

Codexis, Inc. (CDXS)

SMALL & MID CAP RESEARCH

Guidance Unchanged, Awaiting Catalysts

- **Guidance Unchanged:** At Q2 results, management reiterated FY revenue guidance of \$94-98M and positive adjusted EBITDA for 2010. Headline net income of \$-4M was a little ahead of our \$-5M forecast. 2Q10 cash burn was \$-6M (worse than we expected) leaving cash at \$100M at the end of the quarter versus our \$109M expectation. However, the main reason for the cash shortfall was the timing of receipt of payments from Shell. This working capital effect should reverse over the balance of the year. After results, are forecasts are broadly unchanged.
- **Pace of newsflow should pick up in 2H:** (1) In pharmaceuticals, Merck has announced good results for Boceprevir, a drug that should be manufactured with a CDXS enzyme process. We also look for some newsflow regarding CDXS signing new pharma customers in Europe. (2) The Shell-Cosan JV should close soon, enabling CDXS to talk more fully about its enzyme plans for Brazil. (3) We anticipate an FID for the logen pilot plant by 1Q11. (4) We expect CDXS's progress in carbon capture should generate interest from a large manufacturer to backstop further R&D and help provide a potential route to market.
- **Valuation :** With the shares back at \$8.3, the current value is supported by cash, NOLs and placing the pharma business on just 11-16x 2013 P/E. The substantial option value in biofuels and carbon offers a good risk/reward, we think.

Rating	OUTPERFORM* [V]
Price (05 Aug 10, US\$)	8.34
Target price (US\$)	17.00 ¹
52-week price range	14.45 - 7.11
Market cap. (US\$ m)	282.43
Enterprise value (US\$ m)	248.62

*Stock ratings are relative to the relevant country benchmark.

¹Target price is for 12 months.

[V] = Stock considered volatile (see Disclosure Appendix).

Financial and valuation metrics

Year	12/09A	12/10E	12/11E	12/12E
Revenue (US\$ m)	82.9	97.7	113.4	155.4
EBIDAX (US\$ m)	—	—	—	—
EPS (CS adj.) (US\$)	-0.52	-0.32	-0.14	0.13
Prev. EPS (US\$)	—	-0.27	-0.13	0.14
ROIC (%)	-27.3	-8.5	-3.3	2.5
P/E (x)	NM	NM	NM	54.3
P/E rel. (%)	NM	NM	NM	540.1
OCFPS (US\$)	-0.20	0.11	0.31	0.67
P/OCF (x)	—	63.8	23.3	10.8
Qtrly ent. val./tot. EBIDAX	—	—	—	—
Net debt (US\$ m)	-48	-110	-102	-82
Dividend (12/09A, US\$)	—	Dividend yield (%)		—
Net debt current qtr (US\$ m)	-33.8	Net debt qtr/total mcap		-12.0
BV/share (current, US\$)	-3.7	GIC (12/10E, US\$)		—
EV qtr/GIC (x)	—	Current WACC		—
Free float (%)	—	Number of shares (m)		39.01

Source: Company data, Credit Suisse estimates

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Reiterating our Thesis

Spun out of Maxygen in 2002, Codexis is a west coast based technology company that uses advanced genetics to accelerate the development of industrial enzymes across the pharmaceutical and environmental sectors (notably biofuels, chemicals, carbon capture, and water treatment). These markets offer the prospect of strong growth potential. At the same time, after recent weakness, downside looks protected by the progress in Codexis' most mature business – pharmaceuticals.

Low Cost Option on Biofuels and Carbon

After recent weakness, at \$8.34/sh, Codexis shares are valued at just 11-16x the 2013 earnings potential from their more established pharmaceutical business alone, after adjusting for NOL's and cash. Delivery of biofuel and carbon milestones could drive the shares towards our \$17 target over time. Importantly the company's business plan is fully funded after the recent IPO.

Exhibit 1: Implied P/E Multiple of the Pharma Business After Deducting Cash and NOLs

		2013 Pharma Revenues, \$M					
Implied P/E		50	60	70	80	90	100
Multiple at	20%	26	22	18	16	14	13
Different	25%	21	17	15	13	11	10
EBIT Margins	30%	17	14	12	11	10	9
@8.34 per share							

Source: Company data, Credit Suisse estimates

Catalysts

In our initiation report, we detailed the \$10 billion market available to Codexis (and its competition) by 2020. This \$10bn market compares with our \$94-98 million forecast for 2010 Codexis revenues and suggests strong revenue growth potential. Key catalysts to provide line of sight on this revenue growth include (1) signing up additional pharmaceutical companies, (2) commercializing the existing Pharma pipeline (e.g. Boceprevir, Telaprevir, Januvia) (3) sanctioning a pilot cellulosic ethanol plant with Shell/Logen in Saskatchewan in 4Q10/1Q11, (4) closing the Shell-Cosan Brazilian ethanol joint venture in 3Q10, and (5) signing an industrial partner to backstop Codexis R&D investment in lower cost carbon capture technology. We believe newsflow on these catalysts should pick up in 2H10/early 2011.

