

CareDx, Inc. (CDNA)

Overweight

4Q14 In-Line, But Kidney Delayed; Reducing Estimates But Stay Overweight on Valuation

CONCLUSION

CareDx reported 4Q14 revenue growth of 35.8% to \$8.0M, above our (\$6.7M) and consensus (\$6.9M) expectations, although a one-time \$1.1M LabCorp payment drove the upside. Excluding the one-time payment, revenue was in-line. Management reiterated its cfDNA-based heart assay launch timelines and data release (ISHLT), although announced a change to cfDNA kidney expectations. Specifically, management will launch the DART study 1H15 (clinical validity) to replace KIDNA, with an 18-month follow up (6-month early access look). As a result, management expects no kidney revenue in 2016 (we were modeling \$10M). While the change in kidney timelines is disappointing, we are encouraged with the first take of cfDNA heart data, suggesting cfDNA can detect rejection before traditional biopsies. We remain Overweight with an \$8 price target based on an unchanged 3.2x FY17E EV/revenue discounted 25% basis, with a lower price target reflecting delayed kidney test timelines.

- 4Q14 In-Line:** CareDx reported 35.8% yoy revenue growth to \$8.0M, above our (\$6.7M) and Street consensus' (\$6.9M) expectations, although excluding a one-time \$1.1M LabCorp lupus payment, revenue was in-line. Product gross margin increased 720 bpts yoy to 67.1%, above our 66.0% estimate. Overall, operating expenses of \$5.3M were unfavorable to our \$5.0M estimate. CDNA's cash balance decreased \$2.6M sequentially to \$36.4M (\$25.0M net cash).
- Business Update:** Management described continued progress penetrating the domestic AlloMap opportunity, with tests delivered increasing 13% yoy to ~3,100 (PJC: 2,996). Management reiterated upcoming cfDNA heart data at ISHLT (4/15-18). As a reminder, our initial take of the data is positive (see our note [here](#)), with cfDNA detecting rejection (up to 25 days) before traditional biopsies. Beyond heart, management announced a change to its kidney cfDNA test development. Specifically, management will launch DART 1 (clinical validity, 1H15) and DART 2 (clinical utility) to collect additional kidney samples necessary for test development (replaces KIDNA), with a DART 1 18-month follow up (6 month early access look), ~200 patients, ~10 centers. As a result to the study change, management expects no kidney contribution to 2016 revenue (we were modeling \$10.0M in F2016 cfDNA kidney).
- F2015 Guidance:** Management guided revenue to increase 2.6%-9.9% to \$28M-\$30M, with the mid-point just below consensus expectations (\$29.7M). We believe initial guidance is conservative, with incremental centers adhering to transplant protocols (48 centers currently out of 109, up 3 sequentially) providing potential upside.

RISKS TO ACHIEVEMENT OF PRICE TARGET

Risks for CareDx include weaker-than-expected AlloMap penetration, pipeline delays and competition.

COMPANY DESCRIPTION

CareDx develops novel tests for recipient organ transplant surveillance.

YEAR	REVENUE (US\$ m)						EARNINGS PER SHARE (US\$)					
	Mar	Jun	Sep	Dec	FY	FY RM	Mar	Jun	Sep	Dec	FY	FY P/E
2014A	5.9	6.8	6.7	8.0	27.3	2.9x	(0.21)	0.02	0.12	0.00	(0.08)	NM
2015E	6.8	7.1	7.4	7.7	29.0	2.8x	(0.18)	(0.19)	(0.18)	(0.16)	(0.72)	NM
2016E	8.2	8.7	9.2	9.7	35.8	2.2x	(0.15)	(0.13)	(0.12)	(0.12)	(0.51)	NM

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PRICE: US\$6.64

TARGET: US\$8.00

3.2x FY17E EV/Revenue discounted 25% to FY16E (FY17E Rev: \$43.4M, FY16E: 13.2M shares outstanding, \$0.02 in net debt/sh).

