

## Biocept, Inc.

*Company Description: Biocept is an early-stage cancer diagnostics company with proprietary platforms for circulating tumor cells (CTCs) and circulating tumor DNA (ctDNA) with one test currently marketed and five tests intended to launch in the next 18 months. The company also offers clinical research services to support biopharmaceutical drug development and clinical trial support at their CLIA certified and CAP accredited lab. Biocept is based in San Diego, California.*

Healthcare- Molecular Diagnostics August 15, 2014

### Biocept reports Q2 results, announces sales team, reiterate STRONG BUY (BIOC - \$4.65) STRONG BUY

#### Key Points

- Biocept reported Q2 results last week, with negligible revenue compared to our \$0.1 million estimate and a loss per share of (\$0.67), inline with our estimate.
- Operating expenses of \$2.6 million compared to our \$2.3 million estimate as R&D spend of \$1.1 million compared to our \$0.8 million estimate (the company broke down the increases as follows: \$0.2 million from a higher proportion of R&D-related lab activities, \$0.1 million from facilities, repairs, and maintenance expense). G&A spend of \$1.0 million (including \$0.2 million of stock-based comp) compared to our \$0.9 million estimate, and sales and marketing expenses of \$0.4 million compares to our \$0.6 million estimate.
- ASPs for commercial tests remained flat sequentially at \$758 in the quarter from \$599 for the first six months of 2013. Clinical trial test ASPs remained flat sequentially and year-over-year at \$400. While we have not modeled increasing ASPs during 2014, we anticipate they will increase as Biocept broadens their test menu.
- Management announced the launch of ER (estrogen receptor) status testing on CTCs in the quarter. This will eventually allow for the company to begin marketing the OcoCEE-BR test with ER.
- Biocept's sales force is now at ten reps, with the company noting each hire has more than 15 years of oncology sales experience with firms such as Genentech, Eli Lilly, GE Healthcare, Clariant, Life Technologies, and Labcorp. In chatting with management, we understand the reps are holding their own sales contests and there is competition, which we read as multiple reps closing deals. Management also noted there is strong interest in their technology and that their schedule of meetings with biopharma and other potential collaborators is often full.
- We believe the company remains on track to largely achieve the milestones as previously laid out. However, they have pushed back the introduction date for PR (progesterone receptor) in breast cancer until Q2 2015 in order to focus their resources on lung cancer marker validations. We think this is an appropriate choice as lung cancer represents a more pressing clinical need.
- The company exited June with \$12.5 million of cash on hand. Biocept netted \$17.4 million in a February IPO.
- Reiterating STRONG BUY rating and \$14.00 (3.5x 2016 EV/sales, discounted back 25%) price target.

#### Financial Summary

Rev(mil)	2013A	2014E	2015E
Mar	\$0.0A	\$0.0A	\$1.5E
June	\$0.0A	\$0.0A	\$2.3E
Sept	\$0.0A	\$0.4E	\$3.6E
Dec	\$0.0A	\$0.8E	\$5.1E
FY	\$0.1A	\$1.2E	\$12.5E
P/Sales	207x	17.3x	1.7x

EPS	2013A	2014E	2015E
Mar	(\$10.67)A	(\$1.96)A	(\$0.55)E
June	(\$10.83)A	(\$0.67)A	(\$0.52)E
Sept	(\$15.72)A	(\$0.73)E	(\$0.44)E
Dec	(\$13.57)A	(\$0.77)E	(\$0.29)E
FY	(\$50.80)A	(\$3.70)E	(\$1.79)E
P/E	NM	NM	NM

Price:	\$4.65
52-Week Range:	\$10.02-\$4.16
Target:	\$14.00
Rating:	STRONG BUY
Shares Outstanding:	4.4 mil
Mkt. Capitalization:	\$21 mil
Ave. Volume:	26,000
Instit. Ownership:	N/A
BV / Share:	\$1.55
Debt / Tot. Cap.:	17%
Est. LT EPS Growth:	40%

