NeoGenomics Q4 2019 Conference Call Script

Doug VanOort

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

Our team is here together in San Antonio at our Annual Sales Meeting, and joining me for this call is Kathryn McKenzie, our Chief Financial Officer, Rob Shovlin, President of our Clinical Division, George Cardoza, President of our Pharma Services Division, Bill Bonello, President of our Informatics Division and Director of Investor Relations, Dr. Larry Weiss, our Chief Medical Officer, and Doug Brown, our Chief Strategy and Corporate Development 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 4 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.

Before I discuss the results, I would like to discuss a couple of important additions to our leadership team. First, we are delighted to introduce Kathryn McKenzie as our Chief Financial Officer. Many of you already know Kathryn, as she served as our Chief Accounting Officer for the past two years, and in a Senior Finance leadership capacity over the past six months.

We would also like to introduce Doug Brown, who joins us as Chief Strategy and Corporate Development Officer. Doug joins us from SVP Leerink where he was Senior Managing Director. Doug brings years of experience in the oncology diagnostic sector and has been a long-time advisor and trusted friend of our Company.

We couldn't be more pleased to have Kathryn and Doug joining our senior leadership team.

Now, let's turn to 2019 Full Year and Quarter 4 highlights.

Full Year and Quarter 4 Performance

2019 was an outstanding year for NeoGenomics. We grew revenue by nearly 50%, including greater than 20% organic growth, and increased gross margin by more than 200 basis points year-over-year to 48.1%. More importantly, we significantly strengthened our competitive position as a leading global oncology diagnostic company.

Fourth quarter revenue increased 40% year-over-year to $107 million. As a reminder, Genoptix was included in part of last year's fourth quarter. Importantly, organic revenue growth once again exceeded 20%. Both Divisions had very strong performance.

In the fourth quarter, Clinical Division test volumes increased 27% year-over-year, with combined company organic volume growth of approximately 14%. We are pleased that, even during an integration year, organic growth rates accelerated each quarter since we acquired Genoptix in December 2018.

We continued to drive growth across all testing modalities, with particular strength in Next Generation Sequencing and molecular testing which once again grew by approximately 50%.

We believe that our test volume growth rates reflect a steady increase in market share. The growth also results from very high customer retention rates which are reflective of our continued high measures of customer satisfaction.

Clinical Division revenue-per-test increased 11% to $370, marking the sixth 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 Next Generation Sequencing and flow cytometry volume are growing at higher relative rates.

Pharma Services revenue increased 27% year-over-year to more than $13 million. New contracts signed in the quarter were a record $33 million, and the backlog of signed contracts increased 32% year-over-year to more than $130 million. With the recent

acquisition of the Oncology Division assets of HLI, our backlog is approximately $145 million.

In Pharma Services, we continue to benefit from our domain expertise, global expansion, investments in Flow Cytometry, global alliance with PPD, and positioning for companion diagnostics. Over the course of 2019, we assisted numerous pharmaceutical companies in securing FDA approvals for their therapies. The Pharma business is stronger than it has ever been and is well-positioned to capitalize on a robust environment for oncology therapy development.

In terms of profitability, we are in a holding pattern as we work towards completion of the Genoptix integration. While gross margin was up more than 200 basis points for the year, in the fourth quarter gross margin was down 180 basis points year over year to 46.7% primarily because we are in the final throes of integration related activities.

We expect to see a more substantial improvement in margins in the second half of 2020 as we realize Genoptix-related cost synergies and are able to focus on the type of cost and productivity improvement that has been a hallmark of our operations for years.

In summary, we are pleased with our Full Year and the Quarter Four 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 Financial Officer, to discuss some of the details of Quarter Four financial results.

Kathryn's Comments

Thank you Doug.

Fourth quarter Review

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

Clinical Gross Margin and Cost per Test

On a full year basis, Gross Margin for our Clinical Services Division increased 160 basis points to 48.6%, primarily driven by improvements in revenue per test. For the Fourth Quarter, clinical services Gross Margin was down 120 basis points sequentially, primarily due to increased hiring to accommodate both integration and anticipated growth. As a reminder, we staffed up significantly in the Third and Fourth quarters in both the Clinical Services and Pharma Services Divisions to support existing and anticipated growth and complete the transition of Genoptix clients to a common laboratory system and process.

In 2019, our average cost-of-goods-sold per clinical test (also known as our "Cost per Test") increased by 10% to $188, primarily due to the impact of Genoptix and test mix shift. On a pro forma basis, cost per test decreased by 4.5%, driven by increasing scale, automation and process improvement.

