NeoGenomics Q4
2018 Conference Call Script

Doug VanOort

Good morning. I'd like to welcome everyone to NeoGenomics' Fourth Quarter 2018 conference call.

Joining me from our Fort Myers headquarters is Sharon Virag, our Chief Financial Officer, Rob Shovlin, President of our Clinical Services Division, George Cardoza, President of our Pharma Services Division, and Bill Bonello, Chief Strategy and Corporate Development Officer and Director of Investor Relations.

Before we begin our prepared remarks, Bill Bonello will read the standard language about Forward-Looking Statements.

Bill Bonello

This conference call may contain forward looking statements, which represent our current expectations and beliefs about our operations, performance, financial condition, and growth opportunities. Any statements made on this call that are not statements of historical fact are forward-looking statements. These statements, by their nature, involve substantial risks and uncertainties, certain of which are beyond our control.

Should one or more of these risks or uncertainties materialize or should the underlying assumptions prove incorrect, actual outcomes and results could differ materially from those indicated in the forward-looking statements. Any forward-looking statement speaks only as of today, and we undertake no obligation to update any such statements to reflect events or circumstances after today.

Before turning it back to Doug, I want to let everyone know that we will be making a copy of our prepared remarks for this morning's call available on the investor relations section of our website shortly after the call is completed. We also want to let everyone know that we are going to limit the number of questions to two per person in order to give more people a chance to ask questions within the one hour that has been allotted for this call.

Doug's Comments

Thanks Bill.

For today's call, I will briefly review some Quarter 4 highlights and then turn the call over to Sharon for a more detailed review of the financial results. After that financial review, I will comment on several of our growth initiatives and investments that we are making to drive both near-term and long-term growth. We will then have time for Questions and Answers.

Let's begin with the Quarter 4 highlights.

Quarter 4 Performance

We were very pleased with our Quarter 4 financial performance. We reported record revenue and adjusted-EBITDA, with 25% top-line growth and 30% adjusted EBITDA growth. Those results included 20 days of Genoptix results, and when excluding the impact of Genoptix, organic revenue growth was 17% and Adjusted EBITDA was up 27%.

In the Clinical Services Division, we continued to achieve good results from our efforts to improve both revenue and cost per test. Excluding the impact of Genoptix, we actually increased average revenue per test by 6% year-over-year, and we lowered cost per test by 3%. Obviously, the resulting impact was an expansion of our margins.

Clinical test volume growth was a little bit lower than normal as we were up against an exceptionally strong prior-year comparison. Clinical test volume increased 13% year over year with Genoptix, and 9% year-over-year excluding Genoptix. Volume growth was unusually low in November, but has returned to historical levels in both December and year-to-date in 2019.

Pharma Services revenue grew 33% year-over-year to a record $10.6 million. We signed $15 million of new contracts during the quarter and our backlog was up 44% year over year to $99 million.

The Quarter's record levels of profitability were achieved even as we continued to make significant investments for future growth, and Adjusted EBITDA margin reached an all-time high of 17.0%. Importantly, service levels were excellent and customer retention levels were outstanding. Cash collections were very strong and also reached a record level for the quarter.

On the strategic front, we completed our acquisition of Genoptix on December 10th. Now that we've had two months of ownership, we are even more excited about the acquisition today than we were at the time we announced the deal.

This combination of NeoGenomics and Genoptix sets our company apart, with unprecedented reach to all customer segments, including hospitals, pathologists, and community oncology practices. It also allows us to be even more competitive by leveraging best practices and offerings from each company, and unifying cancer care among oncologists, pathologists, hospitals, payors and patients. I will provide a more detailed update on the Genoptix integration activities later in the call.

The strong fourth quarter results capped an eventful year for our company which included good quarterly performance, a new strategic partnership with PPD, our redemption of the Preferred stock owned by GE and GE's subsequent exit from their ownership position in NEO stock, and a $135 million secondary offering followed by our acquisition of Genoptix. We feel very good about 2018, and are even more excited about our opportunities in 2019.

Before we talk more about those opportunities, I would like to turn the call over to our Chief Financial Officer, Sharon Virag, for a more detailed review of fourth quarter financial results.

Doug transitions to Sharon

Thank you Doug.

Fourth quarter Review

Our fourth quarter revenues were $76.5 million, a 25% increase from last year. Clinical Services revenue increased 23% to $65.9 million and Pharma Services revenue increased 32.6% to $10.6 million. Clinical volume increased 13% to 198,000 tests and average revenue per test increased 9% to $333.

