

Roka Bioscience (ROKA)

2Q14 Results Consistent with Our Initiation -- Revenue Estimates Unchanged -- Pipeline Roughly On Track -- Maintain OP

- **2Q14 revenue was in line. Pro-forma EPS loss was better by \$0.05.** ROKA reported 2Q14 sales of \$1.4 MM and GAAP EPS loss of \$0.40 which was in line with our sales estimate of \$1.4 MM and better than our (\$0.45) EPS loss estimate. Wall Street consensus estimates were unavailable.
- **Produce and beef progress continues.** Management is optimistic about bringing a large beef customer on board this year, but visibility remains challenging.
- **Pipeline is roughly on track. Next generation (i.e., faster E.coli) test appears to be developing slightly faster, while mini-Atlas looks later than we thought.** We had previously not anticipated any meaningful improvement in e.coli time-to-result in 2015, but comments on the 2Q14 call suggest it is a strong possibility that the company obtains AOAC certification by the 2015 year end. It is unclear exactly how ROKA is achieving the faster performance on its next-gen tests, but it appears to be based on breakthroughs in chemistry unrelated to the Gen-Probe technology license. As a reminder, the Atlas e.coli test is on par with competitors in time-to-result, but the continuous workflow automation gives Atlas advantages in direct labor savings and the Atlas chemistry facilitates better accuracy versus competitors. The mini-Atlas prototype is on track for next year following a recently signed development agreement, but the company says it is expecting to launch in 2017 which is later than our 2016 expectations.
- **SG&A slightly better than we had modeled, while other opex was in-line.**
- **Sales estimates are unchanged and we are tweaking our EPS loss estimates.**
- **Maintain OUTPERFORM.** We arrive at our 12-month \$15 price target through EV/sales valuation framework where we assume a 10x 2016E EV/sales multiple with no cash and roughly 19 MM shares outstanding discounted back at 20%. Versus early stage life science tools, diagnostics and med tech group, ROKA is trading at a premium on a 2015 EV/sales multiple basis (7.8 vs. 3.7). We believe the hyper growth phase, lower technical risk and regulatory risk plus the scarcity value in food safety testing and strength of management helps justify the multiple.

August 12, 2014

Price
\$10.71

Rating
OUTPERFORM

12-Month Price Target
\$15

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Company Information

Shares Outst (M)	18
Market Cap (M)	\$189
52-Wk Range	\$9.15 - \$13
Cash/sh	2
Enterprise Value	157
LT Debt/Cap	-0.011
2015 EV/Sales	7 x
Book Value/sh	2.2

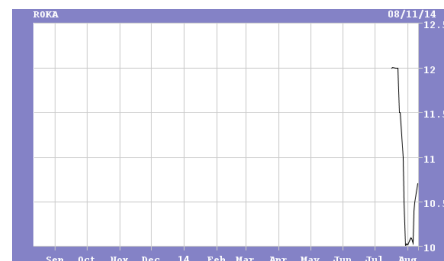
Company Description

ROKA is an early stage diagnostics company focused on pathogen detection for food safety. The company's Atlas system and assay technologies represent a more accurate and more highly automated platform versus the competition.

FYE Dec	2013A	2014E			2015E		
REV (M)	ACTUAL	CURR.	PREV.	CONS.	CURR.	PREV.	CONS.
Q1 Mar	\$0.3A	\$0.8A		N/A	\$3.6E		N/A
Q2 Jun	\$0.7A	\$1.4A		N/A	\$4.6E		N/A
Q3 Sep	\$0.6A	\$2.1E		N/A	\$5.6E		N/A
Q4 Dec	\$0.7A	\$2.8E		N/A	\$6.7E		N/A
Year*	\$2.2A	\$7.1E		N/A	\$20.5E		N/A
Change	1979%	226%			188%		
	2013A	2014E			2015E		
EPS	ACTUAL	CURR.	PREV.	CONS.	CURR.	PREV.	CONS.
Q1 Mar	\$0.00A	(\$0.45)A		N/A	(\$0.39)E	(\$0.40)E	N/A
Q2 Jun	\$0.00A	(\$0.40)A	(\$0.45)A	N/A	(\$0.38)E	(\$0.39)E	N/A
Q3 Sep	\$0.00A	(\$0.45)E	(\$0.49)E	N/A	(\$0.37)E		N/A
Q4 Dec	\$0.00A	(\$0.41)E	(\$0.45)E	N/A	(\$0.34)E	(\$0.35)E	N/A
Year*	(\$0.30)A	(\$1.72)E	(\$1.84)E	N/A	(\$1.48)E	(\$1.51)E	N/A
P/E	NM	NM			NM		
Change	-96%	481%			-14%		

Consensus estimates are from Thomson First Call.

