



Wednesday, December 31, 2008

2009 Diagnostics & Life Sciences Outlook: Pockets of Strength with a Few Companies Positioned for Significant Upside

Summary and Recommendation

With strong valuation support, significant potential for upside to 2009 EPS, and a professional diagnostics business which we believe is less sensitive (than other areas of healthcare) to the weak macroeconomic environment, IMA (1*Buy, \$43) is our top pick for 2009. Looking to next year, we believe the epidemic of hospital acquired infection (i.e. MRSA superbug et. al.) will continue to gain mindshare, driving greater investment in related diagnostics tools with a bias toward rapid molecular diagnostics where CPHD (1*Buy, \$21) leads in MRSA surveillance and will continue to expand its footprint and menu in 2009. Blood screening, lab services, genotyping, and next generation sequencing also represent segments with more attractive growth profiles in 2009, in our view.

Key Points

- **Rapid point-of-care space not a bad place to be.** Rapid point-of-care diagnostics is sub-segment with few pure-plays and where there has been substantial consolidation. We believe rapid point-of-care diagnostics may be a safer place in healthcare during 2009 due to the lower ASPs and high utility per test. From a valuation perspective, IMA represents the most attractive Company on our coverage list and one of the least expensive Companies in all of healthcare. On a 2008 PE multiple basis, shares of IMA are trading at 12x (includes \$0.32 impact related to stock comp) versus the closest comp QDEL (2*Above Average, \$21.50) and the group which trade at 22x and 21x respectively. IMA trades at a discount to the group on a 2009 PE multiple basis (9x (includes stock comp) vs. the peer group median of 20x which is the basis of our \$43 price target. Shares are trading at an EV/Sales multiple of 1.9x and a PEG of 0.5x. There appears to still be confusion on Wall Street regarding the Company's debt situation which is well within all total leverage and coverage covenants. We estimate that the Company's floating rate debt could be a positive in 2009. If one month LIBOR were to stay at or near current levels for full year 2009, the benefit to EPS could be approximately \$0.48 or 19%. QDEL the world's leader in flu testing, represents an attractive long term pure-play in the space benefiting from strong domestic organic growth on the order of 40% y/y and continued gross margin expansion.
- **Strength in HAI Segment.** CPHD is one of our top picks for 2009 as the Company continues to set the tone in rapid molecular-based diagnostics for hospital acquired infection (HAI). We believe 2009 will be a strong year for CPHD as the Company's clinical diagnostics franchise continues to grow north of 75% y/y. With California's MRSA surveillance legislation going into effect in 2009 and the likely approval and US launch of the Company's molecular C.Diff test (marking the most comprehensive HAI menu in the field) mid-year 2009 we believe there could be upside to estimates in 2009. CPHD represents one of the few remaining pure play molecular diagnostics companies and as competition lags substantially behind and patent royalties are anticipated to roll off beginning in 2010, we believe the Company is becoming more attractive as an acquisition candidate. Shares are trading roughly in line with the peer group on a 2009 EV/Sales multiple basis (2.9x vs. group mean of 2.7x) yet we point out that the mean out-year EV/Sales takeout multiple is slightly north of 6x.
- **Blood screening and lab services potentially safer in 2009.** Due to the philanthropic nature of blood donations as well as significant barriers to entry, we believe blood screening (See GPRO (2*Above Average, \$59) on page 2) is an area of relative safety in 2009. In addition, esoteric lab services (See GXDX (2*Above Average, \$35) on Page 2), which represent the fastest growing lab segment and a crucial tool for difficult to treat conditions like cancer, is another area of relative strength, in our view.

Diagnostics

Key Investment Points

CPHD (1) may be the most attractive acquisition candidate in our coverage universe as there continues to be little competition in the rapid close-to-patient molecular diagnostic space. We believe 2009 will be a strong year for CPHD as the Company's clinical diagnostics franchise continues to grow north of 75% y/y. With California's MRSA surveillance legislation going into effect in 2009 and likely approval and US launch of the Company's molecular C.Diff test mid-year 2009 we believe there is likely upside to estimates in 2009. We believe management needs to demonstrate more consistent improvement in performance before the stock begins to work again.

