NeoGenomics Q1 2022 Conference Call Script

Lynn Tetrault

Good morning. I'd like to welcome everyone to NeoGenomics' first quarter 2022 conference call.

Joining me for this call from our Fort Myers headquarters are Bill Bonello, our Chief Financial Officer, Dr. David Sholehvar, President of our Clinical Division, Doug Brown, our Chief Strategy and Corporate Development Officer, and Charlie Eidson, our Director of Investor Relations.

Joining on the call via phone is Dr. Shashi Kulkarni our Chief Scientific Officer and Executive Vice President of Research and Development.

Before we begin our prepared remarks, Charlie will discuss the Forward-Looking Statements and Non-GAAP measures used on this call.

Charlie Eidson

This conference call includes forward looking statements about our 2022 initiatives, 2022 financial outlook, growth opportunities, and anticipated operating results and performance. Each forward-looking statement is subject to risks and uncertainties that could cause actual results to differ materially from those projected in such statements. Additional information regarding these risk factors appears under the heading "Forward-Looking Statements" in the press release we issued this morning and in the "Risk Factors" section in our Annual Report on Form 10-K for the year ended December 31, 2021 that is filed with the Securities and Exchange Commission. The forward-looking statements made during this call speak only as of the original date of the call, and we undertake no obligation to update or revise any of these statements.

In addition, during this conference call, in order to provide greater transparency regarding our operating performance, we refer to certain non-GAAP financial measures that involve adjustments to GAAP results. The non-GAAP financial measures presented should not be considered to be an alternative to financial measures required by GAAP, should not be considered measures of liquidity, and are unlikely to be comparable to non-GAAP financial measures provided by other companies. Any non-GAAP financial measures referenced on this call are reconciled to the most directly comparable GAAP financial measure in a table available in the press release we issued this morning.

Before turning the call back to Lynn, 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 one per person in order to give more people a chance to ask questions within the one hour that has been allotted for this call.

Lynn's Comments

Thank you Charlie.

For today's call, I will begin by sharing my perspective on the state of our company and the actions we have taken since we announced the departure of our Chief Executive Officer on March 28th. Bill Bonello will then review our first quarter financial results, including some of the factors underlying the underperformance of the business, and outline the near-term actions we are taking to improve our performance and return to profitable growth.

Finally, I will introduce our new Chief Scientific Officer, Dr. Shashi Kulkarni and the new President of our Clinical Division, Dr. David Sholehvar. These two talented executives are experts in oncology diagnostics and will play leading roles in our company's future. Each of them will share their background and reason for joining NeoGenomics and offer their early insights on our business and their critical priorities since joining in early March. We will then have time for Questions and Answers.

General Business Review and Organizational Steps

I would like to begin with some historical context. I have served on the Board of NeoGenomics for seven years and became Lead Independent Director in 2020 before taking over the Board Chair role in October 2021. During the majority of that time, our business performed very well with consistent top line growth, strong operational efficiency, increasing market share and a world class culture.

Unfortunately, our performance over the past year has been inconsistent with that historical track record, as evidenced by slowing growth and decreased profitability. The company experienced a number of challenges in 2021, including the transition of our longstanding Chairman and Chief Executive Officer, Doug Van Oort, continuing headwinds from COVID and shifting dynamics in the external environment. Though the company's market position remains strong, and our overall strategy is sound, our execution over the last year was poor. The Board of Directors took decisive action last month to change leadership in order to restore the operational performance of the business and better position the company for long-term success.

Since March 28th, I have had three main priorities. First, we have moved quickly to stabilize the organization. I and other members of the management team have visited many of our sites and met with leaders and employees at all levels to share our direction, hear their feedback and engage them in our efforts. I am consistently impressed with the degree of commitment that our people have to our mission and their desire to improve our performance.

Second, the Office of the CEO, together with other members of the management team, have worked swiftly and collaboratively to identify actions to improve performance. Bill will describe some of these positive changes later in our prepared remarks. The addition of Dr. Kulkarni and Dr. Sholehvar to the management team, with their extensive experience and deep expertise, has helped us identify additional opportunities for improvement and you will hear from them later on in our prepared remarks.

Third, the Board of Directors and I are making progress in our search for a new CEO. We have developed a list of key criteria and Russell Reynolds is in the process of sourcing qualified candidates. We recognize that there is significant work to be done, but we are confident that in time we will return to the growth and operating efficiency that drove our success for many years.

Our long-term strategy remains intact. In particular, we see great strategic value in marrying new technology such as RaDaR with our longstanding channel leadership. Finally, The board and I are confident that our strong executive leadership team will advance the execution of our strategy while we recruit an outstanding Chief Executive Officer.

