

Equity Research

November 7, 2014

Price: \$8.34 (11/6/2014)

Price Target: \$9.00 (Prior \$13.00)

OUTPERFORM (1)

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Key Data

Symbol	NASDAQ: ROKA
52-Week Range:	\$13.00 - 8.06
Market Cap (MM):	\$151.0
Net Debt (MM):	\$(53.0)
Cash/Share:	\$2.93
Dil. Shares Out (MM):	18.1
Enterprise Value (MM):	\$98.0
ROIC:	NM
ROE (LTM):	NM
BV/Share:	\$4.77
FCF Yield:	NM
Dividend:	NA
Short Interest:	NM

FY (Dec)	2013E	2014E	2015E
Earnings Per Share			
Year	\$(1.81)	\$(1.82)	\$(1.71)
Prior Year	-	\$(1.83)	\$(1.42)
P/E	NM	NM	NM

Revenue (MM)			
Q1	\$0.3A	\$0.8A	\$1.7
Prior Q1	-	-	\$3.8
Q2	\$0.7A	\$1.4A	\$2.4
Prior Q2	-	-	\$4.7
Q3	\$0.6A	\$1.5	\$3.1
Prior Q3	-	\$2.3	\$5.9
Q4	\$0.7A	\$1.5	\$4.1
Prior Q4	-	\$3.3	\$7.3
Year	\$2.2A	\$5.2	\$11.3
Prior Year	-	\$7.7	\$21.7
EV/S	44.5x	18.8x	8.7x

Earnings Update

A Setback for ROKA; Maintaining Outperform on LT Outlook

The Cowen Insight

ROKA reported revenue below expectations, resulting from issues with the Listeria test experienced at a major lab customer site. This appears addressable over the next few quarters, but the direct and trickle-through effects will impact NT placements and the timing of the consumables revenue ramp. This is a setback, but we remain at Outperform on the LT potential, which we view as intact.

Revenue Below Expectations on Key Customer Issues with the Listeria Test

Revenue of \$1.5MM was up only slightly Q/Q and well below the consensus mean of \$2.2MM. About 150K tests were sold in the quarter, which was well below our 240K estimate. While ASPs appear to have been stable in the \$8-9 range, and utilization across the bulk of the installed base appears directionally positive as customers continued to ramp, a major reference lab customer failed to ramp as expected (systems and consumables) resulting from a false positive issue it was having with the Listeria test (detailed below). OpEx of \$6.5MM was about \$1MM below our expectations. ROKA ended Q3 with \$62MM in cash on the balance sheet.

The Issue

Management noted that in the Spring of 2014, some labs were having sporadic false positive issues with the company's Listeria assay. In response, ROKA released an alternative protocol to reduce the potential for cross-contamination, which appeared to be the cause of these false-positive issues. Most customers were able to successfully overcome these issues using the alternative protocol, and have been able to continue to run the Listeria assays without issue since then. However, in late August, one of ROKA's major lab customers stated it was still having these false positive issues. As a result, this customer did not progress as expected with its plans to scale its system installed base or to ramp kit consumption. In October, ROKA began work on a more "user friendly" sample preparation protocol to further reduce susceptibility to cross-contamination; management believes this could be made available in Q2:15.

The Impact

To frame the exposure, Listeria represents about 1/3 of sample volume for ROKA, and likely over 40% of pathogen testing volumes market-wide. Management believes most customers that were able to successfully implement the original alternative protocol will continue to run the test without disruption. The large customer that was having the issue will collaborate with ROKA on the "user friendly" protocol in development and management appears confident this customer will eventually ramp on this assay as expected; the company is redirecting resources to help the customer manage through this issue. The greatest impact from this is likely on the prospective customers who planned to run Listeria; it appears these opportunities are unlikely to progress through the sales funnel until the new assay is at least closer to market.

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At A Glance

Our Investment Thesis

We view ROKA as a potential disruptor in the attractive food safety market. The company's flagship Atlas system is clearly best in class and should become the standard for high-volume food pathogen testing; early adopters validate the potential. Further, we view Roka as employing a capital-efficient model, while investing towards broader opportunities targeting the broader \$2B food testing market. There are clearly risks given the early stage and lengthy selling cycles inherent to this industry, but we believe Roka represents a compelling investment on an attractive macro-investment theme (food safety), and expect shares to Outperform the market over the next 12-18 months.