IMA (1), from a valuation perspective, represents the most attractive Company on our coverage list and one of the least expensive Companies in diagnostics. On a 2008 PE multiple basis, shares are trading at 12x (includes \$0.32 impact related to stock comp) versus the closest comp QDEL and the group which trade at 22x and 21x respectively. IMA trades at a discount to the group on a 2009 PE multiple basis (9x (including stock comp) vs. the peer group median of 20x which is the basis of our \$43 price target. Shares are trading at an EV/Sales of 1.9x and a PEG of 0.5x. We estimate that if one month LIBOR were to stay at or near current levels for full year 2009 the benefit to EPS could be approximately \$0.48 or 19%. In addition, we believe rapid point-of-care diagnostics may be a safer place in healthcare during 2009 due to the lower ASPs per test and high utility the tests represent.

GPRO (2), in our opinion, has lower 2009 EPS risk than most names in our coverage universe do to the philanthropic nature of blood screening. While the multiple has come in significantly to levels slightly below the group mean 2009 PE of 23x we feel that there may be more operational leverage achieved in 2009 than the street is thinking and potential acquisition of Novartis' blood screening business (a long shot in our view) would be highly accretive to EPS and boost shares significantly.

GXXD (2) will likely be the fastest grower in our coverage universe as we anticipate roughly 46% top-line growth and approximately 42% EPS growth in 2009. We believe that the esoteric lab services space is less sensitive to the weak macroeconomic environment due to its cancer focus, valuable results, and outsourced nature of the work.

ILMN (2) continues to dominate the fast growing genotyping space and leads the next generation sequencing field. We believe the threat of potential sequencing competition from private next-next generation sequencing players Complete Genomics and Pacific Biosciences as well as valuation have weighed on shares during the recent correction. ILMN continues to be the innovation and execution leader in life science tools and shares are attractive on PEG basis.

QDEL (2) continues to be world's leader in flu testing and is an attractive long term pure-play in the rapid point-of-care diagnostics space which continues to experience consolidation. We believe flu is an attractive area in diagnostics due to strong domestic organic growth on the order of 40% y/y and in general, rapid point-of-care diagnostics may be a safer place in healthcare during 2009 due to the lower ASPs per test and high utility which the tests represent.

MGRM (2) remains a difficult stock to recommend in the near term given the lack of clear catalysts and a diminishing cash position (4-5 quarter cash runway) however we are encouraged by the long term cancer opportunity. Trofile testing and the recently launched cancer business are simply not growing fast enough at this time to offset the Company's cash needs in 2009.