Lynn transitions to Bill

I will now turn the call over to Bill.

Bill's Comments

Thank you Lynn.

This morning I would like to review our First Quarter financial results, provide some additional color on the factors that have been impacting revenue growth and margin, and provide detail on some of the actions that we are already taking to return to profitable growth.

While we will not be providing formal revenue or EBITDA guidance today, we will provide some directional commentary with respect to both revenue growth and profitability.

First Quarter Review

Before I walk through the numbers, I wish to point out that the growth rates we cite exclude prior-period revenue from COVID 19 PCR testing. We have made this adjustment to make the year-over-year comparisons more useful as we stopped performing COVID testing during the first quarter of 2021.

Revenue increased 3% year-over-year to $117 million, with Clinical Services revenue up 4% year-over-year and Pharma Services revenue down 4% year-over-year.

Clinical revenue increased 4% year-over-year to $99 million. Clinical Division test volumes increased 2% year-over-year. The Omicron variant had a significant impact on test volume during the month of January, with volume down 7% month-over-month and flat year-over-year. While volume grew both sequentially, and on a year-over-year basis, in both February and March, we have not returned to pre-COVID growth rates.

Our volume growth is being impacted by a couple factors. First, our test mix is weighted to legacy modalities and disease-specific NGS offerings while the market is moving towards larger, more comprehensive panels. Second, operational challenges have made it difficult to add new business at our historical rates. We are taking a number of steps to

upgrade our NGS product offering and improve our lab operations, which Shashi and Dave will discuss in greater detail later in the call.

Average revenue per test increased 2% year over year to $371, with positive contributions from our ongoing strategic reimbursement efforts partially offset by Medicare rate cuts.

Pharma Services bookings were $41 million in Q1 and we ended the quarter with a backlog of $282 million which was up 6% sequentially and 30% year-over-year. While backlog was up, Pharma Services revenue decreased 4% year-over-year to $18 million. We view the year-over-year decline as an anomaly and not a trend as we faced a very tough prior-year comp. Revenue was quite a bit lower than we had been expecting in March of this year as one very large project got pushed out to later in the year. By contrast, March 2021 was a record revenue month for Pharma Services.

We are taking action to drive near-term Pharma revenue, including increasing our efforts to secure pre-clinical business, which tends to convert more quickly than clinical trials work, even as we continue to build out our backlog of large clinical studies. We are also implementing processes designed to pull revenue through earlier in the life-cycle of a project.

Our Informatics business which is reported as Pharma services continues to grow at a rapid clip and we are excited about the progress of those initiatives.

Gross Margin

Our GAAP Gross Margin was 32.6%. Adjusted Gross Margin, which excludes Inivata related non-cash amortization expense, was 36.8%. Adjusted Gross Margin declined 380 basis points year over year and 310 basis points sequentially.

There are several factors that contributed to the decline in Adjusted Gross Margin and we are taking immediate action to mitigate these trends.

First, in late 2021, we significantly increased the size of our laboratory workforce in preparation for a return to pre-COVID growth rates. As noted earlier, volume growth did not rebound to the extent that we had expected. As a result, we have significantly scaled back our laboratory hiring plans to better align with near-term volume trends.

Second, like most companies, we have experienced significant wage and supply cost inflation. In response to this cost pressure, we are implementing price increases in both our Clinical and Pharma businesses and pursuing strategic reimbursement opportunities to increase value capture for the services that we are providing.

Third, we did have extra-cost associated with the transition to our new Ft. Myers lab. While this move will drive productivity and efficiency improvements over time, we did incur extra costs related to operating two different Fort Myers labs during the transition. We expect this transition to conclude over the next couple months.

In addition to these factors, we have seen a notable decrease in lab efficiency over the course of the past year. This decrease is largely attributable to increased complexity of both our product offerings and our lab processes due in part to efforts to respond to

customer requests for customization. We are already taking action to significantly reduce this complexity. These actions include eliminating low margin services, streamlining our NGS processes to drive reductions in labor, supplies and bioinformatics cost while simultaneously improving turn-around time, and implementing AI to substantially increase lab tech productivity. We estimate that these actions plus our pricing actions could contribute at least $15 million of annualized gross profit once fully implemented. Moreover, we have every expectation that we will identify additional near-term actions as we continue to engage the organization.

