NeoGenomics Q2 2019 Conference Call Script

Doug VanOort

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

Joining me from our Fort Myers headquarters is Sharon Virag, our Chief Financial Officer, 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 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'll briefly review our Quarter 2 highlights and then turn the call over to Sharon for a more detailed review of the financial results. After that financial review, I'll 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 2 highlights.

Quarter 2 Performance

Our Quarter 2 results were strong, building on the momentum that we reported in Quarter 1.

Revenue increased 50% year-over-year to $102, with organic growth of approximately 20%. Growth was strong in both Divisions.

Clinical volumes increased 34% year-over-year. Volume growth was better than expected as we continued to gain market share, particularly in next generation sequencing testing. We performed more than 250 thousand tests during the quarter, putting us on track to perform approximately 1 million tests in 2019. Revenue per test increased 12% over the second quarter of 2018, marking the fourth straight quarter in which revenue per test has increased year-over-year.

We also achieved very strong growth in our Pharma Services division, with revenue up 55% year over year to a record $12.7 million. We signed $20 million of new contracts during the quarter and our backlog was up 18% year-over-year to $106 million. We drove growth across all our testing platforms and are seeing an increase in Phase II and Phase III trials being placed with us. Adding to our global footprint, we recently opened our new lab in Singapore and are working on plans for a laboratory in China in 2020.

Importantly, we continued to grow profitably. Adjusted EBITDA increased 49% year-over-year to almost $15 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.

Looking forward to the rest of the year, we expect our momentum to continue. On the clinical side, we've added large hospital and oncology clients and continue to gain market share with both hospitals and community oncology practices. We also launched an important new companion diagnostic test which only began to ramp at the end of the second quarter. Importantly, we are actively hiring, which should increase our capacity to accommodate new business at a faster pace.

On the Pharma side, our backlog is larger than ever, which bodes well for revenue in the second half of this year. Our pipeline is robust and we expect to benefit from our international expansion.

While things are going well, we do have a lot on our plate. Operationally, we are accommodating significant increases in test volume while also expanding capacity, integrating Genoptix and maintaining outstanding service. So far, so good, as our most recent Clinical Division customer survey results were better than ever. But we have more integration activities ahead and remain laser focused on delivering outstanding service.

Strategically, we are developing and introducing new tests to strengthen our test menu. We are expanding our service offering with informatics products and other tools to improve our clients' ability to diagnose and treat patients. We are also working with Pharma and Biotech sponsors to identify biomarkers and companion diagnostics, and provide services for the drug development process. We are confident in our competitive position, but are constantly changing and adapting to the rapidly changing competitive environment.

In summary, we feel very good about the second quarter results and remain excited about our future.

Doug transitions to Sharon

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

Sharon's Comments

Thank you Doug.

Second quarter Review

As Doug mentioned, our second quarter revenues were 102 million, a 50% increase from last year. We are very pleased with our team's execution.

Clinical

Clinical Services revenue increased 49% to $89 million driven by the Genoptix acquisition and continued market share gains. Clinical volume increased 34% while revenue per test increased 12% year-over-year to $355.

Revenue per test decreased $13, or about 3%, sequentially. While a good portion of this decline is attributable to test mix, which will vary from quarter to quarter, we did incur greater than anticipated revenue volatility from the finalization of managed care contract negotiations necessary to include Genoptix in our contracts. Importantly, we feel confident that these negotiations are behind us and we expect revenue per test to be flat to up slightly in the third quarter.

Pharma

Pharma Services revenue increased 55% to almost $13 million, which is a new high water mark for the division and was ahead of our internal projections. For the first half of 2019, Pharma Services revenue is up over 50% compared with last year.

We booked $20 million of new business in the second quarter and increased our backlog quarter-over-quarter to $106 million despite reporting strong Q2 revenue performance that converted a significant chunk of backlog to revenue. Importantly, cancellations normalized from an unusually high level in Q1, and we saw broad-based growth across nearly every test modality.

Gross Profit/Margin

Combined gross profit increased by $18 million to $49 million, up 60%, from the prior year. This increase represents a 54% contribution on the $34 million of revenue growth. Gross margin improved just over 300 basis points year-over-year to 48.1%. This annual improvement was driven by the impact of volume growth, higher average revenue per test, productivity gains, and cost efficiencies.

As expected, gross margin declined modestly sequentially as we continued to add employees to accommodate growth in our Clinical Division. Notably, our Pharma Services

gross margin was outstanding, reaching 50% for the first time ever. The Pharma services business is beginning to reach the scale at which they are expected to be more in line with company gross margins.

Our average cost-of-goods-sold per clinical test (also known as our “Cost per Test”) decreased 6% year-over-year on a pro-forma basis to $185 reflecting our increasing scale and focus on efficiency. Cost per Test increased 2% sequentially reflecting the impact of additional employees hired during the quarter to support our rapid growth.

Operating Expenses
General & Administrative expenses increased 41% year-over-year to $30 million million due to the addition of Genoptix. G&A expense decreased by $3 million sequentially due to lower transaction related expenses, decreased professional fees and acquisition synergies.