## INVESTMENT THESIS

Biocept has developed an intriguing platform for the capture of circulating tumor cells (CTCs) and circulating tumor DNA (ctDNA) from whole blood, in essence a "liquid biopsy". Their solution enables analysis of CTCs and ctDNA through traditional methods of cancer diagnostic analysis such as fluorescence in situ hybridization (FISH) as well as newer methods, such as next-generation sequencing (NGS). The "liquid biopsy" aspect presents a huge opportunity to improve care, in our view, as many cancer patients are too unwell to undergo tissue biopsies to monitor their cancers, or the cancer tissues may be inaccessible; in any case, tissue biopsies can be quite expensive. By enabling cancer diagnosis and monitoring through blood draws, we believe Biocept's technology can improve care and reduce costs. That said, the company only has a breast cancer test commercialized to date, and while their pipeline is strong and projected to come to market in the near future, competition exists in the CTC market. We think Biocept's platform has a strong chance of succeeding, given the smart design choices made in the development of their platform. The company, however, has not generated significant revenue to date, and would, as a result, be considered a more speculative investment. Based upon our outlook for the company, we have assigned BIOC share a \$14.00 price target (3.5x 2016 EV/sales, discounted back 25%), and we have assigned the company a STRONG BUY rating.

### Biocept Q1 2014 Variance Analysis

	Estimate	Actual	Variance
<b>Revenue</b>	<b>0.0</b>	<b>0.0</b>	<b>-5.8%</b>
Cost of revenues	0.7	0.7	0.5%
Gross profit	(0.6)	(0.6)	-0.8%
Gross margin	-2083.3%	-2228.3%	
Research and development expenses	0.8	1.0	26.1%
General and administrative expenses	0.9	1.9	105.7%
Sales and marketing expenses	0.3	0.0	-96.6%
Total operating expenses	2.0	2.9	42.2%
<b>Operating income (loss)</b>	<b>(2.7)</b>	<b>(3.5)</b>	<b>-32.5%</b>
Operating margin	-8875.0%	#####	
Interest income (expense)	-	(1.4)	
Change in fair value of warrant liability	-	(0.2)	
Other income (expense)	-	(1.6)	
Income (loss) before income taxes	(2.7)	(5.1)	-92.6%
Income tax expense	-	-	
Tax rate	0.0%	0.0%	
<b>Net income (loss)</b>	<b>(2.7)</b>	<b>(5.1)</b>	<b>-92.6%</b>
<b>EPS</b>			
Basic	\$ (0.91)	\$ (1.96)	-116.3%
Diluted	\$ (0.91)	\$ (1.96)	-116.3%
Weighted average shares outstanding			
Basic	2.9	2.6	-11.0%
Diluted	2.9	2.6	-11.0%

August 15, 2014

Biocept, Inc. (BIOC)

