

CareDx, Inc. (CDNA)

Overweight

3Q14 Strong, Pipeline Remain On Track, Reiterate Overweight

CONCLUSION

CareDx reported a strong quarter, with 14.6% yoy revenue growth to \$6.7M, above our in-line \$6.6M estimate. CareDx received >3,000 Allomap tests in the quarter (+15.5% yoy), above our 2,930 estimate, reflecting strong growth in both new heart transplant recipients and maintenance users. EPS of \$0.12 was favorable to our (\$0.16) estimate and consensus of (\$0.13), with the Roche royalty settlement and change in consideration owed to ImmuMetrix benefiting EPS by ~\$0.16. Management reiterated FY14 guidance, with revenues in the range of \$26M-\$26.5M. Additionally, cfDNA Kidney remains on track. Given Allomap adoption and cfDNA remains in-line with our previous forecasts, we are leaving forward estimates largely unchanged and reiterate our Overweight rating on CDNA shares, with a \$13 price target (unchanged).

- 3Q14 Strong:** CareDx reported a 14.6% yoy revenue increase to \$6.7M, above our \$6.6M estimate (Street: \$6.6M). CareDx received >3,000 Allomap tests in the quarter, an increase of 15.5% yoy and above our 2,930 estimate. Gross margins increased 1,650 bpts yoy to 73.4%, above our 65.4% estimate, although adjusting for the Roche settlement, gross margins were in-line with our estimates. After adjusting for the change in consideration owed to ImmuMetrix, operating expenses increased 31.1%. EPS of \$0.12 was favorable to both our (\$0.16) estimate and consensus of (\$0.13), although both the Roche settlement and change in consideration owed to ImmuMetrix benefited EPS by ~\$0.16.
- Business Update:** Management provided an update on cfDNA test development, with the D-OAR trial on schedule with management's expectations, with expected results to enforce the ability to use cfDNA as a tool to assist in diagnosing heart rejection. Management expects additional heart data will be shown at ISHLT 2015 (April 15-18, 2015). Additionally, Kidney cfDNA KARGO trial remains on track, with data expected 1H15. Management also provided an update on Allomap adoption, with testing protocols established at 45 transplant centers (out of 105) and 28 centers in the protocol development stages. Given testing protocols lead to increased adoption and usage by transplant center physicians, we believe additional centers establishing protocols is a key driver for Allomap volumes going forward.
- F2014 Guidance:** Management reiterated FY14 guidance, with revenue expected to increase 17.7%-19.9% to \$26M-\$26.5M. Given Allomap adoption and cfDNA development remains on track, we are leaving our forward estimates largely unchanged and continue to expect FY17 revenue of \$55.8M, yielding a price target of \$13 (unchanged).

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
2014E	5.9A	6.8A	6.7A	6.7	26.1	2.8x	(0.21)A	0.02A	0.12	(0.09)	(0.16)	NM
2015E	6.8	7.1	7.4	7.8	29.1	2.5x	(0.13)	(0.14)	(0.13)	(0.10)	(0.50)	NM
2016E	8.4	10.0	11.2	12.5	42.1	1.7x	(0.09)	(0.01)	0.04	0.10	0.04	NM

PRICE: US\$6.41

TARGET: US\$13.00

3.2x FY17E EV/Revenue discounted 25% to FY16E (FY17E Rev: \$55.8M, FY16E: 12.3M shares outstanding, \$1.53 in net cash/sh).

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Changes	Previous	Current
Rating	—	Overweight
Price Tgt	—	US\$13.00
FY15E Rev (mil)	US\$29.2	US\$29.1
FY16E Rev (mil)	—	US\$42.1
FY15E EPS	—	US\$(0.50)
FY16E EPS	—	US\$0.04

52-Week High / Low	US\$10.89 / US\$5.40
Shares Out (mil)	11.2
Market Cap. (mil)	US\$71.8
Avg Daily Vol (ooo)	27
Book Value/Share	US\$3.66
Net Cash Per Share	US\$2.35
Debt to Total Capital	24%
Yield	0.00%
Fiscal Year End	Dec

