NeoGenomics Q3 2019 Conference Call Script

Doug VanOort

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

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

Thank you Bill.

For today's call, I'll briefly review some Quarter 3 highlights, Kathryn McKenzie will then provide a more detailed review of the financial results, and I'll then share with you 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 Quarter 3 highlights.

Quarter 3 Performance

Third Quarter results were excellent, and we have significant momentum heading into the end of the year.

Revenue increased 51% year-over-year to $105 million, with organic revenue growth once again greater than 20%. Adjusted EBITDA increased 32% year-over-year to $15 million. Both Divisions had very strong performance.

Clinical Division test volumes increased 35% year-over-year, with combined company organic volume growth approaching 13%. Year-over-year growth rates have accelerated each quarter since acquiring Genoptix late last year. We once again drove growth across all testing modalities. Next Generation Sequencing and molecular testing growth rates also accelerated and were well in excess of 50%. We believe those growth rates reflect a steady increase in market share with very high rates of customer retention in both the Legacy NeoGenomics and the Genoptix customer base.

Clinical Division revenue per test increased 15% to $369, marking the fifth straight quarter in which revenue per test has increased on a year-over-year basis. That increase primarily reflects the addition of Genoptix and a favorable change in the mix of test volume. As expected, revenue per test increased sequentially as we continue to work through and transition Genoptix reimbursement to the NeoGenomics managed care contract rates at slightly more favorable terms than expected.

Pharma Services revenue increased 26% year-over-year to $12 million. New bookings in the quarter were a record $28 million and the backlog increased 22% year-over-year to more than $118 million. We achieved outstanding revenue increases in flow cytometry, and very strong increases in immunohistochemistry. We opened our new office in Singapore during the third quarter as our global expansion remains on track and we are winning global studies as a result. The Pharma business has great momentum and is well positioned to capitalize on a robust environment for oncology therapy development.

Importantly, we also saw significant growth in profitability. Gross margin increased nearly 200 basis points year over year, and 50 basis points sequentially, to 48.6%. Adjusted EBITDA grew 32% to $15 million. We were pleased with the increase in profitability, particularly since we increased our R&D spending significantly, and the Genoptix business is initially dilutive to EBITDA. Adjusting for the impact from the Genoptix business, the incremental EBITDA contribution in the quarter approximated 25%, in line with our long-term guidance of 25% to 35% EBITDA contribution on revenue growth.

In summary, we are pleased with the Quarter Three results and feel good about our outlook for the future.

Doug transitions to Kathryn

I will now turn the call over to Kathryn McKenzie, our Chief Accounting Officer, to discuss some of the details of Quarter Three financial results.

Kathryn's Comments

Thank you Doug.

Third quarter Review

Doug already touched on the high points of revenue and profitability, so I will focus my commentary on some of the other important financial metrics in the quarter.

Cost per test

Our average cost-of-goods-sold per clinical test (also known as our "Cost per Test") decreased 4% year-over-year on a pro-forma basis to approximately $190, despite adding 124 net new employees during the quarter. We continue to benefit from increasing scale, automation and process improvement.

On a reported basis, cost per test increased 12% year-over-year due to the addition of Genoptix. Cost per Test increased 2% sequentially reflecting the impact of additional employees hired during the quarter to support our rapid growth as well as our test mix shifting to higher priced and higher cost NGS panels.

While we continue to expect to drive reductions in cost per test going forward, the reductions may be mitigated to some extent by continued test mix-shift to higher-cost next generation sequencing panels. As a reminder, these next generation sequencing panels also have higher revenue per test and higher margin. Also, the year-over-year decline may be lower than normal in Q4 due to the high level of investment made to accommodate growth and upgrade our Next Generation Sequencing products and capabilities during the quarter.

Operating Expenses

General & Administrative expenses increased 57%, or $12 million, year-over-year to $33 million, primarily due to the addition of Genoptix. G&A expense increased by $3 million sequentially largely due to the influx of new hires, incremental growth related investments and other one-time items.

Sales and Marketing costs increased 67% year over year to $12 million, driven by the acquisition of Genoptix and the expanded size of our Sales Teams on both the Clinical and Pharma sides of the business.

Research & Development costs increased nearly five-fold, driven by continued investments in new test development, including our Next Generation Sequencing and FDA initiatives.

Balance Sheet

We exited Q3 with $179 million in cash and $109 million in debt. We have approximately $115 million of availability on our credit facilities.

DSO declined four days year over year and one day sequentially to 80 days as cash collections were especially strong in the quarter. Cash Flow from Operations was strong at $19 million for the quarter.

Guidance

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

We now expect consolidated revenue to be in the range of $401 to $406 million versus our previous guidance of $388 to $402 million. We now expect Adjusted EBITDA to be in the range of $56 to $58 million, versus our previous guidance of $54 to $58 million. The increase in guidance reflects the better than expected third quarter results and our growth momentum.

I will now turn the call back over to Doug to provide commentary on our key growth initiatives.

Kathryn transitions to Doug

Thank you Kathryn.

Before addressing your questions, I'll share some thoughts about our business.

As you can tell from our quarterly results, we continue to benefit from our position as the leading cancer testing provider in the United States. We are experiencing very high growth in both Divisions and our outlook suggests that that growth is likely to continue for the foreseeable future.

In the Clinical Division, we've recently added some the largest and most recognizable hospital systems and oncology practices in the country, with most of that business still in front of us. And in the Pharma Services business, our backlog of signed contracts is larger than ever and our pipeline remains robust.