Excluding the impact of Genoptix, revenue increased 17% to $71.8 million, volume grew 9% and average revenue per test increased 5.5% to $323. As we discussed last quarter, we are optimistic that we are beginning to see less downward pressure on price per test than we have experienced over the past several years. Also impacting revenue per test are improvements in our cash collections.

Gross profit increased by $10.3 million to $37.1 million, up 39%, from the prior year. This increase represents a 69% contribution on the $15.1 million of revenue growth. Gross margin improved by 495 basis points year over year to 48.5%. This improvement was driven by productivity gains, cost efficiencies, and improved revenue per test. Genoptix had a modestly positive impact on gross margin during the quarter.

G&A expenses increased by $9.1 million, or 55% year over year, to $25.7 million. Approximately $2.3 of this increase is related to one-time, non-recurring acquisition-related transaction costs. These expenses are counted as Non-GAAP adjustments in our calculation of adjusted EBITDA, adjusted net income, and adjusted EPS. The balance of the increase is primarily attributable to the addition of Genoptix, higher professional fees and increases in payroll and payroll-related costs. Excluding one-time costs and the impact of Genoptix, G&A expenses were 24% higher than last year. This increase reflects key investments made in the company's G&A infrastructure to support our continued growth.

Sales and Marketing costs increased by 37% year over year to $8.0 million, primarily due to the Genoptix acquisition. Excluding the impact of Genoptix, Sales and Marketing expenses were 24% higher than last year. Similar to G&A, this increase reflects important investments made in the company's Sales and Marketing team to support top-line growth.

Fourth quarter GAAP net income attributable to common shareholders was $353,000 compared to net income of $1.9 million in the fourth quarter of 2017, and Diluted Income per share was $0.00 versus Diluted Income per share of $0.02 in the prior year.

We believe that in order to compare the net income related to the true operations of the Company on a more consistent basis across periods, it is appropriate to adjust GAAP net income or (loss) available to common shareholders to exclude certain non-cash items and, if applicable, one-time costs. We refer to this measure as "Adjusted Net Income" and on a per share basis, "Adjusted Diluted Earnings per Share", and we have included a table with how these are calculated in our earnings release.

Adjusted EBITDA was $13.0 million, an increase of 30% year-over-year. The marginal adjusted EBITDA contribution on revenue growth excluding Genoptix was 26%, which is within our long-term guidance of 25% to 35%. As we have mentioned in the past, the 25% to 35% guidance is a range that we expect to fall into on average, with some quarters above and some quarters below that range.

In the fourth quarter, Adjusted Net Income was $5.5 million compared to $3.2 in the prior year. Adjusted Diluted EPS was $0.06 versus $0.04 in Quarter 4, 2017.

Cash collections were strong in the quarter with clinical DSOs improving 7 days sequentially to 77 days, excluding the impact of Genoptix. Cash flow from Operations increased 148% for the full year to $44.8 million. Capital expenditures for the year were $21.9 million with $14.3 million of cash capex and the remainder under lease financing.

We ended the quarter with $10 million of cash and $112 million of total debt, including capital leases. During the quarter we completed the acquisition of Genoptix for approximately $125 million in cash and 1 million shares of common stock.

We finished the Fourth quarter with 1,475 full-time equivalent employees, contract doctors, and temps including 359 legacy Genoptix employees, versus 1,078 as of September 30, 2018, and 980 as of December 31, 2017.

On a consolidated full year basis, we finished 2018 with $276.7M in revenues representing 15.2% year over year growth and test volumes increased 14.1% compared to 2017. We also saw revenue per test improve 1.2% and experienced a decrease in cost per test of 4.6%. This corresponded to a 360 basis point gross margin improvement year over year. Additionally, we posted 2018 Adjusted EBITDA of $43.6M which represents 29.6% growth year over year and our Adjusted EBITDA Margin expanded 170 basis points versus 2017 to 15.7%.

We are issuing full year 2019 revenue and earnings guidance. We expect consolidated revenue to be in the range of $379 million to $395 million and Adjusted EBITDA to be in the range of $49 million to $53 million. This guidance assumes $80 to $85 million of revenue from Genoptix, approximately 10% volume growth in the legacy NeoGenomics business, low single digit declines in legacy NeoGenomics Clinical Services revenue per test, approximately 20% growth in Pharma Services revenue.

