the type of open source software we use. If we combine our proprietary software with open source software in a certain manner, we could, under certain open source licenses, be required to release the source code of our proprietary software to the public. This would allow our competitors to create similar products with less development effort and time and ultimately could result in a loss of product sales.

Although we monitor our use of open source software to avoid subjecting our products to conditions we do not intend, the terms of many open source licenses have not been interpreted by U.S. courts, and there is a risk that these licenses could be construed in a way that could impose unanticipated conditions or restrictions on our ability to commercialize our products. Moreover, we cannot assure investors that our processes for controlling our use of open source software in our products will be effective. If we are held to have breached the terms of an open source software license, we could be required to seek licenses from third parties to continue offering our products on terms that are not economically feasible, to re-engineer our products, to discontinue the sale of our products if re-engineering could not be accomplished on a timely basis, or to make generally available, in source code form, our proprietary code, any of which could adversely affect our business, operating results, and financial condition.

***We use third-party software that may be difficult to replace or cause errors or failures of our products that could lead to lost customers or harm to our reputation.***

We use software licensed from third parties in our products. In the future, this software may not be available to us on commercially reasonable terms, or at all. Any loss of the right to use any of this software could result in delays in the production of our products until equivalent technology is either developed by us, or, if available, is identified, obtained and integrated, which could harm our business. In addition, any errors or defects in third-party software, or other third-party software failures could result in errors, defects or cause our products to fail, which could harm our business and be costly to correct. Many of these providers attempt to impose limitations on their liability for such errors, defects or failures, and if enforceable, we may have additional liability to our customers or third-party providers that could harm our reputation and increase our operating costs.

We will need to maintain our relationships with third-party software providers and to obtain software from such providers that does not contain any errors or defects. Any failure to do so could adversely impact our ability to deliver

reliable products to our customers and could harm our results of operations.

### **Risks Related to Our Common Stock**

*The price of our common stock may be volatile, and you could lose all or part of your investment.*

The trading price of our common stock has fluctuated and may continue to fluctuate substantially. The trading price of our common stock depends on a number of factors, including those described in this Risk Factors section, many of which are beyond our control and may not be related to our operating performance. These fluctuations could cause stockholders to lose all or part of their investment in our common stock. Factors that could cause fluctuations in the trading price of our common stock include the following:

actual or anticipated quarterly variation in our results of operations or the results of our competitors;

announcements by us or our competitors of new products, significant contracts, commercial relationships or capital commitments;

failure to obtain or delays in obtaining product approvals or clearances from the FDA or foreign regulators;

adverse regulatory or reimbursement announcements;

issuance of new or changed securities analysts' reports or recommendations for our stock;

developments or disputes concerning our intellectual property or other proprietary rights;

commencement of, or our involvement in, litigation;

market conditions in the research and diagnostics markets;



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manufacturing disruptions;

any future sales of our common stock or other securities;

any change to the composition of the board of directors or key personnel;

expiration of contractual lock-up agreements with our executive officers, directors and security holders;

announcements by us or our competitors of significant acquisitions, strategic partnerships, joint ventures or capital commitments;

general economic conditions and slow or negative growth of our markets; and

the other factors described in this Risk Factors section.

The stock market in general, and market prices for the securities of life sciences and diagnostic companies like ours in particular, have from time to time experienced volatility that often has been unrelated to the operating performance of the underlying companies. These broad market and industry fluctuations may adversely affect the market price of our common stock, regardless of our operating performance. In several recent situations where the market price of a stock has been volatile, holders of that stock have instituted securities class action litigation against the company that issued the stock. If any of our stockholders were to bring a lawsuit against us, the defense and disposition of the lawsuit could be costly and divert the time and attention of our management and harm our operating results.