2Q10 Newsflow

Merck has good test results with Boceprevir : On August 4th, Merck announced good test results for Boceprevir, for which Codexis hope to use their manufacturing process. "Aug. 4, 2010 – Merck today reported that two pivotal Phase III registration studies for boceprevir, its investigational oral hepatitis C protease inhibitor, have been completed and met the primary endpoints: in both studies in patients with chronic hepatitis C virus (HCV) genotype 1 infection, the addition of boceprevir to treatment with PEGINTRON® (peginterferon alfa-2b) and REBETOL® (ribavirin, USP) (Peg/riba) significantly increased the number of patients who achieved sustained virologic response (SVR; defined as undetectable virus levels 24 weeks after the end of treatment), compared to control groups that received Peg/riba plus placebo."

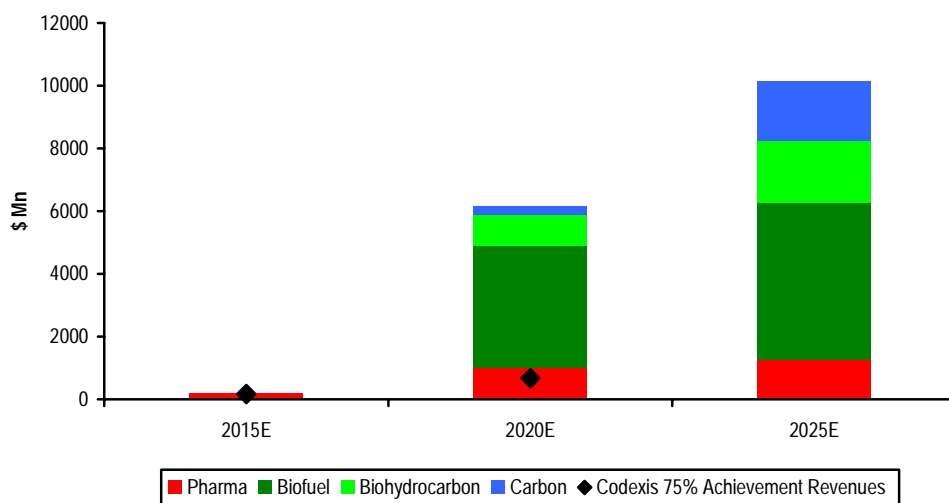
Codexis hit two 2010 Shell milestones : Codexis has hit 2 out of its 6 2010 milestones with Shell already this year, under its biofuel R&D program. Milestone payments would add around \$5-10M of revenue if they are all hit – but more importantly hitting milestones early signals progress on Codexis 2nd generation ethanol enzymes and biodiesel pathways (news of progress on the latter would be a material catalyst if released).

Codexis Unveiled Low Cost Carbon Capture : On June 23, 2010, Codexis partner CO2 Solution announced that its enzyme-based technology shows the potential to reduce the size of carbon capture equipment by more than 90% and achieve substantial reduction in process energy consumption. Given these strong demonstration results, we would expect Codexis to sign up in 2H10 or 1H11 a major manufacturer to backstop R&D expenditure and future marketing.

\$10 billion market size is the prize

In 2010, we expect Codexis to report revenues of \$98 million (at the the upper end of management's latest \$94-98 million guidance). The company is operating in a fast growing (Novozymes increased revenues by circa 10% per year since 2000) and new area. On our estimates, the end markets for Codexis enzymes could grow to as large as \$6 billion by the end of this decade and over \$10 billion by the middle of the next decade. The market size could be larger as companies such as Codexis innovate in their use of enzymes for new industrial applications. Although a long way into the future, our forecast of Codexis revenue potential in 2020 of up to \$800 million (in the high success case) would approximately represent a 15% share of these new markets. If Codexis makes faster progress in its development of enzymes for use in bio-industrial and carbon markets, the market potential could be realized earlier than the chart below indicates. Codexis could also capture a higher share of the market than we forecast.

Exhibit 2: Enzyme Market Revenues—The Prize, \$ Million



Codexis' fiscal 2010 \$94-98 million revenue compares with a \$6 billion revenue market prize in 2020 and over \$10 billion of market potential by 2025

Source: Credit Suisse estimates.