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Changes	Previous	Current
Rating	—	Overweight
Price Tgt	US\$13.00	US\$8.00
FY15E Rev (mil)	US\$29.1	US\$29.0
FY16E Rev (mil)	US\$42.1	US\$35.8
FY15E EPS	US\$(0.50)	US\$(0.72)
FY16E EPS	US\$0.04	US\$(0.51)

52-Week High / Low	US\$10.89 / US\$5.40
Shares Out (mil)	12.1
Market Cap. (mil)	US\$80.3
Avg Daily Vol (ooo)	33
Book Value/Share	US\$3.40
Net Cash Per Share	US\$2.06
Debt to Total Capital	22%
Yield	0.00%
Fiscal Year End	Dec

Price Performance - 1 Year



Source: Bloomberg

	2014A				2015E				2016E				Annual				
	Mar Qtr 1 A	Jun Qtr 2 A	Sep Qtr 3 A	Dec Qtr 4 A	Mar Qtr 1 E	Jun Qtr 2 E	Sep Qtr 3 E	Dec Qtr 4 E	Mar Qtr 1 E	Jun Qtr 2 E	Sep Qtr 3 E	Dec Qtr 4 E	2013A	2014A	2015E	2016E	2017E
Total Revenue	5,924	6,776	6,654	7,952	6,757	7,145	7,393	7,743	8,234	8,697	9,178	9,672	22,098	27,306	29,038	35,781	43,378
Cost of Product Revenue	2,162	2,403	1,772	2,204	2,262	2,343	2,356	2,406	2,519	2,612	3,055	3,409	9,078	8,541	9,368	11,595	15,417
Gross Profit	3,762	4,373	4,882	5,748	4,495	4,801	5,036	5,338	5,714	6,085	6,123	6,263	13,020	18,765	19,670	24,185	27,961
Operating Expenses:																	
Research & Development - Total	720	792	1,036	1,298	1,937	2,268	2,355	2,396	2,550	2,610	2,666	2,715	0	3,846	8,956	10,541	10,783
Research & Development - Core	720	792	961	1,198	1,824	2,143	2,218	2,246	2,388	2,435	2,478	2,515	3,176	3,671	8,431	9,816	9,733
RUO Heart	-	-	75	100	113	125	138	150	163	175	188	200	0	175	525	725	1,050
Sales & Marketing	1,474	1,610	1,753	1,635	2,335	2,510	2,535	2,560	2,690	2,740	2,645	2,695	5,891	6,472	9,940	10,770	11,555
General & Administrative	1,795	1,566	1,976	2,349	2,027	2,036	2,063	2,091	2,058	2,087	2,111	2,128	4,808	7,686	8,217	8,384	8,664
Other		750	(1,276)	37					110	110	110	110					
Total Operating Expense	3,989	4,718	3,489	5,319	6,299	6,815	6,953	7,046	7,409	7,547	7,531	7,648	13,875	17,515	27,113	30,135	31,442
Operating Income (Loss)	(227)	(345)	1,393	429	(1,804)	(2,013)	(1,917)	(1,709)	(1,694)	(1,463)	(1,408)	(1,385)	(855)	1,250	(7,443)	(5,950)	(3,480)
Interest & other income (expense), net	(1,077)	(278)	(69)	(434)	(404)	(382)	(380)	(360)	(310)	(291)	(267)	(251)	(2,686)	(1,858)	(1,526)	(1,119)	(782)
Pretax Income (Loss)	(1,304)	(623)	1,324	(5)	(2,209)	(2,395)	(2,296)	(2,069)	(2,004)	(1,754)	(1,675)	(1,635)	(3,540)	(608)	(8,969)	(7,069)	(4,263)
Provision for Income Taxes	0	(1,500)	0	0	0	0	0	0	0	0	0	0	0	(1,500)	0	0	0
