

Reason for report:

**EARNINGS****CAREDX, INC.**

**Another Steady Q, Look to 1H15 for Upcoming Catalysts; Reit. OP at \$10 PT**

• **Bottom Line:** CareDx reported 3Q14 results after the close November 10. We reiterate our Outperform rating following the quarter while reducing our price target to \$10 from \$13 due to compression of the group multiple.

• **Revenue beat and positive operating margin track with growth expectations.** Revenue for the quarter came in at \$6.7M, above our \$6.6M estimate. AlloMap test volumes came in at >3,000, representing 16% YoY volume growth. Gross margin came in at 73.4%, above our estimate of 65%. Gross margin includes a \$550k one-time benefit from the reversal of an accrual related to the Roche settlement, the exclusion of which brings gross margin in line with our estimate. EBIT margin came in at 1.8%, above our (18.5%) estimate, driven primarily by lower-than-anticipated R&D expense. EBIT margin excludes a \$1.3M benefit in the quarter from the reversal of a contingent consideration owed to ImmuMetrix shareholders.

• **AlloMap growth is tracking to expectations, with data discussion on the Outcomes AlloMap Registry (OAR) expected at the International Society for Heart & Lung Transplantation (ISHLT) in April 2015.** AlloMap is used in 105 of 125 heart transplant centers (no change since 2Q14). 45 centers have now established official protocols while 28 are developing a protocol or utilization policy. OAR has ~750 patient results from 300 patients as of Sept. 30, up from 500 in June. Reimbursement collection remains steady at ~79% of AlloMap tests delivered in the 12 months ended March 31, 2014.

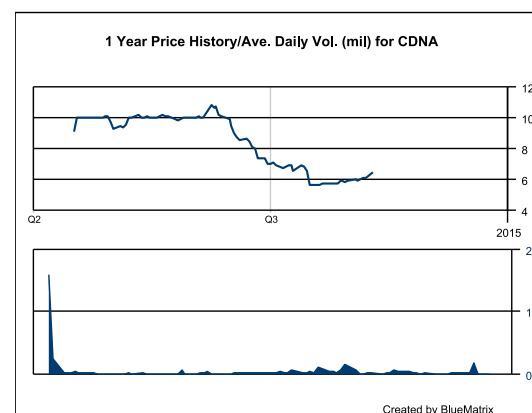
• **Pipeline cell free DNA (cfDNA) products on track for upcoming data disclosures and cfDNA kidney trial launch in 1H15.** Enrollment in the cfDNA outcomes registry (D-OAR) in heart is progressing on track, with abstracts submitted for data discussion at ISHLT 2015. cfDNA kidney development continues on track behind cfDNA heart, with initial validation data from the KARGO historical sample expected in 1H15. Management plans to commence a cfDNA kidney clinical study (KIDNA prospective study) in mid-2015 following positive validation data from the KARGO study.

• **Our estimates remain largely unchanged aside from shifting R&D expense from 2014 to 2015-16 to account for timing of clinical trial costs.** We lower our price target to \$10 from \$13 due to compression of the group multiple.

**Key Stats:****(NASDAQ:CDNA)**

**S&P 600 Health Care Index:** **1,360.47**  
**Price:** **\$6.41**  
Price Target: \$10.00 from \$13.00  
Methodology: ~3x EV/TTM estimated revenue ending Sept 2016

52 Week High: \$10.89  
52 Week Low: \$5.40  
Shares Outstanding (mil): 12.0  
Market Capitalization (mil): \$76.9  
Book Value/Share: \$3.42  
Cash Per Share: \$3.25  
Dividend (ann): \$0.00  
Dividend Yield: 0.0%