* Numbers may not add up due to rounding.



Source: Thomson Reuters

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Results

ROKA is a pure play diagnostics company focused on the food safety industry. The company operates a razor/razorblade business model where it sells equipment and testing consumables directly to food processing plants and third party laboratories. ROKA's Atlas platform represents a more highly automated, accurate and flexible platform for detection of pathogens (e.coli, listeria and salmonella), which we believe will over time take share from incumbent players and become the gold standard. The commercial story remains early and the company is beginning to see positive inflection with higher quality and higher volume customers. With low technical risk, ROKA is primarily an execution story and the company's strong management team, with a prior record of success, inspires confidence. We believe ROKA represents an attractive play on the automation secular theme and the growing global need for better food safety. Near-term catalysts include earnings results and potential contract wins with large food processing players.

We arrive at our 12-month \$15 price target through EV/sales valuation framework where we assume a 10x 2017E EV/sales multiple with no cash and roughly 19 MM shares outstanding discounted back at 20%. Versus early stage life science tools, diagnostics and med tech group, ROKA is trading at a premium on a 2015 EV/sales multiple basis (7.8 vs. 3.7). We believe the hyper growth phase, lower technical risk and regulatory risk plus the scarcity value in food safety testing and strength of management helps justify the multiple.

Risks to the attainment of our price target include: ROKA continues to burn cash and the path to profitability is murky. We estimate that the company has at least two years' worth of cash and may need to raise additional funds at some point in the next two years. ROKA has execution risk as sales cycles in the food testing business tend to be long and unpredictable. Additionally, the period of time between placement of and Atlas instrument and full implementation can take several months. In addition, the adoption curve is more difficult to predict relative to other diagnostics companies given the lack of close comparables

Figure 1: Catalysts

Catalyst/Milestones	Timing
Earnings (system placements and test utilization metrics)	Quarterly
Large Beef Contract	2014
Additional Large Lab Wins	2014
Listeria Non-Amplified Test Launch	2015
Min-Atlas Prototype Completion	2015
Next-Gen E.Coli test (faster)	2H15
Min-Atlas Commercial Launch	2016/2017
Potential multiplexed allergen testing	2017+

Source: Company data, Wedbush Securities, Inc.

Results

Figure 2: Results

	2Q:14	
	REV (m)	EPS
Actual	1.39	(\$0.40)
Wedbush	1.4	(\$0.45)
Consensus	NA	NA

Source: Company data, Wedbush Securities, Inc.

Figure 3: Variance

	2Q13A	2Q14E	2Q14A	Δ Y/Y	Δ A/E
Product Revenue	671	1,369	1,390	107%	2%
Total Revenues	671	1,369	1,390	107%	2%
Cost of revenues	863	1,611	1,573	82%	-2%
COGS as % of sales	129%	118%	113%	-12%	-4%
Gross profit	(192)	(242)	(183)	-5%	-24%
Gross Margins	-28.6%	-17.7%	-13.2%	-54%	-25%
Research and development	1,945	2,250	2,227	14%	-1%
General and administrative	1,667	2,375	4,548	173%	91%
Selling and Marketing	2,608	3,125	0	-100%	-100%
Amortization of intangibles	42		42	0%	NA
Total operating expenses	6,262	7,750	6,817	9%	-12%
Operating Income	(6,454)	(7,992)	(7,000)	8%	-12%
Interest income	(80)	(200)	(378)	373%	89%
Other	0	(88)	41	NA	-147%
Income before taxes	(6,534)	(8,280)	(7,337)	12%	-11%
Provision for income taxes	(618)	0	0	NA	NA
Tax Rate				NA	NA
Net income	(5,916)	(8,280)	(7,337)	24%	-11%
Net Income	(5,916)	(8,280)	(7,337)	24%	-11%
GAAP EPS -Basic		(\$0.47)	(\$0.42)		-11%
GAAP EPS -Diluted		(\$0.45)	(\$0.40)		-11%
Non-GAAP EPS -Diluted		(\$0.45)	(\$0.40)		-11%
Weighted average shares - basic		17,600	17,600		0%
Weighted average shares - diluted		18,400	18,400		0%
Cash and Equivalents (pro forma)		78,440	79,352		1%
Debt		19,725	19,725		0%
Net Cash		58,715	59,627		2%
Net Cash/share		3.2	3.2		2%

