

Reason for report:

EARNINGS**CELLULAR DYNAMICS INTERNATIONAL****Solid Close to Year; Raising Price Target**

• **Bottom Line:** ICEL reported fourth quarter revenues roughly in line with our expectations. We have increased our price target to \$17 from \$15 but maintain our Market Perform rating.

• **4Q results roughly in line with expectations.** ICEL's 4Q revenue of \$4.2M was roughly in line with our \$4M forecast, a result which represented 41% growth year-over-year, comprised of 9% product growth and 155% growth in the collaborations, partnerships, and other category. Gross margin of 72.7% meaningfully exceeded our forecast for the second quarter in the row (68% was our estimate), but we believe gross margin will moderate to the high 60% in 2014E as new products and MyCell revenue comprise a larger proportion of the product mix.

• **Revenue from top 10 customers continues to increase.** ICEL's revenue from its top 10 customers averaged \$830k in 2013, up from \$445k in 2012 and \$179k in 2011. We believe this is a positive sign and suggests large pharma/biotech is increasingly standardizing on ICEL's products, which portends positively for future revenue growth.

• **2014 growth to be driven by continued adoption of existing products, new product launches, and MyCell.** We expect continued adoption of ICEL's existing products in 2014 should be augmented by new product launches as well as continued uptake of its MyCell offering, which launched in 2013. While product revenue has approximated ~\$2M/quarter for the past 5 quarters, we believe the new supply agreement with Nestle could help catalyze a step upward.

• **Reducing 2014 revenue forecast to reflect more conservative assumptions around stem cell banking and therapeutic partnerships.** We have removed contribution from therapeutic partnerships and additional stem cell banking agreements beyond the California Institute for Regenerative Medicine (CIRM) award from our 2014 forecast. While we fully expect such agreements will occur over the next 12 – 24 months, we thought it prudent to remove them from the baseline 2014 expectation in advance of any announcements. These sources of revenue comprised \$4.6M of our prior 2014 forecast.

• **Price target to \$17.** We believe an increase in our ICEL price target is justified by the company's recent progress on the strategic front, illustrated by its supply agreements with Nestle and the Jain Foundation, partially offset by the uncertainty of ICEL's revenue ramp. We implicitly consider ICEL's therapeutics opportunity worth ~\$2 of this valuation using comps, analysis is illustrated on the following page.

Key Stats:**(NASDAQ:ICEL)**

S&P 600 Health Care Index: **1,311.16**
Price: **\$16.04**

Price Target: \$17.00 from \$15.00

Methodology: ~6x EV/2015E revs for tools and \$2 for Rx

52 Week High: \$24.11

52 Week Low: \$9.50

Shares Outstanding (mil): 15.8

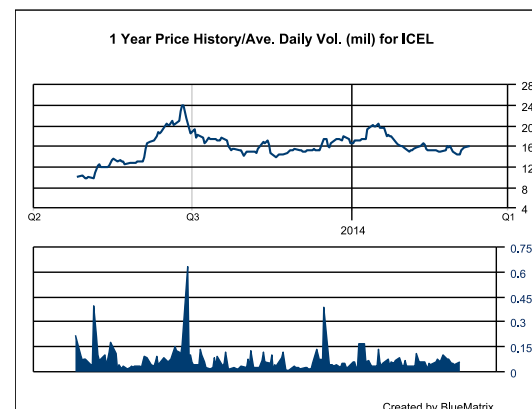
Market Capitalization (mil): \$253.4

Book Value/Share: \$5.28

Cash Per Share: \$3.94

Dividend (ann): \$0.00

Dividend Yield: 0.0%



Dec Yr	1Q	2Q	3Q	4Q	FY Rev	1Q	2Q	3Q	4Q	FY EPS	P/E
2013A	\$2.4	\$2.8	\$2.5	\$4.2	\$11.9	(\$3.28)	(\$2.92)	(\$0.62)	(\$0.43)	(\$3.19)	NM
2014E - New	\$5.3	\$5.7	\$5.4	\$6.5	\$22.8	(\$0.33)	(\$0.36)	(\$0.34)	(\$0.41)	(\$1.44)	NM
2014E - Old	--	--	--	--	\$26.3	--	--	--	--	(\$1.32)	NM
2015E - New	--	--	--	--	\$47.8	--	--	--	--	(\$0.75)	NM
2015E - Old	--	--	--	--	\$47.8	--	--	--	--	(\$0.83)	NM
2016E	--	--	--	--	\$71.0	--	--	--	--	(\$0.04)	NM

Source: Company Information and Leerink Partners LLC Research
Revenues in millions.
GAAP EPS.