***An active trading market for our common stock may not be sustained.***

Although our common stock is listed on The NASDAQ Global Market, the market for our shares has demonstrated varying levels of trading activity. Furthermore, the current level of trading may not be sustained in the future. The lack of an active market for our common stock may impair investors' ability to sell their shares at the time they wish to sell them or at a price that they consider reasonable, may reduce the fair market value of their shares and may impair our ability to raise capital.

***If securities or industry analysts do not publish research reports about our business, or if they issue an adverse opinion about our business, our stock price and trading volume could decline.***

The trading market for our common stock will be influenced by the research and reports that industry or securities analysts publish about us or our business. If one or more of the analysts who cover us issues an adverse opinion about our company, our stock price would likely decline. If one or more of these analysts ceases coverage of us or fails to regularly publish reports on us, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline.

***Future sales of our common stock in the public market could cause our stock price to fall.***

Our stock price could decline as a result of sales of a large number of shares of our common stock or the perception that these sales could occur. These sales, or the possibility that these sales may occur, also might make it more difficult for us to sell equity securities in the future at a time and at a price that we deem appropriate.

Holders of approximately 7.4 million shares (including shares underlying outstanding warrants), or approximately 41%, of our outstanding shares, have rights, subject to some conditions, to require us to file registration statements covering the sale of their shares or to include their shares in registration statements that we may file for ourselves or other stockholders. We have also registered the offer and sale of all shares of common stock that we may issue under our equity compensation plans.

In addition, in the future, we may issue additional shares of common stock or other equity or debt securities convertible into common stock in connection with a financing, acquisition, litigation settlement, employee arrangements or otherwise. Any such issuance could result in substantial dilution to our existing stockholders and could cause our stock price to decline.

***Our principal stockholders and management own a significant percentage of our stock and will be able to exercise significant influence over matters subject to stockholder approval.***

Our executive officers, directors and principal stockholders, together with their respective affiliates, beneficially own approximately 48% of our outstanding common stock as of March 31, 2014. Accordingly, our executive officers, directors and principal stockholders will effectively be able to determine the composition of the board of directors, approve all matters requiring stockholder approval, including mergers and other business combinations, and continue to have significant influence over our operations. This concentration of ownership could have the effect of delaying or preventing a change in our control or otherwise discouraging a potential acquirer from attempting to obtain control of us, which in turn could have a material adverse effect on our stock price and may prevent attempts by our stockholders to replace or remove the board of directors or management.

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***Our management team has broad discretion to use the net proceeds from our initial public offering and our January 2014 public offering and its investment of these proceeds may not yield a favorable return. We may invest the proceeds of these offerings in ways with which investors disagree.***

We have broad discretion as to how to spend and invest the proceeds from our initial public offering and our January 2014 public offering, and we may spend or invest these proceeds in a way with which our stockholders disagree. Accordingly, investors will need to rely on our judgment with respect to the use of these proceeds and these uses may not yield a favorable return to our stockholders. In addition, until the net proceeds are used, they may be placed in investments that do not produce significant income or that may lose value.

***Anti-takeover provisions in our charter documents and under Delaware or Washington law could make an acquisition of us difficult, limit attempts by our stockholders to replace or remove our current management and limit our stock price.***

Provisions of our certificate of incorporation and bylaws may delay or discourage transactions involving an actual or potential change in our control or change in our management, including transactions in which stockholders might otherwise receive a premium for their shares, or transactions that our stockholders might otherwise deem to be in their best interests. Therefore, these provisions could adversely affect the price of our stock. Among other things, the certificate of incorporation and bylaws:

permit the board of directors to issue up to 15,000,000 shares of preferred stock, with any rights, preferences and privileges as they may designate;

provide that the authorized number of directors may be changed only by resolution of the board of directors;

provide that all vacancies, including newly-created directorships, may, except as otherwise required by law, be filled by the affirmative vote of a majority of directors then in office, even if less than a quorum;

divide the board of directors into three classes;

provide that a director may only be removed from the board of directors by the stockholders for cause;