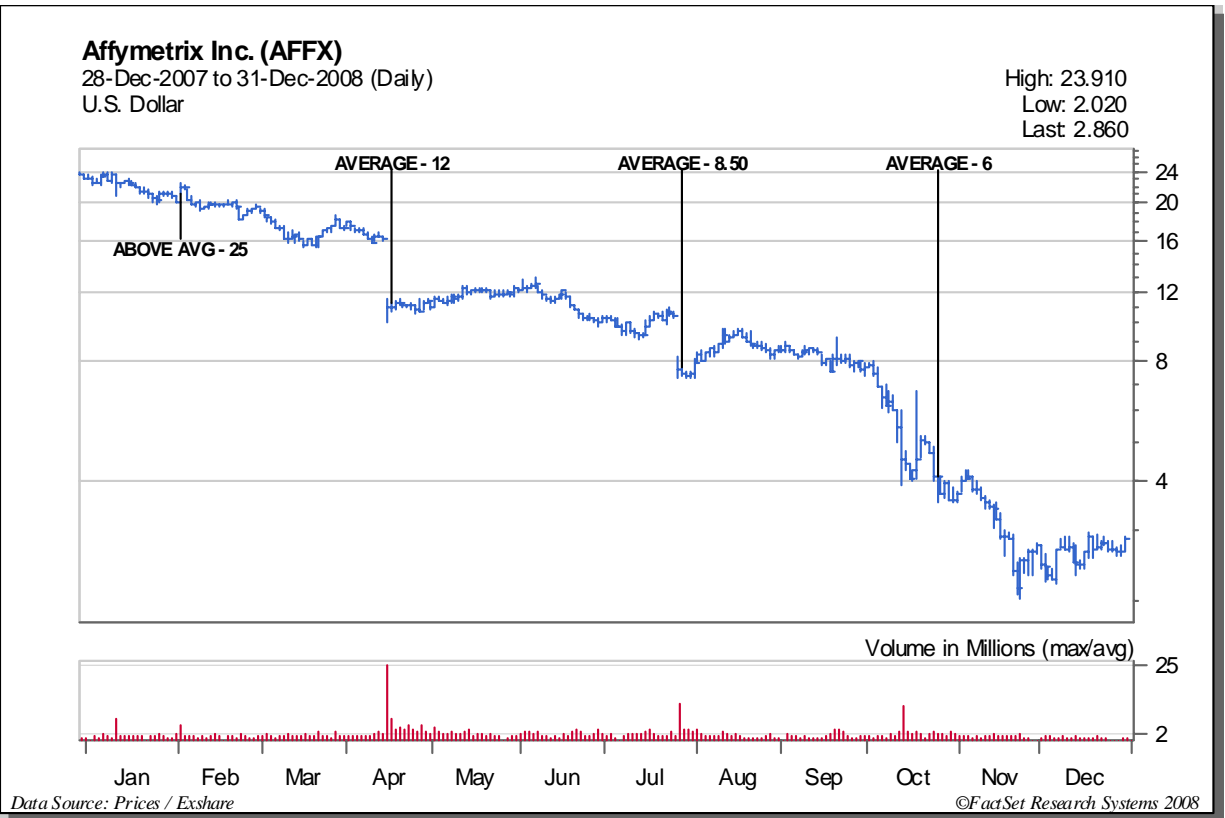
AFFX (3) remains difficult to recommend at this time given the unending challenges facing the core gene expression business and softening genotyping sales. New product launches, which have not been mapped out, will be key to this story.