Dec Yr	1Q	2Q	3Q	4Q	FY Rev	1Q	2Q	3Q	4Q	FY EPS	P/E
2013A	\$5.0	\$5.5	\$5.8	\$5.9	\$22.1	(\$0.19)	(\$0.12)	(\$0.12)	(\$0.08)	(\$0.51)	NM
2014E - New	\$5.9A	\$6.8A	\$6.7A	\$7.0	\$26.3	(\$0.21)A	\$0.13A	(\$0.01)A	(\$0.07)	(\$0.14)	NM
2014E - Old	\$5.9A	\$6.8A	\$6.6	\$7.0	\$26.2	(\$0.21)A	\$0.13A	(\$0.15)	(\$0.10)	(\$0.37)	NM
2015E - New	--	--	--	--	\$30.1	--	--	--	--	(\$0.49)	NM
2015E - Old	--	--	--	--	\$30.3	--	--	--	--	(\$0.43)	NM
2016E - New	--	--	--	--	\$40.1	--	--	--	--	(\$0.10)	NM
2016E - Old	--	--	--	--	\$40.3	--	--	--	--	(\$0.08)	NM

Source: Company Information and Leerink Partners LLC Research  
Revenues in millions.

3Q14 excludes \$1.2m benefit from reversal of contingent consideration allowance for ImmuMetrix acquisition.

## INVESTMENT THESIS

We rate Brisbane, California-based CareDx (CDNA) Outperform with a \$10 price target. CDNA markets a non-invasive molecular gene expression test (AlloMap) of 20 genes for heart transplant recipients to diagnose acute cellular rejection, reduce use of biopsy, and better tailor immunosuppression post-transplant to patient needs. Additionally, the company is developing products for post-transplant monitoring that use nextgen sequencing (NGS) to detect cell free DNA (cfDNA). We believe the company will continue to successfully expand its core AlloMap franchise while developing its cfDNA products, which could be marketed as early as 1H15. We believe CDNA's pipeline opportunity is undervalued at current levels and thus our Outperform rating.

## VALUATION

Our \$10 price target corresponds to an enterprise value (using projected levels of debt and cash) that is ~3x our revenue estimate for the twelve months ended Sept-16. This is in line with the tools/diagnostics peer group median multiple, which we believe adequately balances concerns over the size of CDNA's opportunity in heart transplant with its opportunities in kidney and other transplants.

## RISKS TO VALUATION

CDNA's risks include, but are not limited to: the trajectory of the AlloMap revenue ramp, the ability to successfully develop and commercialize products using cfDNA for transplant surveillance, and the impact of a changing regulatory environment in the U.S. for diagnostics.

