

Reason for report:  
**EARNINGS**

## ROKA BIOSCIENCE, INC.

### Forecast and Price Target Reduced Following Q Miss

• **Bottom Line:** We have reduced our forecast and price target meaningfully following ROKA's Q3 miss. The issues which drove the miss are not quick fixes, in our view. That said, they are also not permanent impairments to our belief that ROKA's automation and performance advantages versus conventional molecular food pathogen tests will enable it to garner a meaningful share of this market long term. Thus, while we've reduced our price target to \$8 from \$13, we maintain our Outperform rating.

• **Revenue miss drove negative variance down the P&L.** ROKA reported Q3 revenue of \$1.5M, well shy of the Street's \$2.2M and our \$2.1M forecast. Moreover, the company placed no new Atlas instruments with customers under commercial agreements, which compares negatively to 4 placements in Q2 and 9 placements in Q1. The revenue miss drove negative comparisons versus our expectations down the P&L, ending in a \$0.64 loss per share versus our expectation of a \$0.52 loss.

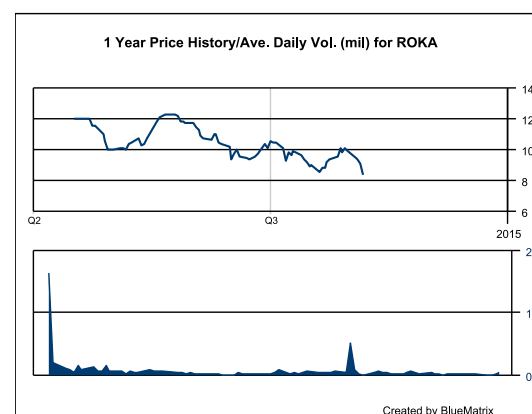
• **False positives with listeria assay at a large customer negatively impact quarter and outlook.** In late August, one of ROKA's largest customers experienced sporadic false positives with the company's listeria test, which negatively impacted its use of this test as well as appetite for additional Atlas instruments. We expect this issue will both directly and indirectly harm ROKA's sales prospects in the near term, though think some perspective is warranted. The potential for false positives has always been a knock on molecular food pathogen and environmental tests, yet these testing modalities have nonetheless captured >30% of the North American food pathogen testing market.

• **Fix for listeria in place; target mid-2015 resolution.** ROKA began work on a more user friendly version of its listeria test in October, and plans to initiate alpha testing for this product in Jan. 2015, with hopes to achieve necessary regulatory clearances for product availability in Q2 2015. While the timeline from alpha to commercialization seems aggressive, we'll note that an environmental listeria test is much more straightforward than a food pathogen test, which must be calibrated to work in many different types of matrices. Thus, we believe the timing doable. The company has done quite a bit of work on the assay already, with real world samples.

• **Other large strategic accounts progressing more slowly than planned.** While we had expected ROKA could have another big customer win to announce by now, this process is progressing slower than planned. One big potential customer now wants to evaluate ROKA's method on real-world samples, a study which it plans to commence next month.

### Key Stats: (NASDAQ:ROKA)

<b>S&amp;P 600 Health Care Index:</b>	<b>1,370.82</b>
<b>Price:</b>	<b>\$8.34</b>
Price Target:	\$8.00 from \$13.00
Methodology:	~6x revenue for 12-mo ended Sept-17, discounted back at 20%
52 Week High:	\$13.00
52 Week Low:	\$8.06
Shares Outstanding (mil):	17.7
Market Capitalization (mil):	\$147.6
Book Value/Share:	\$4.17
Cash Per Share:	\$4.44
Net Debt to Total Capital:	NM
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	\$0.3	\$0.7	\$0.6	\$0.7	\$2.2	(\$0.85)	(\$0.72)	(\$1.19)	(\$0.84)	(\$3.60)	NM
2014E - New	<b>\$0.8A</b>	<b>\$1.4A</b>	<b>\$1.5A</b>	<b>\$1.4</b>	<b>\$5.0</b>	<b>(\$11.92)A</b>	<b>(\$11.28)A</b>	<b>(\$0.64)A</b>	<b>(\$0.52)</b>	<b>(\$4.03)</b>	<b>NM</b>
2014E - Old	\$0.8A	\$1.4A	\$2.1	\$3.8	\$8.2	(\$11.92)A	(\$11.28)A	(\$0.52)	(\$0.45)	(\$24.16)	NM
2015E - New	--	--	--	--	<b>\$9.1</b>	--	--	--	--	<b>(\$1.89)</b>	<b>NM</b>
2015E - Old	--	--	--	--	\$24.5	--	--	--	--	(\$1.43)	NM
2016E - New	--	--	--	--	<b>\$22.3</b>	--	--	--	--	<b>(\$1.56)</b>	<b>NM</b>
2016E - Old	--	--	--	--	\$45.4	--	--	--	--	(\$0.92)	NM

