

Equity Research

March 11, 2014

Price: \$16.04 (03/10/2014)

Price Target: \$20.50

OUTPERFORM (1)

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Key Data

Symbol [NASDAQ: ICEL](#)

Market Cap (MM) [\\$252.8](#)

Company Quick Take

Solid Quarterly Update; Awaiting Additional Details On Call At 8 AM ET

The Cowen Insight

Cellular Dynamics reported another solid quarterly update. Q4 revenue was about in line with consensus and our forecast and there appears to be increasing traction with existing and new customers. Further, new product initiatives continue with sales of new cell types in early release testing with customers. We await 2014 guidance and additional Q4 details on the conference call at 8:00 AM ET.

Conference Call At 8:00 AM ET; Dial-in: 877-312-5886; Passcode: 3865935

In Line Revenue Quarter; Customer Uptake And Utilization Comments Encouraging

Q4 revenue of \$4.2MM (+41.3% Y/Y) was about in line with consensus and our forecast for \$4.3MM. Product sales of \$2.5MM (+8.6% Y/Y) was \$0.6MM below our forecast but we had noted that sales could be lumpy due to the early stages of product rollout and irregular customer demand. Q4 iCell Cardiomyocytes revenue of \$1.4MM (+20.2% Y/Y) was \$0.4MM below our forecast; iCell Neurons revenue of \$0.8MM (-11.8% Y/Y) was \$0.3MM below our forecast; and other Product revenue of \$0.3MM (+159.6% Y/Y) was \$0.1MM ahead of our forecast. Collaborations/Other revenue of \$1.7MM (+155.3% Y/Y) was \$0.5MM ahead of our forecast, likely due to recognition of CIRM revenue. Management noted revenue was driven by: (1) increased unit sales of iCell products; (2) significant increases in Collaborations, Partnerships, and Other revenues arising from ICEL's center of excellence agreements with Eli Lilly and AstraZeneca; and (3) sales of new cell types in early release testing with customers. Encouragingly, ICEL's top 10 customers averaged \$830K in revenue for F13 as compared to \$445K last year, indicating increasing traction with existing customers. Further, customer adoption appears to be increasing as well – ICEL sold to 150 customers in FY13 as compared to 128 last year.

Gross Margin Higher Than Expected; Operating Expenses Increasing

Q4 gross margin of 83.7% was 11 percentage points above our forecast likely due to favorable mix and recognition of CIRM revenue. Q4 R&D expense increased to \$4.9MM (+25.3% Y/Y) due to an increase in materials expense within ICEL's R&D organization. SG&A expense increased to \$4.9MM (+38% Y/Y) due to increases in staffing within ICEL's S&M organization and increases in G&A costs related to ICEL's IPO.

We Await Additional Details On The Conference Call

Figure 1 Cellular Dynamics (ICEL) Earnings Snapshot

Conference Call: Tuesday March 11 at 8:00 AM ET; Dial-in: (877) 312-5886; Passcode: 3865935

Cowen vs. Consensus (\$MM, except EPS)

	Q4:12A	Q4:13E		Q4:13A	Full Year Guidance
		Cowen	Consensus		
Revenue	\$2.9	\$4.3	\$4.3	\$4.2	Not provided
Gross Margin	57.8%	72.7%	71.9%	83.7%	Not provided
Operating Margin	(197.0%)	(101.7%)	NM	(153.1%)	Not provided
EPS	(\$0.54)	(\$0.29)	(\$0.30)	(\$0.43)	Not provided

Selected Revenue Metrics (\$MM, except EPS)

	Q4:12A	Q3:13A	Q4:13E	Q4:13A	Comments
Product Sales	\$2.3	\$1.8	\$3.1	\$2.5	
Organic Growth (Y/Y)	366.5%	66.8%	36.1%	8.6%	Product revenue was \$0.6MM below our forecast; however we had noted that sales could be lumpy due to the early stages of product rollout and irregular customer demand.
Collaborations/Other	\$0.7	\$0.7	\$1.2	\$1.7	
Organic Growth (Y/Y)	54.6%	362.0%	84.9%	155.3%	Collaborations/Other revenue was \$0.5MM ahead of our forecast.