require that any action to be taken by our stockholders must be effected at a duly called annual or special meeting of stockholders and may not be taken by written consent;

provide that stockholders seeking to present proposals before a meeting of stockholders or to nominate candidates for election as directors at a meeting of stockholders must provide notice in writing in a timely manner, and meet specific requirements as to the form and content of a stockholder's notice;

prevent cumulative voting rights (therefore allowing the holders of a plurality of the shares of common stock entitled to vote in any election of directors to elect all of the directors standing for election, if they should so choose);

provide that special meetings of our stockholders may be called only by the chairman of the board, our chief executive officer or by the board of directors; and

provide that stockholders are permitted to amend the bylaws only upon receiving at least two-thirds of the total votes entitled to be cast by holders of all outstanding shares then entitled to vote generally in the election of directors, voting together as a single class.

In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which generally prohibits a Delaware corporation from engaging in any of a broad range of business combinations with any interested stockholder for a period of three years following the date on which the stockholder became an interested stockholder. Likewise, because our principal executive offices are located in Washington, the anti-takeover provisions of the Washington Business Corporation Act may apply to us under certain circumstances now or in the future. These provisions prohibit a target corporation from engaging in any of a broad range of business combinations with any stockholder constituting an acquiring person for a period of five years following the date on which the stockholder became an acquiring person.

***We are an emerging growth company, and any decision on our part to comply only with certain reduced reporting and disclosure requirements applicable to emerging growth companies could make our common stock less attractive to investors.***

We are an emerging growth company, as defined in the Jumpstart Our Business Startups Act, or the JOBS Act, enacted in April 2012, and, for as long as we continue to be an emerging growth company, we may choose to take advantage of exemptions from various reporting requirements applicable to other public companies but not to emerging growth companies, including, but not limited to, not being required to have our independent registered public accounting firm audit our internal control over financial reporting under Section 404, reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements, and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and stockholder approval of any golden parachute payments not previously approved. We could be an emerging growth company until December 31, 2018, although, if we have more than \$1.0 billion in annual revenue, if the market value of our common stock that is held by non-affiliates exceeds \$700 million as of June 30 of any year, or we issue more than \$1.0 billion of non-convertible debt over a three-year period before the end of that five-year period, we would cease to be an emerging growth company as of the following December 31. We cannot predict if investors will find our common stock less attractive if we choose to rely on these exemptions. If some investors find our common stock less attractive as a result of any choices to reduce future disclosure, there may be a less active trading market for our common stock and our stock price may be more volatile.

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As an emerging growth company the JOBS Act allows us to delay adoption of new or revised accounting pronouncements applicable to public companies until such pronouncements are made applicable to private companies. We have elected to use this extended transition period under the JOBS Act. As a result, our financial statements may not be comparable to the financial statements of issuers who are required to comply with the effective dates for new or revised accounting standards that are applicable to public companies, which may make our common stock less attractive to investors.

***Complying with the laws and regulations affecting public companies will increase our costs and the demands on management and could harm our operating results.***

As a public company, and particularly after we cease to be an emerging growth company, we incur and will continue to incur significant legal, accounting and other expenses that we did not incur as a private company. In addition, the Sarbanes-Oxley Act and rules subsequently implemented by the SEC and The NASDAQ Global Market impose numerous requirements on public companies, including requiring changes in corporate governance practices. Also, the Exchange Act requires, among other things, that we file annual, quarterly and current reports with respect to our business and operating results. Our management and other personnel will need to devote a substantial amount of time to compliance with these laws and regulations. These burdens may increase as new legislation is passed and implemented, including any new requirements that the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 may impose on public companies. These requirements have increased and will continue to increase our legal, accounting, and financial compliance costs and have made and will continue to make some activities more time consuming and costly. For example, we expect these rules and regulations to make it more difficult and more expensive for us to obtain director and officer liability insurance, and in the future we may be required to accept reduced policy limits and coverage or to incur substantial costs to maintain the same or similar coverage. These rules and regulations could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors or our board committees or as executive officers.