Net Income (Loss) - Reported	(1,304)	877	1,324	(5)	(2,209)	(2,395)	(2,296)	(2,069)	(2,004)	(1,754)	(1,675)	(1,635)	(3,540)	892	(8,969)	(7,069)	(4,263)
SBC	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Non-Recurring	0	(750)	0	0	0	0	0	0	110	110	110	110	0	(750)	0	440	440
Net Income (Loss) - Ongoing (w/ SBC)	(1,304)	127	1,324	(5)	(2,209)	(2,395)	(2,296)	(2,069)	(1,894)	(1,644)	(1,565)	(1,525)	(3,540)	142	(8,969)	(6,629)	(3,823)
Net Income (Loss) - Non-GAAP	(1,304)	127	1,324	(5)	(2,209)	(2,395)	(2,296)	(2,069)	(1,894)	(1,644)	(1,565)	(1,525)	(3,540)	142	(8,969)	(6,629)	(3,823)
Net Income (assuming 40% Tax)																	
Diluted EPS (Reported)	(0.21)	0.13	0.12	(0.00)	(0.18)	(0.19)	(0.18)	(0.16)	(0.16)	(0.14)	(0.13)	(0.12)	(0.35)	0.03	(0.72)	(0.54)	(0.32)
Diluted EPS (Ongoing, w/ SBC)	(0.21)	0.02	0.12	(0.00)	(0.18)	(0.19)	(0.18)	(0.16)	(0.15)	(0.13)	(0.12)	(0.12)	(0.57)	(0.08)	(0.72)	(0.51)	(0.29)
Avg. Share Outstanding, Diluted	6,172	6,940	11,219	12,129	12,229	12,329	12,429	12,757	12,857	12,957	13,057	13,157	6,172	9,115	12,436	13,007	13,407
Expense Variables:																	
Cost of Revenue	36.5%	35.5%	26.6%	27.7%	33.5%	32.8%	31.9%	31.1%	30.6%	30.0%	33.3%	35.2%	41.1%	31.3%	32.3%	32.4%	35.5%
Research & Development - Total	12.2%	11.7%	15.6%	16.3%	28.7%	31.7%	31.9%	30.9%	31.0%	30.0%	29.0%	28.1%					
Research & Development - Core	12.2%	11.7%	14.4%	15.1%	27.0%	30.0%	30.0%	29.0%	29.0%	28.0%	27.0%	26.0%	14.4%	13.4%	29.0%	27.4%	22.4%
RUO Heart	0.0%	0.0%	1.1%	1.3%	1.7%	1.7%	1.9%	1.9%	2.0%	2.0%	2.0%	2.1%					
Sales & Marketing	24.9%	23.8%	26.3%	20.6%	34.6%	35.1%	34.3%	33.1%	32.7%	31.5%	28.8%	27.9%	26.7%	23.7%	34.2%	30.1%	26.6%
General & Administrative	30.3%	23.1%	29.7%	29.5%	30.0%	28.5%	27.9%	27.0%	25.0%	24.0%	23.0%	22.0%	21.8%	28.1%	28.3%	23.4%	20.0%
Total Operating Expenses	67.3%	69.6%	52.4%	66.9%	93.2%	95.4%	94.1%	91.0%	90.0%	86.8%	82.1%	79.1%	62.8%	64.1%	93.4%	84.2%	72.5%
Effective Interest Rate, cash	0.4%	0.4%	0.4%	0.4%	0.5%	0.5%	0.6%	0.4%	0.7%	0.7%	0.8%	0.8%	-52.4%	-5.1%	-6.7%	-10.0%	-11.0%
Effective Tax Rate	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Margin Analysis:																	
Gross Margin	63.5%	64.5%	73.4%	72.3%	66.5%	67.2%	68.1%	68.9%	69.4%	70.0%	66.7%	64.8%	58.9%	68.7%	67.7%	67.6%	64.5%
Incremental Gross Margin	96.0%	78.5%	186.0%	106.2%	88.0%	116.2%	20.9%	196.9%	82.6%	82.7%	60.9%	48.0%	77.6%	110.3%	52.2%	67.0%	49.7%
Operating Margin	NM	NM	20.9%	5.4%	NM	NM	NM	NM	NM	NM	NM	NM	NM	4.6%	NM	NM	NM
