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Zacks Small-Cap Research

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CombiMatrix Cp (CBMX-NASDAQ)

CBMX: Solid Q4, PGS and Miscarriage Remain On A Tear

Current Recommendation	**Buy**
Prior Recommendation	N/A
Date of Last Change	07/07/2014
Current Price (02/18/16)	$5.52
Target Price	**$20.00**

OUTLOOK

Molecular diagnostics company CBMX has offered a variety of genetic tests for various indications but just recently shifted the majority of its focus for growth on chromosomal microarray analysis (CMA) in the prenatal setting. A relatively novel genetic testing method, CMA has gained more attention due to two recent NEJM-published studies and a recommendation from an influential trade association supporting its use in prenatal analysis. CBMX is positioning itself to exploit an industry shift away from the current standard testing method towards CMA by expanding distribution, beefing up their sales force, launching new products, entering into key partnerships and leveraging competitive advantages. Early indications are that this plan is already bearing fruit.

SUMMARY DATA

52-Week High	**$31.48**
52-Week Low	**$5.12**
One-Year Return (%)	**-78.57**
Beta	**0.33**
Average Daily Volume (sh)	**13,022**
Shares Outstanding (mil)	**1**
Market Capitalization ($mil)	**$5**
Short Interest Ratio (days)	**3.32**
Institutional Ownership (%)	**13**
Insider Ownership (%)	**3**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**21.6**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2016 Estimate	**N/A**
P/E using 2017 Estimate	**N/A**
Zacks Rank	**N/A**

Risk Level	**High,**
Type of Stock	**Small-Value**
Industry	**Instru-Scientfc**

ZACKS ESTIMATES

Revenue
(in 000s of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2015	2,329 A	2,549 A	2,526 A	2,684 A	10,088 A
2016	2,751 E	2,984 E	2,987 E	3,087 E	11,808 E
2017					14,025 E
2018					16,465 E

Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2015	-$2.24 A	-$1.91 A	-$2.00 A	-$1.82 A	-$7.95 A
2016	-$1.95 E	-$1.76 E	-$1.54 E	-$1.34 E	-$6.46 E
2017					-$2.50 E
2018					-$1.88 E

Zacks Projected EPS Growth Rate - Next 5 Years % **N/A**

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WHAT'S NEW….

Q4: Miscarriage and PGS Drive 21% Revenue Growth

CBMX reported financial results for the fourth quarter ending December 31st. Diagnostic services revenue growth (21% yoy, 7% sequential) remains impressive with most of the recent fuel coming from reproductive health segment, specifically miscarriage analysis and the new rockstar, CombiPGS. PGS was just launched earlier this year and has experienced a steep ramp in sales, including 202 tests sold in Q4, up from 127 in Q3. PGS revenue already accounts for more than 8% of total diagnostics revenue and we think this continues to climb rapidly. Management clearly sees this product as having significantly more potential and, with the recent introduction of the multicycle offering, is leveraging the already positive reception the product has received by providing even more value-add to the growing customer base. Additional catalysts related directly to PGS include New York coming online (NY and CA are top 2 in IVF demand) in November which adds incremental market opportunity and the recent addition of IVF specialists to CBMX's sales team.

And while per-test pricing of PGS slipped about 6% from Q3 ($1,173 to $1,099), as this is 100% cash pay, as this product grows to account for a larger proportion of total diagnostics volume, overall cash collections will benefit. In fact, improved cash collections helped bump total average pricing (across all products) up by about 4% on a sequential basis and up 8% from Q4 2014. The customer-pay products also have a direct benefit on cash burn, which is becoming evident – cash burn was $1.5M in Q4 2015, down from $2.1M in Q4 2014.

Miscarriage analysis has been the other major recent driver of the top-line, turning in 11% volume growth in Q4 and 35% for the full year 2015. The 939 miscarriage tests sold in Q4 and $1.36M in revenue (52% of total diagnostics revenue) were both quarterly records. Similar to PGS, we think miscarriage analysis has more room to run and CBMX is putting more effort towards this goal. One part of this is sponsoring additional studies comparing CMA to traditional prenatal and miscarriage testing.