I want to address an anticipated question about our volume growth expectations. As many of you know, we have historically guided to mid-teens volume growth. We continue to believe that we can grow the business at that rate on a long term basis and in a normal operating year. However, 2019 is an integration year. It's our goal not to lose a single customer during that integration. The top priority for our sales team will be customer retention. Thus, while we are encouraged by the growth opportunities in front of us, it seems prudent to forecast slightly lower than normal volume growth this year.

Finally, I want to take just a minute to discuss our plans for reporting 2019 results. This quarter, we quantified the impact that Genoptix had on certain results and metrics. We did this because our

2018 revenue and EBITDA guidance, and most analyst estimates, excluded the impact of the Genoptix acquisition on Fourth Quarter results. Going forward, we will not be quantifying the impact of Genoptix on specific results. We expect that our integration activities will progress at a rapid clip and it would be both impractical, and counterproductive to segregate Genoptix results from the rest of our business. That said, we will keep you apprised on how we are tracking with basic assumptions such as cost synergies and revenue compression.

I will now turn the call back over to Doug to provide some additional commentary on our key 2019 initiatives and opportunities.

Sharon transitions to Doug

Thank you Sharon.

I would like to begin with an update on Genoptix and our integration activities. We are very excited about his opportunity to combine the best of Genoptix with the best of NeoGenomics.

Virtually everything we have seen and heard since closing the acquisition on December 10th reaffirms our conviction that this combination makes a lot of sense for patients, providers, payors, employees and shareholders.

As a privately-held company for many years, Genoptix focused on building its business with community-based Oncologists. The company developed outstanding products and services for this market segment, and developed an excellent reputation for quality of testing and reporting that remains a gold standard in our industry.

I am happy to report that we are moving forward at a rapid pace with integration activities and are very much on schedule. Rob Shovlin is leading the commercial and operational integration, and Sharon Virag is leading the financial aspects of the integration process. Most of our NeoGenomics team now has experience with complex integrations, and we're applying our learnings to this integration. We're moving as deliberately and quickly as possible, we're making very good progress, our estimates of synergy have been verified, and we feel that our plans are on track.

Several Genoptix Leaders have assumed key leadership positions in our commercial, operations, and finance teams, and we are working to fill a number of new growth positions with highly-qualified people from Genoptix. Since finding great people is a constraint to growth, this is a welcome relief.

Shortly after closing the deal, a number of us met with each member of the Genoptix sales team. Then after significant review and analysis, we developed and rolled out a complete integrated sales organization and new territory alignment all within six weeks after closing. Just last week, we held a very successful National Sales Meeting. We now have 80 sales professionals in our clinical services division and 9 in our Pharma services division. Counting our marketing and managed care teams, we now have approximately 100 people in our Commercial organization.

We have found a very high level of experience, commitment and enthusiasm across all departments at Genoptix, including the medical team, lab operations and corporate support functions.

On the Medical Team, a strong group of Genoptix Pathologists and PhDs have added to the our existing team, which now combines to total approximately 80 MDs and PhDs. I believe we now have one of the largest and most capable team of Medical and Scientific professionals for cancer diagnostics in the country.

In Operations, in particular, Genoptix has an excellent Molecular Lab, and the combination of our Molecular teams and capabilities is going to be extremely beneficial to our operations and future strategies. Former molecular leaders at Genoptix are now part of the current molecular leadership for our combined company.

Also in Operations, we have already worked to consolidate test menus and identify best practices which we will standardize on. The broader NeoGenomics solid tumor test menu has allowed for tests formerly sent out by Genoptix to nearly immediately be performed internally at our Lab in Aliso Viejo. Internalizing send out testing is both a cost reduction and an improvement in service and turnaround time for clients and patients.

Although we purposely did not include revenue synergy in our deal models, we have come to believe that there is a good opportunity to increase business with existing customers over time by leveraging our comprehensive test menu and large portfolio of managed care and GPO contracts.

Genoptix Sales representatives have confirmed that many customers were sending solid tumor work to other labs because Genoptix was not actively trying to win that business. The reps also believe that they missed out on a significant amount of business because they did not have contracts to serve as an "in-network" provider with a large number of managed care plans that NeoGenomics does have contracts with. We hope to leverage our large test menu and portfolio of payor contracts to gain revenue synergy over time.