Price Performance - 1 Year



Source: Bloomberg

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	2014E				2015E				2016E								
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	2013A	2014E	Annual 2015E	2016E	2017E
	Qtr 1 A	Qtr 2 A	Qtr 3 A	Qtr 4 E	Qtr 1 E	Qtr 2 E	Qtr 3 E	Qtr 4 E	Qtr 1 E	Qtr 2 E	Qtr 3 E	Qtr 4 E					
Total Revenue	5,924	6,776	6,654	6,733	6,757	7,147	7,410	7,816	8,447	10,012	11,153	12,456	22,098	26,087	29,131	42,068	55,832
Cost of Product Revenue	2,162	2,403	1,772	2,287	2,278	2,702	2,766	2,904	3,327	3,775	4,185	4,665	9,078	8,624	10,650	15,953	20,352
Gross Profit	3,762	4,373	4,882	4,446	4,479	4,445	4,644	4,912	5,120	6,237	6,968	7,791	13,020	17,463	18,481	26,115	35,480
Operating Expenses:																	
Research & Development - Total	720	792	1,036	1,200	1,937	2,055	2,064	2,026	2,063	2,077	2,195	2,193	0	3,748	8,082	8,528	8,556
Research & Development - Core	720	792	961	1,100	1,824	1,930	1,927	1,876	1,901	1,902	2,008	1,993	3,176	3,573	7,557	7,803	7,506
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	1,778	1,678	1,703	1,728	1,753	1,883	1,933	1,838	1,888	5,891	6,615	6,862	7,542	10,682
General & Administrative	1,795	1,566	1,976	1,985	1,960	1,965	1,964	1,954	1,985	2,052	2,175	2,242	4,808	7,322	7,843	8,454	9,411
Other		750	(1,276)						110	110	110	110					
Total Operating Expense	3,989	4,718	3,489	4,963	5,574	5,723	5,756	5,733	6,041	6,173	6,318	6,433	13,875	17,159	22,786	24,965	29,089
Operating Income (Loss)	(227)	(345)	1,393	(517)	(1,095)	(1,278)	(1,112)	(821)	(921)	64	650	1,358	(855)	304	(4,305)	1,151	6,392
Interest & other income (expense), net	(1,077)	(278)	(69)	(500)	(404)	(383)	(379)	(359)	(307)	(287)	(261)	(240)	(2,686)	(1,924)	(1,525)	(1,095)	(694)
Pretax Income (Loss)	(1,304)	(623)	1,324	(1,017)	(1,499)	(1,661)	(1,491)	(1,179)	(1,228)	(223)	389	1,118	(3,540)	(1,620)	(5,830)	56	5,698
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	(1,017)	(1,499)	(1,661)	(1,491)	(1,179)	(1,228)	(223)	389	1,118	(3,540)	(120)	(5,830)	56	5,698
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	(1,017)	(1,499)	(1,661)	(1,491)	(1,179)	(1,118)	(113)	499	1,228	(3,540)	(870)	(5,830)	496	6,138
Net Income (Loss) - Non-GAAP	(1,304)	127	1,324	(1,017)	(1,499)	(1,661)	(1,491)	(1,179)	(1,118)	(113)	499	1,228	(3,540)	(870)	(5,830)	496	6,138
Net Income (assuming 40% Tax)																	
Diluted EPS (Reported)	(0.21)	0.13	0.12	(0.09)	(0.13)	(0.14)	(0.13)	(0.10)	(0.10)	(0.02)	0.03	0.09	(0.35)	(0.06)	(0.50)	0.00	0.45
Diluted EPS (Ongoing, w/ SBC)	(0.21)	0.02	0.12	(0.09)	(0.13)	(0.14)	(0.13)	(0.10)	(0.09)	(0.01)	0.04	0.10	(0.57)	(0.16)	(0.50)	0.04	0.49
Avg. Share Outstanding, Diluted	6,172	6,940	11,219	11,319	11,419	11,519	11,619	11,947	12,047	12,147	12,247	12,347	6,172	8,913	11,626	12,197	12,597
Expense Variables:																	
Cost of Revenue	36.5%	35.5%	26.6%	34.0%	33.7%	37.8%	37.3%	37.2%	39.4%	37.7%	37.5%	37.5%	41.1%	33.1%	36.6%	37.9%	36.5%
Research & Development - Total	12.2%	11.7%	15.6%	17.8%	28.7%	28.7%	27.9%	25.9%	24.4%	20.7%	19.7%	17.6%	14.4%	13.7%	25.9%	18.5%	13.4%
Research & Development - Core	12.2%	11.7%	14.4%	16.3%	27.0%	27.0%	26.0%	24.0%	22.5%	19.0%	18.0%	16.0%	14.4%	13.7%	25.9%	18.5%	13.4%
RUO Heart	0.0%	0.0%	1.1%	1.5%	1.7%	1.7%	1.9%	1.9%	1.9%	1.7%	1.7%	1.6%	0.0%	0.0%	1.1%	1.5%	1.5%
Sales & Marketing	24.9%	23.8%	26.3%	26.4%	24.8%	23.8%	23.3%	22.4%	22.3%	19.3%	16.5%	15.2%	26.7%	25.4%	23.6%	17.9%	19.1%
General & Administrative	30.3%	23.1%	29.7%	29.5%	29.0%	27.5%	26.5%	25.0%	23.5%	20.5%	19.5%	18.0%	21.8%	28.1%	26.9%	20.1%	16.9%
Total Operating Expenses	67.3%	69.6%	52.4%	73.7%	82.5%	80.1%	77.7%	73.3%	71.5%	61.7%	56.6%	51.6%	62.8%	65.8%	78.2%	59.3%	52.1%
