NeoGenomics Q2 2020 Earnings Conference Call Script

Doug VanOort

Good morning. I'd like to welcome everyone to NeoGenomics' Second Quarter 2020 conference call.

Joining me from our Fort Myers headquarters with social distancing precautions in place are Kathryn McKenzie, our Chief Financial Officer, Rob Shovlin, President of our Clinical Division, and Bill Bonello, President of our Informatics Division and Director of Investor Relations.

Joining the call via phone from locations across the country are George Cardoza, President of our Pharma Services Division, 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.

This morning, I will begin with some comments on Quarter Two results, some strategic actions we have taken to accelerate growth, and our outlook for Quarter Three. Kathryn McKenzie will then provide a more detailed review of the Quarter Two financial results. I will wrap up with some summary thoughts on our strategy for operating and growing the business in these difficult times. We will then have time for Questions and Answers.

Quarter Two results and investments

As expected, Quarter 2 financial results were challenging. The revenue and profit loss caused by the COVID-19 pandemic were significant. Revenue was way below our trend. Margins were affected by the lower volume, and also by decisions we made to invest in our business despite the pandemic.

We made several strategic decisions in the second quarter to put us in a stronger competitive position to drive near-term and long-term growth. Those decisions are already beginning to show results, and we fully expect a rapid and strong recovery in financial results in the third quarter.

There are six noteworthy strategic decisions and investments that we would like to share with you:

Covid-19 testing

First, as a demonstration of the value we place on culture and people, we retained all of our employees during the crisis. With skilled employees available, we decided to build a COVID testing Lab to do our part to help in the crisis.

We started with a minimal level of testing capacity and now have steadily built capacity for the past eight weeks. We currently have capacity to perform more than 10,000 tests per day, which we may scale up further. We began to process COVID volume in the latter part of June, and we have ramped that up considerably in July and anticipate a steady stream of business throughout the third quarter.

Our strategy for COVID-19 testing is to serve as a network reference lab for our hospital client labs and for commercial labs. In this way, we leverage our expertise by performing the molecular laboratory testing but our partners perform the front-end logistics and sample gathering, as well as the back-end reporting. As a result, our average revenue per COVID test will be lower than what you might see from other laboratories performing this full testing service, but our costs will also be lower. We have made sizable investments in equipment, supplies, R&D, people, training, and systems to get this lab operational.

For us, while we are benefitting financially from the revenue associated with COVID-19 testing, we view this service as short-term in nature and not part of our overall strategy as a leader in oncology testing. Our intent is to partner with the Lab industry to help the country combat this crisis.

Although there is uncertainty about the amount of volume and duration of demand, we expect Covid-19 testing to result in incremental revenue and profit throughout the third quarter and into the fourth quarter as well. At this time, demand is so high that we have redeployed 50 employees and hired and trained temporary employees to perform COVID testing.

Over the next several months, we expect our core oncology testing volume will continue to improve. Should COVID-19 testing demand fall, we will scale back those dedicated resources and redirect some of our COVID-testing staff back to our core oncology testing.

Fortifying our Balance Sheet

Second, we fortified our balance sheet by successfully completing an offering of common stock and convertible securities, resulting in net proceeds of $322 million for our company. We used approximately $100 million of the proceeds to repay our term loan and terminate the associated interest-rate hedge, creating significantly increased financial flexibility for our Company. The remainder of the proceeds are available to fund strategic investments and mergers and acquistions.

Investment in Inivata

Third, we formed a strategic collaboration and made a $25 million minority investment in Inivata, a leader in liquid biopsy testing technology. As part of our deal, we have a seat on the Inivata Board of Directors, and the exclusive option to buy the entire company. We also have the right to commercialize the InVisionFirst-Lung liquid biopsy test in the U.S. and to help commercialize their Minimal Residual Disease test, which is currently in development.