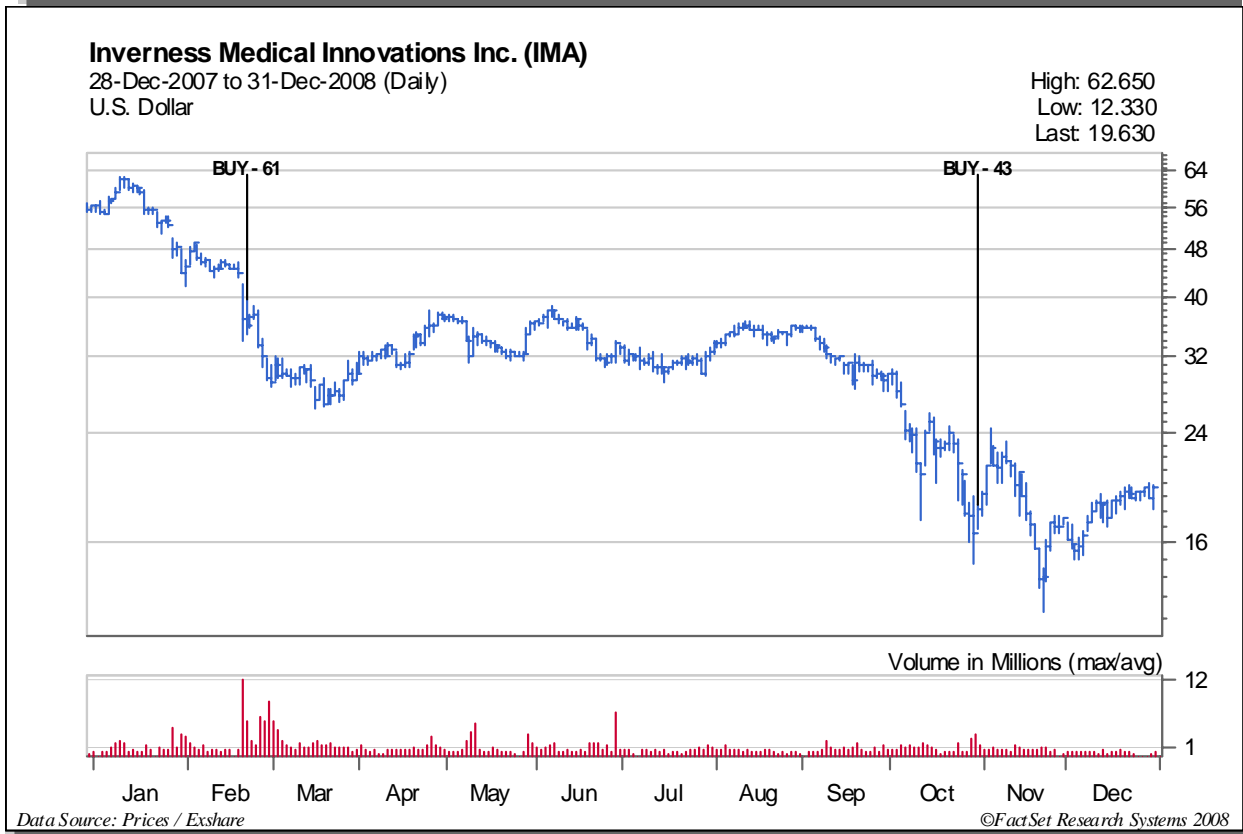
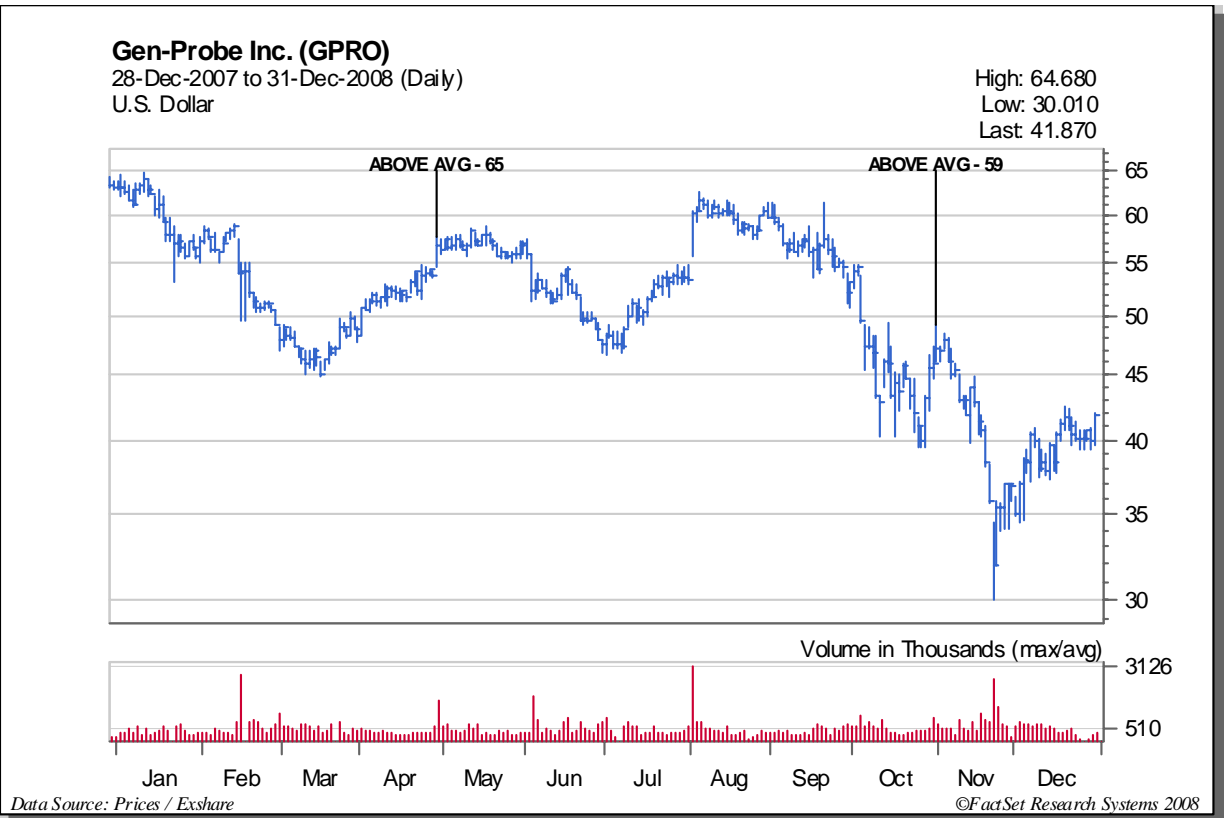
RGDX (3) may continue to be plagued in the near term by its slower than expected diagnostics ramp and diminishing cash position however we continue to believe that ResponsDx represents a significant long-term opportunity in cancer management and recent strategic initiatives (i.e. Neogenomics agreement) and early clinical feedback is encouraging to us.

