

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 November 14, 2014

Q3 results, lung cancer test launched, reiterate STRONG BUY (BIOC - \$3.46) STRONG BUY

Key Points

- Biocept reported Q3 results yesterday, with revenue of \$10,000 compared to our \$0.3 million estimate and a loss per share of (\$0.87) compared to our (\$0.75) estimate.
- The company accessioned 96 commercial cases during the quarter at an average ASP of \$1,512. In the year-ago quarter, the company accessioned 10 tests at an average ASP of \$1,011. We had neglected to consider the company would not recognize revenue on an accrual basis due to a lack of collection experience; assuming the revenue was recognized on an accrual basis and the average ASP was unchanged, the company would have recognized ~\$150,000 in revenue during the quarter.
- This was compounded by sales force training occurring during the quarter. As a result, the commercial volumes were heavily back-end loaded during the quarter.
- We believe the level of commercial cases despite a “late start” to the quarter due to sales training signals a level of demand from end users slightly ahead of what we would have expected. ASPs on commercial cases were also well above our \$600 assumption.
- Earlier in the week, the company launched its new OncoCEE-LU liquid biopsy test for ALK fusions in non-small cell lung cancer (NSCLC). This is the first of at least five biomarkers the company intends to validate and launch by early 2015.
- Importantly, ALK testing is already incorporated into testing guidelines followed by oncologists when making treatment decisions on NSCLC patients. In addition, Pfizer and Novartis currently market drugs (Xalkori and Zykadia) that treat ALK positive patients, with others in development.
- We believe the test offers an attractive value proposition to healthcare providers, as a study presented recently at the 2014 Chicago Multidisciplinary Symposium in Thoracic Oncology documented that traditional lung biopsy attempts result in a 19.3% risk of complication such as collapsed lung or infection, often increasing cost of care by as much as 300%. With Biocept’s platform able to capture similar information from a blood sample, we believe it will allow for improved patient monitoring at less risk to the patient than a lung biopsy, which typically is only done once in a lung cancer case.
- Management sees additional lung cancer biomarker test launches in the coming months, including EGFR mutations, Ros1 fusions, KRAS mutations, and EGFR and MET amplification.
- Reiterating STRONG BUY rating, but lowering price target to \$11.00 (2.0x 2016 EV/sales, discounted back 25%) from \$14.00. The reduction stems from a lower multiple (previously 3.5x) reflecting a decline in small cap molecular diagnostic firm valuations.

Financial Summary

Rev(mil)	2013A	2014E	2015E
Mar	\$0.0A	\$0.0A	\$0.7E
June	\$0.0A	\$0.0A	\$1.4E
Sept	\$0.0A	\$0.0A	\$3.2E
Dec	\$0.0A	\$0.3E	\$4.7E
FY	\$0.1A	\$0.3E	\$10.0E
P/Sales	1536x	512x	1.5x

EPS	2013A	2014E	2015E
Mar	(\$10.67)A	(\$1.96)A	(\$0.63)E
June	(\$10.83)A	(\$0.67)A	(\$0.58)E
Sept	(\$15.72)A	(\$0.87)E	(\$0.48)E
Dec	(\$13.57)A	(\$0.88)E	(\$0.34)E
FY	(\$50.80)A	(\$3.98)E	(\$2.02)E
P/E	NM	NM	NM

Price:	\$3.46
52-Week Range:	\$10.02-\$2.27
Target:	\$11.00
Rating:	STRONG BUY
Shares Outstanding:	4.4 mil
Mkt. Capitalization:	\$15 mil
Ave. Volume:	25,000
Instit. Ownership:	9%
BV / Share:	\$0.75
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 \$11.00 price target (2.0x 2016 EV/sales, discounted back 25%), and we have assigned the company a STRONG BUY rating.

Quarter Recap

Biocept reported Q3 results yesterday, with revenue of \$10,000 compared to our \$0.3 million estimate and a loss per share of (\$0.87) compared to our (\$0.75) estimate. The company accessioned 96 commercial cases during the quarter at an average ASP of \$1,512. In the year-ago quarter, the company accessioned 10 tests at an average ASP of \$1,011. We had neglected to consider the company would not recognize revenue on an accrual basis due to a lack of collection experience; assuming the revenue was recognized on an accrual basis and the average ASP was unchanged, the company would have recognized ~\$150,000 in revenue during the quarter. This was compounded by sales force training occurring during the quarter. As a result, the commercial volumes were heavily back-end loaded during the quarter. We believe the level of commercial cases despite a "late start" to the quarter due to sales training signals a level of demand from end users slightly ahead of what we would have expected. ASPs on commercial cases were also well above our \$600 assumption.