Base Case Assumptions

- Initial strategic accounts ramp in 2015
- Steady new placement trends
- Steady utilization ramp
- No OUS or pipeline contributions included in forecasts

Upside Scenario

- Additional strategic accounts drive further upside potential
- Pipeline progress exceeds expectations
- Faster than expected market growth and share gains

Forthcoming Catalysts

- Quarterly results
- Pipeline updates
- Strategic account announcements
- Food testing market trends

Downside Scenario

- Listeria issue lingers through 2015, further slowing new placement trends and utilization ramp
- Pipeline progress stalls
- Competitive positioning becomes less favorable

Price Performance



Source: Bloomberg

Company Description

ROKA BIOSCIENCE is a molecular diagnostics company initially focused on providing advanced testing solutions for the detection of foodborne pathogens, which is projected to be the fastest growing segment of the \$2B food safety testing market. The proprietary molecular technology used in Roka's assays enable the company to offer accurate and rapid testing solutions while our fully automated instrument helps its customers reduce labor costs and minimize operator error. Roka recently launched its proprietary Atlas Detection Assays and Atlas instrument in the North American food safety testing market and has worldwide rights to develop and commercialize advanced molecular testing solutions for a wide range of other industrial applications.

Analyst Top Picks

	Ticker	Price (11/6/2014)	Price Target	Rating
Genmark Diagnostics	GNMK	\$11.43	\$15.00	Outperform

As a result, management expects revenue in Q4 to be flat to down sequentially (consensus was expecting a >50% Q/Q increase), and this issue seems likely to have a lingering impact into 2015. We are making significant cuts to our forecasts as a result of this update. We now forecast 2015 revenue of \$11MM and 2016 revenue of \$23MM; this is essentially pushing our prior revenue expectations out by 3-4 quarters.

We Remain Outperform on the LT Potential but Cutting PT to \$9

This is clearly a setback for ROKA. This said, we do believe management will work through these issues, which are not totally surprising for a company in the early stages of rolling out a disruptive technology. We remain positive on ROKA's competitive positioning and target market (food pathogen testing), and continue to believe that while the initial placement and validation / implementation cycles could be long and a bit choppy, that the result will be a very sticky, long-duration customer base. After this setback, it seems likely that it will take time for ROKA to regain momentum, but we are maintaining our Outperform rating on the compelling long-term potential which we view as intact. We are lowering our PT to \$9 from \$13, which equates to 4.7x (EV/sales) our revised 2016 revenue forecast.

Figure 1 ROKA Revenue Model

SMM	Q1:13	Q2:13	Q3:13	Q4:13	Q1:14	Q2:14	Q3:14	Q4:14E	Q1:15E	Q2:15E	Q3:15E	Q4:15E	2013	2014E	2015E	2016E	2017E	2018E	5 Yr.CAGR
Total Revenues	\$0.3	\$0.7	\$0.6	\$0.7	\$0.8	\$1.4	\$1.5	\$1.5	\$1.7	\$2.4	\$3.1	\$4.1	\$2.2	\$5.2	\$11.3	\$23.3	\$37.5	\$54.8	90.4%
growth (Y/Y)					NM	NM	NM	NM	NM	70.6%	NM	NM	NM	NM	NM	NM	60.8%	45.5%	
growth (Q/Q)					19.4%	69.1%	6.7%	4.1%	12.8%	36.3%	30.9%	30.8%							
Non-Product Revenues	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.1	\$0.2	\$0.2	\$0.2	\$0.2	\$0.4	\$0.4	\$0.6	\$0.6	\$0.6	\$0.6	6.4%
growth (Y/Y)					0.0%	0.0%	40.0%	0.0%	50.0%	50.0%	7.1%	50.0%	NM	10.0%	36.4%	0.0%	0.0%	0.0%	
% of sales	37.6%	14.9%	18.0%	14.5%	12.2%	7.2%	9.4%	6.5%	8.6%	6.3%	4.8%	3.7%	18.3%	8.4%	5.3%	2.6%	1.6%	1.1%	
Product Revenues	\$0.2	\$0.6	\$0.5	\$0.6	\$0.7	\$1.3	\$1.3	\$1.4	\$1.8	\$2.2	\$3.0	\$3.9	\$1.8	\$4.8	\$10.7	\$22.7	\$36.9	\$54.0	97.8%
growth (Y/Y)					NM	NM	NM	NM	NM	72.2%	NM	NM	NM	NM	NM	NM	62.4%	46.3%	
% of sales	62.4%	85.1%	82.0%	85.5%	87.8%	92.8%	90.6%	93.5%	91.4%	93.7%	95.2%	96.3%	81.7%	91.6%	94.7%	97.4%	98.4%	98.9%	
System Revenues	\$0.0	\$0.1	\$0.1	\$0.0	\$0.1	\$0.0	\$0.0	\$0.0	\$0.1	\$0.1	\$0.1	\$0.2	\$0.2	\$0.1	\$0.5	\$0.6	\$0.7	\$0.7	30.3%
Reported Growth (Y/Y)					40.0%	NM	NM	NM	14.3%	NM	NM	NM	NM	(40.0%)	NM	41.4%	4.7%	4.4%	
% of Product Revenues	22.6%	11.8%	14.8%	2.5%	7.3%	2.3%	0.0%	2.1%	3.8%	4.3%	4.1%	4.6%	10.5%	2.3%	4.3%	2.8%	1.8%	1.3%	
Consumables Revenues	\$0.1	\$0.5	\$0.4	\$0.6	\$0.7	\$1.3	\$1.3	\$1.4	\$1.5	\$2.1	\$2.8	\$3.7	\$1.8	\$4.7	\$10.2	\$22.1	\$36.2	\$53.3	101.7%
Reported Growth (Y/Y)					NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	64.1%	47.0%	
% of Product Revenues	77.4%	88.2%	85.2%	97.5%	92.7%	97.7%	100.0%	97.9%	96.2%	95.7%	95.9%	95.4%	89.5%	97.7%	95.7%	97.2%	98.2%	98.7%	