Change to Earnings Estimates

Although 2Q10 beat our estimates for revenues and earnings, Codexis highlight that gross margins may not be as strong in 2H. Overall our longer term estimates are broadly unchanged. Strategic progress is a more important driver of share performance until Codexis reach profitability in 2012. The company is well funded and does not need additional cash to fund its business plan.

Exhibit 3: Change to Earnings Estimates

	1Q10	2Q10	3Q10E	4Q10E	2010E	2011E	2012E	2013E
Net Income								
Old	-1.4	-5.0	-3.4	-0.8	-10.6	-5.2	5.8	21.1
New	-1.4	-3.9	-4.6	-2.6	-12.6	-5.5	5.5	21.4
% Change	0.0%	nm	nm	nm	nm	nm	-5.6%	1.3%
EPS								
Old	-0.04	-0.13	-0.09	-0.02	-0.27	-0.13	0.14	0.51
New	-0.04	-0.10	-0.12	-0.07	-0.32	-0.14	0.13	0.51
% Change	0.0%	nm	nm	nm	nm	4.7%	-6.0%	0.9%
Consensus Net Income					-12.8	-10.8	5.6	21.9
Versus Consensus, %					nm	nm	-2%	-2%

Source: Company data, Credit Suisse estimates

Companies Mentioned (Price as of 05 Aug 10)

Codexis, Inc. (CDXS, \$8.34, OUTPERFORM [V], TP \$17.00)

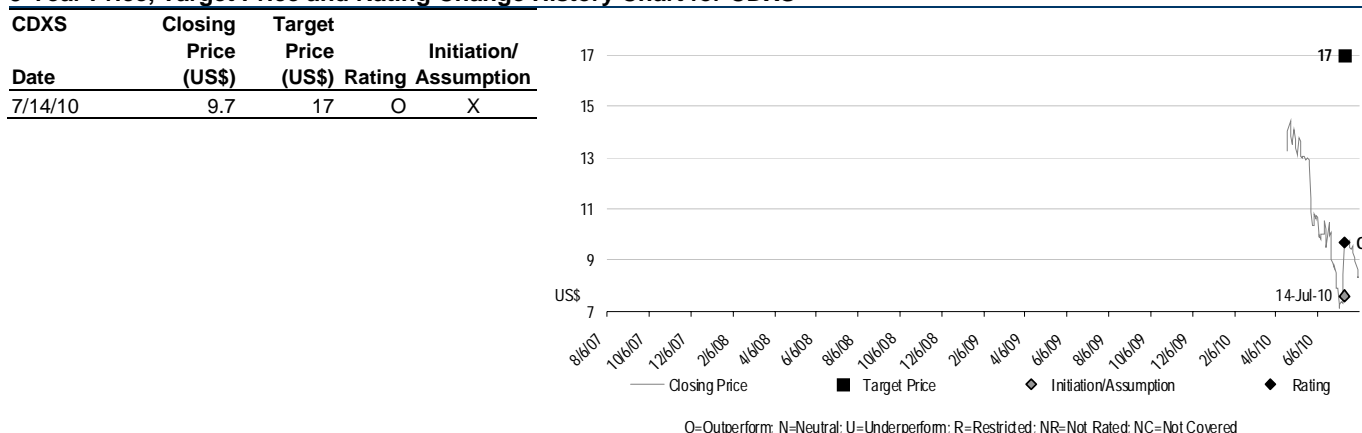
Merck & Co. (MRK, \$35.19, OUTPERFORM, TP \$46.00)

Royal Dutch Shell PLC (ADR) (RDSa.N, \$57.68, NEUTRAL, TP \$59.70, MARKET WEIGHT)

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3-Year Price, Target Price and Rating Change History Chart for CDXS

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Price Target: (12 months) for (CDXS)

Method: The valuation of Codexis stock presents a number of issues: there are a limited number of publicly traded comparables, much of the near-term revenue is effectively funded R&D, rather than underlying product sales, and we don't expect Codexis to break even until 2012. To accommodate these issues, we use several valuation methods, including a multiple-based approach and a discounted cash flow (DCF) analysis. Applying a 50% weighting to the our Mid-Success DCF derived value of \$18.1/share and a 50% weighting to the P/E derived value of \$15.8/share (19x 2014E EPS), we determine a target price of \$17/share for CDXS.

Risks: The primary risk to our \$17 target price for Codexis is that this is a relatively young company that is reliant on licensed technology and only a few customers for the bulk of its revenues and value. Other key risks include: (1) loss of any rights under the license from Maxygen, (2) reliance on pharmaceutical manufacturing innovation and FDA approvals, (3) second generation economics, (4) commercialization of pharmaceutical cost savings, and (5) competition from a substantial number of other companies, including well capitalized companies such as Novozymes, Danisco, DuPont, and DSM.

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