As we work through the integration, our top priority is customer retention. Obviously, maintaining high service levels and turnaround time is critical to customer retention, as is a long list of other aspects of superior service. NeoGenomics is laser-focused on client satisfaction. We are quite proud that, with approximately 2,000 responses to our customer surveys during 2018, our Net Promoter scores ranged from 59 to 60. We understand what it takes to satisfy customers, and we will try to maintain those throughout the integration process.

While successfully integrating Genoptix is our most important job this year, we do have a lot of other exciting growth initiatives underway. There are four that warrant an explanation:

First, we continue to sign contracts with commercial payors, group purchasing organizations, integrated delivery systems, large hospital networks, and large oncology practices. This activity is a direct result of our scale and strong ability to serve providers and payors on a national basis.

In addition to recently announced Agreements with Cigna and Premier, we added several important new contracts in the fourth quarter to further expand our access to referring physicians and patients. Once contracts are awarded, they typically take several months before beginning and

then several more months to fully transition. As a result, we have some good visibility to volume growth beginning in the next several months.

Second, we continue to make progress with our proactive measures to address revenue per test. We have enhanced our analysis of existing reimbursement trends, identified areas where we are being underpaid, and implemented a plan for improvement. These activities include securing coverage for non-covered tests, improving our billing process to avoid denials, and working denials more effectively when they do occur. We are also evaluating our fee schedules to identify tests that are not appropriately priced. Our recent results suggest that we are seeing some initial benefits from these efforts.

A third area of growth is in our exciting Pharma Services Division. You may have noticed that our revenue grew nicely, on a sequential and year-over-year basis, each quarter during 2018. That revenue growth is driven by our strong backlog of signed contracts which totaled nearly $100 million at year end. We believe this growth is fueled by strong market demand for oncology clinical trials, and also to our unique capabilities. One of those capabilities – the ability to help sponsors with a complimentary biomarker or companion diagnostic, and then be able to immediately offer that test commercially upon drug approval, is becoming of increasing interest to our Pharma clients.

We continue to invest in our capabilities to serve Pharma clients, including a build out of our global infrastructure. We are beginning to see projects roll through our lab in Switzerland, we are slated to open our Singapore lab in just two weeks, and we are in the planning stages for China as well.

We also continue to be excited about our global partnership with PPD. We have a handful of early wins and a number of bids outstanding with pharma and biotech customers today. We expect the pace of activity to increase over time, especially as we add capabilities in Asia.

Fourth, we continue to make progress with our FDA initiative. As we have discussed on previous calls, we are in the process of seeking FDA approval for a large, multi-gene, next generation sequencing panel. We believe that an FDA approved Next Generation Sequencing test offering will benefit both our Pharma Services and Clinical testing Divisions, by further differentiating us from other oncology labs, helping to drive reimbursement for our multi-gene panel, and increasing our attractiveness to pharma companies for clinical trials involving companion diagnostics.

After we closed the Genoptix deal and reviewed our plans in detail with our new broader team, we decided to make some additions to our assay and we are quite excited about it. Even with these revisions, we expect to submit the assay to the FDA late in the third quarter or in the fourth quarter of this year.

In summary, we are excited about the strength of our business, our position in the market, and our near-term and long-term growth opportunities. Sophisticated laboratory testing plays an increasingly critical role in identifying appropriate care protocols for cancer patients, ultimately improving quality of care and saving lives. We are pleased to play an important role in this vital segment of our health care system, and believe that our services are creating value for patients, employees, customers, and for our investors.

I will now hand the call over to Bill Bonello to lead us through Q&A.

Transition to Bill for Q&A

At this point, we would like to open it up for questions. Incidentally, if you are listening to this conference call via webcast only and would like to submit a question, please feel free to email us at bill.bonello@neogenomics.com during the Q&A session and we will address your questions at the end if the subject matter hasn't already been addressed by our call-in listeners. As mentioned at the beginning of this call, we would like to ask each person to limit their questions to two so that we may hear from everyone and still keep within the hour allotted for this call.

Operator, you may now open up the call for questions.

Closing Remarks (Doug)

Before we end the call, I would like to recognize the approximately 1,475 NeoGenomics team members around the world for their dedication and commitment to building a world-class cancer-genetics testing company.

On behalf of our NeoGenomics team, I want to thank you for your time in joining us this morning. For those of you listening that are investors or are considering an investment in NeoGenomics, we thank you for your interest in our Company.

Goodbye.