

Company name: Natera, Inc. (NASDAQ: NTRA)

Recommendation: Long (as of July 26, 2024)

I. Company Overview

We recommended longing on Natera (NTRA), a leading clinical genetic testing company, on the basis that the consensus underestimates Natera's product moats and its ability to outperform topline estimates in the next 12 months. The company's stock currently trades at \$102.1 per share versus **our estimated NTM stock price of \$137.6 per share, implying a 35.0% potential upside**. In its most recent fiscal year, the company generated \$1.08 billion in revenue and a net loss of \$434.8 million. Its current market cap is \$13.08 billion, and its enterprise value is \$12.64 billion (TTM EV/Sales of 10.4x).

II. Product Description

Natera is a pioneer in non-invasive, cell-free DNA testing technology, specializing in next-generation accuracy and reliability in preconception and prenatal genetic testing services (NIPT). The Company's revenue profile includes two different segments: Product and Licensing. Specifically, the product revenue streams are divided into three parts: Reproductive health (inc. Panorama and Horizon Carrier Screening tests), Organ transplant (inc. Prospera), and Oncology (inc. Signatera). The company generates most revenues from the sale of its genetic tests from Panorama and HCS tests.

III. Competitive Landscape

Despite the highly competitive nature of the life science diagnostics market, we believe that Natera's dominant role in NIPT and its innovative products positions itself in a robust place. With significant growth in NTRA's women health business, Natera has emerged as the market leader in the NIPT testing market, steadily increasing its market share and creating high barriers for new entrants. From a mid-term to long term perspective, more competitors are expected to enter the minimal residual disease (MRD) space due to its large total addressable market (TAM) presence, creating more competition for Natera's oncology business. However, with the advantage of ADLT reimbursement, Natera maintains a strong moat, leading ahead of its competitors in this space.

IV. Investment Thesis

The current consensus estimate for Natera's FY 2025 revenue stands at \$1.69 billion. However, we believe this estimate underestimates Natera's topline growth potential due to further penetration in the Signatera MRD space and higher total products blended average selling price (ASP) driven by incremental sales of Signatera. We view the FY2025 revenue will reach to \$1.83 billion, implying an incremental upside of 8.49% and \$143.4 million revenue.

Firstly, the strong volume momentum of Signatera MRD targeting a \$15 billion TAM market with **only a 2% penetration rate** will continue to drive Natera's topline growth. Recall Q1 2024 earnings call, management highlighted the substantial growth potential in the largely underpenetrated MRD market. According to the National Cancer Institute, as of January 2022, there are approximately 18.1 million cancer survivors in the U.S. Assuming an annual MRD market annual penetration growth rate of 1%, reaching 4% by FY2025, and considering Natera's estimated 80% market share and an Average Selling Price (ASP) of ~\$1200 per test (assumption of 10% YoY growth), Signatera's annual MRD test volume would be 579,200 tests, translating to \$700.8 million in revenue (equivalent of 59% of consensus FY2025 topline estimates). However, we anticipate a faster penetration rate than the implied 1.0% annually, bolstered by management focus into breast cancer, the cancer type with the highest number of survivors in the U.S. This will speed up the penetration velocity if the study makes progress in the near term to midterm. If annual penetration rate just increases by 0.5% more, it will reach 4.5% market penetration in FY2025 delivering 651,600 test volumes and \$788.4 million revenues, **representing an incremental upside of 72,400 tests and \$87.6 million in revenue**. In addition, besides just focusing on new market share gains, many existing patients will require more than 1 test per year, this multiple frequency of testing will bring more volumes and revenue upside.

Secondly, increasing selling volumes of Signatera with higher Average selling price (ASP) will lift the total blended ASP, which

translates into more revenue upside. Per Q4 2023 earnings presentation, management indicated that Signatera ASP met the target of ~\$1000 per test, positioning it as a higher profit margin product compared to Panorama and Horizon Carrier Screening (HCS). Equally, Signatera has the highest volume growth rate (36.0% implied growth rate of FY2025 our estimate Signatera revenues) driven by early penetration of MRD market and Natera's leading position in the MRD market. This means signatera will contribute a greater share of Natera total products volumes, **driving up the total blended ASP per test**, which provides more revenue upside for the overall total product revenue streams. Specifically, based on our model estimation, by FY 2025, Signatera will grow into the highest revenue product of \$788.4 million revenue. Moreover, management has indicated significant potential to further improve Signatera's ASP. **With the support of its ALDT status**, which competitors can only obtain through FDA approval, Signatera will become more competitive in the market. This status allows management to further increase Signatera's ASP, leading to additional revenue in midterm timeline. Considering the increasing volume mix of Signatera and the potential for higher ASP in the future, we project the total blended ASP per test to reach \$589 by FY2025, which implies an additional ~\$70 million in revenue upside.

V. Catalyst

In the near term, we see two major catalysts. Firstly, the market is closely watching the **Signatera ALTAIR trial readout** release in Q3, which could significantly boost Natera's stock price. If the readout shows positive, it has the potential to expand the Signatera MRD TAM and foster partnerships with pharmaceutical companies for early-stage cancer treatment development, which further increases testing volumes. Secondly, **earnings sentiment** could serve as another catalyst. Notably, Natera's stock jumped 17.56% on August 4th, 2023, following a full-year guidance raise. Therefore, any future earnings guidance increases over the next 6-12 months could also drive short-term price gains.

VI. Valuation

We valued Natera based on a public comparable approach, picking EV/sales valuation multiple. We viewed forward FY25 EV/Sales multiple as the most appropriate valuation metrics, given the company's profitability metrics (Inc. EBIT, EBITDA, uFCF) are still in negative territory. **Peer comparison:** When compared to its peers based on consensus forward sales growth estimates, Natera exhibits the highest revenue growth rate at 27.1%, significantly outpacing the peer median of 11.0%. This indicates a strong and continuing volume momentum. While the median forward EV/Sales multiple for peers is 3.2x, Natera trades at a much higher multiple of 8.8x. Given Natera's robust future topline growth prospects, we consider an 8.8x EV/Sales multiple to be reasonable for valuation purposes. **Historical comparison:** If we recall Natera 5-year historical EV/Sales trend, you will find Natera has traded at an estimate ~ 5x EV/Sales range. Although the current multiple is significantly higher, we believe it is justified by Natera's compelling growth narrative. Over the course of years, Natera has solidified its position as the leading player in the NIPT testing market, developed first commercialized Signatera liquid biopsy assay for recurrence monitoring, and expanded into the MRD market, which offers substantial potential upside. Those milestones demonstrate the real power of lab data and technology innovation; hence, we do not view the current multiple as overvalued.

VII. Risk

The primary risk to Natera's stock price is increasing competition in the MRD market. The entry of more competitor products could impact Signatera's sales and affect topline growth. Specifically, EXAT Sciences (NASDAQ: EXAS) has announced its MRD testing development in recent website updates and press releases. However, we believe Natera's early entry into the MRD space and its advanced testing development position it ahead of competitors. Additionally, management's continued reinvestment in product development further strengthens Natera's competitive edge.