SQNM (4) has a lot to accomplish before its SequareDx Down Syndrome test begins generating meaningful revenue for the Company. We think management will continue to manage news flow effectively and believe one could see the stock trading higher in front of the Society for Maternal & Fetal Medicine meeting (San Diego, 1/26-1/31/09) where the Company is releasing additional proof of concept data. With a 2009 EV/Sales around 18x versus the molecular dx subgroup trading at 4x we believe valuation will weigh on shares in between catalysts. Additionally, news related to competitive threats as well as the confusing IP estate could challenge shares in 2009.

Risk

Risks to our thesis include 1) Increased competition from larger, well capitalized competitors 2) Unpredictable seasonal disease activity 3) Reductions in CMS physician and laboratory fee schedules, negatively impacting reimbursement and 4) Reduction or shift in NIH related research spending.

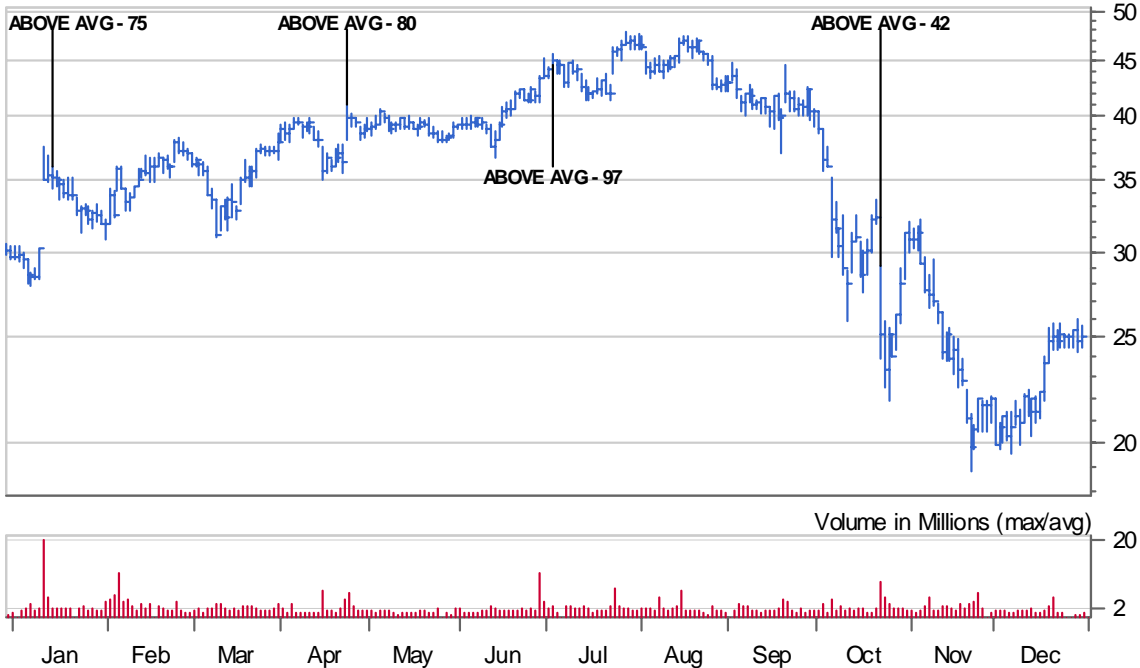




Illumina Inc. (ILMN)