Sales and Marketing costs increased 60% year over year to $12 million, driven by the acquisition of Genoptix and the expanded size of our Sales Team.

Research & Development costs increased by more than 100% year-over-year, driven by continued investments in new test development, including our FDA initiatives.

Net Income
Second quarter GAAP net income was $2 million compared to a net loss of $380 thousand in the second quarter of 2018.

Adjusted EBITDA and Adjusted Net Income
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 increased 49% year-over-year to a record $15 million for the quarter.

Adjusted Net Income was $7.2 million compared to $4.5 million in the prior year. Adjusted Diluted EPS was $0.07 versus $0.05 in the second quarter of 2018.

Balance Sheet
We exited Q2 with $167 million in cash and $110 million in debt.

DSO remained healthy at 81 days. While DSO was up 3 days sequentially, this increase is timing related and we saw substantial cash inflows in the first few days of July .

Before I discuss updated 2019 guidance, I want to take some time to address our Q2 operating cash flow. During the quarter, we saw a $5 million use of cash which as many of you know is unusual for our business. This is partially attributed to a final $7 million cash payment to HDC, as we no longer use any of their technology, but another big piece is the $7 million sequential increase in accounts receivable that led to the timing-related

uptick in DSO I just discussed with the remainder due to normal fluctuations in working capital. We continue to believe our Adj. EBITDA serves as a good proxy for the underlying profitability of our business and expect operating cash flow to improve in future quarters.

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

We now expect consolidated revenue to be in the range of $388 to $402 million versus our previous guidance of $384 to $400 million. We now expect Adjusted EBITDA to be in the range of $54 to $58 million, versus our previous guidance of $52 to $56 million. The increase in guidance reflects better than expected second quarter results.

Physician Fee Schedule
Finally, I would like to briefly comment on the proposed Physician Fee Schedule released last night.

As a reminder, we generate less than 12% of our revenue from Medicare payments billed under the Physician Fee Schedule.

Based on our preliminary analysis, we believe that the net impact to NeoGenomics will be neutral in 2020, with modest reductions to IHC and Flow offset by modest increases in FISH.

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.

Before opening up the call for questions, I'd like to update you on a number of important developments that have transpired since our last earnings call.

First, we significantly strengthened our balance sheet during the quarter. In May, we raised $161 million in net proceeds from a secondary equity offering. And in June, we announced a new $250 million credit facility that provides additional borrowing capacity at a lower interest rate than our previous facility. We now have more than $250 million in available liquidity to deploy for strategic growth initiatives, including M&A.

Second, in late May, we launched an important new companion diagnostic test for breast cancer, the QIAGEN therascreen PIK3CA PCR test. This test is a companion diagnostic recently approved by the FDA to aid clinicians in identifying breast cancer patients suitable for treatment with PIQRAY® (alpelisib), a newly approved therapy developed and marketed by Novartis.

Mutations in the PIK3CA gene can act as cancer drivers and are found in approximately 40% of hormone receptor-positive (HR+) and HER2 negative breast cancer cases. These

PIK3CA mutations are the most common mutations in Hormone receptor positive breast cancer and have been associated with a poor prognosis.

Until recently, there has been no targeted therapy available for patients with advanced or metastatic HR+/HER2- breast cancer. PIQRAY is now available as the first targeted therapy approved for advanced or metastatic HR+/HER2- breast cancer patients who have progressed after endocrine therapy and whose tumors have a PIK3CA mutation.

Only patients with a PIK3CA mutation, as detected using an FDA-approved companion diagnostic test, are eligible for Novartis' PIQRAY therapy. QIAGEN's therascreen® PIK3CA RGQ PCR is the only FDA-approved companion diagnostic test for PIQRAY.

Novartis and NeoGenomics have collaborated to provide a Companion Diagnostic Testing Program designed to ensure access to testing for patients eligible for PIQRAY. Enrolled patients receive one free PIK3CA mutation test using QIAGEN therascreen® PIK3CA RGQ PCR test for purposes of determining whether the patient is eligible for alpelisib for the FDA-approved indication. The Companion Diagnostic Testing Program is sponsored by Novartis Pharmaceuticals Corporation and is offered exclusively through NeoGenomics.

As we have discussed on previous calls, our capabilities with regard to companion diagnostics are 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. 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, and increasingly 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 market share by being first to market with companion diagnostic tests.

We have several 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. More generally, we have a pipeline of opportunities to work collaboratively with Pharma companies to leverage our clinical data and market position to accelerate patient access to life saving therapies and clinical trials.

The final development that I would like to discuss is our plan to build a state-of-the art laboratory and global headquarters in Fort Myers, Florida. The laboratory will include leading edge molecular and next generation sequencing capabilities, an ability to support clinical trials for new oncology therapeutics, and ample capacity for growth. We clearly need additional capacity to support our growth projections and having a large, full-service East Coast lab to support our clients in the Eastern U.S. will add to our ability to consistently deliver world-class service. We anticipate breaking ground before the end of the year and to open the new facility in 2021.

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

As we end the call, I'd like to recognize the approximately 1,485 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.