% of Rev.	2Q13A	2Q14E	2Q14A
Gross Margins	-29%	-18%	-13%
Research and development	290%	164%	160%
General and administrative	248%	173%	327%
Total operating expenses	933%	566%	490%
EBIT	-962%	-584%	-504%
Tax rate	0%	0%	0%
Net income	-882%	-605%	-528%

Source: Company data, Wedbush Securities, Inc.

Figure 4: Income Statement

	2012	2013	1Q14	2Q14	3Q14E	4Q14E	2014E	1Q15E	2Q15E	3Q15E	4Q15E	2015E	2016E
Product Revenue	105	2,183	828	1,390	2,097	2,797	7,112	3,632	4,584	5,585	6,672	20,473	34,756
Total Revenues	105	2,183	828	1,390	2,097	2,797	7,112	3,632	4,584	5,585	6,672	20,473	34,756
Cost of revenues	3,186	6,601	1,265	1,573	2,154	2,657	7,649	3,297	3,911	4,486	4,999	16,694	24,861
Gross profit	(3,081)	(4,418)	(437)	(183)	(57)	139	(537)	335	673	1,098	1,672	3,779	9,896
Gross Margins	-2934.3%	-202.4%	-52.7%	-13.2%	-2.7%	5.0%	-7.6%	9.2%	14.7%	19.7%	25.1%	18.5%	28.5%
Research and development	9,584	7,568	1,842	2,227	2,300	2,325	8,694	2,000	2,000	2,000	2,000	8,000	6,800
G&A (plus S&M as of 2Q14)	16,052	7,264	2,255	4,548	2,400	2,425	11,628	2,600	2,600	2,600	2,600	10,400	10,800
Selling & Marketing	0	10,218	2,793	0	3,050	2,725	8,568	2,724	2,980	3,072	3,136	11,911	12,476
Amortization of intangibles	168	168	42	42	50	50	184	200	200	200	200	800	800
Total operating expenses	25,804	25,218	6,932	6,817	7,800	7,525	29,074	7,524	7,780	7,872	7,936	31,111	30,876
Operating Income	(28,885)	(29,636)	(7,369)	(7,000)	(7,857)	(7,386)	(29,611)	(7,189)	(7,106)	(6,773)	(6,263)	(27,332)	(20,980)
Interest income	(140)	(2,980)	(389)	(378)	(338)	(200)	(1,305)	(34)	(49)	(66)	(81)	(229)	(454)
Other	0	(53)	(603)	41	(84)	(81)	(727)	0	0	0	0	0	0
Income before taxes	(29,025)	(32,669)	(8,361)	(7,337)	(8,279)	(7,667)	(31,643)	(7,223)	(7,155)	(6,839)	(6,345)	(27,561)	(21,434)
Provision for income taxes	0	(3,092)	6	0	0	0	6	0	0	0	0	0	0
Tax Rate													
Net income	(29,025)	(29,577)	(8,367)	(7,337)	(8,279)	(7,667)	(31,649)	(7,223)	(7,155)	(6,839)	(6,345)	(27,561)	(21,434)
Accretion of convertible preferred stock	(286)	-					0	0	0	0	0	0	0
Net Income	(29,311)	(29,577)	(8,367)	(7,337)	(8,279)	(7,667)	(31,649)	(7,223)	(7,155)	(6,839)	(6,345)	(27,561)	(21,434)
GAAP EPS - Basic	(\$8.05)	(\$0.30)	(\$0.48)	(\$0.42)	(\$0.47)	(\$0.43)	(\$1.79)	(\$0.41)	(\$0.40)	(\$0.38)	(\$0.35)	(\$1.54)	(\$1.18)
GAAP EPS - Diluted	(\$8.05)	(\$0.30)	(\$0.45)	(\$0.40)	(\$0.45)	(\$0.41)	(\$1.72)	(\$0.39)	(\$0.38)	(\$0.37)	(\$0.34)	(\$1.48)	(\$1.13)