Source: Company Information and Leerink Partners LLC Research  
 Revenues in \$MM, GAAP EPS, IPO priced 7.17.14

## INVESTMENT THESIS

ROKA is a commercial stage company whose molecular technology platform differentiates itself from legacy food safety testing methods. The company has forged customer relationships with some of the largest food companies, contract food testing labs, as well as regulatory bodies. We believe early adoption by sector trendsetters and secular tailwinds are positive signposts for the company's growth prospects, and the automation and performance advantages of its Atlas instrument and tests will enable the company to capture a meaningful share of the molecular food pathogen testing market over time.

## VALUATION

Both the reduction in our revenue forecast as well as compression of the emerging growth tools/diagnostics multiple drove the reduction in our price target for ROKA from \$13 to \$8. Additionally, we are changing our valuation methodology to be consistent with the way we value companies at ROKA's now earlier stage in the product adoption curve (e.g., TTOO [MP]). When calculating a 12-month price target, we would normally calculate an enterprise value, using projected levels of debt and cash, that is a multiple of revenue for the twelve months ended Sept-16 (the forward twelve month revenue estimate, twelve months from now). However, for ROKA, we now project out a year further given the company's stage. We apply a revenue multiple of ~6x (down from ~7.5x previously, due to group multiple compression) to our revenue estimate of ~\$35M for the twelve months ended Sept-17 to yield a price of \$10 in two years. We discount that back at a rate of 20% to arrive at an \$8 12-month price target.

## RISKS TO VALUATION

The primary risks to our price target for ROKA include, but are not limited to: the trajectory of the company's revenue ramp, ability to attract new customers and convert traditional testing methods to molecular, competitive pressures from incumbent and emerging food testing technologies, and failure to innovate product lines.