Incremental Operating Margin	58.4%	50.1%	52.8%	-2.1%	-189.4%	-452.6%	-448.1%	1026.5%	14.9%	42.6%	34.6%	22.5%	126.7%	40.4%	-501.9%	22.1%	32.5%
Pretax Margin	NM	NM	19.9%	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Net Income Margin	NM	12.9%	19.9%	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	3.3%	NM	NM	NM
YoY Growth Rates:																	
Total Revenues	18.9%	24.2%	14.6%	35.8%	14.1%	5.4%	11.1%	-2.6%	21.9%	21.7%	24.1%	24.9%	792.9%	23.6%	6.3%	23.2%	21.2%
Cost of Goods Sold (Product Sales)	1.8%	13.4%	-29.2%	-5.5%	4.6%	-2.5%	33.0%	9.2%	11.4%	11.5%	29.6%	41.7%	94.0%	-5.9%	9.7%	23.8%	33.0%
Research & Development	-6.1%	4.0%	20.7%	23.7%	58.4%	55.9%	44.6%	56.6%	15.2%	9.2%	4.3%	5.3%	-61.8%	15.6%	129.7%	16.4%	-0.8%
S, G & A	-28.1%	-6.4%	44.1%	81.2%	153.4%	170.6%	130.8%	87.4%	30.9%	13.6%	11.7%	12.0%	-26.3%	9.9%	53.6%	8.4%	7.3%
Operating Expenses	9.7%	31.3%	-4.0%	76.5%	57.9%	44.4%	99.3%	32.5%	17.6%	10.8%	8.3%	8.5%	-41.0%	26.2%	54.8%	11.1%	4.3%
Operating Income	NM	NM	NM	-16.0%	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Pretax Income	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Net Income (Reported)	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Net Income (Ongoing)	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
EPS	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Other Data:																	
Days Sales Outstanding	33.6	25.7	23.8	25.5	30.4	23.5	23.4	23.1	22.5	19.7	18.3	16.7	37.5	35.9	25.1	16.0	19.1
Inventory Turns	13.9	14.4	12.8	14.9	15.0	17.5	16.0	16.0	16.0	16.0	16.0	16.0	NA	NA	32.6	16.9	16.1
EBITDA Per Share	(0.02)	(0.14)	0.14	0.06	(0.12)	(0.14)	(0.13)	(0.11)	(0.10)	(0.08)	(0.07)	(0.07)	(0.03)	0.13	(0.49)	(0.32)	(0.13)
Free Cash Flow Per Share	0.20	(0.08)	(0.39)	(0.07)	(0.00)	(0.16)	(0.14)	(0.13)	(0.13)	(0.07)	(0.12)	(0.06)	0.33	(0.54)	(0.44)	(0.38)	(0.27)
Net Debt (Cash) Per Share	1.66	1.57	(2.35)	(2.06)	(1.87)	(1.53)	(1.22)	(0.90)	(0.61)	(0.38)	(0.06)	0.02	(0.83)	(4.00)	(1.84)	(0.86)	(0.53)

Source: Company reports and Piper Jaffray & Co. Current disclosure information for this company is located at <http://www.piperjaffray.com/researchdisclosures>.

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R: Resuming Coverage
T: Transferring Coverage
D: Discontinuing Coverage
S: Suspending Coverage
OW: Overweight
N: Neutral
UW: Underweight
NA: Not Available
UR: Under Review

Distribution of Ratings/IB Services Piper Jaffray				
Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY [OW]	371	59.84	100	26.95
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