28-Dec-2007 to 31-Dec-2008 (Daily)
U.S. Dollar

High: 47.875
Low: 18.820
Last: 25.000



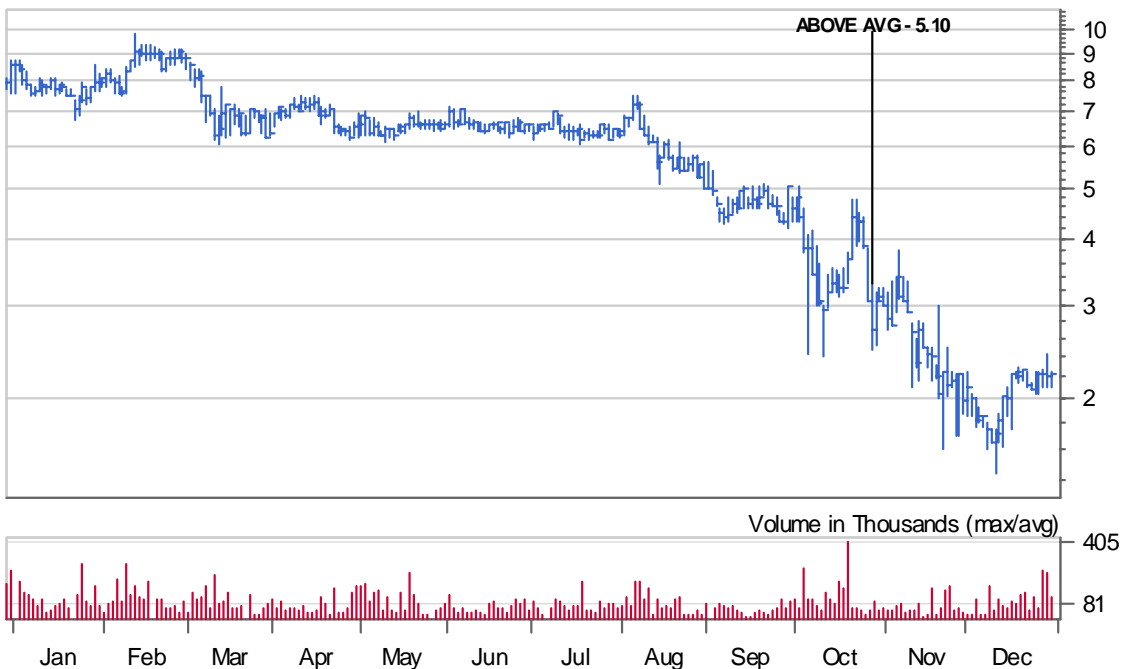
Data Source: Prices / Exshare

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Monogram Biosciences Inc. (MGRM)