Source: Company reports Cowen and Company

Figure 2 ROKA P&L

SMM, except per share data	Q1:13	Q2:13	Q3:13	Q4:13	Q1:14	Q2:14	Q3:14	Q4:14E	Q1:15E	Q2:15E	Q3:15E	Q4:15E	2013	2014E	2015E	2016E	2017E	2018E	5 Yr CAGR	Comments
Net sales	\$0.3	\$0.7	\$0.8	\$0.7	\$0.8	\$1.4	\$1.5	\$1.5	\$1.7	\$2.4	\$3.1	\$4.1	\$2.2	\$6.2	\$11.3	\$23.3	\$37.5	\$54.8	80.4%	No formal guidance provided
Growth	NM	NM	NM	NM	NM	NM	NM	NM	NM	70.6%	NM	NM	140.1%	115.2%	106.9%	60.8%	45.5%			
Cost of sales	\$1.9	\$0.9	\$2.1	\$1.8	\$1.3	\$1.8	\$2.8	\$2.0	\$2.1	\$2.8	\$3.1	\$3.9	\$6.6	\$7.4	\$11.7	\$18.7	\$25.5	\$32.7		
Gross Profit	(\$1.6)	(\$0.2)	(\$1.5)	(\$1.1)	(\$0.4)	(\$0.2)	(\$1.1)	(\$0.5)	(\$0.3)	(\$0.2)	\$0.0	\$0.2	(\$4.4)	(\$2.2)	(\$0.4)	\$4.7	\$12.0	\$21.8	NM	
% of sales	(603.7%)	(28.6%)	(276.2%)	(157.2%)	(53.9%)	(13.2%)	(73.8%)	(30.0%)	(20.0%)	(10.0%)	0.0%	5.0%	NM	(41.7%)	(3.4%)	20.0%	32.0%	40.0%		Target 55-60% at ~\$100MM revenue
Growth	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM		
Research and Development	\$1.8	\$1.9	\$2.1	\$1.7	\$1.8	\$2.2	\$1.9	\$2.0	\$1.9	\$1.9	\$1.9	\$1.9	\$7.8	\$8.0	\$7.5	\$7.8	\$8.0	\$8.5	2.4%	
% of sales	NM	NM	NM	NM	NM	NM	NM	NM	107.8%	79.1%	60.4%	46.2%	NM	153.3%	66.5%	32.6%	21.3%	15.6%		
Growth	NM	NM	NM	NM	5.1%	14.5%	(10.1%)	17.7%	1.8%	(15.8%)	(2.4%)	(8.0%)	(21.0%)	6.1%	(6.6%)	1.3%	5.3%	6.3%		
Selling, General and Administrative	\$4.3	\$4.3	\$4.4	\$4.6	\$5.0	\$4.5	\$4.6	\$5.1	\$5.4	\$5.4	\$5.4	\$5.4	\$17.5	\$19.3	\$21.8	\$24.0	\$26.0	\$27.0	8.1%	
% of sales	NM	NM	NM	NM	18.4%	6.4%	5.8%	10.8%	310.7%	228.0%	174.2%	133.2%	NM	368.2%	191.8%	102.9%	69.3%	49.5%		
Growth	NM	NM	NM	NM	18.4%	6.4%	5.8%	10.8%	7.3%	18.9%	17.0%	6.3%	8.9%	10.3%	12.1%	11.0%	8.3%	3.8%		
Other (Amort. of Intang.)	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.7	\$0.3	\$0.0	\$0.0	\$0.0	\$0.0	\$0.2	\$1.1	\$0.0	\$0.0	\$0.0	\$0.0	NM	
% of sales	15.8%	6.3%	7.5%	6.1%	5.1%	3.0%	49.8%	19.4%	0.0%	0.0%	0.0%	0.0%	NM	21.4%	0.0%	0.0%	0.0%	0.0%		
Growth	NM	NM	NM	NM	0.1%	0.1%	NM	NM	NM	NM	NM	NM	(0.1%)	NM	NM	NM	NM	NM		
Total Operating Expenses	\$6.1	\$6.3	\$6.5	\$6.4	\$6.9	\$6.8	\$7.3	\$7.4	\$7.3	\$7.3	\$7.3	\$7.3	\$25.2	\$28.4	\$29.1	\$31.6	\$34.0	\$35.5	7.1%	Expected to remain relative flat Q/Q into 2015 (from H2:14)
% of sales	NM	NM	NM	NM	14.4%	8.9%	11.2%	16.7%	5.1%	6.8%	0.0%	(1.9%)	(2.3%)	12.8%	2.4%	8.5%	7.6%	4.4%		
Growth	NM	NM	NM	NM	14.4%	8.9%	11.2%	16.7%	5.1%	6.8%	0.0%	(1.9%)	(2.3%)	12.8%	2.4%	8.5%	7.6%	4.4%		