INVESTMENT THESIS

ICEL is well positioned as the leading commercial supplier of differentiated human cells derived from induced pluripotent stem cells (iPSCs). We believe cells derived from iPSCs will become increasingly utilized for compound screening and toxicity testing in the biopharmaceutical industry, among other applications. Several signposts suggest the iPSC industry is poised for rapid growth. Our Market Perform rating reflects a view that risks are balanced with rewards absent greater visibility on the revenue ramp.

Stem-cell based technology platform and therapeutics companies

Company	Ticker	Current price 3/07/2014	Market Cap (\$M)
BioRestorative Therapies	BRTX	\$0.64	nm
Brainstorm Cell Therapeutics	BCLI	0.27	\$47.9
Capricor Therapeutics	CAPR	12.00	140.3
Cellular Biomedicine Group	CBMG	5.20	32.9
IntelliCell BioSciences	SVFC	0.01	9.2
International Stem Cell Corp	ISCO	0.23	30.5
StemCells Inc	STEM	1.54	84.7
VistaGen Therapeutics	VSTA	\$0.37	\$8.7
MEDIAN			\$32.9
ICEL shares (M)			15.8
Implied Rx value / share			\$2.09

Source: Leerink, FactSet; Company list from Griffin Securities fairness opinion for Medistem's acquisition by Intrexon

VALUATION

Our \$17 price target assumes an enterprise value (using projected levels of debt and cash) that is ~6x our revenue forecast for the twelve months ended Dec-2015, including ~\$0.30/share of value for the CIRM contract, which we value separately due to its fixed term. This multiple is a premium to the median Life Science Tools & Diagnostics median forward twelve month revenue multiple of 4x, which we believe appropriate given ICEL's strong growth prospects. We additionally consider ICEL's Rx opportunity worth ~\$2/share based on the median of comparable stem cell technology companies.

RISKS TO VALUATION

Risks to our price target for ICEL include, but are not limited to: the pace of adoption of its iCell products among biopharmaceutical customers, nature and timing of FDA guidance/regulations, competitive pressures from in-house and commercial producers of iPSC lines, policy decisions, and market extension into therapeutic applications.

Cellular Dynamics (ICEL)