**CareDx (CDNA)**

Dan Leonard, 212-277-6116

**Income statement**

dan.leonard@leerink.com

Period Ended (\$ thousands)	2012	2013	Mar-14	Jun-14	Sep-14	Dec-14e	2014e	2015e	2016e
Revenues									
Testing revenue	\$19,730	\$21,672	\$5,834	\$6,710	\$6,601	\$6,861	\$26,006	\$29,312	\$38,536
Other	721	426	90	66	53	90	299	800	1,600
Total revenues	20,451	22,099	5,924	6,776	6,654	6,951	26,305	30,112	40,136
Cost of service	7,930	9,078	2,162	2,403	1,772	2,433	8,770	10,539	13,847
Gross profit	12,521	13,021	3,762	4,373	4,882	4,518	17,535	19,573	26,289
SG&A	10,111	10,701	3,269	3,926	3,729	3,823	14,747	15,658	18,061
R&D	4,752	3,176	720	792	1,036	1,112	3,660	8,431	8,027
Operating income (loss)	(2,342)	(856)	(227)	(345)	117	(417)	(872)	(4,517)	201
Interest expense (income)	2,703	2,150	548	644	535	372	2,099	1,397	1,400
Other, net	14	536	529	(366)	(355)	0	(192)	0	0
Pretax income	(5,059)	(3,542)	(1,304)	(623)	(63)	(789)	(2,779)	(5,914)	(1,199)
Taxes	0	0	0	(1,500)	0	0	(1,500)	0	0
Net income	(\$5,059)	(\$3,542)	(\$1,304)	\$877	(\$63)	(\$789)	(\$1,279)	(\$5,914)	(\$1,199)
Basic shares outstanding	6,913	6,923	6,172	1,013	9,280	12,000	7,116	12,125	12,325
Diluted shares outstanding	6,913	6,923	6,172	6,940	11,219	12,000	9,083	12,125	12,325
EPS diluted	(\$0.73)	(\$0.51)	(\$0.21)	\$0.13	(\$0.01) (1)	(\$0.07)	(\$0.14)	(\$0.49)	(\$0.10)
EPS growth									
Revenue growth		9.8%	21.3%	25.8%	15.5%	18.0%	20.0%	12.7%	31.5%
Volume (Ths)	8,337	10,064	2,792	3,000	3,020	3,191	12,003	13,564	15,598
Gross margin	61.2%	58.9%	63.5%	64.5%	73.4%	65.0%	66.7%	65.0%	65.5%
SG&A % of revenue	49.4%	48.4%	55.2%	57.9%	56.0%	55.0%	56.1%	52.0%	45.0%
R&D % of revenue	23.2%	14.4%	12.2%	11.7%	15.6%	16.0%	13.9%	28.0%	20.0%
Operating margin	(11.5%)	(3.9%)	(3.8%)	(5.1%)	1.8%	(6.0%)	(3.3%)	(15.0%)	0.5%
Tax rate	0.0%	0.0%	0.0%	240.8%	0.0%	0.0%	54.0%	0.0%	0.0%
D&A expense	\$1,072	\$663	\$106	\$116	\$115	\$91	\$428	\$391	\$514
EBITDA	(\$1,270)	(\$193)	(\$121)	(\$229)	\$232	(\$326)	(\$444)	(\$4,126)	\$714
Free cash flow									
Operating cash flow	(\$1,776)	(\$546)	\$180	\$853			(\$7)	(\$4,910)	(\$36)
CapX	(141)	(98)	(19)	(145)			(219)	(669)	(1,117)
Free cash flow	(\$1,917)	(\$644)	\$161	\$708			(\$226)	(\$5,578)	(\$1,154)

Guidance  
Revenue \$26 - \$26.5M

**Notes:**

Source: Company reports and Leerink Partners estimates

(1) Excludes \$1.3M in benefit from change in fair value of Immumetrix consideration

**CareDx (CDNA)****Balance sheet**

Period Ended (\$ thousands)	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14e
<b>Assets</b>					
Cash, equivalents, ST investments, restricted cash	\$5,128	\$4,837	\$7,872	\$39,048	\$37,136
Accounts receivable	2,270	2,093	1,725	1,749	2,285
Inventory	518	725	614	496	587
Prepaid expenses and other current assets	<u>255</u>	<u>1,825</u>	<u>3,319</u>	<u>718</u>	<u>556</u>
Total current assets	8,171	9,480	13,530	42,011	40,564
Property and equipment, net	1,553	1,466	1,665	2,049	1,830
Restricted cash / LT investments	147	147	147	147	147
Other assets	<u>2</u>	<u>2</u>	<u>18,655</u>	<u>18,655</u>	<u>18,655</u>
Total assets	\$9,873	\$11,095	\$33,997	\$62,862	\$61,196
<b>Liabilities and shareholders' equity</b>					
Notes payable - current portion	\$4,461	\$5,485	\$10,434	\$5,798	\$4,200
Accounts payable	618	781	1,741	1,036	830
Accruals	2,434	4,247	8,365	3,611	2,780
Other liabilities	<u>80</u>	<u>65</u>	<u>674</u>	<u>673</u>	<u>673</u>
Total current liabilities	7,593	10,578	21,214	11,118	8,483
Notes payable - long-term portion	10,914	9,591	8,338	6,930	8,528
Other liabilities	<u>6,837</u>	<u>7,648</u>	<u>5,911</u>	<u>3,775</u>	<u>3,775</u>
Total liabilities	\$25,344	\$27,817	\$35,463	\$21,823	\$20,786
Convertible preferred stock	\$135,202	\$135,202	\$149,444	\$0	\$0
Shareholders' equity	(\$150,673)	(\$151,924)	(\$150,910)	\$41,039	\$40,409
Total liabilities and shareholders' equity	\$9,873	\$11,095	\$33,997	\$62,862	\$61,196