In the Fourth Quarter, Cost per Test increased by 14% year over year to $194, primarily due to the acquisition of Genoptix. On a pro-forma basis, including Genoptix in the base year, cost per test was essentially flat on a year over year basis in the Quarter.

Pharma Gross Margin
Pharma Services Gross Margin increased 540 basis points to 44.7% for the full year, but declined to 41.4% in the Fourth Quarter as we continued to build an independent testing capacity for this business. With a signed contract backlog of approximately $145 million the Pharma Services business has reached a scale which necessitates its own testing infrastructure. We believe that having pharma testing decoupled from clinical testing will enhance efficiency in both divisions over time.

We continue to expect that Pharma Services gross margin will expand to levels at or above Clinical Division margins over time.

Operating Expenses
General & Administrative expenses increased 29%, or $7.5 million, year-over-year to $33 million, primarily due to the addition of Genoptix. G&A expense was flat sequentially. G&A expense as a percent of revenue declined 250 basis points year-over-year primarily due to the impacts of leverage and Genoptix cost synergies.

Sales and Marketing costs increased 53% 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.

In the fourth quarter, funding for Research & Development increased four-fold as we continue to internally develop new testing solutions for our customers, including our Next Generation Sequencing assays and single-site PMA submission with the FDA. We have grown our team of scientists engaged in R&D and now have approximately 22 people dedicated to Research and Development.

Adjusted EBITDA
Fourth quarter Adjusted EBITDA increased 5% year over year to $13.6 million, which was in line with the mid-point of our guidance range. While the Quarter 4 Adjusted EBITDA contribution was lower than normal due to activities surrounding the Genoptix integration and heavy investments in growth-related activities, the incremental Adjusted EBITDA contribution for the full year was 24%, close to our long-term guidance of 25% to 35% EBITDA contribution on revenue growth.

Balance Sheet
We exited Quarter 4 with $173 million in cash and $105 million in debt. We have approximately $131 million of availability on our credit facilities. You will note that, after year end, we acquired the Oncology Division assets of Human Longevity for approximately $37 million.

DSO increased 3 days year-over-year and one day sequentially to 81 days due to timing of payments. Cash Flow from Operations was $23 million for the year.

Guidance
We also issued full-year 2020 revenue and earnings guidance.

We expect revenue to be in the range of $464 to $474 million, which equates to 13% to 16% top line growth, and Adjusted EBITDA to be in the range of $60 to $65 million. Our EBITDA guidance reflects approximately $7 million of incremental growth investments related to Informatics and dilution related to the HLI acquisition.

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.

Q1 Outlook
Kathryn provided full year guidance and we feel great about 2020.

However, before addressing some of the key drivers and dynamics that have us feeling so optimistic about full year growth, I want to set expectations for the first Quarter.

Normally, we would expect to start the year strong and to gradually improve from there. Unfortunately, that is not the case for 2020. Our forecast for profitability in the first quarter is significantly below what we would normally expect. There are several reasons for this.

Most significantly, given the tremendous growth in Pharma Services backlog and our record Q4 revenue, we have built a global cost structure to support a high level of activity. Unfortunately, the timing of revenue conversion for Pharma Services projects in the first quarter looks to be down by approximately $4 million sequentially. We had a number of projects end in December, and a number of other large projects are not starting up until late March and April. Despite this timing dynamic, I can assure you that our team and our business is very healthy, and our $145 million in backlog of signed contracts give us high confidence that Pharma Services revenue will continue to grow at rates exceeding 20% in subsequent quarters and for the year.

First Quarter Adjusted EBITDA will also be impacted by dilution from the HLI acquisition which was just recently acquired and is not yet at a breakeven point.

We expect Adjusted EBITDA to also be lower as a result of our investment in Informatics. We're executing our strategy, and now have a team of 27 people working on informatics-related initiatives. We expect these initiatives to strengthen our competitive position in both the Clinical and Pharma Services Divisions and provide an incremental source of revenue – with some of that beginning later this year. We're being deliberate about our strategy and execution and are committed to this initiative.

Even with confidence in our Adjusted EBITDA guidance of $60 to $65 million for the full year, our current expectation for first Quarter Adjusted EBITDA is approximately $8 million.

2020 Outlook
Looking ahead to 2020 as a whole, I must say that we are extremely excited about our outlook. That excitement is evident here in San Antonio, where we are holding our annual National Sales Meeting.

I wish I could properly convey to our investors and customers why each of the nearly 150 attendees here are so excited, committed, and driven. It's partly because they know they are saving lives. And it's partly because they believe that we have an extraordinary competitive position and ability to lead and grow in this revolutionary time in Oncology care.

We believe that we have the building blocks in place to be the leading global oncology diagnostics company.