Non-GAAP EPS - Diluted	(\$8.05)	(\$0.30)	(\$0.45)	(\$0.40)	(\$0.45)	(\$0.41)	(\$1.72)	(\$0.39)	(\$0.38)	(\$0.37)	(\$0.34)	(\$1.48)	(\$1.13)
Weighted average shares - basic	3,639	100,121	17,600	17,600	17,653	17,706	17,640	17,768	17,830	17,892	17,955	17,861	18,113
Weighted average shares - diluted	3,639	100,121	18,400	18,400	18,455	18,511	18,441	18,575	18,640	18,706	18,771	18,673	18,936
Cash and Equivalents	17,314	32,728	32,699	26,013	73,809	71,102	71,102	65,036	58,396	52,104	45,712	45,712	27,946
Debt	0	9,725	19,725	14,100	14,100	14,100	14,100	14,100	14,100	14,100	14,100	14,100	14,100
Net Cash	17,314	23,003	12,974	11,913	59,709	57,002	57,002	50,936	44,296	38,004	31,612	31,612	13,846
Net Cash/share		NA	0.7	0.6	3.2	3.1	3.1	2.7	2.4	2.0	1.7	1.7	0.7
% of Sales	2012	2013	1Q14	2Q14	3Q14E	4Q14E	2014E	1Q15E	2Q15E	3Q15E	4Q15E	2015E	2016E
Gross Margins	-2934%	-202%	-53%	-13%	-3%	5%	-8%	9%	15%	20%	25%	18%	28%
Research and development	9128%	347%	222%	160%	110%	83%	122%	55%	44%	36%	30%	39%	20%
General and administrative	15288%	333%	272%	327%	114%	87%	164%	72%	57%	47%	39%	51%	31%
Sales and Marketing	0%	468%	337%	0%	145%	97%	120%	75%	65%	55%	47%	58%	36%
Total operating expenses	24575%	1155%	837%	490%	372%	269%	409%	207%	170%	141%	119%	152%	89%
EBIT	-27510%	-1358%	-890%	-504%	-375%	-264%	-416%	-198%	-155%	-121%	-94%	-134%	-60%
Tax rate	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Net income	-27915%	-1355%	-1010%	-528%	-395%	-274%	-445%	-199%	-156%	-122%	-95%	-135%	-62%
Free Cash Flow	-27918%	-1493%	-901%	-458%	-323%	-199%	-368%	-184%	-142%	-109%	-82%	-121%	-48%
y/y Δ	2012	2013	1Q14	2Q14	3Q14E	4Q14E	2014E	1Q15E	2Q15E	3Q15E	4Q15E	2015E	2016E
Total Revenues	NA	1979%	211%	107%	276%	306%	226%	339%	230%	166%	139%	188%	70%
Cost of revenues	NA	107%	-32%	82%	3%	50%	16%	161%	149%	108%	88%	118%	49%
Gross Margins	NA	-93%	-91%	-54%	-99%	-103%	-96%	-117%	-212%	-823%	403%	-344%	54%
Sales and Marketing	NA	-21%	5%	14%	8%	34%	15%	9%	-10%	-13%	-14%	-8%	-15%
General and administrative	NA	-55%	23%	173%	39%	19%	60%	15%	-43%	8%	7%	-11%	4%
Research and development	NA	NA	15%	-100%	16%	7%	-16%	-2%	NA	1%	15%	39%	5%
Total operating expenses	NA	-2%	15%	9%	19%	18%	15%	9%	14%	1%	5%	7%	-1%
EBIT	NA	3%	-4%	8%	-3%	-1%	0%	-2%	2%	-14%	-15%	-8%	-23%
Tax rate	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Net income	NA	1%	20%	24%	-15%	11%	7%	-14%	-2%	-17%	-17%	-13%	-22%

