NeoGenomics Q1 2019 Conference Call Script

Doug VanOort

Good morning. I'd like to welcome everyone to NeoGenomics' First Quarter 2019 conference call.

Joining me from our Fort Myers headquarters is Sharon Virag, our Chief Financial Officer, Rob Shovlin, President of our Clinical Services Division, and Bill Bonello, Chief Strategy and Corporate Development Officer and Director of Investor Relations. Joining us on the phone from Aliso Viejo is Dr. Larry Weiss, our Chief Scientific Officer.

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 the call 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 1 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 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 1 highlights.

Quarter 1 Performance

First quarter results were outstanding, and we have substantial momentum as we head into the rest of the year.

Revenue increased 51% year-over-year to $96 million, driven by organic growth of approximately 20% and by the acquisition of Genoptix.

Clinical volumes increased 31%, with organic growth of approximately 12%. During the quarter, we added several large hospital and oncology customers, with most of the revenue benefit from those additions still to come. We feel confident that there are more large new accounts on the horizon.

Revenue per test increased 15% year-over-year, due in part to adding Genoptix, but also to continued success with our reimbursement initiatives. We recently signed a new national contract with Humana and are now contracted with every major national commercial health plan in the US. The benefits from the Humana contract are still ahead of us.

We are especially excited by the momentum in our Pharma Services Division, where Revenue grew 45% year-over-year to more than $9 million. We signed $21 million of new contracts during the quarter and our backlog was up 41% year over year to $101 million.

Importantly, we continued to grow profitably. Adjusted EBITDA increased 49% year-over-year to $14 million, with most of the cost synergies from the Genoptix acquisition yet to be realized. Our integration efforts are well underway and tracking as expected.

While things are going well, there are risks and challenges. In addition to handling rapid growth, we are in the middle of an integration. It's a management challenge to maintain the excitement around growth and sustain high levels of performance without exhausting our people. We are trying to simplify, prioritize, and pay close attention to the morale of our people and our culture.

We also need to strike the right balance between achieving cost synergies and maintaining sufficient capacity to accommodate our growth both this year and in the future.

Although these are challenges, our team is seasoned, and we are confident in our ability to manage through these challenges.

In summary, we feel very good about the state of our business, we are clearly benefiting from our strategic positioning, and we are excited about the opportunities ahead of us.

Doug transitions to Sharon

I will now turn the call over to Sharon to discuss our Quarter One financial results.

Sharon's Comments

Thank you Doug.

First quarter Review

As Doug mentioned, our first quarter revenues were $96 million, a 51% increase from last year. Of course, a substantial portion of that increase is due to the Genoptix acquisition but it is the remaining portion of the growth that we are really excited about, as it represents organic revenue growth in both businesses of around 20%.

Clinical

Clinical Services revenue alone increased 51% to $86 million. The majority of the Genoptix revenue went to the Clinical division so this was directionally as expected but we also saw substantial organic growth in this segment.

That revenue growth came from both volume and price improvements. Clinical volume increased 31% to more than 234 thousand tests, with organic volume growth of approximately 12.0% and the remaining growth from the addition of Genoptix. We are especially encouraged by the organic volume growth rate, given the potential for salesforce distraction during the integration period. Fortunately, we have seen our salesforce staying focused on strengthening the sales pipeline.

Our average revenue per test increased 15% to $368. Approximately three quarters of this increase is from the addition of Genoptix, while the remainder of the increase is the result of our ongoing reimbursement initiatives.

Looking to the future, we expect reimbursement to further improve – as Doug said earlier, we are very pleased to announce that we have entered into a new national contract with Humana, effective April 1, 2019. Humana is the fourth largest national insurance plan in the country, with six million covered members. Our contract includes all products and covers all 50 states and incorporates all of our US laboratories.

Previously, neither NeoGenomics nor Genoptix had been contracted with Humana. Historically, this out-of-network status has negatively impacted volume growth and revenue per test. The new contract will allow us to better serve existing customers, add additional customers, reduce billing complexity, and improve our average revenue per test in the Clinical Segment.

Pharma

Pharma Services revenue increased 45% to more than $9 million, which was also stronger than we had projected. This is almost entirely from organic growth as the pharma services revenue from Genoptix was very small.

We booked $21 million of new business in the first quarter. Although our new bookings were outstanding, we did see $9 million of cancellations due to sponsors discontinuing certain development projects. Even with this unusually high level of cancellations, our backlog was up versus last quarter and increased 41% year over year. Our Pharma Services backlog now exceeds $100 million.