CBMX also remains committed to bringing new products to market that will complement their current offerings. In January they announced the launch of an SNP genetic array for intrauterine fetal demise (IUFD) – or more commonly called, stillbirth testing. This IUFD array is one more of CBMX's planned expansion of their testing menu (PGS was another), including a product line which will lessen their reliance on insurance reimbursement. While the IUFD market is on the smaller side – CBMX estimates about $40M, this should be an add-to-the-bag type of product and one we don't expect to add much in the way of incremental cost to detail as it should fit seamlessly into the company's miscarriage product line and rep call points.

Non-microarray also remains meaningful, accounting for 27% of total test volume in Q4 and 28% for the full year 2015. But, with non-microarray reimbursed at a much lower level than the rest of the product portfolio, it accounts for only about 10% of total diagnostic services revenue. But non-microarray continues to exhibit very strong volume growth, up 12% in Q4 and +50% for the full year.

Total billable tests were 2,563 which is the 2nd best in company history – only beaten by the 2,599 tests billed in Q2 of this year. Volume growth was 12% on a yoy basis and 3% sequentially. And while below our 2,686 estimate, the difference relates entirely to prenatal volumes, which have tempered based on what we think may be CBMX's distribution partner, Sequenom, driving a push of their NIPT tests (although NIPT testing continues to be plagued by high rates of false-positives). CBMX's prenatal testing volumes were on a tear earlier in 2015 but have declined since, falling from 664 tests sold in 1H to 500 in 2H. As prenatal remains an important segment, accounting for 11% of revenue in Q4 and 15% for the full year, we think upside to our revenue estimates is likely if prenatal volumes can come back to the ~325/quarter level.

Meanwhile, miscarriage analysis and PGS both outperformed our expectations. Given that these are both areas where CBMX believes present outsized growth opportunities, the beat to our numbers is a particularly positive sign, in our opinion. Miscarriage volume and revenue were 939 and $1.36M compared to our 925 and $1.21M estimates – along with the beat on volume, upside to miscarriage revenue came from relatively very strong reimbursement – which relates to a combination of improved collections activity, beneficial payer mix and price increases with some payers. But PGS was the real outperformer, with 202 tests sold in the quarter, well ahead of our 175 estimate. Again, miscarriage analysis and PGS is where we think the bulk of growth comes from over the near-to-mid term.

Relative to reimbursement, as we have discussed in our coverage of CBMX, sliding average reimbursement has been an issue in trying to maximize revenue. But 2015 saw encouraging developments including a lower rate of deterioration in average reimbursement (in prenatal microarray and miscarriage analysis) than what had been the case in the prior year. Average reimbursement has actually increased sequentially over the last two quarters; from $971 in Q2 to $994 in Q3 and $1,034 in Q4. And while we will refrain from suggesting this is definitely the beginning of a trend towards firming reimbursement, there is reason to believe that the collections picture could improve further. CBMX has been targeting favorable payor territories, recently hired additional payer-relations and billing professionals and new tests such as CombiPGS which are cash pay and not impacted by reimbursement. These all could benefit average reimbursement going forward and almost certainly contributed to the high collection rates over the last three to four quarters.

Q4 total revenue of $2.7M was up 21% yoy and 6% sequentially and inline with our $2.7M estimate. For the full year, revenue was $10.1M, up 25% from 2014. To put into perspective the significance of the newly launched PGS test, it contributed 20% of the revenue growth in 2015 despite it not launching until the second quarter of the year.