With that as background, I would like to focus my comments on two key topics:

First, actions we are taking to focus and fortify our operations to accommodate high levels of growth, including the final phase of the Genoptix integration, and

Second, investments we are making to enable those high levels of growth to continue well into the future.

In terms of fortifying our operations, we've recently taken a number of actions to maintain a laser focus on execution and to ensure that we consistently deliver the exceptional service that is expected of us.

First, we hired and on-boarded almost two hundred full-time employees during the quarter. The additional technical staff and Pathologists have put us in a much better position to accommodate continued growth while maintaining exceptional service.

Second, we added much-needed facility capacity in Fort Myers and in Aliso Viejo. This is providing additional lab and office space to accommodate existing volume and allow us to have capacity until the new Fort Myers Headquarters and Lab facility is completed in 2021.

Third, we significantly upgraded our Next Generation Sequencing instrumentation and assays during the quarter. We moved our assays to the high throughput NovaSeq instruments, upgraded our chemistry, and optimized our pipeline. We also incorporated microsatellite instability (MSI) and Tumor mutational burden (TMB) into most of our NGS panels, updated our gene lists, and upgraded our physician reports. With NGS growth rates well over 50%, these upgrades are providing us with much needed capacity, higher quality, and the ability to streamline and further automate the workflow and processes.

Fourth, we delayed the planned migration of Genoptix customers to the NeoGenomics systems and processes by three months. This is providing our Teams additional time to finalize plans and prepare more thoroughly for a seamless client migration process. We feel very good about the Genoptix integration. While we made a decision to delay, we are on track with all other integration activities and synergies are tracking as expected. Customer retention is our top priority during the integration period, and so far, so good. In fact, we have already stemmed the volume decline occurring when we took the business over, and organic growth for the combined company has been better than we expected at the beginning of the year.

We also passed on several smaller M&A opportunities which could have been a distraction to our teams.

With these actions, we feel that our Lab Operation is ready to seamlessly complete the Genoptix integration and will be in great shape to accept greater volume with higher levels of productively and efficiency.

Let's now turn our attention to investments we are making to enable high levels of growth to continue well into the future. I will highlight just a few of those investments this morning.

First, we continue to invest in new test development, particularly in next generation sequencing. We are in various stages of development with several Next Generation Sequencing panels, including a comprehensive genomic profile for hematologic cancer, a 500+ gene solid tumor profile, a suite of liquid biopsy offerings, and an NGS-based test for minimal residual disease. We have a well-defined plan and a much broader and deeper organizational capability to execute it than ever before.

Second, we continue to invest in companion diagnostics. We have a unique and powerful capability to help develop and validate companion diagnostic tests, and to quickly respond to new drug approvals with the timely launch of companion diagnostic tests. Among the most important of those capabilities is our 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. Few labs have our same ability to take an oncology companion test across the continuum from development, through clinical trials, and into the market.

This capability is clearly a synergy of operating both a Pharma Services and Clinical Services operation focused in oncology, and increasingly our services are of interest to both pharma and clinical clients. We are currently winning Pharma Services business

because of our companion diagnostic capabilities and boosting our Clinical services market share by being first to market with companion diagnostic tests.

We have a track record of responding quickly to new drug approvals. I'll give you several recent examples:

- We already have several offerings for NTRK (for TRK inhibitor therapies), including a small fusion panel incorporating NTRK 1, 2 and 3, an IHC pan-TRK screening panel, and a FISH NTRK 1,2, and 3 assay. We have also incorporated NTRK into our NeoTYPE NGS panels.
- We have always been a leading provider, if not the world's leading provider of PD-L1 testing for lung cancer and other neoplasms, and we were quick to market with the SP142 assay for triple negative breast cancer as well as assays for other new indications.
- We have talked at length about PIK3CA, which is the companion diagnostic for Novartis' PIQRAY and have seen uptake that is even better than we had expected.
- We also were quick to market with the Qiagen Therascreen CDx PCR assay for FGFR in metastatic bladder carcinoma, and
- We have already included RET into some of our small fusion panels and have incorporated RET testing into several of our NeoTYPE offerings.

In addition, we have over two dozen companion diagnostic assays in our pipeline of signed projects for a variety of Pharma and Biotech companies, and are increasingly in discussions to add to the pipeline.

Finally, we have begun to make initial investments in data and informatics. We are quite excited about the possibilities here. Over the past year, a number of leading payors, providers, and pharma services companies have approached us to partner on data and informatics-related initiatives. We have developed our strategy and plans, have begun to build our team, and are investing to develop our capabilities and initial products. Areas of particular interest for us, based on market research, include clinical decision support, real world analytics, clinical trials matching, and several other ideas. We anticipate that informatics and data will enhance our competitive position in both Clinical and Pharma Services, and eventually be an incremental source of revenue for the company.

The need for precision oncology diagnostics is growing and changing rapidly. We believe that investments in advanced technologies, companion diagnostics, and informatics have the potential to create exciting opportunities for future growth and continued market leadership for our company.

Conclusion

In summary, Quarter Three results were extremely strong, and we feel good about our momentum heading into the rest of the year. More importantly, our leading position in the market is proving to offer significant, sustainable competitive advantages today and in the future, and we remain committed 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)

As we end the call, I'd like to recognize the approximately 1,600 NeoGenomics team members around the world for their dedication and commitment to building a world-class oncology diagnostics 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.