

CareDx, Inc. (CDNA)

Overweight

2Q14 Solid; Allomap Volumes Strong; cfDNA On-Track; Remain Overweight

CONCLUSION

CareDx reported a solid quarter, with 24.2% yoy revenue growth to \$6.8M, above our in-line \$6.4M estimate. CareDx received >3,000 Allomap tests in the quarter (+20.7% yoy, 7.5% qoq), above our 2,867 estimate, reflecting strong growth in both new heart transplant recipients and maintenance users. EPS of \$0.02 was favorable to our (\$0.15) and consensus' (\$0.13) estimates, due to lower R&D and G&A spend. Management provided F2014 guidance, forecasting revenues of \$26M-\$26.5M (PJC: \$25.7M). Additionally, cfDNA Kidney remains on-track, with KARGO data expected 1H15. Given Allomap adoption and cfDNA remain in-line with our previous forecasts, we are leaving forward estimates largely unchanged and continue to remain Overweight CDNA shares with a \$13 price target (unchanged).

- 2Q14 Solid:** CareDx reported a 24.2% yoy revenue increase to \$6.8M, above our in-line \$6.4M estimate (Street: \$6.3M). CareDx received >3,000 Allomap tests in the quarter, an increase of 20.7% yoy and above our 2,867 estimate. Gross margins increased 340 bpts yoy to 64.5%, below our 65.0% estimate. Operating expenses increased 31.3% yoy, reflecting higher G&A and S&M spend. After eliminating a one-time tax benefit and expenses related to the ImmuMetrix acquisition, EPS of \$0.02 was favorable to both our (\$0.15) and consensus' (\$0.13) estimates.
- Business Update:** Management provided an update on cfDNA test development, discussing the launch of the D-OAR trial at Allegheny General, with expected results to enforce the ability to use cfDNA as a tool to assist in diagnosing heart rejection. Additionally, kidney cfDNA trials remain on-track, with data from KARGO expected 1Q15 and 1H15, respectively. Management discussed the recently announced LDT regulation from the FDA, with cfDNA Kidney expected to remain a LDT for commercialization. Management believes they are prepared for FDA approval if necessary, given their experience with the already FDA-approved Allomap. Management also provided an update on Allomap adoption, with testing protocols established at 60 transplant centers (out of 105). 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 provided FY14 guidance, with revenue expected to increase 17.7%-19.9% to \$26M-\$26.5M, topping our \$25.7M estimate (Street: \$25.6M). Given Allomap adoption and cfDNA development remains on-track, we are leaving our forward estimates largely unchanged and continue to expect F2017 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.

PRICE: US\$9.95

TARGET: US\$13.00

3.2x FY17E EV/Revenue discounted 25% to FY16E (FY17E Rev: \$55.8M, FY16E: 12.5M shares outstanding, \$1.44 in net cash/sh).

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Changes	Previous	Current
Rating	—	Overweight
Price Tgt	—	US\$13.00
FY15E Rev (mil)	US\$29.1	US\$29.2
FY16E Rev (mil)	—	US\$42.1
FY15E EPS	—	US\$(0.50)
FY16E EPS	—	US\$0.04
52-Week High / Low	US\$10.88 / US\$8.49	
Shares Out (mil)	6.9	
Market Cap. (mil)	US\$68.7	
Book Value/Share	US\$(0.21)	
Net Cash Per Share	US\$0.73	
Debt to Total Capital	0%	
Yield	0.00%	
Fiscal Year End	Dec	

Price Performance - 1 Year

Source: Bloomberg

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	6.6	6.7	26.0	2.6x	(0.21)A	0.02A	(0.16)	(0.12)	(0.48)	NM
2015E	6.8	7.1	7.4	7.8	29.2	2.4x	(0.13)	(0.15)	(0.13)	(0.10)	(0.50)	NM
2016E	8.4	10.0	11.2	12.5	42.1	1.6x	(0.09)	(0.01)	0.04	0.10	0.04	NM