	Q4E	Q4A
Number of tests		
Prenatal yoy growth	*22.7%*	*-17.7%*
Prenatal tests	340	228
Miscarriage yoy growth	*9.0%*	*10.6%*
Miscarriage analysis tests	925	939
CombiPGS yoy growth	-	*#DIV/0!*
CombiPGS	175	202
Total Reproductive Hlth	**1,440**	**1,369**
prenatal as %of total microarray tests	73%	74%
YOY Growth	*27.9%*	*21.6%*
Pediatric Microarray	541	493
pediatric as %of total microarray tests	27%	26%
YOY Growth	*1.0%*	*-8.0%*
Total Microarray tests	1,981	1,862
microarray %of total tests	74%	73%
YOY Growth	*19.1%*	*12.0%*
Non-microarray tests	705	701
non-microarray %of total tests	26%	27%
YOY Growth	*12.6%*	*12.0%*
Total Billable tests	**2,686**	**2,563**
YOY Growth	*17.4%*	*12.0%*
Pricing per test		
Prenatal microrray	$1.280	$1.285
Miscarriage analysis	$1.310	$1.452
CombiPGS	$1.200	$1.099
Total Reproductive Hlth	**$1.290**	**$1.372**
Pediatric	$1.030	$1.085
All microarrays	$1.226	$1.296
Non-microarrays	$0.351	$0.337
Total	**$0.991**	**$1.034**
Total revenue per test		
Prenatal microrray	$435	$293
Miscarriage analysis	$1,212	$1,363
CombiPGS	$210	$222
Total Reproductive Hlth	**$1,857**	**$1,878**
YOY Growth	*31.1%*	*32.6%*
Pediatric Microarray	$558	$535
YOY Growth	*-0.3%*	*-4.3%*
All microarrays	$2,415	$2,413
YOY Growth	*22.1%*	*22.1%*
Non-microarrays	$247	$236
YOY Growth	*18.4%*	*12.9%*
Total	**$2,662**	**$2,649**
YOY Growth	*21.8%*	*21.2%*
Diagnostic Svcs	$2,662.0	$2,649.0
YOY Growth	*21.8%*	*21.2%*
Royalties	$40.0	$35.0
YOY Growth	*29.0%*	*12.9%*
Total Revenues	$2,702.0	$2,684.0
YOY Growth	*21.9%*	*21.1%*

Service margin has actually strengthened despite the slight slippage in average test pricing since 2014. Service margin was a very strong 46.5% in Q4 and 46% for the full year. This compares to 42.7% and 43.8% for the year-earlier comparable periods. Lab efficiencies, higher testing volumes and benefits realized from recently implemented reimbursement initiatives have us continuing to model some slight improvement in GM in 2016.

CBMX recently completed transfer of processing of their microarray tests to a higher throughput system - management believes this will shave ~$60 in cost of their microarray tests.

Q4 OpEx was $2.8M, inline with our estimate. Operating expenses improved considerably from 2014, some of which relates to lower litigation expense. CBMX continues to experience increasing operating leverage and at 98.7% of revenue in Q4, OpEx was at the lowest level in at least the last several years. We continue to model further improvement in operating leverage with ramping revenue and a relative flattening of operating expenses. Q4 net loss and EPS were $1.5M and ($1.82), mostly inline with our $1.6M and ($1.87) estimates.

CBMX exited the year with $3.9M in cash and liquid investments. Management believes this is sufficient to fund operations until Q3 2016.

OUTLOOK / VALUATION

OUTLOOK

Our 2016 revenue growth, including +23% from reproductive health services testing, is driven from the recent expansion and increasing productivity of the sales force, new payor contracts (3 new commercial payers and 9M new covered lives just recently added), more insurers starting to cover recurrent pregnancy loss testing (which includes two in the BC/BS system which recently came online) increasing number of billable customers (including a 7% increase alone in Q4 2015), greater awareness of the benefits of CMA analysis and some incremental growth from new products. Relative to the sale force, management has noted increased productivity per rep, which they think will continue to help drive revenue higher – we think as additional add-to-the-bag products come online there will be even more room for productivity gains.

Beyond 2016 we think contribution from the additional, aforementioned catalysts begin to make a more substantial impact. We also think it is not unreasonable to believe that additional future studies and publications will provide further insight into the human genome, soften certain current headwinds to adoption of CMA (i.e. - provide more knowledge related to variants of unknown significance) and provide support for the utility of chromosomal microarray analysis in the prenatal space. These catalysts should result in steepening of the rate of adoption of chromosomal microarray analysis. This, coupled with the company's competitive positioning and our assumption that CBMX continues to grow their distribution footprint, provide what we believe will be a position of strength for CBMX in terms of being able to increase penetration of their target prenatal markets and grow revenue over the long-term.

Additional new product launches could prompt an upward revision to our forecast, particularly as it relates to our out-years. We look for incremental widening of services margin as prenatal microarray, the highest priced of the company's tests, grows to account for an ever larger proportion of total revenue and increased testing volumes provides greater scale. We model improvement in leverage in operating expenses.

VALUATION

We use a 10-year DCF model to value CBMX. We model revenue to grow from $10.1M in 2015 to $20M in 2019. We believe our revenue estimates are reasonable, particularly as out our out-year number assumes just less than 13% penetration of the estimated prenatal chromosomal microarray analysis market at that time. We also do not incorporate contribution from any new products that CBMX may potentially bring to market through the term of DCF - new product launches and/or a higher rate of revenue growth (relative to our assumptions) from existing tests could provide some upside to our numbers and associated calculated valuation.