Clinical Division
Our Clinical Division has an excellent market position and product portfolio.

With the acquisition of Genoptix, we greatly expanded our distribution channel and gained an excellent market position with community oncology practices.

We fortified our market position as the leading oncology-lab for hospitals and pathologists by adding large, national health system accounts, group purchasing contracts, and managed care contracts. We are now contracted with every national payor and with most significant regional plans.

Technologically, we significantly enhanced our next-generation-sequencing capabilities and are rapidly emerging as one of the largest providers of oncology-focused molecular testing in the country. In fact, during the fourth quarter, we performed over 70,000 molecular and Next Generation Sequencing tests in our Clinical Division representing over 25% of our total volume of testing. This test category grew at a rate of about 50% compared with the prior year, and we expect its growth rate to remain very strong.

We plan to continue leveraging our market position with the introduction of new tests and services to help our customers deliver better care for cancer patients.

Next Generation sequencing is an area of particular development focus for us, and we expect to introduce several products in 2020. We are working hard on a suite of liquid biopsy offerings for cases where tissue samples are not possible to obtain, and expect to complete our validation and introduce a pan-cancer liquid biopsy test early in the second half. We are working to expand our offering of RNA-based sequencing assays, for both solid tumor and hematologic malignancies. We are also developing a rapid Next Generation Sequencing panel designed for acute myeloid leukemia, which often requires prompt treatment. In addition, we are working on assays for identifying minimal residual disease, particularly for hematologic neoplasms.

Because of our reach into thousands of hospitals and oncology practices, we are able to facilitate the adoption of these advanced oncology diagnostic tools beyond the academic environment into the community setting so that cancer patients can have access to the leading Oncology care in their own communities.

Importantly, our team of over 120 MDs and PhDs, along with the highly-trained oncology-focused sales team provide continuous education to our clients to ensure that they remain abreast of developments in oncology.

Pharma Services

In Pharma Services, we significantly strengthened our competitive position over the past year as well. Our Pharma Services Division supports pharmaceutical clients on a global basis across the drug development continuum, from research and development, through clinical trials testing, to commercialization of companion diagnostic tests. We currently provide service for more than 150 different clients around the world.

We plan to grow our global Pharma Services business by expanding our market presence in both Europe and Asia, and by expanding our test offering, particularly with leading edge next-generation-sequencing tools and unique capabilities for developing and commercializing companion diagnostic tests.

We made an important strategic move to build our Pharma Services product capabilities in January through the acquisition of the Oncology Division assets of Human Longevity, Inc. The team in La Jolla performs Next Generation Sequencing services for pharmaceutical customers, including germline, whole exome and whole genome sequencing. We now have an even more experienced, specialized molecular workforce with strong Next Generation Sequencing expertise, particularly in serving pharmaceutical customers. This business generated approximately $10 million in revenues in 2019 and ended the year with a backlog of approximately $15 million of signed contracts.

Companion Diagnostics is an important area of growth as precision medicine and immuno-therapies increasingly rely on these tests to predict their effectiveness in patients. Included in our backlog of signed contracts are 30 different companion diagnostic assays for a variety of Pharma and Biotech companies. We are increasingly in discussions with Pharma sponsors to help with companion diagnostic projects.

We also have agreements with several large pharmaceutical companies to provide day-one commercial launch services, and advanced analytical support, for companion diagnostic testing associated with drugs in the late-stage pipeline. Few labs have our same ability to take an oncology companion test across the continuum from development, through clinical trials, and into the market.

Informatics

During 2019, we also laid the foundation for a new data and informatics business that will leverage our unique market position and oncology expertise to help our stakeholders solve real-world problems such as identifying patients for clinical trials or implementing clinical decision support tools for physicians, health care systems, payors, Pharma companies, and patients.

While we are in the very early innings in terms of product development, we already have significant engagement from various stakeholders including global pharmaceutical firms, large national health systems and major managed care payors.

In 2020, we plan to continue to invest in our Informatics Division. We expect this division to be an incremental source of revenue in the long-term, while strengthening our competitive position in both the Clinical and Pharma Services Divisions.

Conclusion

In summary, 2019 was an exceptional year for NeoGenomics and we are extremely excited about our opportunities in 2020 and beyond.

Oncology diagnostics is an exciting place to be. Advances in science and technology are driving a proliferation of oncology therapies and associated diagnostic tests. These diagnostic tools and therapies are increasing survival and enhancing quality-of-life for cancer patients.

Our leading position in the market is proving to offer significant, sustainable competitive advantages today and we are working hard to make our competitive position even stronger in the future as we pursue our vision to become the world's leading oncology diagnostics company.

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 1,678 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.