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	2014E				2015E				2016E				Annual				
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	2013A	2014E	2015E	2016E	2017E
	Qtr 1 A	Qtr 2 A	Qtr 3 E	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	6,574	6,733	6,757	7,147	7,432	7,816	8,447	10,012	11,167	12,456	22,098	26,008	29,152	42,082	55,847
Cost of Product Revenue	2,162	2,403	2,277	2,302	2,293	2,718	2,783	2,921	3,346	3,795	4,206	4,687	9,078	9,145	10,716	16,033	20,392
Gross Profit	3,762	4,373	4,297	4,431	4,464	4,429	4,648	4,895	5,101	6,217	6,961	7,769	13,020	16,863	18,436	26,048	35,456
Operating Expenses:																	
Research & Development - Total	720	792	1,575	1,700	1,869	1,983	1,995	1,948	1,923	1,863	1,848	1,803	0	4,787	7,796	7,437	8,128
Research & Development - Core	720	792	1,500	1,600	1,757	1,858	1,858	1,798	1,774	1,702	1,675	1,619	3,176	4,612	7,271	6,770	7,162
R&D Heart	-	-	75	100	113	125	138	150	150	161	173	184	0	175	525	667	966
Sales & Marketing	1,474	1,610	2,190	1,765	1,770	1,820	1,790	1,795	1,925	2,125	2,170	2,220	5,891	7,039	7,175	8,440	11,010
General & Administrative	1,795	1,566	1,850	1,900	1,926	1,965	1,969	1,993	2,027	2,103	2,200	2,242	4,808	7,111	7,854	8,572	9,338
Other		750							110	110	110	110					
Total Operating Expense	3,989	4,718	5,615	5,365	5,565	5,769	5,755	5,736	5,986	6,201	6,327	6,375	13,875	19,687	22,824	24,889	28,916
Operating Income (Loss)	(227)	(345)	(1,318)	(934)	(1,101)	(1,340)	(1,106)	(841)	(884)	17	633	1,394	(855)	(2,824)	(4,388)	1,160	6,539
Interest & other income (expense), net	(1,077)	(278)	(500)	(500)	(405)	(384)	(381)	(361)	(310)	(291)	(267)	(248)	(2,686)	(2,355)	(1,530)	(1,116)	(735)
Pretax Income (Loss)	(1,304)	(623)	(1,818)	(1,434)	(1,506)	(1,723)	(1,487)	(1,202)	(1,194)	(274)	367	1,146	(3,540)	(5,179)	(5,918)	43	5,804
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	(1,818)	(1,434)	(1,506)	(1,723)	(1,487)	(1,202)	(1,194)	(274)	367	1,146	(3,540)	(3,679)	(5,918)	43	5,804
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	(1,818)	(1,434)	(1,506)	(1,723)	(1,487)	(1,202)	(1,084)	(164)	477	1,256	(3,540)	(4,429)	(5,918)	483	6,244
Net Income (Loss) - Non-GAAP	(1,304)	127	(1,818)	(1,434)	(1,506)	(1,723)	(1,487)	(1,202)	(1,084)	(164)	477	1,256	(3,540)	(4,429)	(5,918)	483	6,244
Net Income (assuming 40% Tax)																	
Diluted EPS (Reported)	(0.21)	0.13	(0.16)	(0.12)	(0.13)	(0.15)	(0.13)	(0.10)	(0.10)	(0.02)	0.03	0.09	(0.35)	(0.37)	(0.50)	0.00	0.45
Diluted EPS (Ongoing, w/ SBC)	(0.21)	0.02	(0.16)	(0.12)	(0.13)	(0.15)	(0.13)	(0.10)	(0.09)	(0.01)	0.04	0.10	(0.57)	(0.48)	(0.50)	0.04	0.49
Avg. Share Outstanding, Diluted	6,172	6,940	11,379	11,479	11,579	11,679	11,779	12,107	12,207	12,307	12,407	12,507	6,172	8,993	11,786	12,357	12,757
Expense Variables:																	
Cost of Revenue	36.5%	35.5%	34.6%	34.2%	33.9%	38.0%	37.5%	37.4%	39.6%	37.9%	37.7%	37.6%	41.1%	35.2%	36.8%	38.1%	36.5%
Research & Development - Total	12.2%	11.7%	24.0%	25.2%	27.7%	27.7%	26.9%	24.9%	22.8%	18.6%	16.5%	14.5%	14.4%	17.7%	24.9%	16.1%	12.8%
Research & Development - Core	12.2%	11.7%	22.8%	23.8%	26.0%	26.0%	25.0%	23.0%	21.0%	17.0%	15.0%	13.0%	14.4%	17.7%	24.9%	16.1%	12.8%