Other key inputs into our DCF include a 9% discount rate and 2% terminal growth rate. Based on our DCF model, CBMX is valued at approximately $20/share. We are maintaining our Buy rating.

FINANCIAL MODEL

CombiMatrix Corporation

	2015 A	Q1E	Q2E	Q3E	Q4E	2016 E	2017 E	2018 E	2019 E
Diagnostic Svcs	$9,941.0	$2,711.4	$2,943.5	$2,946.4	$3,046.8	$11,648.1	$13,865.0	$16,305.0	$19,799.8
YOY Growth	*25.95%*	*18.56%*	*16.6%*	*18.8%*	*15.0%*	*17.17%*	*19.03%*	*17.60%*	*21.43%*
Royalties	$147.0	$40.0	$40.0	$40.0	$40.0	$160.0	$160.0	$160.0	$160.0
YOY Growth	*-1.34%*	*-4.76%*	*60.0%*	*-11.1%*	*14.3%*	*8.8%*	*0.0%*	*0.0%*	*0.0%*
Total Revenues	$10,088.0	$2,751.4	$2,983.5	$2,986.4	$3,086.8	$11,808.1	$14,025.0	$16,465.0	$19,959.8
YOY Growth	*25.4%*	*18.1%*	*17.0%*	*18.2%*	*15.0%*	*17.1%*	*18.8%*	*17.4%*	*21.2%*
Cost of Services	$5,444.0	$1,461.5	$1,627.8	$1,650.0	$1,620.9	$6,360.1	$7,154.3	$8,201.4	$9,345.5
Gross Income	$4,644.0	$1,290.0	$1,355.7	$1,336.4	$1,465.9	$5,448.0	$6,870.7	$8,263.6	$10,614.3
Services Margin	*46.0%*	*46.1%*	*44.7%*	*44.0%*	*46.8%*	*46.2%*	*48.4%*	*49.7%*	*52.8%*
R&D	$466.0	$162.0	$112.0	$140.0	$125.0	$539.0	$628.0	$667.0	$738.0
% R&D	*4.6%*	*5.9%*	*3.8%*	*4.7%*	*4.0%*	*4.6%*	*4.5%*	*4.1%*	*3.7%*
SG&A	$10,519.0	$2,735.2	$2,813.0	$2,845.5	$2,910.2	$11,303.9	$12,077.2	$12,812.6	$14,510.8
% SG&A	*104.3%*	*99.4%*	*94.3%*	*95.3%*	*94.3%*	*95.7%*	*86.1%*	*77.8%*	*72.7%*
Patent amort. & royalties	$100.0	$25.0	$25.0	$25.0	$25.0	$100.0	$110.0	$110.0	$0.0
Goodwill impairment	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Operating Income	($6,441.0)	($1,632.2)	($1,594.3)	($1,674.1)	($1,594.3)	($6,494.9)	($5,944.6)	($5,326.0)	($4,634.5)
Operating Margin	*-63.8%*	*-59.3%*	*-53.4%*	*-56.1%*	*-51.6%*	*-55.0%*	*-42.4%*	*-32.3%*	*-23.2%*
Total Other income	($63.0)	($15.0)	($15.0)	($15.0)	($15.0)	($60.0)	($125.0)	($150.0)	($150.0)
Pre-Tax Income	($6,601.0)	($1,647.2)	($1,609.3)	($1,689.1)	($1,609.3)	($6,554.9)	($6,069.6)	($5,476.0)	($4,784.5)
Taxes	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Tax Rate	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Preferred Dividends	$0	$0	$0	$0	$0	$0	$0	$0	$0
Net Income	($6,601.0)	($1,647.2)	($1,609.3)	($1,689.1)	($1,609.3)	($6,554.9)	($6,069.6)	($5,476.0)	($4,784.5)
YOY Growth	*-24.2%*	*-6.7%*	*-0.2%*	*0.1%*	*4.7%*	*-0.7%*	*-7.4%*	*-9.8%*	*-12.6%*
Net Margin	*-65.4%*	*-59.9%*	*-53.9%*	*-56.6%*	*-52.1%*	*-55.5%*	*-43.3%*	*-33.3%*	*-24.0%*
EPS	($7.95)	($1.95)	($1.76)	($1.54)	($1.34)	($6.46)	($2.50)	($1.88)	($1.52)
YOY Growth	*-32.9%*	*-13.1%*	*-7.8%*	*-23.1%*	*-26.2%*	*-18.7%*	*-61.3%*	*-24.9%*	*-19.0%*
Diluted Shares O/S	831	845	915	1,100	1,200	1,015	2,430	2,920	3,150