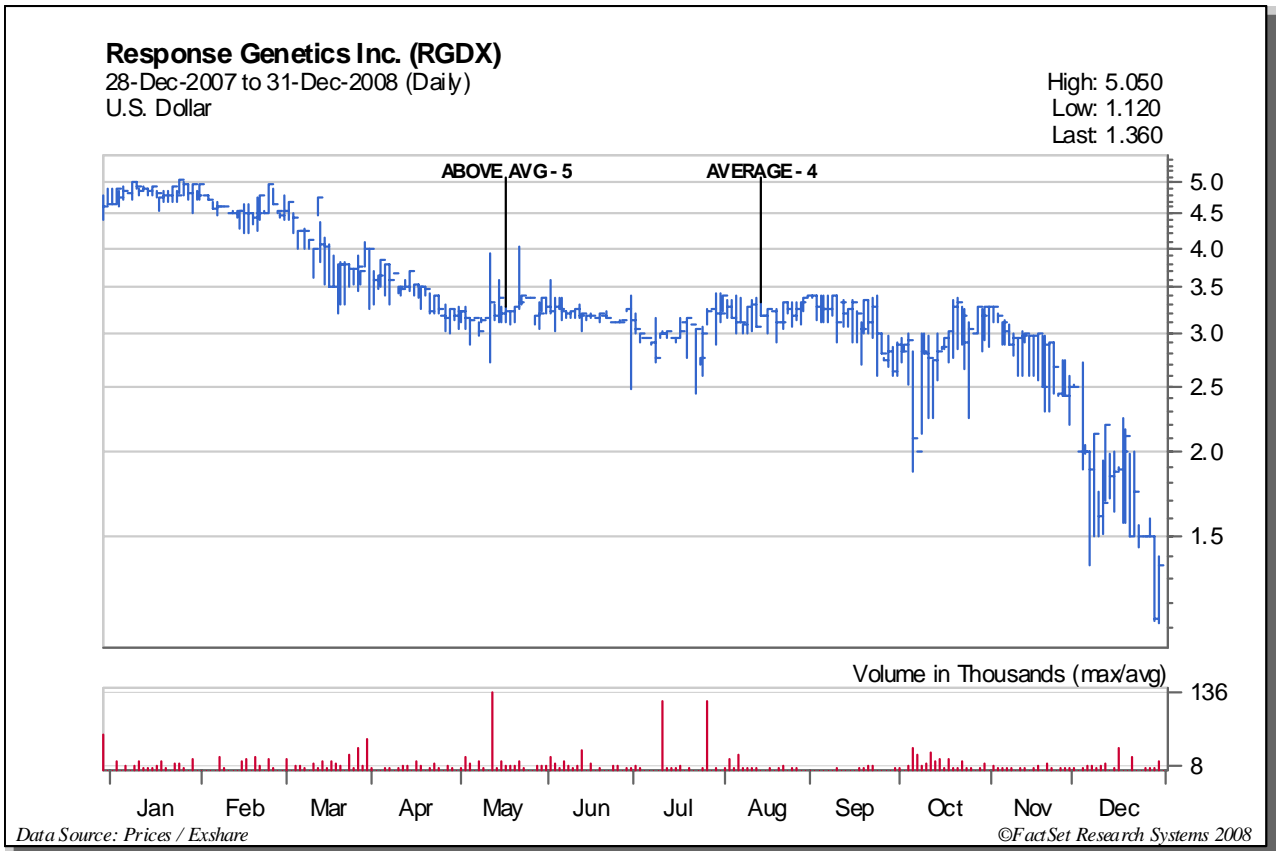
28-Dec-2007 to 31-Dec-2008 (Daily)
U.S. Dollar

High: 9.780
Low: 1.440
Last: 2.230



Data Source: Prices / Exshare

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Ratings Distribution Chart:

Total Securities Rated			
136			
Buy			
Number of Ratings	% of Ratings	No. Provided IB Services	% Provided IB Services
76	55.88%	0	0.00%
Hold/Neutral			
Number of Ratings	% of Ratings	No. Provided IB Services	% Provided IB Services
44	32.35%	0	0.00%
Sell			
Number of Ratings	% of Ratings	No. Provided IB Services	% Provided IB Services
16	11.76%	0	0.00%

First Call ratings are adapted to the above chart as follows: 1 & 2 = Buy, 3 = Hold/Neutral, 4 & 5 = Sell

Companies mentioned in this report:

Ticker	Rating	Price	Cap (\$Bil)	Date	Analyst
AFFX	3/Average	\$2.86	\$0.20	12/10/2008	Zarak Khurshid
IMA	1/Buy	\$19.63	\$1.53	12/30/2008	Zarak Khurshid
GPRO	2/Above Avg	\$41.87	\$2.28	12/30/2008	Zarak Khurshid
GXDX	2/Above Avg	\$33.59	\$0.56	12/30/2008	Zarak Khurshid
ILMN	2/Above Avg	\$25.00	\$3.09	12/30/2008	Zarak Khurshid
QDEL	2/Above Avg	\$12.55	\$0.41	12/30/2008	Zarak Khurshid
MGRM	2/Above Avg	\$2.23	\$0.05	12/30/2008	Zarak Khurshid
RGDX	3/Average	\$1.36	\$0.01	12/30/2008	Zarak Khurshid
SQNM	4/Below Avg	\$19.95	\$1.21	12/30/2008	Zarak Khurshid

*Note: Caris & Company utilizes the First Call rating system when assigning ratings in equity research reports. The following is a list of each numerical rating and its respective definition.

- 1 Buy
- 2 Above Average
- 3 Average
- 4 Below Average
- 5 Sell

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