Income Statement (\$MM, except EPS)

	Q4:12A	Q3:13A	Q4:13E	Q4:13A	Comments
Revenue	\$2.9	\$2.5	\$4.3	\$4.2	
Organic Growth (Y/Y)	221.6%	104.6%	47.0%	41.3%	Overall revenue increased 41.3% Y/Y and was about in line with our forecast. Revenue was driven by (1) increased unit sales of iCell products; (2) significant increases in Collaborations, Partnerships, and Other revenues arising from ICEL's center of excellence agreements with Eli Lilly and AstraZeneca; and (3) sales of new cell types in early release testing with customers.
Gross Profit	\$1.7	\$2.2	\$3.1	\$3.5	
Margin	57.8%	85.3%	72.7%	83.7%	Gross margin was 11 percentage points higher than our forecast likely due to favorable product mix and recognition of CIRM revenue.
R&D	\$3.9	\$3.9	\$3.7	\$4.9	
% of sales	134.2%	154.8%	84.6%	119.0%	R&D growth was noted to be driven by an increase in materials expense within ICEL's R&D organization.
Growth Y/Y	9.9%	10.7%	(7.3%)	25.3%	
SG&A	\$3.6	\$5.4	\$3.9	\$4.9	
% of sales	120.6%	214.3%	89.8%	117.8%	Increases in staffing within ICEL's S&M organization and increases in G&A costs related to ICEL's IPO drove SG&A growth.
Growth Y/Y	45.0%	87.2%	9.4%	38.0%	
Operating Profit	(\$5.8)	(\$7.2)	(\$4.4)	(\$6.4)	
Margin	(197.0%)	(283.8%)	(101.7%)	(153.1%)	
Non-Operating Items	\$0.0	\$0.3	\$0.4	\$0.3	
Pre-Tax Income	(\$5.8)	(\$7.5)	(\$4.8)	(\$6.7)	
Taxes	\$0.0	\$0.0	\$0.0	\$0.0	
Rate	0.0%	0.0%	0.0%	0.0%	
Net Income	(\$5.8)	(\$7.5)	(\$4.8)	(\$6.7)	
Margin	(197.2%)	(297.2%)	(110.0%)	(161.4%)	
Earnings Per Share	(\$0.54)	(\$0.62)	(\$0.29)	(\$0.43)	
Growth (Y/Y)	NM	NM	NM	NM	
Share Count (MM)	11	12	16	16	

Source: Company Reports, Thomson One, and Cowen and Company.

Valuation Methodology And Risks

Valuation Methodology

Life Science & Diagnostic Tools:

Price targets are based on several methodologies which may include: analysis of market risk, growth rate, revenue stream, discounted cash flows (DCF), EBITDA, EPS, cash flow (CF), free cash flow (FCF), EV/EBITDA, P/E, PE/growth, P/CF, P/FCF, premium (discount) / average group EV/EBITDA, premium (discount) / average group P/E, sum of the parts, net asset value, dividend returns, and return on equity (ROE) over the next 12 months.

Investment Risks

Life Science & Diagnostic Tools:

Risks to the Medical and Life Science Tools sector may include: reduction or delay in research and development budgets and government funding, reduced or delayed purchasing from health care / hospital customers, increased or extended regulatory hurdles or processes for regulated products, increased dependence on volatile emerging markets for revenues and profitability, and general macroeconomic challenges.

Risks To The Price Target

Risks include but are not limited to: product is in early stage and customer adoption could be slower than expected, competition could intensify, market opportunity is difficult to define, and low visibility on financial trajectory.