EBITDA	(\$7.4)	(\$6.1)	(\$7.5)	(\$6.8)	(\$6.6)	(\$6.2)	(\$7.6)	(\$6.9)	(\$6.1)	(\$5.7)	(\$5.4)	(\$5.6)	(\$27.2)	(\$26.6)	(\$22.8)	(\$18.7)	(\$14.6)	(\$9.8)	NM	
% of sales	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	(202.3%)	(80.3%)	(39.0%)		
Growth	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM		
Depreciation & Amortization	\$0.3	\$0.4	\$0.8	\$1.1	\$0.8	\$0.8	\$0.8	\$1.8	\$1.5	\$1.8	\$1.9	\$1.5	\$2.4	\$4.0	\$6.7	\$8.2	\$7.4	\$8.8		
Operating Profit	(\$7.7)	(\$6.5)	(\$8.1)	(\$7.4)	(\$7.4)	(\$7.0)	(\$8.4)	(\$7.9)	(\$7.6)	(\$7.6)	(\$7.3)	(\$7.1)	(\$29.6)	(\$30.6)	(\$29.5)	(\$28.8)	(\$22.6)	(\$13.7)	NM	
% of sales	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	(115.5%)	(58.7%)	(25.0%)		
Growth	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM		
Incremental Margin	NM	NM	NM	NM	NM	NM	NM	NM	(28.5%)	(52.7%)	67.5%	32.1%	(36.2%)	(32.3%)	18.6%	21.3%	34.8%	48.8%		
Other non-Operating Expense	(\$0.0)	\$0.0	\$0.0	\$0.0	\$0.6	(\$0.0)	\$0.2	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	(\$0.0)	\$0.8	\$0.0	\$0.0	\$0.0	\$0.0		
Net Interest Expense	\$0.1	\$0.1	\$2.7	\$0.2	\$0.4	\$0.4	\$0.5	\$0.3	\$0.4	\$0.4	\$0.4	\$0.4	\$8.0	\$1.5	\$1.7	\$1.7	\$1.7	\$1.7		
Earnings Before Taxes	(\$7.7)	(\$6.5)	(\$10.6)	(\$7.6)	(\$8.4)	(\$7.3)	(\$8.1)	(\$8.2)	(\$8.0)	(\$7.8)	(\$7.7)	(\$7.5)	(\$32.7)	(\$32.9)	(\$31.2)	(\$28.6)	(\$23.7)	(\$15.3)	NM	
% of sales	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	(122.7%)	(63.1%)	(28.1%)		
Growth	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM		
Income Taxes	\$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	\$0.0	\$0.0	\$0.0	\$0.0		
Rate	NM	NM	NM	NM	NM	NM	NM	(0.1%)	0.0%	0.0%	0.0%	(0.1%)	(0.1%)	(0.1%)	(0.0%)	0.0%	0.0%	0.0%		
Net Income	(\$7.7)	(\$6.5)	(\$10.6)	(\$7.6)	(\$8.4)	(\$7.3)	(\$8.1)	(\$8.2)	(\$8.0)	(\$7.8)	(\$7.7)	(\$7.5)	(\$32.7)	(\$33.0)	(\$31.2)	(\$28.6)	(\$23.7)	(\$15.3)	NM	
% of sales	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	(122.7%)	(63.1%)	(28.1%)		
Growth	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM		
Earnings Per Share	(\$0.48)	(\$0.36)	(\$0.60)	(\$0.42)	(\$0.46)	(\$0.41)	(\$0.50)	(\$0.45)	(\$0.44)	(\$0.44)	(\$0.42)	(\$0.41)	(\$1.81)	(\$1.82)	(\$1.71)	(\$1.56)	(\$1.28)	(\$0.82)	NM	
Shares Outstanding	18.1	18.1	18.1	18.1	18.1	18.1	18.1	18.1	18.2	18.2	18.3	18.3	18.1	18.1	18.2	18.4	18.5	18.7		
Growth	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM		