R&D Heart	0.0%	0.0%	1.1%	1.5%	1.7%	1.7%	1.9%	1.9%	1.8%	1.6%	1.5%	1.5%	26.7%	27.1%	24.6%	20.1%	19.7%
Sales & Marketing	24.9%	23.8%	33.3%	26.2%	26.2%	25.5%	24.1%	23.0%	22.8%	21.2%	19.4%	17.8%	21.8%	27.3%	26.9%	20.4%	16.7%
General & Administrative	30.3%	23.1%	28.1%	28.2%	28.5%	27.5%	26.5%	25.5%	24.0%	21.0%	19.7%	18.0%	62.8%	75.7%	78.3%	59.1%	51.8%
Total Operating Expenses	67.3%	69.6%	85.4%	79.7%	82.4%	80.7%	77.4%	73.4%	70.9%	61.9%	56.7%	51.2%	-52.4%	-6.6%	-6.7%	-8.0%	-4.0%
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%	NM	NM	NM	0.0%	0.0%
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%	65.4%	65.8%	66.1%	62.0%	62.5%	62.6%	60.4%	62.1%	62.3%	62.4%	58.9%	64.8%	63.2%	61.9%	63.5%
Incremental Gross Margin	96.0%	78.5%	129.2%	103.5%	84.3%	15.1%	41.0%	42.8%	37.7%	62.4%	61.9%	62.0%	77.6%	98.3%	50.0%	58.9%	68.3%
Operating Margin	NM	NM	NM	NM	NM	NM	NM	NM	NM	0.2%	5.7%	11.2%	NM	NM	NM	2.8%	11.7%
Incremental Operating Margin	58.4%	50.1%	-128.3%	-164.6%	-105.0%	-268.0%	24.7%	8.6%	19.3%	51.2%	49.5%	50.5%	126.7%	-50.4%	-49.8%	42.9%	39.1%
Pretax Margin	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	3.3%	9.2%	NM	NM	NM	0.1%	10.4%
Net Income Margin	NM	12.9%	NM	NM	NM	NM	NM	NM	NM	NM	3.3%	9.2%	NM	NM	NM	0.1%	10.4%
YoY Growth Rates:																	
Total Revenues	18.9%	24.2%	13.3%	15.0%	14.1%	5.5%	13.0%	16.1%	25.0%	40.1%	50.3%	59.4%	792.9%	17.7%	12.1%	44.4%	32.7%
Cost of Goods Sold (Product Sales)	1.8%	13.4%	-9.0%	-1.3%	6.1%	13.1%	22.2%	26.9%	45.9%	39.6%	51.1%	60.4%	94.0%	0.7%	17.2%	49.6%	27.2%
Research & Development	-6.1%	4.0%	50.8%	33.5%	20.1%	13.0%	-18.3%	1.7%	8.8%	16.8%	21.2%	23.7%	-61.8%	45.2%	57.6%	-6.9%	5.8%
S, G & A	-28.1%	-6.4%	124.9%	142.1%	144.0%	134.6%	23.9%	12.4%	1.0%	-8.4%	-9.8%	-9.9%	-26.3%	19.5%	1.9%	17.6%	30.5%
Operating Expenses	9.7%	31.3%	54.5%	78.1%	39.5%	22.3%	2.5%	6.9%	7.6%	7.5%	9.9%	11.1%	-41.0%	41.9%	15.9%	9.0%	16.2%
Operating Income	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	463.9%
Pretax Income	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	13257.6%
Net Income (Reported)	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	13257.6%
Net Income (Ongoing)	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	1191.5%
EPS	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	1234.4%
Other Data:																	
Days Sales Outstanding	38.4	36.9	27.0	29.2	29.9	29.0	28.7	30.4	33.2	31.7	31.7	31.7	37.5	30.0	34.7	39.0	35.6
Inventory Turns	12.0	11.0	13.0	11.0	10.0	11.0	10.5	10.0	10.5	11.0	11.0	11.0	NA	NA	17.2	10.5	10.2
EBITDA Per Share	(0.02)	(0.15)	(0.09)	(0.05)	(0.07)	(0.09)	(0.07)	(0.05)	(0.04)	0.03	0.08	0.14	(0.03)	(0.31)	(0.27)	0.23	0.64
Free Cash Flow Per Share	0.20	(0.16)	(0.22)	(0.05)	(0.08)	(0.11)	(0.10)	(0.11)	(0.13)	(0.06)	(0.07)	(0.00)	0.33	(0.33)	(0.40)	(0.23)	0.39
Net Debt (Cash) Per Share	(0.49)	(0.73)	(3.40)	(3.13)	(2.84)	(2.53)	(2.24)	(1.89)	(1.58)	(1.35)	(1.08)	(1.11)	(0.83)	(3.99)	(1.94)	(1.12)	(1.44)

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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]	363	61.53	98	27.00
HOLD [N]	216	36.61	22	10.19
SELL [UW]	11	1.86	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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