Zacks Small-Cap Research

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CAS Medical Systems Inc. (CASM-NASDAQ)

CASM: Preannounces 2016 Revenue Growth of 14%. Further Acceleration of FORE-SIGHT Sales in 2H 2017

Based on EV/S and P/S comps other publicly traded companies in the tissue oximeter, patient monitoring and cardiac surgery industries including BABY, MASI, BRSYF and MDT, CASM should trade near $4/share.

Current Price (02/12/17)	$1.74
Valuation	**$4.00**

OUTLOOK

Recently launched FORE-SIGHT next-gen ELITE product has been the main impetus to recent sales growth. Q3 marked the 26th quarter of double-digit yoy U.S. sensor sales growth. A plethora of clinical data supporting utility of cerebral oximetry is expanding total market. Clinical studies showing that ELITE outperforms market-share leading cerebral oximeters has been a major catalyst to CASM's growth and has resulted in about one-half of new business coming from customers switching from competing devices. The growing monitor installed base is providing a multiplier effect to sensor (i.e consumables) sales. CASM is adding to U.S. sales force to further exploit FORE-SIGHTS competitive advantages and overall expansion of the tissue oximetry market. The rapid revenue growth combined with expanding gross margin and growing leverage in OpEx should result in rapid improvement in profitability and cash flow. Based on comp valuation, CASM shares should trade near $4.

SUMMARY DATA

52-Week High	**$2.15**
52-Week Low	**$1.40**
One-Year Return (%)	**-1.18**
Beta	**-0.54**
Average Daily Volume (sh)	**40,713**
Shares Outstanding (mil)	**27**
Market Capitalization ($mil)	**$46**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**32**
Insider Ownership (%)	**34**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**0.6**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2017 Estimate	**N/A**
P/E using 2018 Estimate	**N/A**
Zacks Rank	**N/A**

Risk Level	**Below Avg.,**
Type of Stock	**N/A**
Industry	**Med Products**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2015	4.5 A	4.7 A	5.0 A	5.3 A	19.5 A
2016	5.5 A	5.5 A	5.8 A	5.5 E	22.2 E
2017					24.8 E
2018					28.3 E

Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2015	-$0.09 A	-$0.09 A	-$0.08 A	-$0.08 A	-$0.34 A
2016	-$0.03 A	-$0.08 A	-$0.06 A	-$0.07 E	-$0.24 E
2017					-$0.16 E
2018					-$0.06 E

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

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WHAT'S NEW…

Q4 2016 Revenue Preannouncement

CAS Medical preannounced Q4 and full year 2016 revenue and provided general guidance for 2017. While the Q4 numbers were slightly below what we had been looking for, the revision implies FY2016 revenue growth will still be a relatively beefy 14% and driven by 17% growth of the company's flagship FORE-SIGHT tissue oximetry segment. The revision also has no impact on our forecasted EPS or calculated per-share price target.

Much of the difference relative to our prior revenue estimate relates to a greater number of monitor returns in Q4 (37 A vs. 21 E) – but despite this, CASM was still able to ship a record number of monitors to U.S. customers. We remind investors that a certain number of monitors are regularly returned each quarter as lower utilization sites are weeded out – Q4 was somewhat of an anomaly due to the loss of a top-50 account which resulted in greater than usual returns and what we expect to be a short-term hiccup in net monitor placement growth. While as of the Q3 call (mid-November) management was still guiding to hit their goal of 400 monitor placements in 2016, the Q4 preannouncement implies total placements will come in about 5% shy of this, or 380.

Fundamentals, particularly relative to adoption (i.e. growth of the installed base) and utilization (growth in sensor sales) of FORE-SIGHT, remain solid as evidenced by the;

- 4% and 22% growth of the FORE-SIGHT monitor installed base in Q4 and FY2016, respectively. The U.S. installed base grew 23% in 2016
- 15% and 22% increase in FORE-SIGHT sensor sales in Q4 and FY2016, respectively. U.S. sensor sales increased 16% in Q4
- 2017 Guidance: management is guiding for 20% growth in sensor sales and 20% growth in the U.S. installed base in 2017

Growth in sales of the tissue oximetry segment continue to come at the expense of competitors' market share as well as from an overall expansion of the cerebral oximetry market. The former has been and continues to be driven by the technological and clinical advantages of FORE-SIGHT as compared to competing technologies while the latter largely relates to new customers' initial adoption of tissue oximetry as a result of the growing body of evidence supporting its benefits, including significantly improved patient outcomes.