Income Statement

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	2011	2012	Mar-13	Jun-13	Sep-13	Dec-13	2013	Mar-14e	Jun-14e	Sep-14e	Dec-14e	2014e	2015e	2016e
Revenue														
Product	\$1,460	\$5,178	\$1,754	\$1,969	\$1,793	\$2,482	\$7,998	\$2,806	\$3,150	\$2,869	\$3,971	\$12,797	\$30,564	\$45,152
Collabs, partnerships, other	<u>1,137</u>	<u>1,404</u>	<u>636</u>	<u>843</u>	<u>730</u>	<u>1,677</u>	<u>3,886</u>	<u>2,500</u>	<u>2,500</u>	<u>2,500</u>	<u>2,500</u>	<u>10,000</u>	<u>17,200</u>	<u>25,800</u>
Total revenue	2,597	6,582	2,390	2,812	2,523	4,159	11,884	5,306	5,650	5,369	6,471	22,797	47,764	70,952
COGS	<u>727</u>	<u>2,089</u>	<u>577</u>	<u>676</u>	<u>371</u>	<u>678</u>	<u>2,302</u>	<u>898</u>	<u>1,008</u>	<u>918</u>	<u>1,271</u>	<u>4,095</u>	<u>9,780</u>	<u>14,449</u>
Gross profit	1,870	4,493	1,813	2,136	2,152	3,481	9,582	4,408	4,642	4,451	5,200	18,702	37,983	56,504
SG&A	9,513	12,422	3,636	3,282	5,406	4,949	17,273	4,670	4,972	4,725	5,695	20,061	26,270	31,929
R&D	<u>13,660</u>	<u>14,301</u>	<u>3,856</u>	<u>3,911</u>	<u>3,906</u>	<u>4,899</u>	<u>16,572</u>	<u>4,723</u>	<u>5,029</u>	<u>4,778</u>	<u>5,759</u>	<u>20,289</u>	<u>22,449</u>	<u>24,124</u>
Operating income (loss)	(21,303)	(22,230)	(5,679)	(5,057)	(7,160)	(6,367)	(24,263)	(4,984)	(5,359)	(5,052)	(6,254)	(21,649)	(10,736)	451
Interest expense (income)	44	34	7	4	358	347	716	261	265	268	271	1,065	1,115	1,137
Other expense, net	<u>(3)</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>(20)</u>	<u>(1)</u>	<u>(21)</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Pretax income	(21,344)	(22,264)	(5,686)	(5,061)	(7,498)	(6,713)	(24,958)	(5,245)	(5,624)	(5,320)	(6,525)	(22,714)	(11,851)	(686)
Taxes	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Net income	(\$21,344)	(\$22,264)	(\$5,686)	(\$5,061)	(\$7,498)	(\$6,713)	(\$24,958)	(\$5,245)	(\$5,624)	(\$5,320)	(\$6,525)	(\$22,714)	(\$11,851)	(\$686)
Basic shares outstanding	1,734	1,734	1,734	1,734	12,087	15,756	7,828	15,766	15,776	15,786	15,796	15,781	15,821	15,861
Diluted shares outstanding	1,734	1,734	1,734	1,734	12,087	15,756	7,828	15,766	15,776	15,786	15,796	15,781	15,821	15,861
EPS diluted	(\$12.31)	(\$12.84)	(\$3.28)	(\$2.92)	(\$0.62)	(\$0.43)	(\$3.19)	(\$0.33)	(\$0.36)	(\$0.34)	(\$0.41)	(\$1.44)	(\$0.75)	(\$0.04)
<i>EPS growth</i>														
Sales growth		153.4%	108.6%	123.2%	104.6%	41.3%	80.6%	122.0%	100.9%	112.8%	55.6%	91.8%	109.5%	48.5%
Product gross margin	50.2%	59.7%	67.1%	65.7%	79.3%	72.7%	71.2%	68.0%	68.0%	68.0%	68.0%	68.0%	68.0%	68.0%
SG&A % of revenue	366.3%	188.7%	152.1%	116.7%	214.3%	119.0%	145.3%	88.0%	88.0%	88.0%	88.0%	88.0%	55.0%	45.0%
R&D % of revenue	526.0%	217.3%	161.3%	139.1%	154.8%	117.8%	139.4%	89.0%	89.0%	89.0%	89.0%	89.0%	47.0%	34.0%
Operating margin	(820.3%)	(337.7%)	(237.6%)	(179.8%)	(283.8%)	(153.1%)	(204.2%)	(93.9%)	(94.8%)	(94.1%)	(96.6%)	(95.0%)	(22.5%)	0.6%
Tax rate	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
D&A	\$1,366	\$1,433	\$341	\$338	\$322	\$321	\$1,322					\$1,450	\$2,172	\$2,435
EBITDA	(\$19,937)	(\$20,797)	(\$5,338)	(\$4,719)	(\$6,838)	(\$6,046)	(\$22,941)					(\$20,199)	(\$8,564)	\$2,886
Free cash flow														
Operarating cash flow	(\$19,232)	(\$21,004)	(\$4,829)	(\$4,624)	(\$6,940)	(\$4,907)	(\$21,300)					(\$21,346)	(\$12,107)	\$962
CapX	<u>(558)</u>	<u>(132)</u>	<u>(120)</u>	<u>(173)</u>	<u>(353)</u>	<u>(1,171)</u>	<u>(1,817)</u>					<u>(1,979)</u>	<u>(3,953)</u>	<u>(3,876)</u>
Free cash flow	(\$19,790)	(\$21,136)	(\$4,949)	(\$4,797)	(\$7,293)	(\$6,078)	(\$23,117)					(\$23,326)	(\$16,060)	(\$2,913)