Operating expenses of \$3.7 million compared to our \$3.3 million estimate as R&D spend of \$1.3 million compared to our \$0.9 million estimate. G&A spend of \$1.1 million compared to our \$1.0 million estimate, and sales and marketing expenses of \$0.8 million compared to our \$0.9 million estimate.

Our Thoughts and Model Adjustments

We neglected to consider Biocept would have to recognize revenue on a cash basis for commercial cases during the quarter and will need to do so until it establishes significant collections experience. However, ASPs were far better than expected. We expect Biocept to establish contracts with commercial insurers in the near future, which management plans on announcing as they take place, which will lead to faster and more assured revenue recognition. Fortunately, the biomarkers being targeted by Biocept are largely well established in clinical practice and guidelines. Thus, we believe the company will be able to obtain payor reimbursement without inordinate difficulty. However, in recognition these developments will not occur immediately, we are adjusting our revenue estimates accordingly to reflect cash-based revenue recognition through Q3 2015. As a result, our Q4 revenue estimate falls to \$0.3 million from \$0.8 million, while our 2015 sales estimate falls to \$10 million from \$12.5 million, as we shift collections by a quarter from when the test was run. From Q3 2015 on, our model is largely unchanged. For instance, our 2016 estimate slips ever so slightly to \$27.6 million from \$28.2 million.

Biocept Q3 2014 Variance Analysis

	Estimate	Actual	Variance
Revenue	0.3	0.0	-96.6%
Cost of revenues	1.0	0.5	-43.9%
Gross profit	(0.7)	(0.5)	20.0%
Gross margin	-220.0%	-5138.3%	
Research and development expenses	0.9	1.3	54.2%
General and administrative expenses	1.0	1.1	9.4%
Sales and marketing expenses	0.9	0.8	-4.5%
Total operating expenses	2.7	3.2	19.2%
Operating income (loss)	(3.3)	(3.7)	-11.5%
Operating margin	-1110.0%	-36126.4%	
Interest income (expense)	-	(0.1)	
Change in fair value of warrant liability	-	-	
Other income (expense)	-	(0.1)	
Income (loss) before income taxes	(3.3)	(3.9)	-15.9%
Income tax expense	-	-	
Tax rate	0.0%	0.0%	
Net income (loss)	(3.3)	(3.9)	-15.9%
EPS			
Basic	\$ (0.75)	\$ (0.87)	-15.9%
Diluted	\$ (0.75)	\$ (0.87)	-15.9%
Weighted average shares outstanding			
Basic	4.450	4.450	0.0%
Diluted	4.450	4.450	0.0%

November 14, 2014

Biocept, Inc. (BIOC)