Source: Company data, Wedbush Securities, Inc.

Figure 5: Balance Sheet

	2012	2013	Q1	Q2E	Q3E	Q4E	2014E	2015E	2016E
Current assets:									
Total Cash and Cash Equivalents	17,314	32,728	32,699	26,013	73,188	69,861	69,861	44,424	26,645
Accounts Receivable	30	277	515	566	2,097	1,398	1,398	3,336	5,212
Inventory	4,066	3,879	4,180	4,706	3,000	233	233	556	869
Prepaid expenses and other Current Assets	1,088	5,572	3,031	3,819	3,819	3,000	3,000	3,000	3,000
Total current assets	22,498	42,456	40,425	35,104	82,104	74,492	74,492	51,316	35,725
Property, Plant and Equipment	13,783	14,510	13,860	13,258	13,658	13,798	13,798	14,821	16,559
Intangible assets/Goodwill	1,512	1,344	1,662	1,260	1,260	(540)	(540)	(7,540)	(16,340)
Restricted cash and other non-current assets	624	804	333	3,183	183	683	683	2,283	(875)
Total assets	38,417	59,114	56,280	52,805	97,205	88,433	88,433	60,880	35,069
LIABILITIES AND STOCKHOLDERS' EQUITY									
Current liabilities:									
Accounts Payable and accrued expenses	3,333	1,226	993	882	1,299	832	832	852	846
Deferred revenue and Other Current Liabilities	1,733	7,639	12,259	15,808	15,808	15,808	15,808	15,808	15,808
Total current liabilities	5,066	8,865	13,252	16,690	17,107	16,640	16,640	16,660	16,654
Long-term liabilities:									
Long Term Debt	0	212	383	4,358	4,358	4,358	4,358	4,358	0
Other long term liabilities	2,542	3,584	4,395	382	382	382	382	382	382
Total liabilities	7,608	12,661	18,030	21,430	21,847	21,380	21,380	21,400	17,036
Stockholders' equity:									
Preferred Stock	100,537	127,797	127,961	127,698	127,698	127,698	127,698	127,698	127,698
Common Stock, APIC, RE	(69,728)	(81,344)	(89,711)	(96,323)	(52,340)	(60,644)	(60,644)	(88,218)	(109,665)
Total liabilities and stockholders' equity	38,417	59,114	56,280	52,805	97,205	88,433	88,433	60,880	35,069

Source: Company data, Wedbush Securities, Inc.

Figure 6: Cash Flow Statement

	2012	2013	Q1E	Q2E	Q3E	Q4E	2014E	2015E	2016E
Cash Flows from Operating Activities:									
Net (loss) income	(23,246)	(29,577)	(8,367)	(7,337)	(8,917)	(8,305)	(32,925)	(27,574)	(21,447)
Depreciation	2,045	2,437	661	670	1,200	1,800	4,331	7,000	8,800
change in FV of investor rights obligation	(4,996)	2,595	836	0	0	0	836	0	0
Loss on disposal/provision for inventory	2,197	1,118	167	0	0	0	167	0	0
Stock-based compensation expense	739	696	261	500	500	500	1,761	2,400	2,800
Deferred taxes	0	(3,127)	0	0	0	0	0	0	0
non-cash interest expense/impairment/deferred taxes	186	457	268	(1,180)	(1,000)	(1,000)	(2,912)	(4,000)	(4,000)
Change in working capital	(4,699)	(2,050)	1,993	2,073	592	3,817	8,475	(2,240)	(2,195)
Net cash provided by operating activities	(27,774)	(27,451)	(4,181)	(5,274)	(7,625)	(3,187)	(20,267)	(24,413)	(16,042)
Cash Flows from Investing Activities:									
Purchase of property and equipment	(5,929)	(3,410)	12	602	(400)	(140)	74	(1,024)	(1,738)
increase in restricted cash		0	0	(614)	0	0	(614)	0	0
Net cash used in investing activities	(5,929)	(3,410)	12	(12)	(400)	(140)	(540)	(1,024)	(1,738)
Cash Flows from Financing Activities:									
Proceeds from Issuance of Restricted Stock	0	4,672	0	0	0	0	0	0	0
proceeds from issuance of preferred stock	20,000	41,783	(15)	0	0	0	(15)	0	0
proceeds from issuance of common stock	0	20	5,000	0	60,000	0	65,000	0	0
costs of issuance/other	4	(199)	(845)	(1,400)	(4,800)	0	(7,045)	0	0
Net cash provided by financing activities	20,004	46,276	4,140	(1,400)	55,200	0	57,940	0	0
Net increase (decrease) in cash and cash equivalents	(13,699)	15,415	(29)	(6,686)	47,175	(3,327)	37,133	(25,437)	(17,780)
Cash and cash equivalents, beginning of period	31,013	17,314	32,728	32,699	26,013	73,188	32,728	69,861	44,424
Cash and cash equivalents, end of period	17,314	32,729	32,699	26,013	73,188	69,861	69,861	44,424	26,645

Source: Company data, Wedbush Securities, Inc.