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Income Statement (000s)	2012	Q1	Q2	Q3	Q4	2013	Q1	Q2	Q3	Q4	2014	Q1	Q2E	Q3E	Q4E	2015E	2016E	2017E
Revenue	0.1	0.0	0.0	0.0	0.0	0.1	0.0	0.1	0.4	0.8	1.2	1.5	2.3	3.6	5.1	12.5	28.2	46.4
Cost of revenues	1.2	-	-	-	-	2.3	0.7	0.7	1.0	1.3	3.7	1.9	2.3	2.7	3.1	10.0	11.1	15.4
Gross profit	(1.1)	(0.5)	(0.5)	(0.6)	(0.6)	(2.2)	(0.6)	(0.7)	(0.7)	(0.6)	(2.5)	(0.3)	0.1	0.8	2.0	2.6	17.1	30.9
Gross margin	-999.6%	-1456.7%	-1126.5%	-1839.4%	-2933.7%	-1635.6%	-2228.3%	-1083.3%	-182.5%	-78.3%	-210.7%	-23.0%	2.9%	23.3%	39.4%	20.5%	60.7%	66.7%
Research and development expenses	6.6	0.7	0.7	1.0	0.7	3.1	1.0	0.8	0.9	0.9	3.6	1.0	1.0	1.1	1.2	4.3	4.8	4.8
General and administrative expenses	2.1	0.5	0.5	0.8	0.8	2.5	1.9	0.9	1.0	1.0	4.8	1.0	1.0	1.0	1.0	3.9	4.4	5.0
Sales and marketing expenses	0.0	0.1	0.0	0.0	0.0	0.1	0.0	0.6	0.8	1.0	2.3	1.2	1.4	1.6	1.7	5.9	8.9	12.2
Total operating expenses	8.6	1.3	1.2	1.8	1.5	5.7	2.9	2.3	2.6	2.8	10.7	3.1	3.4	3.6	3.9	14.0	18.1	22.0
Operating income (loss)	(10.5)	(1.8)	(1.7)	(2.4)	(2.1)	(7.9)	(3.5)	(3.0)	(3.3)	(3.4)	(13.2)	(3.5)	(3.3)	(2.8)	(1.9)	(11.5)	(1.0)	9.0
Operating margin	-9610.4%	-5034.6%	-3600.5%	-7438.4%	-10949.7%	-5917.9%	-12474.0%	-4937.5%	-905.1%	-458.2%	-1100.3%	-231.2%	-141.0%	-78.7%	-36.4%	-91.4%	-3.4%	19.3%
Other income (expense)	(0.0)	(0.2)	(0.2)	(0.5)	(0.4)	-	(1.6)	-	-	-	(1.6)	-	-	-	-	-	-	-
Income (loss) before income taxes	(12.3)	(1.9)	(2.0)	(2.9)	(2.5)	(9.2)	(5.1)	(3.0)	(3.3)	(3.4)	(14.8)	(3.5)	(3.3)	(2.8)	(1.9)	(11.5)	(1.0)	9.0
Income tax expense	0.0	-	-	-	-	0.0	-	-	-	-	-	-	-	-	-	-	-	3.6
Tax rate	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%	40.0%
Net income (loss)	(12.3)	(1.9)	(2.0)	(2.9)	(2.5)	(9.2)	(5.1)	(3.0)	(3.3)	(3.4)	(14.8)	(3.5)	(3.3)	(2.8)	(1.9)	(11.5)	(1.0)	5.4
EPS																		
Basic	\$ (76.43)	\$ (10.67)	\$ (10.83)	\$ (15.72)	\$ (13.57)	\$ (50.80)	\$ (1.96)	\$ (0.67)	\$ (0.73)	\$ (0.77)	\$ (3.70)	\$ (0.55)	\$ (0.52)	\$ (0.44)	\$ (0.29)	\$ (1.79)	\$ (0.15)	\$ 0.84
Diluted	\$ (76.43)	\$ (10.67)	\$ (10.83)	\$ (15.72)	\$ (13.57)	\$ (50.80)	\$ (1.96)	\$ (0.67)	\$ (0.73)	\$ (0.77)	\$ (3.70)	\$ (0.55)	\$ (0.52)	\$ (0.44)	\$ (0.29)	\$ (1.79)	\$ (0.13)	\$ 0.62
Weighted average shares outstanding																		
Basic	0.2	0.2	0.2	0.2	0.2	0.2	2.6	4.4	4.4	4.4	4.0	6.4	6.4	6.4	6.4	6.4	6.4	6.4
Diluted	0.2	0.2	0.2	0.2	0.2	0.2	2.6	4.4	4.4	4.4	4.0	6.4	6.4	6.4	6.4	6.4	7.5	8.7

## Analyst Certification

I, **Ben Haynor, CFA**, certify that the views expressed in this research report accurately reflect my personal views about the subject company and its securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation related to the specific recommendations expressed in this report.