## Roka Biosciences (ROKA)

## Income Statement

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Period Ended (\$ thousands)	2012	2013	Mar-14	Jun-14	Sep-14	Dec-14e	2014e	2015e	2016e	2017e	2018e
Revenue											
<b>Product</b>	<b>\$105</b>	<b>\$2,182</b>	<b>\$828</b>	<b>\$1,390</b>	<b>\$1,483</b>	<b>\$1,350</b>	<b>\$5,051</b>	<b>\$9,109</b>	<b>\$22,316</b>	<b>\$40,313</b>	<b>\$56,342</b>
Other	<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>
Total revenue	105	2,182	828	1,390	1,483	1,350	5,051	9,109	22,316	40,313	56,342
COGS	<u>3,186</u>	<u>6,600</u>	<u>1,265</u>	<u>1,573</u>	<u>2,578</u>	<u>2,295</u>	<u>7,711</u>	<u>9,200</u>	<u>16,068</u>	<u>22,979</u>	<u>28,171</u>
Gross profit	(3,081)	(4,418)	(437)	(183)	(1,095)	(945)	(2,660)	(91)	6,248	17,335	28,171
SG&A	16,052	17,651	5,090	4,590	5,356	5,873	20,909	23,682	23,432	24,188	25,354
R&D	<u>9,584</u>	<u>7,568</u>	<u>1,842</u>	<u>2,227</u>	<u>1,922</u>	<u>1,917</u>	<u>7,908</u>	<u>8,198</u>	<u>8,926</u>	<u>9,675</u>	<u>10,141</u>
<b>Operating income (loss)</b>	<b>(28,717)</b>	<b>(29,637)</b>	<b>(7,369)</b>	<b>(7,000)</b>	<b>(8,373)</b>	<b>(8,735)</b>	<b>(31,477)</b>	<b>(31,971)</b>	<b>(26,110)</b>	<b>(16,528)</b>	<b>(7,324)</b>
Interest expense (income)	140	3,033	389	378	476	392	1,635	1,607	1,908	2,863	2,753
Other expense, net	<u>(4,996)</u>	<u>0</u>	<u>0</u>	<u>(41)</u>	<u>223</u>	<u>0</u>	<u>182</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Pretax income	(23,861)	(32,670)	(7,758)	(7,337)	(9,072)	(9,127)	(33,294)	(33,578)	(28,018)	(19,391)	(10,078)
Taxes	<u>(763)</u>	<u>0</u>	<u>6</u>	<u>12</u>	<u>11</u>	<u>0</u>	<u>29</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Net income	(\$23,098)	(\$32,670)	(\$7,764)	(\$7,349)	(\$9,083)	(\$9,127)	(\$33,323)	(\$33,578)	(\$28,018)	(\$19,391)	(\$10,078)
Basic shares outstanding		9,069	652	652	14,154	17,654	8,278	17,779	17,979	18,179	18,379
Diluted shares outstanding		9,069	652	652	14,154	17,654	8,278	17,779	17,979	18,179	18,379
<b>EPS diluted</b>		<b>(\$3.60)</b>	<b>(\$11.92)</b>	<b>(\$11.28)</b>	<b>(\$0.64)</b>	<b>(\$0.52)</b>	<b>(\$4.03)</b>	<b>(\$1.89)</b>	<b>(\$1.56)</b>	<b>(\$1.07)</b>	<b>(\$0.55)</b>
<i>EPS growth</i>											
Sales growth		1978.1%	211.2%	107.3%	166.5%	95.9%	131.5%	80.3%	145.0%	80.6%	39.8%
Gross margin	(2934.3%)	(202.5%)	(52.8%)	(13.2%)	(73.8%)	(70.0%)	(52.7%)	(1.0%)	28.0%	43.0%	50.0%
SG&A % of revenue	15287.6%	808.9%	614.7%	330.2%	361.2%	435.0%	413.9%	260.0%	105.0%	60.0%	45.0%
R&D % of revenue	9127.6%	346.8%	222.5%	160.2%	129.6%	142.0%	156.6%	90.0%	40.0%	24.0%	18.0%
<b>Operating margin</b>	<b>(27349.5%)</b>	<b>(1358.2%)</b>	<b>(890.0%)</b>	<b>(503.6%)</b>	<b>(564.6%)</b>	<b>(647.0%)</b>	<b>(623.2%)</b>	<b>(351.0%)</b>	<b>(117.0%)</b>	<b>(41.0%)</b>	<b>(13.0%)</b>
Tax rate	3.2%	0.0%	(0.1%)	(0.2%)	(0.1%)	0.0%	(0.1%)	0.0%	0.0%	0.0%	0.0%
D&A	\$2,045	\$2,437	\$661	\$667	\$700	\$750	\$2,778	\$2,720	\$5,227	\$11,656	\$7,454
<b>EBITDA</b>	<b>(\$26,672)</b>	<b>(\$27,200)</b>	<b>(\$6,708)</b>	<b>(\$6,333)</b>	<b>(\$7,673)</b>	<b>(\$7,985)</b>	<b>(\$28,699)</b>	<b>(\$29,251)</b>	<b>(\$20,883)</b>	<b>(\$4,872)</b>	<b>\$130</b>
<b>Free cash flow</b>											
Operating cash flow	(\$27,774)	(\$27,452)	(\$4,181)	(\$6,217)			(\$26,498)	(\$31,854)	(\$23,408)	(\$6,636)	\$295
CapX	<u>(5,929)</u>	<u>(3,410)</u>	<u>12</u>	<u>(75)</u>			<u>(225)</u>	<u>(920)</u>	<u>(4,717)</u>	<u>(6,529)</u>	<u>(8,150)</u>
Free cash flow	(\$33,703)	(\$30,862)	(\$4,169)	(\$6,292)			(\$26,723)	(\$32,774)	(\$28,125)	(\$13,165)	(\$7,855)