As noted on the Q3 call, CASM is looking to further exploit their technological-leading position and growth of the overall market by increasing the size of their sales force. As a reminder, management noted that they believe their growth is only constrained by the size of its direct domestic sales force. The company expects FORE-SIGHT growth to accelerate in 2H 2017 as a result of increased size of the sales force as well as greater productivity from the more recently hired reps.

And while the company's non-invasive blood pressure segment ("Traditional monitoring") has been largely deprioritized, this business has held up better than what had been expected. Early in 2016 management had guided for revenue in this business to experience an approximate decline of about 10%, while it now looks like it will actually post growth of about 3% for the year. While FORE-SIGHT remains the catalyst to CASM's revenue growth, continued outperformance of the non-invasive blood pressure business could provide upside to our out-year estimates.

We reiterate our $4/share price target.

OUTLOOK / VALUATION

We think the performance advantages of FORE-SIGHT compared to competing systems, most notably market-leading INVOS, coupled with increasing adoption of cerebral oximetry in surgical and other applications sets the stage for deeper and wider market penetration of FORE-SIGHT. Shedding of the 740 vital signs and neonatal disposables product lines has allowed CASM to dedicate more resources and focus on that goal. Sales force expansion, improved productivity and the pediatric/neonatal indications should further facilitate growth of the installed base and, most importantly, increase utilization and related sensor sales. The transition to a disposables company is already well underway, the benefits of which we think will accelerate and result in continued double-digit growth of the tissue oximetry business, widening of gross margin and more rapid improvement towards reaching profitability.

Valuation

We value CASM using comparable EV/S and P/S ratios of other publicly traded companies in the tissue oximeter, patient monitoring and cardiac surgery industries including direct competitors Masimo Corporation (MASI) and Medtronic (MDT). As the other tissue oximetry competitors are not publicly traded, we have rounded out our comparable cohort with companies which have similar exposure to CASM's end markets including Brainsway (BRSYF), a manufacturer non-invasive brain stimulation devices and Natus Medical (BABY), which makes monitoring and detection devices for neonatal neurological disorders.

Both EV/S and P/S value CASM at approximately $4/share, indicating the market is substantially undervaluing the stock.

	Sales Estimate (M)							
	2016	2017	EV	EV/2016	EV/2017	MC	P/S '16	P/S '17
BABY	$382	$455	$1,120	2.9	2.5	$1,220	3.2	2.7
MASI	$692	$738	$3,530	5.1	4.8	$3,520	5.1	4.8
BRSYF	$10	$12	$57	5.7	4.8	$67	6.7	5.6
MDT	$29,590	$31,790	$123,390	4.2	3.9	$103,060	3.5	3.2
Avg.				**4.5**	**4.0**		**4.6**	**4.1**

CASM Valuation Based On:					
Comparable EV/Sales			Comparable Price/Sales		
	EV	Implied Share Value		MC	Implied Share Value
2016 S	$100	$3.71	2016 S	$103	$3.82
2017 S	$99	$3.68	2017 S	$101	$3.77
Average		**$3.70**	**Average**		**$3.80**

FINANCIAL MODEL

CAS Medical Systems Inc. (figures in 000s of $)