Effective Interest Rate, cash	0.4%	0.4%	0.4%	0.4%	0.5%	0.5%	0.6%	0.6%	0.7%	0.7%	0.8%	0.8%	-52.4%	-5.3%	-6.2%	-5.9%	-2.8%
Effective Tax Rate	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	0.0%	0.0%
Margin Analysis:																	
Gross Margin	63.5%	64.5%	73.4%	66.0%	66.3%	62.2%	62.7%	62.8%	60.6%	62.3%	62.5%	62.5%	58.9%	66.9%	63.4%	62.1%	63.5%
Incremental Gross Margin	96.0%	78.5%	186.0%	105.2%	86.1%	19.5%	-31.5%	43.1%	37.9%	62.5%	62.1%	62.0%	77.6%	111.4%	33.4%	59.0%	68.0%
Operating Margin	NM	NM	20.9%	NM	NM	NM	NM	NM	NM	0.6%	5.8%	10.9%	NM	1.2%	NM	2.7%	11.4%
Incremental Operating Margin	58.4%	50.1%	52.8%	-117.1%	-104.2%	-251.3%	-331.1%	-28.0%	16.8%	50.7%	50.0%	49.3%	126.7%	29.1%	-151.5%	42.2%	38.1%
Pretax Margin	NM	NM	19.9%	NM	NM	NM	NM	NM	NM	NM	3.5%	9.0%	NM	NM	NM	0.1%	10.2%
Net Income Margin	NM	12.9%	19.9%	NM	NM	NM	NM	NM	NM	NM	3.5%	9.0%	NM	NM	NM	0.1%	10.2%
YoY Growth Rates:																	
Total Revenues	18.9%	24.2%	14.6%	15.0%	14.1%	5.5%	11.4%	16.1%	25.0%	40.1%	50.5%	59.4%	792.9%	18.1%	11.7%	44.4%	32.7%
Cost of Goods Sold (Product Sales)	1.8%	13.4%	-29.2%	-2.0%	5.3%	12.4%	56.1%	27.0%	46.1%	39.7%	51.3%	60.7%	94.0%	-5.0%	23.5%	49.8%	27.6%
Research & Development	-6.1%	4.0%	20.7%	34.5%	13.8%	5.8%	-1.4%	-1.4%	12.2%	13.5%	6.4%	7.7%	-61.8%	12.5%	111.5%	3.3%	-3.8%
S, G & A	-28.1%	-6.4%	44.1%	66.4%	153.4%	143.7%	100.5%	70.5%	4.2%	-1.4%	4.2%	6.2%	-26.3%	12.3%	3.7%	9.9%	41.6%
Operating Expenses	9.7%	31.3%	-4.0%	64.7%	39.7%	21.3%	65.0%	15.5%	8.4%	7.9%	9.8%	12.2%	-41.0%	23.7%	32.8%	9.6%	16.5%
Operating Income	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	455.5%
Pretax Income	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	10104.2%
Net Income (Reported)	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	10104.2%
Net Income (Ongoing)	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	1137.9%
EPS	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	1177.1%
Other Data:																	
Days Sales Outstanding	33.6	25.7	23.8	24.0	24.3	23.5	23.4	23.1	22.5	19.7	18.3	16.7	37.5	25.1	25.5	20.0	16.8
Inventory Turns	13.9	14.4	12.8	18.0	17.0	17.5	16.0	16.0	16.0	16.0	16.0	16.0	NA	NA	28.3	16.2	15.5
EBITDA Per Share	(0.02)	(0.14)	0.15	(0.01)	(0.07)	(0.08)	(0.07)	(0.04)	(0.04)	0.04	0.09	0.14	(0.03)	0.05	(0.26)	0.23	0.64
Free Cash Flow Per Share	0.20	(0.08)	(0.28)	(0.02)	(0.07)	(0.10)	(0.08)	(0.07)	(0.08)	0.00	0.01	0.05	0.33	(0.23)	(0.32)	0.02	0.52
Net Debt (Cash) Per Share	1.66	1.57	(2.35)	(2.11)	(1.84)	(1.55)	(1.27)	(0.99)	(0.74)	(0.57)	(0.39)	(0.48)	(0.83)	(4.11)	(2.11)	(1.53)	(1.97)

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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Legend:

I: Initiating Coverage
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]	375	61.68	95	25.33
HOLD [N]	221	36.35	23	10.41
SELL [UW]	12	1.97	0	0.00

Note: Distribution of Ratings/IB Services shows the number of companies currently in each rating category from which Piper Jaffray and its affiliates received compensation for investment banking services within the past 12 months. FINRA rules require disclosure of which ratings most closely correspond with "buy," "hold," and "sell" recommendations. Piper Jaffray ratings are not the equivalent of buy, hold or sell, but instead represent recommended relative weightings. Nevertheless, Overweight corresponds most closely with buy, Neutral with hold and Underweight with sell. See Stock Rating definitions below.

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- **Neutral (N):** Anticipated to perform in line relative to the median of the group of stocks covered by the analyst.
- **Underweight (UW):** Anticipated to underperform relative to the median of the group of stocks covered by the analyst.

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