Source: Company reports and Leerink Partners estimates

## Disclosures Appendix

### Analyst Certification

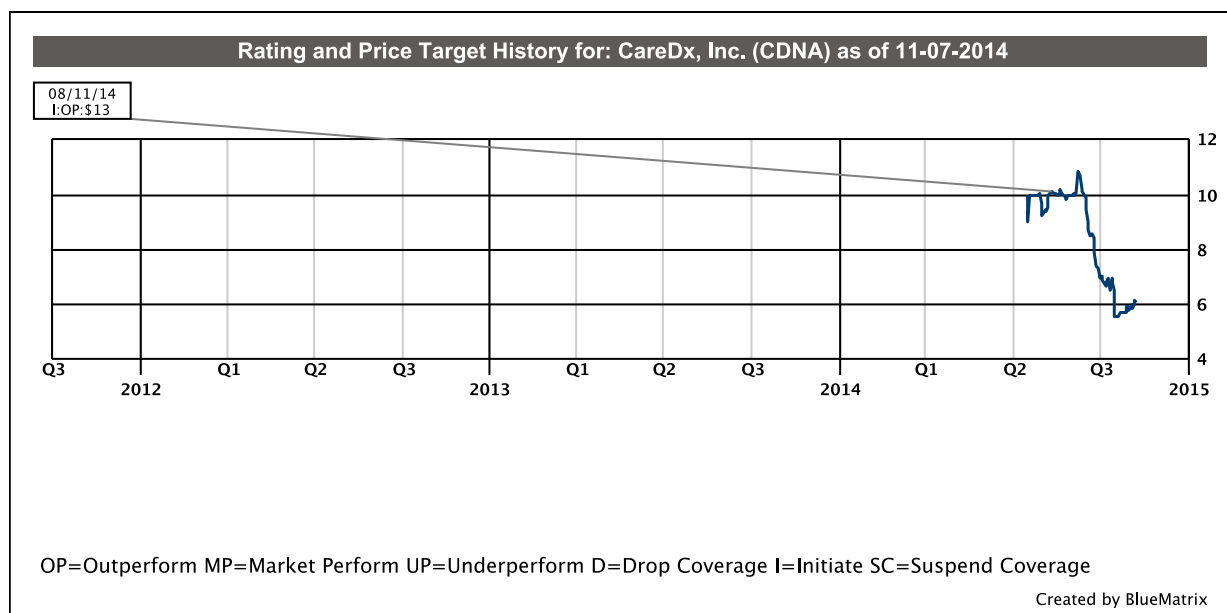
I, Dan Leonard, certify that the views expressed in this report accurately reflect my views and that no part of my compensation was, is, or will be directly related to the specific recommendation or views contained in this report.

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Distribution of Ratings/Investment Banking Services (IB) as of 09/30/14				
Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY [OP]	138	69.30	51	37.00
HOLD [MP]	61	30.70	2	3.30
SELL [UP]	0	0.00	0	0.00

## Explanation of Ratings

**Outperform (Buy):** We expect this stock to outperform its benchmark over the next 12 months.

**Market Perform (Hold/Neutral):** We expect this stock to perform in line with its benchmark over the next 12 months.

**Underperform (Sell):** We expect this stock to underperform its benchmark over the next 12 months. The degree of outperformance or underperformance required to warrant an Outperform or an Underperform rating should be commensurate with the risk profile of the company.

For the purposes of these definitions the relevant benchmark will be the S&P 600® Health Care Index for issuers with a market capitalization of less than \$2 billion and the S&P 500® Health Care Index for issuers with a market capitalization over \$2 billion.

## Important Disclosures

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In the past 12 months, the Firm has received compensation for providing investment banking services to CareDx, Inc. .

Leerink Partners LLC makes a market in CareDx, Inc.

Leerink Partners LLC has acted as the manager for a public offering of CareDx, Inc. in the past 12 months.