Addendum

Stocks Mentioned In Important Disclosures

Ticker	Company Name
ICEL	Cellular Dynamics International Inc

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Cowen and Company Rating System effective May 25, 2013

Outperform (1): The stock is expected to achieve a total positive return of at least 15% over the next 12 months

Market Perform (2): The stock is expected to have a total return that falls between the parameters of an Outperform and Underperform over the next 12 months

Underperform (3): Stock is expected to achieve a total negative return of at least 10% over the next 12 months

Assumption: The expected total return calculation includes anticipated dividend yield

Cowen and Company Rating System until May 25, 2013

Outperform (1): Stock expected to outperform the S&P 500

Neutral (2): Stock expected to perform in line with the S&P 500

Underperform (3): Stock expected to underperform the S&P 500

Assumptions: Time horizon is 12 months; S&P 500 is flat over forecast period

Cowen Securities, formerly known as Dahlman Rose & Company, Rating System until May 25, 2013

Buy – The fundamentals/valuations of the subject company are improving and the investment return is expected to be 5 to 15 percentage points higher than the general market return

Sell – The fundamentals/valuations of the subject company are deteriorating and the investment return is expected to be 5 to 15 percentage points lower than the general market return

Hold – The fundamentals/valuations of the subject company are neither improving nor deteriorating and the investment return is expected to be in line with the general market return

Cowen And Company Rating Definitions

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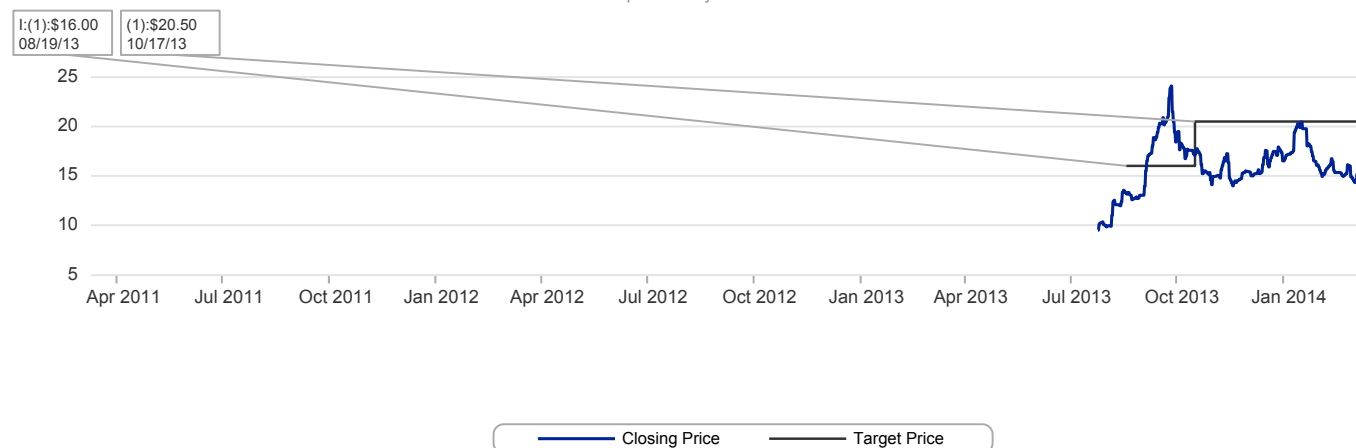
Rating	Count	Ratings Distribution	Count	IB Services/Past 12 Months
Buy (a)	415	59.20%	68	16.39%
Hold (b)	270	38.52%	4	1.48%
Sell (c)	16	2.28%	1	6.25%

(a) Corresponds to "Outperform" rated stocks as defined in Cowen and Company, LLC's rating definitions. (b) Corresponds to "Market Perform" as defined in Cowen and Company, LLC's ratings definitions. (c) Corresponds to "Underperform" as defined in Cowen and Company, LLC's ratings definitions.

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Cellular Dynamics International Inc Rating History as of 03/10/2014

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Legend for Price Chart:

I = Initiation | 1 = Outperform | 2 = Market Perform | 3 = Underperform | UR = Price Target Under Review | T = Terminated Coverage | \$xx = Price Target | NA = Not Available

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