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Income Statement (000s)	2012	Q1	Q2	Q3	Q4	2013	Q1	Q2	Q3	Q4E	2014E	Q1E	Q2E	Q3E	Q4E	2015E	2016E	2017E
Revenue	0.1	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.3	0.3	0.7	1.4	3.2	4.7	10.0	27.6	45.6
Cost of revenues	1.2	-	-	-	-	2.3	0.7	0.4	0.5	0.9	2.5	1.3	1.6	2.5	2.9	8.4	10.9	15.3
Gross profit	(1.1)	(0.5)	(0.5)	(0.6)	(0.6)	(2.2)	(0.6)	(0.3)	(0.5)	(0.7)	(2.2)	(0.5)	(0.3)	0.7	1.8	1.7	16.7	30.4
Gross margin	-999.6%	-1456.7%	-1126.5%	-1839.4%	-2933.7%	-1635.6%	-2228.3%	-1789.5%	-5138.3%	-250.2%	-671.2%	-74.6%	-19.8%	20.8%	38.1%	16.5%	60.4%	66.6%
Research and development expenses	6.6	0.7	0.7	1.0	0.7	3.1	1.0	1.1	1.3	1.2	4.6	1.2	1.0	1.1	1.2	4.5	4.8	4.8
General and administrative expenses	2.1	0.5	0.5	0.8	0.8	2.5	1.9	1.0	1.1	1.0	5.0	1.0	1.0	1.1	1.1	4.2	5.0	5.0
Sales and marketing expenses	0.0	0.1	0.0	0.0	0.0	0.1	0.0	0.4	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	2.6	3.2	3.2	11.9	3.5	3.4	3.7	4.0	14.6	18.6	22.0
Operating income (loss)	(10.5)	(1.8)	(1.7)	(2.4)	(2.1)	(7.9)	(3.5)	(2.9)	(3.7)	(3.9)	(14.1)	(4.0)	(3.7)	(3.0)	(2.2)	(12.9)	(2.0)	8.4
Operating margin	-9610.4%	-5034.6%	-3600.5%	-7438.4%	-10949.7%	-5917.9%	-12474.0%	-15284.2%	-36126.4%	-1480.3%	-4369.6%	-549.9%	-271.3%	-95.0%	-46.2%	-129.0%	-7.2%	18.4%
Other income (expense)	(0.0)	(0.2)	(0.2)	(0.5)	(0.4)	-	(1.6)	(0.1)	(0.1)	-	(1.8)	-	-	-	-	-	-	-
Income (loss) before income taxes	(12.3)	(1.9)	(2.0)	(2.9)	(2.5)	(9.2)	(5.1)	(3.0)	(3.9)	(3.9)	(15.9)	(4.0)	(3.7)	(3.0)	(2.2)	(12.9)	(2.0)	8.4
Income tax expense	0.0	-	-	-	-	0.0	-	(0.0)	-	-	(0.0)	-	-	-	-	-	-	3.4
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)	(3.9)	(3.9)	(15.9)	(4.0)	(3.7)	(3.0)	(2.2)	(12.9)	(2.0)	5.0
EPS																		
Basic	\$ (76.43)	\$ (10.67)	\$ (10.83)	\$ (15.72)	\$ (13.57)	\$ (50.80)	\$ (1.96)	\$ (0.67)	\$ (0.87)	\$ (0.88)	\$ (3.98)	\$ (0.63)	\$ (0.58)	\$ (0.48)	\$ (0.34)	\$ (2.02)	\$ (0.31)	\$ 0.79
Diluted	\$ (76.43)	\$ (10.67)	\$ (10.83)	\$ (15.72)	\$ (13.57)	\$ (50.80)	\$ (1.96)	\$ (0.67)	\$ (0.87)	\$ (0.88)	\$ (3.98)	\$ (0.63)	\$ (0.58)	\$ (0.48)	\$ (0.34)	\$ (2.02)	\$ (0.29)	\$ 0.58
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	7.0	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.

Important Disclosures:

The analyst or a member of his/her household **does not** hold a long or short position, options, warrants, rights or futures of this security in their personal account(s).

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The analyst **has not** received any compensation for any investment banking business with this company in the past twelve months and **does not** expect to receive any in the next three months.

Feltl and Company **has** been engaged for investment banking services with the subject company during the past twelve months and **does** anticipate receiving compensation for such services in the next three months.

Feltl and Company **has not** served as a broker, either as agent or principal, buying back stock for the subject company's account as part of the company's authorized stock buy-back program in the last twelve months.

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Feltl and Company Rating System: Feltl and Company utilizes a four tier rating system for potential total returns over the next 12 months.

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.