Analyst Biography

Zarak Khurshid is a senior equity research analyst covering the Medical Diagnostics and Life Science Tools sectors. Prior to joining Wedbush in January 2010, Mr. Khurshid was Vice President and senior equity research analyst with Caris & Company where he covered the Medical diagnostics and Life Sciences Tools sectors from 2006 to 2010. Mr. Khurshid's aggressive risk/reward focused investment style is supported by data points from a diverse network of contacts from industry, hospitals, clinical labs, and academia. Mr. Khurshid was ranked #1 in the Life Science Tools and Services sectors and #4 on Wall Street for earnings accuracy in 2012 by *Starmine*. Prior to his start on Wall Street with Pacific Growth Equities in 2004, Mr. Khurshid was a Research Associate with Cytokinetics and an Associate Bioengineer with Aurora Biosciences. Mr. Khurshid received a BS in Bioengineering and a BA in Economics from the University of California, San Diego.

Analyst Certification

I, Zarak Khurshid, certify that the views expressed in this report accurately reflect my personal opinion and that I have not and will not, directly or indirectly, receive compensation or other payments in connection with my specific recommendations or views contained in this report.

Disclosure information regarding historical ratings and price targets is available at <http://www.wedbush.com/ResearchDisclosure/DisclosureQ214.pdf>

Investment Rating System:

Outperform: Expect the total return of the stock to outperform relative to the median total return of the analyst's (or the analyst's team) coverage universe over the next 6-12 months.

Neutral: Expect the total return of the stock to perform in-line with the median total return of the analyst's (or the analyst's team) coverage universe over the next 6-12 months.

Underperform: Expect the total return of the stock to underperform relative to the median total return of the analyst's (or the analyst's team) coverage universe over the next 6-12 months.

The Investment Ratings are based on the expected performance of a stock (based on anticipated total return to price target) relative to the other stocks in the analyst's coverage universe (or the analyst's team coverage).*

Rating Distribution (as of July 30, 2014)	Investment Banking Relationships (as of June 30, 2014)
Outperform: 54%	Outperform: 25%
Neutral: 42%	Neutral: 1%
Underperform: 4%	Underperform: 0%

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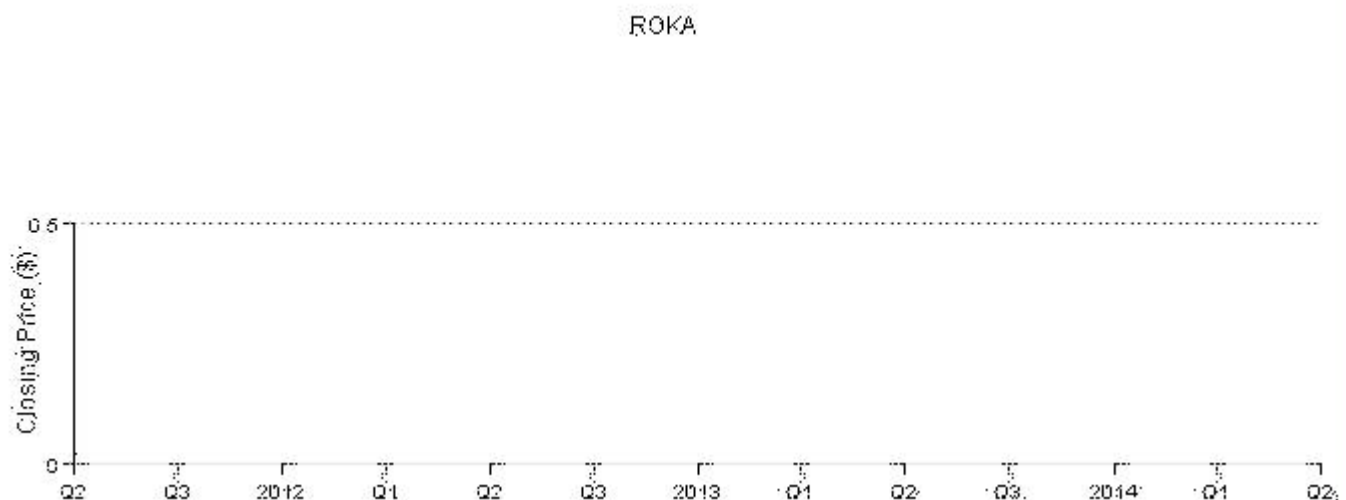
Company	Disclosure
Roka Bioscience	1,3,5,7

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