Importantly, our backlog is converting to revenue. During the quarter, we saw robust growth across nearly every test modality, as well as contributions from our lab in Rolle, Switzerland.

Gross Profit/Margin

Combined gross profit increased by $20 million to $47 million, up 73%, from the prior year. This increase represents a 62% contribution on the $32 million of revenue growth. Gross margin improved by 625 basis points year over year to 49%. This improvement was driven by the impact of volume growth, higher average revenue per test, productivity gains, and cost efficiencies.

It's important to take a moment to talk about this margin. We hope that synergies, and our continued focus on both cost and reimbursement, will help us achieve and maintain a similar margin over time. However, we are currently investing for continued growth, which may impact gross margin in future quarters of this year.

Our average cost-of-goods-sold per clinical test (also known as our "Cost per Test") increased by 5%, reflecting the impact of the Genoptix acquisition. Our expectation was that cost per test would increase by almost 8% due to the higher Genoptix cost per test at the acquisition date. So we are very pleased to see the impact of both the strong organic growth and continued focus on efficiency cutting that increase meaningfully.

G&A

General & Administrative expenses increased by $15 million to $32 million. The increase is due to the acquisition of Genoptix, growth initiatives and approximately $1.3 million of one-time acquisition and integration related costs. These one-time, nonrecurring expenses are counted as Non-GAAP adjustments in our calculation of adjusted EBITDA, adjusted net income, and adjusted EPS.

We expect the investments in infrastructure and innovation to continue throughout the rest of this year. Importantly, the Quarter One G&A expense does not yet reflect the benefit of anticipated cost synergies from the Genoptix acquisition. Those synergies when realized should help off-set the impact of this continuing and possibly increasing investment.

Sales and Marketing costs increased by 66% year over year to $11 million as we doubled the size of our sales force, primarily through the acquisition of Genoptix. This increase was as expected.

Net Income
First quarter GAAP net loss was $2 million compared to net loss of $2 million in the first quarter of 2018, and Diluted loss per share was $0.03 versus Diluted loss per share of $0.03 in the prior year. The first quarter loss was due to a one-time accrual of $4.9 million, net of tax, related to resolution of a dispute arising from a 2012 licensing agreement.

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 and Adjusted Net Income
Adjusted EBITDA was a record $14 million, which represents an increase of 49% year-over-year. This is especially significant because we expected zero adjusted EBITDA growth from the Genoptix acquisition until later in the year when synergies will begin to be realized.

In the first quarter, Adjusted Net Income was $7 million compared to $2.5 million in the prior year. Adjusted Diluted EPS was $0.07 versus $0.03 in the first quarter of 2018.

Balance Sheet
Finally, we are very pleased to see cash collections remain strong in the quarter despite the possibility of integration distractions. Overall DSO remained strong in the first quarter of 2019 at 78 days.

Guidance
We are updating our full-year 2019 revenue and earnings guidance.

We now expect consolidated revenue to be in the range of $384 to $400 million versus our previous guidance of $379 to $395 million. We now expect Adjusted EBITDA to be in the range of $52 to $56 million, versus our previous guidance of $49 to $53 million. The increase in guidance reflects better than expected first quarter results.

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.

Over the years, we have endeavored to build a competitive and differentiated position in the cancer testing market. As you can see from our strong First Quarter results, we are clearly benefitting from our strategic position, which was noticeably bolstered with our acquisition of Genoptix in December.

This morning I would like to focus on three high-growth market segments where we are seeing a significant benefit from our strategic position: next generation sequencing, pharma services, and companion diagnostics.

NGS

Let me start by discussing our leading position and rapid growth in next-generation sequencing. You can see from our strong organic growth that our Clinical Services division continues to gain market share. What you don't necessarily see from our reported numbers is our particular strength in molecular testing, or more specifically, Next Generation Sequencing.

Providers turn to us for NGS testing because of our broad and deep of NGS offering, our capabilities across both solid tumor and hematologic cancers, and our ability to provide other critical, complimentary testing such as FISH and PD-L1.

Just as we have worked to develop and offer the broadest overall somatic cancer testing menu in our industry, we are also working hard to develop and offer the broadest and deepest menu of NGS based tests.