Finally, as we have discussed in the past, our pharma lab expansions, including both our international labs and our La Jolla facility, continue to be a significant drag on Adjusted Gross Margin. While our international labs are important to our long-term growth strategy and allow us to bid on larger, global clinical trials, these international labs are operating well below capacity. Our La Jolla lab, which we acquired through the acquisition of the oncology assets of Human Longevity in 2020, and which is where we perform whole exome and whole genome sequencing, is also operating below capacity. While lab expansion remains an important component of our Pharma Growth strategy, we are working to better align capacity expansion with growth.

In addition to these near-term actions, we are also developing a long-term plan to drive step-function improvements in productivity and efficiency through automation, process improvement. We also expect to drive improvement through our product, payor and customer mix and pricing.

Operating Expenses

Operating expenses increased $34 million year-over-year and $3.8 million sequentially to $90 million. Approximately $13 million of the year-over-year increase is related to ongoing operating expense at both Inivata and Trapelo, which were both acquired in the second quarter of last year. In particular, we continue to make significant investments in RaDaR supporting what we believe is a leading assay for minimal residual disease and recurrence testing. In addition, another $11 million of the annual increase is related to non-cash stock option compensation expense and other non-recurring items that have been excluded from our calculation of adjusted EBITDA.

The sequential increase in operating expense is related to increased legal and accounting costs associated in part with the acquisitions of Inivata and Trapelo as well as the ongoing compliance matter, CEO transition costs, and increased product development expense related to our Informatics business.

We are taking steps to reduce our G&A expense run rate but there is more work to be done.

Adjusted EBITDA

Adjusted EBITDA loss was $19 million for the quarter given the factors we previously discussed.

Balance Sheet

Turning to the balance sheet, we exited Quarter One with $481 million in cash and marketable securities. DSOs were 85 days and at the high end of our normalized range. The increase in DSO is primarily driven by the intra-quarter cadence of revenue with March being the highest month of the quarter. We expect this to normalize as the year progresses.

Outlook
Having reviewed the First Quarter results and the immediate actions that we are taking to improve both revenue growth and margins, I would like to spend a little time discussing our outlook for the remainder of the year. As a reminder, we withdrew our 2022 revenue and EBITDA guidance in March in conjunction with the departure of our CEO. We continue to believe that it is important for the new CEO to influence and feel accountable for the guidance we eventually provide.

That said, we understand that our decision to withhold formal revenue and EBITDA guidance makes it difficult for investors to assess our current financial situation or evaluate our near-term prospects. Therefore, we would like to share some additional thoughts regarding near-term trends in both revenue and profitability.

We view 2022 as a rebuilding year where our primary focus is to improve our current product offering, operational efficiency, drive clinical evidence in support of RaDaR, and lay a foundation to support sustainable, profitable growth in 2023 and beyond.

We expect revenue to be up sequentially in Q2 and up modestly year over year for the full year. Similarly, we expect that our quarterly Adjusted EBITDA will improve modestly sequentially each quarter as the year progresses. Looking to 2023, we expect revenue growth to accelerate and we expect to be Adjusted EBITDA positive exiting the year. We believe that the actions we are taking today are important first steps to achieving these goals.

I will now turn the call back to Lynn who will introduce Dr. Kulkarni and Dr. Sholehvar.

Lynn Introduction

Thanks Bill.

We are delighted to have both Dr. Kulkarni and Dr. Sholehvar officially on board as Chief Scientific Officer and Clinical Division President, respectively. Both executives are already having a major impact on our business despite having joined less than two months ago. I've asked them both to provide some background on some of their relevant experience, express why they chose to join NeoGenomics, and discuss some early areas of focus for them including any quick wins they see for improving our business.

With that, I'd like to introduce our new Chief Scientific Officer, Dr. Shashi Kulkarni.

Chief Scientific Officer Discussion

Thank you Lynn.

It's great to speak on the earnings call today and I'm pleased to be representing NeoGenomics. My career in clinical genomics spans over 30 years and most of my career has been spent in the field of molecular genetics and next generation sequencing. I've held academic, scientific, and operational leadership positions at Washington University in St. Louis and Baylor College of Medicine and helped build and facilitate operational and financial turnarounds at both institutions. I have a passion for using genomic and multi-omic precision oncology tools to improve human health.

I have written a book on NGS that is widely adopted and popular amongst medical professionals, and I have managed the Cancer Genetics Elsevier Journal as editor in chief for more than seven years. I've also authored many best practice NGS guideline papers for organizations including AMP, ASCO, CAP, and the CDC and I frequently serve as an expert panelist at FDA for NGS.

I joined NEO because of the company's unparalleled leadership position in Oncology for multi-modal diagnostic solutions. I see the company's longstanding customer relationships with pathologists and oncologists as a key strategic asset and believe that the fundamentals are there to be a market leader for many years to come.