The Sarbanes-Oxley Act requires, among other things, that we assess the effectiveness of our internal control over financial reporting annually and the effectiveness of our disclosure controls and procedures quarterly. In particular, beginning January 1, 2014, Section 404 of the Sarbanes-Oxley Act, or Section 404, requires us to perform system and process evaluation and testing of our internal control over financial reporting to allow management to report on, and our independent registered public accounting firm potentially to attest to, the effectiveness of our internal control over financial reporting. As an emerging growth company, we expect to avail ourselves of the exemption from the requirement that our independent registered public accounting firm attest to the effectiveness of our internal control over financial reporting under Section 404. However, we may no longer avail ourselves of this exemption when we cease to be an emerging growth company. When our independent registered public accounting firm is required to undertake an assessment of our internal control over financial reporting, the cost of our compliance with Section 404 will correspondingly increase. Our compliance with applicable provisions of Section 404 will require that we incur substantial accounting expense and expend significant management time on compliance-related issues as we implement additional corporate governance practices and comply with reporting requirements. Moreover, if we are not able to comply with the requirements of Section 404 applicable to us in a timely manner, or if we or our independent registered public accounting firm identifies deficiencies in our internal control over financial reporting that are deemed to be material weaknesses, the market price of our stock could decline and we could be subject to sanctions or investigations by the SEC or other regulatory authorities, which would require additional financial and management resources.

Furthermore, investor perceptions of our company may suffer if deficiencies are found, and this could cause a decline in the market price of our stock. Irrespective of compliance with Section 404, any failure of our internal control over financial reporting could have a material adverse effect on our stated operating results and harm our reputation. If we

are unable to implement these requirements effectively or efficiently, it could harm our operations, financial reporting, or financial results and could result in an adverse opinion on our internal control over financial reporting from our independent registered public accounting firm.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

*(b) Use of Proceeds from Public Offering of Common Stock*

On June 25, 2013, our registration statement on Form S-1 (No. 333-188704) was declared effective for our initial public offering, and on July 1, 2013 we consummated the initial public offering consisting of 5,400,000 shares of our common stock for \$10.00 per share. As a result of the offering, we received total net proceeds of approximately \$46.8 million, after deducting total expenses of \$7.2 million, consisting of underwriting discounts and commissions of \$3.8 million and offering-related expenses of approximately \$3.4 million. No payments for such expenses were made directly or indirectly to (i) any of our officers or directors or their associates, (ii) any persons owning 10% or more of any class of our equity securities, or (iii) any of our affiliates. There has been no material change in the planned use of proceeds from our initial public offering from that described in the final Prospectus filed with the SEC pursuant to Rule 424(b)(4) on June 25, 2013.

**Table of Contents****Item 6. Exhibits and Financial Statement Schedules.***(a) Exhibits.*

<b>Exhibit Number</b>	<b>Description</b>
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a).
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a).
32.1*	Certification of Chief Executive Officer pursuant to 18 U.S.C Section 1350.
32.2*	Certification of Chief Financial Officer pursuant to 18 U.S.C Section 1350.
101.INS**	XBRL Instance Document.
101.SCH**	XBRL Taxonomy Extension Schema Document.
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF**	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB**	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document.

\* The Certifications attached as Exhibits 32.1 and 32.2 that accompany this Quarterly Report on Form 10-Q are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of NanoString Technologies, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Form 10-Q, irrespective of any general incorporation language contained in such filing.

\*\* Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files in Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

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**SIGNATURES**

Pursuant to the requirements of the Securities Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NANOSTRING TECHNOLOGIES, INC.

Date: May 15, 2014

By: /s/ R. Bradley Gray  
R. Bradley Gray  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: May 15, 2014

By: /s/ James A. Johnson  
James A. Johnson  
Chief Financial Officer  
(Principal Financial and Accounting Officer)



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