	Q1 A	Q2 A	Q3 A	Q4 E	2016 E	2017 E	2018 E
FORE-SIGHT Sensors	$3,734.0	$4,051.0	$4,068.0	$4,029.8	$15,882.8	$19,229.8	$22,628.0
yoy growth	*27.7%*	*26.7%*	*19.6%*	*15.0%*	*22.0%*	*21.1%*	*17.7%*
% of total oximetry sales	87.3%	90.4%	85.0%	89.8%	88.1%	91.9%	91.8%
FORE-SIGHT Monitors & Access.	$543.0	$431.0	$720.0	$457.6	$2,151.6	$1,700.0	$2,008.7
yoy growth	*54.3%*	*-37.5%*	*33.8%*	*-42.4%*	*-9.4%*	*-21.0%*	*18.2%*
% of total oximetry sales	12.7%	9.6%	15.0%	10.2%	11.9%	8.1%	8.2%
Tissue Oximetry Total Sales	**$4,277.0**	**$4,482.0**	**$4,788.0**	**$4,487.4**	**$18,034.4**	**$20,929.8**	**$24,636.7**
yoy growth	*30.6%*	*15.3%*	*21.6%*	*4.4%*	*17.1%*	*16.1%*	*17.7%*
% of total revenue	**78.4%**	**80.9%**	**83.1%**	**81.9%**	**81.1%**	**84.3%**	**86.9%**
Traditional Mntrng Total Sales	**$1,179.0**	**$1,057.0**	**$974.0**	**$989.6**	**$4,199.6**	**$3,905.6**	**$3,710.3**
yoy growth	*-5.4%*	*28.7%*	*-3.6%*	*1.6%*	*2.7%*	*-7.0%*	*-5.0%*
% of total revenue	**21.6%**	**19.1%**	**16.9%**	**18.1%**	**18.9%**	**15.7%**	**13.1%**
Total Revenues	$5,455.5	$5,539.0	$5,761.9	$5,477.0	$22,233.4	$24,835.4	$28,347.1
YOY Growth	*20.7%*	*17.7%*	*16.5%*	*3.1%*	*14.1%*	*11.7%*	*14.1%*
Cost of Revenues	$2,574.9	$2,510.1	$2,715.4	$2,574.2	$10,374.6	$11,324.93	$12,614.4
Gross Income	$2,880.7	$3,028.9	$3,046.5	$2,902.8	$11,858.8	$13,510.4	$15,732.6
Gross Margin	*52.8%*	*54.7%*	*52.9%*	*53.0%*	*53.3%*	*54.4%*	*55.5%*
R&D	$955.4	$867.2	$849.6	$860.0	$3,532.2	$3,244.0	$3,150.0
% R&D	*17.5%*	*15.7%*	*14.7%*	*15.7%*	*15.9%*	*13.1%*	*11.1%*
SG&A	$3,367.9	$3,491.3	$3,198.2	$3,204.1	$13,261.4	$13,535.3	$14,145.2
% SG&A	*61.7%*	*63.0%*	*55.5%*	*58.5%*	*59.6%*	*54.5%*	*49.9%*
Operating Income	($1,442.6)	($1,329.6)	($1,001.3)	($1,161.2)	($4,934.7)	($3,268.8)	($1,562.6)
Operating Margin	*-26.4%*	*-24.0%*	*-17.4%*	*-21.2%*	*-22.2%*	*-13.2%*	*-5.5%*
Interest Income, net	($199.2)	($322.1)	($264.1)	($252.3)	($1,037.8)	($911.5)	($683.9)
Other income	$4.9	$2.0	$26.7	$0.0	$33.6	$0.0	$0.0
Pre-Tax Income	($1,637.0)	($1,649.7)	($1,238.7)	($1,413.5)	($5,938.9)	($4,180.3)	($2,246.5)
Taxes	($1,091.2)	$30.3	$38.7	$0.0	($1,022.2)	$0.0	$0.0
Tax Rate	*66.7%*	*-1.8%*	*-3.1%*	*0.0%*	*17.2%*	*0.0%*	*0.0%*
Income (loss) from discont. ops	$2,026.6	($86.7)	($110.6)	$30.0	$1,859.3	$0.0	$0.0
Net Income (cont ops)	($906.8)	($2,047.4)	($1,651.2)	($1,793.9)	($6,399.4)	($5,767.3)	($2,246.5)
YOY Growth	*-53.4%*	*-12.7%*	*-21.4%*	*-21.0%*	*-26.1%*	*-9.9%*	*-61.0%*
Net Margin	-	-	-	-	-	-	-
EPS (cont ops)	($0.03)	($0.08)	($0.06)	($0.07)	($0.24)	($0.16)	($0.06)
YOY Growth	*-60.4%*	*-13.4%*	*-22.0%*	*-22.8%*	*-29.6%*	*-32.5%*	*-64.9%*
Diluted Shares O/S	26,800	26,824	26,833	27,400	26,964	36,000	40,000

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