We currently offer 30 different NGS-based multi-gene tumor profiles, which we have branded as NeoTYPE Cancer Profiles, for both hematologic disease and solid tumor. These tests range from highly focused, cancer specific panels to wide spectrum pan-cancer profiles, including our 315-gene NeoTYPE Discovery Panel. We also offer Tumor Mutational Burden testing, or TMB, and microsatellite instability analysis, with many of our panels.

And, we continue to work hard on our voluntary submission to the FDA of a broad-based NGS panel which we still hope to accomplish by year end. The development of FDA approved tests and FDA compliant processes is one area of NGS investment, along with others, that we are making to competitively position our company for success over the long haul.

So far, our strategy is working. In the First Quarter, our NGS test volume increased by more than 50% organically and, we believe that we are one of the largest providers of NGS-based somatic cancer testing in the country. In the most recent quarter, we provided nearly 12 thousand NGS-based tests. Most of these tests are also accompanied by other non-molecular tests such as PD-L1 or FISH, underscoring the fact that physicians are utilizing a portfolio of different test methodologies to generate the best outcome.

Pharma Services

Our strategic positioning is also creating a significant competitive advantage for our Pharma Services Division.

Pharma companies choose NeoGenomics because of the depth and breadth of our capabilities, our scientific leadership and our leading pathologists. They also come to NeoGenomics because of our unique ability to help develop and launch companion diagnostic tests. Pharma companies know that we can be ready to provide a new test on the first day a therapy gains FDA approval. Only a short list of labs have the ability to take a companion diagnostic test across the continuum from development, through clinical trials, and into the market.

Pharma companies also value our unparalleled access to oncology testing data. We have several projects under development to work collaboratively with Pharma companies to identify patients for clinical trials or targeted therapy. These projects could add tremendous value for physicians and patients, differentiate NeoGenomics from other laboratories, and provide a new source of revenue for the company.

These capabilities are driving market share gains, as is evidenced by both new bookings and revenue growth. We booked $21 million of new business in the first quarter, which is 44% higher than in quarter 1 2018 and 19% more than what we booked in the fourth quarter.

The 41% year-over-year increase in our backlog and 45% year-over-year revenue growth are strong evidence of the competitive strength of this business.

Companion Diagnostics

Finally, I would like to discuss how our positioning is driving a significant opportunity in companion diagnostics.

Our capabilities with regard to companion diagnostics are somewhat unique and powerful. We have wide scale and scope across Pharma and Clinical markets, a broad reach to oncologists and pathologists, and access to a massive quantity of oncology-specific test result data. As I noted earlier, very few labs have our same ability to take a companion test across the continuum from development, through clinical trials, and into the market. This is clearly a synergy of operating both a Pharma Services and Clinical Services operation, and increasingly of interest to pharma and clinical clients.

We are currently winning Pharma Services business because of our companion diagnostic capability. For example, as of March 31st, we had approximately 30 different companion diagnostic related projects in our Pharma Services backlog.

Our clinical business will also benefit from our Companion Diagnostic capabilities. In March, we launched the Ventana PD-L1 (SP 142) Assay which is a companion diagnostic test that was recently approved by the FDA to identify advanced, metastatic triple negative breast cancer patients who may respond to the immune checkpoint inhibitor

therapy, TECENTRIQ which is the first such immunotherapy approved specifically for breast cancer.

We have several other companion diagnostic test launches in our pipeline. These tests have the potential to further fuel our revenue growth, as we expect the pace of companion diagnostic activity to increase meaningfully over the next couple of years.

Investments for Growth
Before we close, I would like to briefly comment on our ongoing investments for future growth.

Cancer diagnostics is evolving at an amazing speed and we believe we need to increase our investment in R&D and accelerate our pace of innovation to remain a leader. Specific areas of focus include building a portfolio of FDA-approved tests, developing a competitive liquid biopsy offering and strengthening our informatics capabilities. We are investing to make progress in each of these areas.

We are also making continued investments to grow our Pharma Services business. We recently opened a new laboratory in Singapore and we hope to be open in China by the end of this year. In addition, we added capacity in both Aliso Viejo and Houston, validated a number of new panels in our Houston lab, introduced new testing platforms and significantly beefed up our Flow Cytometry offering for Pharma Services. We have also expanded our Pharma Services sales team both in the United States and in Europe.

Conclusion
In summary, Quarter One results were very strong, and we feel good about our momentum heading into the rest of the year.

And more importantly, we have established a leading position in the market which is proving to offer significant, sustainable competitive advantages today and in the future, and we look forward to further strengthening that position over time.

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 the call 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 1,442 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.