Notes:

Source: Company reports and Leerink Partners estimates

Disclosures Appendix

Analyst Certification

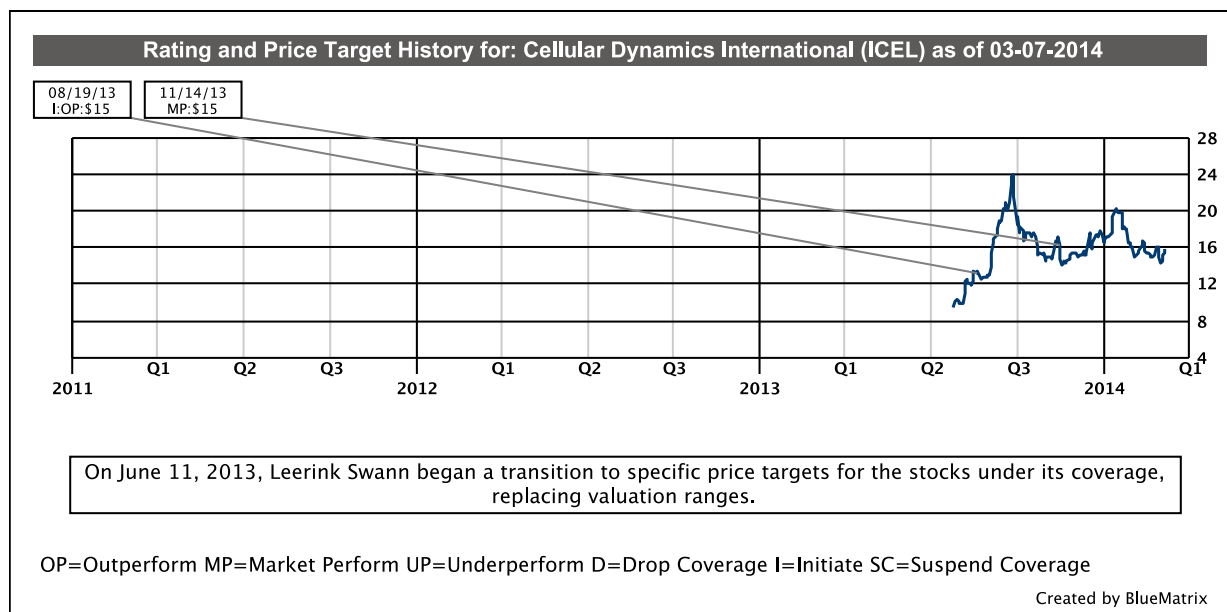
I, Dan Leonard, certify that the views expressed in this report accurately reflect my views and that no part of my compensation was, is, or will be directly related to the specific recommendation or views contained in this report.

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

Explanation of Ratings

Outperform (Buy): We expect this stock to outperform its benchmark over the next 12 months.

Market Perform (Hold/Neutral): We expect this stock to perform in line with its benchmark over the next 12 months.

Underperform (Sell): We expect this stock to underperform its benchmark over the next 12 months. The degree of outperformance or underperformance required to warrant an Outperform or an Underperform rating should be commensurate with the risk profile of the company.

For the purposes of these definitions the relevant benchmark will be the S&P 600® Health Care Index for issuers with a market capitalization of less than \$2 billion and the S&P 500® Health Care Index for issuers with a market capitalization over \$2 billion.

Important Disclosures

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

In the past 12 months, the Firm has received compensation for providing investment banking services to Cellular Dynamics International .

Leerink Partners LLC makes a market in Cellular Dynamics International.

Leerink Partners LLC has acted as a co-manager for a public offering of Cellular Dynamics International in the past 12 months.

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