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**Leerink Partners LLC Equity Research**


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<b>Director of Equity Research</b>	<b>John L. Sullivan, CFA</b>	(617) 918-4875	john.sullivan@leerink.com
<b>Associate Director of Research</b>	<b>Alice C. Avanian, CFA</b>	(617) 918-4544	alice.avanian@leerink.com
<b>Healthcare Strategy</b>	<b>John L. Sullivan, CFA</b>	(617) 918-4875	john.sullivan@leerink.com
	<b>Alice C. Avanian, CFA</b>	(617) 918-4544	alice.avanian@leerink.com
<b>Biotechnology</b>	<b>Howard Liang, Ph.D.</b>	(617) 918-4857	howard.liang@leerink.com
	<b>Joseph P. Schwartz</b>	(617) 918-4575	joseph.schwartz@leerink.com
	<b>Michael Schmidt, Ph.D.</b>	(617) 918-4588	michael.schmidt@leerink.com
	<b>Gena Wang, Ph.D., CFA</b>	(212) 277-6073	gena.wang@leerink.com
	<b>Paul Matteis</b>	(617) 918-4585	paul.matteis@leerink.com
	Jonathan Chang, Ph.D.	(617) 918-4015	jonathan.chang@leerink.com
	Richard Goss	(617) 918-4059	richard.goss@leerink.com
<b>Life Science Tools and Diagnostics</b>	<b>Dan Leonard</b>	(212) 277-6116	dan.leonard@leerink.com
	Justin Bowers, CFA	(212) 277-6066	justin.bowers@leerink.com
<b>Pharmaceuticals/Major</b>	<b>Seamus Fernandez</b>	(617) 918-4011	seamus.fernandez@leerink.com
	Ario Arabi	(617) 918-4568	ario.arabi@leerink.com
	Aneesh Kapur	(617) 918-4576	aneesh.kapur@leerink.com
<b>Specialty Pharmaceuticals</b>	<b>Jason M. Gerberry, JD</b>	(617) 918-4549	jason.gerberry@leerink.com
	Derek C. Archila	(617) 918-4851	derek.archila@leerink.com
<b>Medical Devices, Cardiology &amp; Orthopedics</b>	<b>Danielle Antalffy</b>	(212) 277-6044	danielle.antalffy@leerink.com
	Puneet Souda	(212) 277-6091	puneet.souda@leerink.com
	<b>Richard Newitter</b>	(212) 277-6088	richard.newitter@leerink.com
	Ravi Misra	(212) 277-6049	ravi.misra@leerink.com
<b>Healthcare Services</b>	<b>Ana Gupte, Ph.D.</b>	(212) 277-6040	ana.gupte@leerink.com
<b>Healthcare Technology &amp; Distribution</b>	<b>David Larsen, CFA</b>	(617) 918-4502	david.larsen@leerink.com
	Christopher Abbott	(617) 918-4010	chris.abbott@leerink.com
<b>Digital Health</b>	<b>Steven Wardell</b>	(617) 918-4097	steven.wardell@leerink.com
<b>Sr. Editor/Supervisory Analyst</b>	<b>Mary Ellen Eagan, CFA</b>	(617) 918-4837	maryellen.eagan@leerink.com
<b>Supervisory Analysts</b>	Robert Egan		bob.egan@leerink.com
	Amy N. Sonne		amy.sonne@leerink.com
<b>Editorial</b>	Cristina Diaz-Dickson	(617) 918-4548	cristina.diaz-dickson@leerink.com
<b>Research Associate</b>	Carmen Augustine	(212) 277-6012	carmen.augustine@leerink.com

**New York**  
299 Park Avenue, 21<sup>st</sup> floor  
New York, NY 10171  
(888) 778-1653

**Boston**  
**One Federal Street, 37<sup>th</sup> Floor**  
**Boston, MA 02110**  
**(800) 808-7525**

**San Francisco**  
201 Spear Street, 16<sup>th</sup> Floor  
San Francisco, CA 94105  
(800) 778-1164