

Equity Research

May 6, 2014

Price: \$11.86 (05/5/2014)

Price Target: \$18.00

OUTPERFORM (1)

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Key Data

Symbol [NASDAQ: ICEL](#)

Market Cap (MM) [\\$186.9](#)

Company Quick Take

Results Reflect Inherent Lumpiness; Awaiting Details On Call At 8 AM ET

The Cowen Insight

Q1 revenue increased 23% Y/Y but was ~\$2MM below consensus at ~\$3MM. Revenue growth was driven by Collaborations, Partnerships, and Other revenues and partially offset by Product sales. This was a pretty big miss, in our view, although as previously noted, calling an ICEL quarter is a bit of a "fool's errand" given inherent sales lumpiness. We await further details on 8AM ET conference call.

Conference Call At 8:00AM ET; Dial-in: 877-312-5886; Passcode: 35432190

Inherently Lumpy Product Sales Drag Total Revenue Growth

Q1 revenue of \$2.9MM (+23.0% Y/Y) was ~\$2MM below consensus and ~\$1MM below our forecast. Product sales of \$1.5MM (-16.6% Y/Y) was \$0.7MM below our forecast but we had noted that sales are likely to be lumpy due to the early stages of product rollout and irregular customer demand. Management noted that while Product sales growth did not match prior periods, it believes this reflects the natural volatility of order placement for cryopreserved products that customers can inventory. Unlike past quarters, ICEL did not break out revenue by product in the Q1:2014 10-Q. However, it was noted in the 10-Q that Product sales decreased primarily due to a decrease in unit volume sales of iCell Cardiomyocytes. Encouragingly, it was noted in the 10-Q that the weighted average pricing on iCell products increased by nearly 9%. Collaborations, Partnerships, and Other revenues of \$1.5MM (+132.2% Y/Y) was ~\$0.3MM light of our forecast. Growth was driven by iCell Hepatocytes, as well as increases in revenue on the CIRM and Coriell contracts.

Gross Margin Higher Than Expected; Operating Expenses Increasing

Q1 product gross margin of 69% was in line with our forecast. SG&A of \$5.4MM (+48.2% Y/Y) was \$0.5MM above our forecast. R&D of \$4.9MM (+27.5% Y/Y) was \$0.3MM above our forecast.

We Await Additional Details On The Conference Call

Figure 1 Cellular Dynamics (ICEL) Earnings Snapshot

Conference Call: Tuesday May 6 at 8:00 AM ET; Dial-in: (877) 312-5886; Passcode: 35432190

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

	Q1:13A	Q1:14E		Q1:14A	Full Year Guidance
		Cowen	Consensus		
Revenue	\$2.4	\$4.0	\$4.6	\$2.9	Not provided
Gross Margin	75.9%	82.9%	76.0%	84.8%	Not provided
Operating Margin	NM	NM	NM	(265.8%)	Not provided
EPS	(\$0.48)	(\$0.41)	(\$0.34)	(\$0.52)	Not provided

Selected Revenue Metrics (\$MM, except EPS)

	Q1:13A	Q4:13A	Q1:14E	Q1:14A	Comments
Product Sales	\$1.8	\$2.5	\$2.2	\$1.5	Product sales was \$0.7MM below our forecast. The 10-Q no longer breaks out performance by product line, but Cardiomyocytes revenue was noted to decrease Y/Y.
Organic Growth (Y/Y)	172.8%	8.6%	27.1%	(16.6%)	
Collaborations/Other	\$0.6	\$1.7	\$1.8	\$1.5	\$0.3MM below our forecast. Growth was driven by iCell Hepatocytes, as well as increases in revenue on the CIRM and Coriell contracts.
Organic Growth (Y/Y)	26.4%	155.3%	183.8%	132.2%	

Income Statement (\$MM, except EPS)

	Q1:13A	Q4:13A	Q1:14E	Q1:14A	Comments
Revenue	\$2.4	\$4.2	\$4.0	\$2.9	Revenue was ~\$1MM light of our forecast as Cardiomyocytes revenue declined. As we noted in our preview, calling a quarter is a bit of a fool's errand given the inherent lumpiness of ICEL's
Organic Growth (Y/Y)	108.6%	41.3%	68.8%	23.0%	
Gross Profit	\$1.8	\$3.5	\$3.3	\$2.5	Product gross margin of 69% was in line with our forecast.
Margin	75.9%	83.7%	82.9%	84.8%	
R&D	\$3.9	\$4.9	\$4.6	\$4.9	\$0.3MM above our forecast.
% of sales	161.3%	119.0%	113.5%	167.3%	
Growth Y/Y	26.1%	25.3%	18.8%	27.5%	
SG&A	\$3.6	\$4.9	\$4.9	\$5.4	\$0.5MM above our forecast.
% of sales	152.1%	117.8%	122.5%	183.4%	
Growth Y/Y	33.0%	38.0%	35.9%	48.2%	
Operating Profit	(\$5.7)	(\$6.4)	(\$6.2)	(\$7.8)	
Margin	(237.6%)	(153.1%)	(153.2%)	(265.8%)	
Non-Operating Items	\$0.0	\$0.3	\$0.3	\$0.3	
Pre-Tax Income	(\$5.7)	(\$6.7)	(\$6.5)	(\$8.1)	
Taxes	\$0.0	\$0.0	\$0.0	\$0.0	
Rate	0.0%	0.0%	0.0%	0.0%	
Net Income	(\$5.7)	(\$6.7)	(\$6.5)	(\$8.1)	
Margin	(237.9%)	(161.4%)	(161.8%)	(276.2%)	
Earnings Per Share	(\$0.48)	(\$0.43)	(\$0.41)	(\$0.52)	
Growth (Y/Y)	NM	NM	NM	NM	
Share Count (MM)	12	16	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

Distribution of Ratings/Investment Banking Services (IB) as of 03/31/14

Rating	Count	Ratings Distribution	Count	IB Services/Past 12 Months
Buy (a)	407	57.08%	85	20.88%
Hold (b)	288	40.39%	8	2.78%
Sell (c)	18	2.52%	1	5.56%

(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.

Note: "Buy", "Hold" and "Sell" are not terms that Cowen and Company, LLC uses in its ratings system and should not be construed as investment options. Rather, these ratings terms are used illustratively to comply with FINRA and NYSE regulations.

Cellular Dynamics International Inc Rating History as of 05/05/2014

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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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