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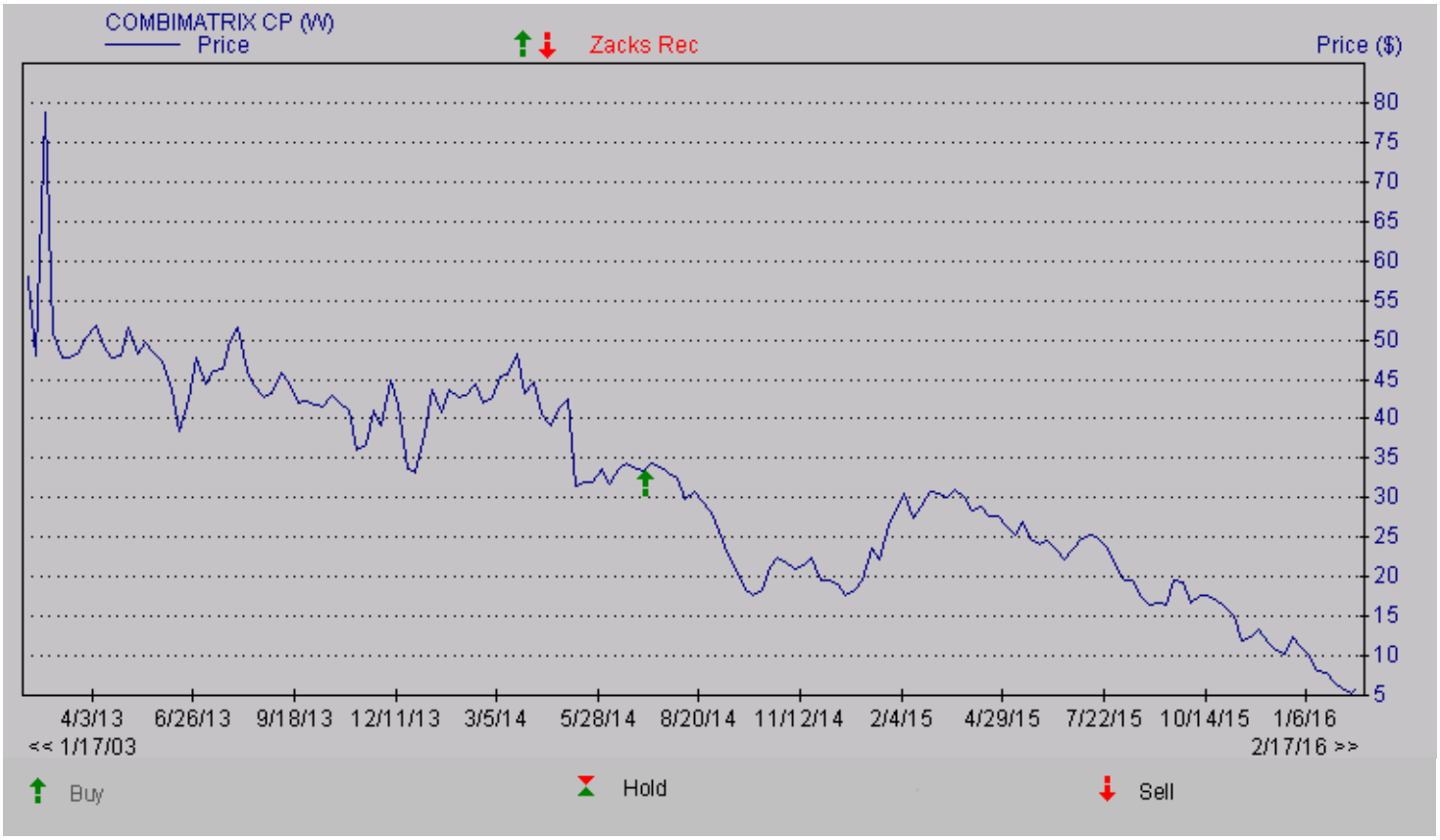

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