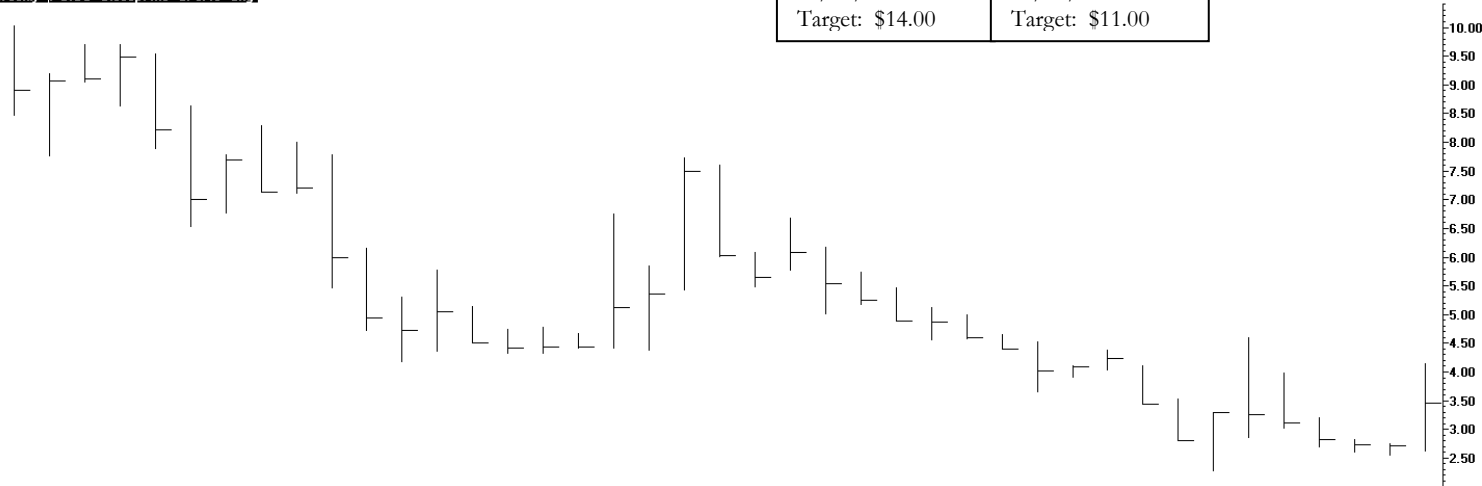
Sell: Expect a negative total return of at least 10%. Current positions may be used as a source of funds.

Ratings Distribution for Feltl and Company					11/14/2014
Rating	Number of Stocks	Percent of Total	----- Investment Banking -----		
			Number of Stocks	Percent of Rating category	
SB/Buy	48	67%	6	13%	
Hold	21	29%	1	5%	
Sell	3	4%	0	0%	
	72	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.					

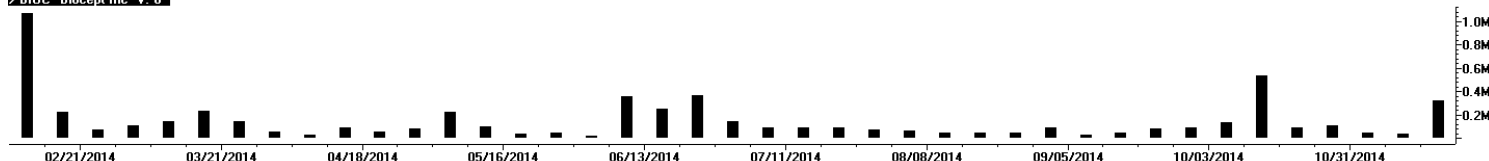
Weekly > BIOC Biocept Inc. C: 3.45 Chn

05/01/14 SB
Target: \$14.00

11/14/14 SB
Target: \$11.00



> BIOC Biocept Inc. V: 0



Date	Nature of Report	Rating	Price Target
05/01/14	Initiation@4.74	StrongBuy	\$14.00
11/14/14	Q3 results, lung cancer test launched, reiterate STRONG BUY	StrongBuy	\$11.00

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Valuation and Price Target Methodology:

Our valuation is based upon an EV/sales methodology. We have chosen 2.0x 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 ~\$11.00 per share based upon 4.4 million shares outstanding.

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.

Other Disclosures:

The information contained in this report is based on sources considered to be reliable, but not guaranteed, to be accurate or complete. Any opinions or estimates expressed herein reflect a judgment made as of this date, and are subject to change without notice. This report has been prepared solely for informative purposes and is not a solicitation or an offer to buy or sell any security. The securities described may not be qualified for purchase in all jurisdictions. Because of individual requirements, advice regarding securities mentioned in this report should not be construed as suitable for all accounts. This report does not take into account the investment objectives, financial situation and needs of any particular client of Feltl and Company. Some securities mentioned herein relate to small speculative companies that may not be suitable for some accounts. Feltl and Company suggests that prior to acting on any of the recommendations herein, the recipient should consider whether such a recommendation is appropriate given their investment objectives and current financial circumstances. Past performance does not guarantee future results. Additional information is available upon request.

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