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**Strong Buy:** The stock is expected to have total return potential of at least 20%. Catalysts exist to generate higher valuations, and positions should be initiated at current levels.

**Buy:** The stock is expected to have total return potential of at least 10%. Near term catalysts may not exist and the common stock needs further time to develop. Investors requiring time to build positions may consider current levels attractive.

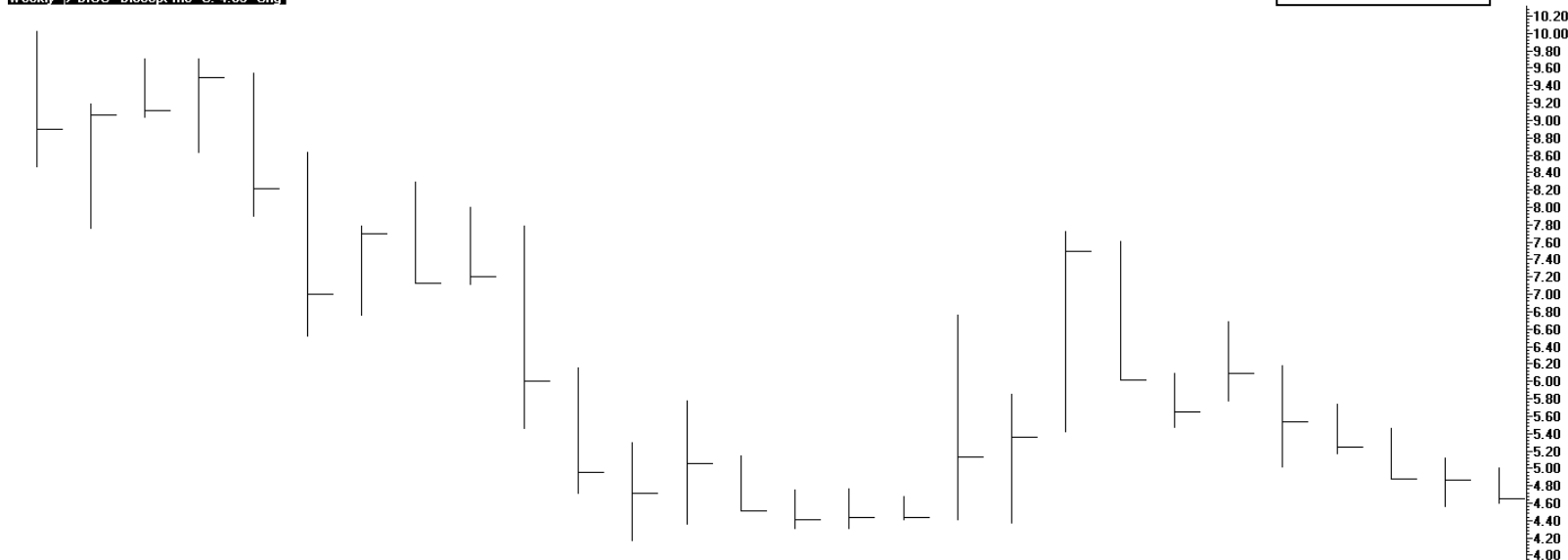
**Hold:** The stock is expected to have total return potential between positive 10% and negative 10%. Fundamental events are not present to make it either a Buy or a Sell. The stock is an acceptable longer-term holding.