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.

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Risks To The Price Target

Risks to our price target include: Regulatory delays / challenges, key account exposure / revenue concentration, new product performance challenges, competitive pressures, financing risk.

Addendum

Stocks Mentioned In Important Disclosures

Ticker	Company Name
GNMK	Genmark Diagnostics
ROKA	Roka Bioscience

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COWEN AND COMPANY RATING DEFINITIONS

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 09/30/14

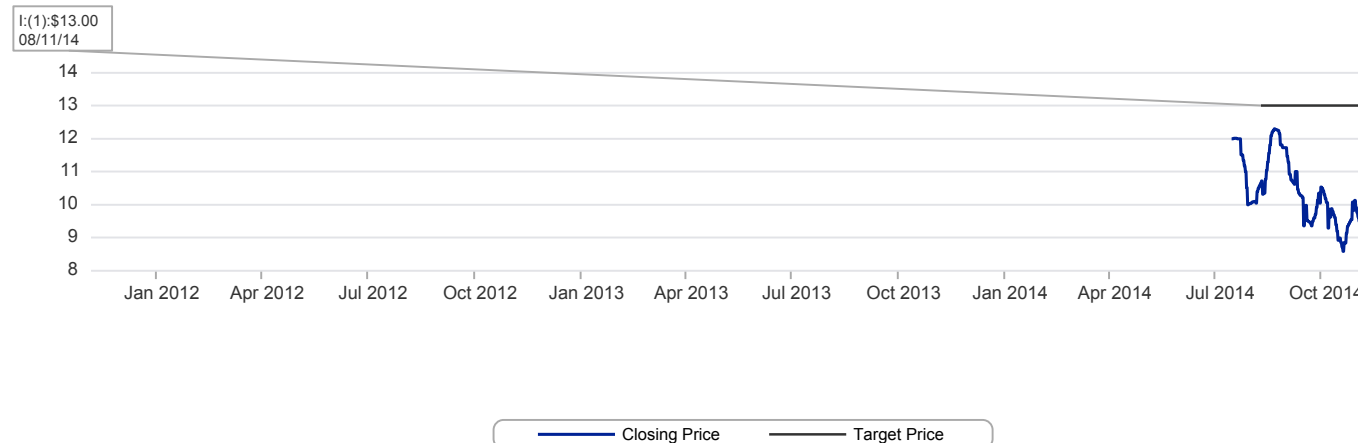
Rating	Count	Ratings Distribution	Count	IB Services/Past 12 Months
Buy (a)	440	59.95%	105	23.86%
Hold (b)	278	37.87%	10	3.60%
Sell (c)	16	2.18%	0	0.00%

(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.

Roka Bioscience Rating History as of 11/06/2014

powered by: BlueMatrix



Genmark Diagnostics Rating History as of 11/06/2014

powered by: BlueMatrix



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 | S=Suspended

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