## Notes:

Source: Company reports and Leerink Partners estimates

## Disclosures Appendix

### Analyst Certification

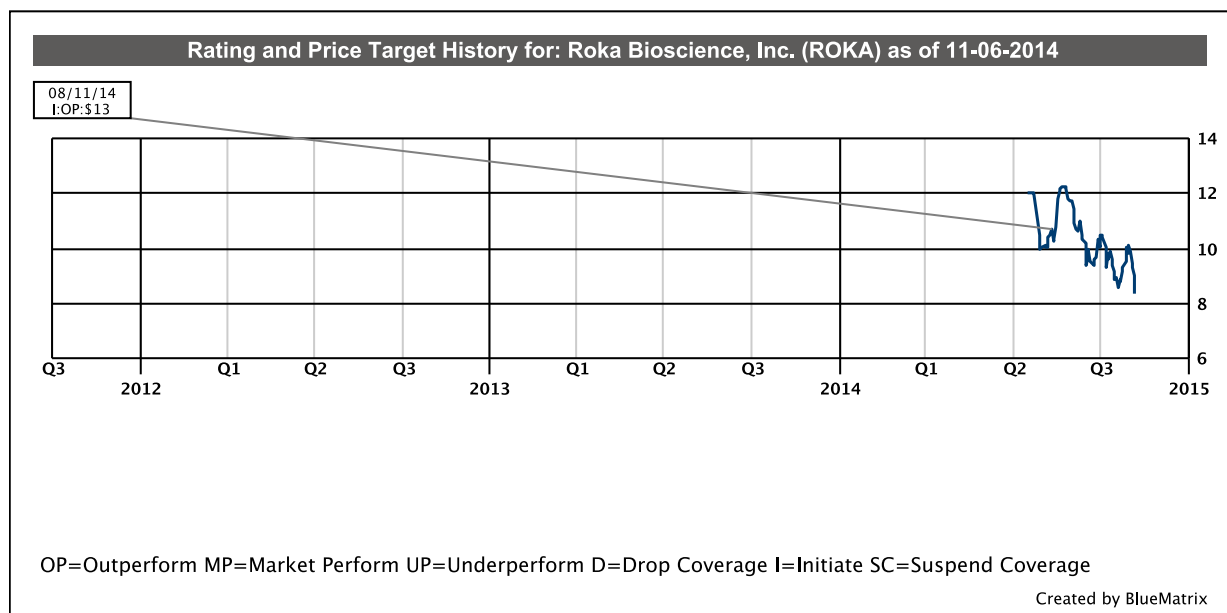
I, Dan Leonard, certify that the views expressed in this report accurately reflect my views and that no part of my compensation was, is, or will be directly related to the specific recommendation or views contained in this report.

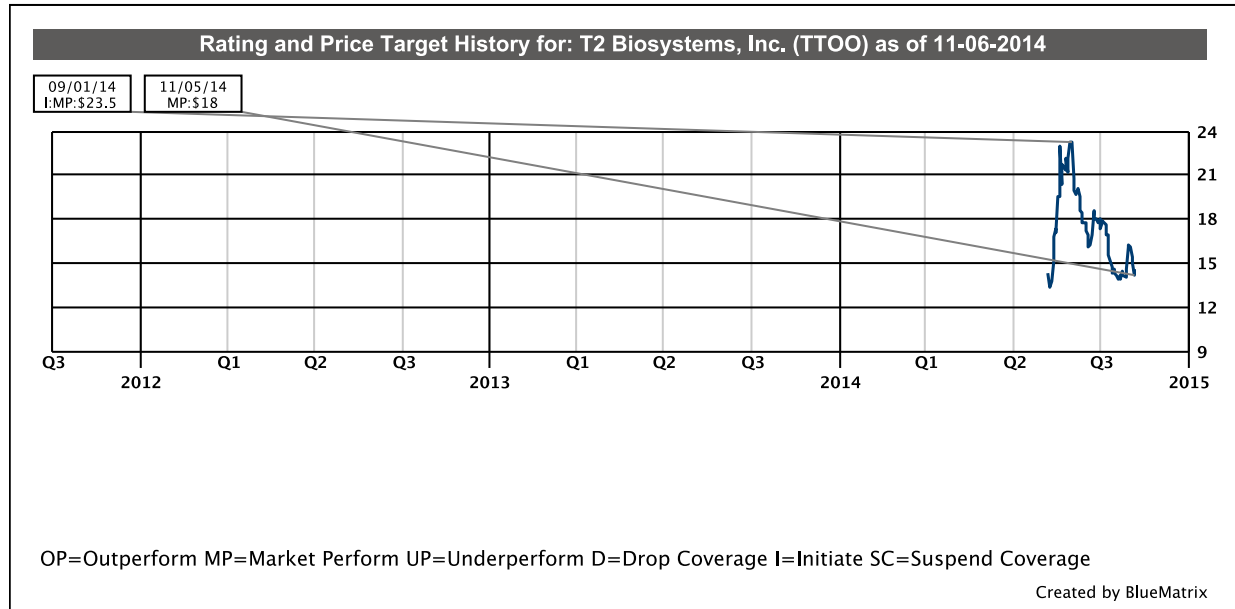
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Distribution of Ratings/Investment Banking Services (IB) as of 09/30/14				
Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY [OP]	138	69.30	51	37.00
HOLD [MP]	61	30.70	2	3.30
SELL [UP]	0	0.00	0	0.00

## 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 Partners LLC makes a market in Roka Bioscience, Inc. and T2 Biosystems, Inc.

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