**Sell:** Expect a negative total return of at least 10%. Current positions may be used as a source of funds.

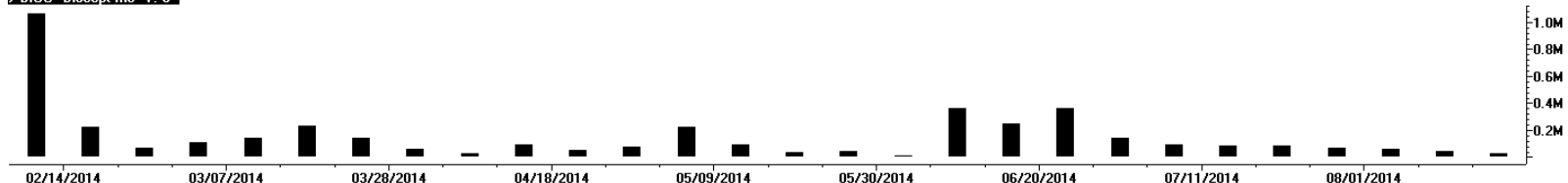
Ratings Distribution for Feltl and Company					8/15/2014
Rating	Number of Stocks	Percent of Total	----- Investment Banking -----		
			Number of Stocks	Percent of Rating category	
SB/Buy	45	63%	6	13%	
Hold	23	32%	1	4%	
Sell	3	4%	0	0%	
	71	100%	7	10%	
The above represents our ratings distribution on the stocks in the Feltl and Company research universe, together with the number in (and percentage of) each category for which Feltl and Company provided investment-banking services in the previous twelve months.					

05/01/14 SB  
Target: \$14.00

Weekly > BIOC Biocept Inc C: 4.65 Chg



> BIOC Biocept Inc V: 0



Date	Nature of Report	Rating	Price Target
05/01/14	Initiation@4.74	StrongBuy	\$14.00

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#### Valuation and Price Target Methodology:

Our valuation is based upon an EV/sales methodology. We have chosen 3.5x 2016 EV/sales as the multiple on which to value Biocept based upon comparable companies at this point in the company's development. Based on our 2016 estimates, discounted back to 2015 at a rate of 25%, this results in a market value of ~\$14.00 per share based upon 6.4 million shares expected to be outstanding at this point next year.

#### Risks to Achievement of Estimates and Price Target:

Additional funding likely needed. Biocept raised net proceeds of \$16.7 million in their recent IPO. The company will likely need to raise additional capital to execute on its plan and fulfill other obligations. We believe the company is most likely to raise additional equity funding, although we cannot rule out non-dilutive funding in the form of a partnership or license agreement. They may also be able to raise capital via a line of credit or debt financing, although we view this as unlikely. If the company chooses to raise funds via an equity offering, which we would consider the most likely option, the raise has the potential to put pressure on the share price.

Biocept has not achieved significant revenue to date. In both 2012 and 2013, Biocept generated just \$0.1 million in revenue. That said, they have not previously had a field sales force. At present, the company has begun building out its sales force, but time-to-productivity for salespeople in the oncology area is usually at least six months.

Requires a behavior change amongst practitioners. The oncology market has long sent off tissue samples to diagnostic laboratories, and behaviors in the medical community can be highly reluctant to change. As such, adoption can be slower than expected for new technologies in medicine; in fact, studies have shown it takes nearly a decade and a half for half of practitioners to adopt a new way of treatment after a major landmark study. In many cancers, it is still in the early innings of the adoption of genomic characterization, although recent FDA approvals of molecularly targeted oncology therapies is likely to increase adoption of molecular diagnostics overall. Despite this, oncologists would need to change their tissue biopsy habits to move to a liquid biopsy, something that may not occur quickly or easily.

Pipeline does not come to fruition. While Biocept believes they have made solid progress towards validation of their pipeline, unforeseen developments can always occur. Based upon other approaches available and validated for capturing CTCs and our belief Biocept's approach has advantages over competing approaches, we believe the company's pipeline will be validated, but there can be no guarantee.

Competitive CTC capture approaches in development or launched, uncertainty on which will capture mind-share. A number of other approaches are being attempted, but it is unclear which ones will ultimately be the winners. Certainly, we have seen cases where better diagnostic technology failed to gain traction in situations where inferior competitors reached market sooner, or similar technological approaches developed by firms with deeper pockets and larger sales forces won out. Please see the "Competition" section that follows for further discussion of competing approaches.

Please review the company's SEC filing for a comprehensive discussion of potential risks.

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