While my focus will be primarily on Next Generation Sequencing, I believe I can help drive improvements in operational productivity through process improvement and automation across our laboratories. I'll look to develop and launch cutting edge NGS solutions for our clinical and pharma divisions and to create an NGS center of excellence. NeoGenomics has a strong market position covering the continuum from diagnosis to monitoring and I will be proactively working to optimize our service menu with sound business principles.

In my short tenure here at NEO, we have identified several operational and informatic improvements that we are already working to implement. These initiatives are expected to reduce our Turn Around Time and lower our cost of testing and could be completed over the next six months. I see multiple areas for improvement within our processes that I would consider low hanging fruit. I am impressed with the scientific talent at NEO, as evidenced by over a dozen presentations at the recent AACR conference.

One exciting action that we have already completed is the launch of our new Lung cancer DNA/RNA NGS-only offering this week. This comprehensive panel includes genomic and transcriptomic and multi-modal readouts driven by clinical evidence which differentiates it from other leading lung cancer offerings on the market. Lilly has selected this panel for a sponsored testing program which we launched to clients on Monday. Additionally, we are beginning validation on larger pan-cancer NGS panels.

Outside of our NGS products for therapy selection, I am impressed with the outstanding sensitivity and strong data from RaDaR for minimal residual disease and recurrence testing. I share the team's belief that RaDaR can be a leading MRD solution and in 2022 we are prioritizing data generation and are actively engaged in discussions with several different pharma companies for larger, late stage opportunities.

Lynn Introduction

Thank you Shashi.

I am also pleased to introduce our new Clinical Division President, Dr. David Sholehvar.

Clinical President Discussion

Thank you Lynn.

I'm excited to be at NEO and for the opportunity to speak with all of you today. Including my time in medical school and residency for pathology, I have spent over 30 years of my career in and around the diagnostics and laboratory space and I believe my experience and passion for patient care fits well with my new role at NeoGenomics.

Over that time, I have served in significant commercial and general management leadership positions at both J&J and Quest Diagnostics in the IVD and lab services businesses, respectively. As a result, I have experience with a wide range of relevant diagnostic technologies, including liquid biopsy, molecular diagnostics, NGS, anatomic pathology, and digital pathology. Each of these positions I held came with full P&L responsibility. I often assumed these positions when the businesses were experiencing challenging circumstances and I have a demonstrated track record of helping to drive improved business performance.

In terms of why I chose to join NEO – Personally I feel there is no more relevant field to be in in health care than helping cancer patients, as well as their caregivers and physicians, navigate the increasingly complex world of cancer diagnostics and care. I also believe that NEO is well placed to be a market leader emerging from a position of strength between earlier stage companies that lack breadth of menu and large diagnostic labs that have difficulty selling specialty testing. I saw an exciting future ahead for NEO and I wanted to be a part of that future.

During my time at NEO thus far, I have been digging in with the team and working to prioritize areas of immediate focus. I believe that there are some near-term actions we can take to improve commercial productivity, operational efficiency, and our overall service to customers. Dr. Kulkarni has touched on exciting, immediate term opportunities we have to launch new, high value tests and make our TATs more reliable, but I also see near term commercial benefits by expanding our already excellent salesforce with Precision Medicine Managers focusing on the oncology channel as well as introducing new tools to manage the sales process and pipeline more effectively. In addition, we are establishing cross-functional, process excellence teams to streamline our approaches in the lab and develop tools in a few key areas to increase productivity and expand margins.

Longer-term I am focused on reinforcing our foundation and building a platform for sustainable growth. While there is significant work ahead of us, I see the challenges we are facing as addressable. I expect that we can drive improving results and return to faster growth and improving profitability over time. I'm energized and ready to get to work!

I will now pass it back to Lynn for some closing comments.

Lynn's Closing

Thank you David.

In closing, while we are disappointed in our Q1 results, we are taking immediate actions to improve our performance. This year will be one of rebuilding to improve our lab operations and drive greater cost efficiency. In addition, we will continue to make strategic investments to improve our current product offering, drive clinical evidence in support of RaDaR, and lay a foundation to support sustainable, profitable growth in 2023 and beyond. We see tremendous opportunities to build on our leading position in the oncology marketplace and achieve our vision of become the leading cancer testing and information company.

I will now hand the call over to Charlie Eidson to lead us through Q&A.

Transition to Charlie Eidson 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 charlie.eidson@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 one 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 (Lynn)

As we end the call, I'd like to recognize the over 2,125 NeoGenomics team members around the world for their dedication and commitment to building a world-class oncology diagnostics and information 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 support and interest in our Company.