InVisionFirst-Lung is a highly competitive circulating tumor DNA Next Generation Sequencing liquid biopsy assay testing 37 genes relevant to the care of advanced non-small-cell lung cancer. The test covers all National Comprehensive Cancer Network (or NCCN) guideline-recommended genomic drivers with FDA-approved targeted therapies for non-small-cell lung cancer. The InVisionFirst-Lung test is covered by Medicare and various private insurance payors and is one of just two NGS-based liquid biopsy tests with specific Medicare coverage.

Launch of Liquid Biopsy Tests

Fourth, we launched a suite of solid-tumor liquid biopsy tests, including InVisionFirst-Lung, as well as the NeoLab Solid Tumor Liquid Biopsy and the QIAGEN therascreen PIK3CA test for plasma.

NeoLab Solid Tumor Liquid Biopsy is a highly sensitive and specific pan cancer NGS test for genomic profiling. We had previously announced that the assay was being validated and that we expected to launch it before mid-year, and we accomplished that on schedule.

The therascreen PIK3CA test is an FDA-approved, companion diagnostic test for PIQRAY (alpelisib). As you may know, we have worked with Novartis on their tissue-based companion diagnostic PIK3CA test, and have a sponsored testing program with them. The PIK3CA liquid biopsy test accompanies the existing tissue biopsy test.

Global Pharma Services Investment

Fifth, we continued to invest in our Pharma Services business. During the quarter, we further established Pharma-specific testing capabilities, hired additional sales and Business Development people in Europe and Asia, and progressed with our China lab in collaboration with our strategic partner PPD, which is expected to be operational by the end of this year.

As you see from our Quarter 2 results, Pharma revenue was negatively impacted by trial delays resulting from the COVID pandemic, as well as reduced enrollment in existing trials. However, while patient access was an issue, new bookings of signed contracts were at an all-time-high, with $40 million of new business signed during the quarter. Clearly, there is strong demand for our services, and the current backlog of over $170 million in signed contracts should pave the way for strong revenue growth over the next several quarters.

Informatics

Finally, we continued to invest in our Informatics business. We continue to have substantial engagement from Pharma companies, Providers, and Payors, and have already had some early commercial success. As the leader in oncology testing, we are uniquely positioned to use the vast amount of our valuable data to help solve real-world problems for our customers and for cancer patients, and we are just beginning to harness the true value of our testing data and information.

Summary and Looking Ahead

Our decisions to maintain our workforce and invest in growth opportunities has positioned NeoGenomics for a strong recovery. Based on current trends, we now expect to report organic revenue growth in excess of 20% for Quarter Three. This growth will be driven by a combination of modest year-over-year organic revenue growth in core oncology testing as well as a boost from COVID-19 testing.

To give you a better sense of the pace of recovery in the core oncology business, and some confidence in our Quarter Three outlook, we thought it might be helpful to share a few statistics related to our Quarter 2 and early Quarter 3 volume trends.

The COVID impact on our testing volume was most severe in April, with volume down nearly 30% year over year. Volume began to recover in May, with further recovery in June. In total, June 2020 volume was essentially in line with June 2019 volume, though still about 15% below our pre-COVID expectations. Volume did get better each week in June, with year-over-year growth in the last week of the quarter.

Volume trends have continued to recover in July, but we are not yet back to our pre-COVID expectations. We have experienced a similar volume trend in our Pharma Services business.

Obviously, there is still a good deal of uncertainty about the continued pace of recovery given the resurgence in infections, which is reflected in our expectations for Quarter Three growth.

In summary, Quarter 2 financial results were poor, as expected, due to the impact of the COVID pandemic. Nevertheless, we are confident that the actions that we took in response to the pandemic have positioned the Company for a strong recovery and we believe that our competitive position and long-term growth prospects are stronger than ever.

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 Two financial results.

Kathryn's Comments

Thank you Doug. And Good Morning everyone.

Second Quarter Review

I will give a brief overview of Second Quarter financial results.

Consolidated Revenue declined 14% year-over-year to $87 million, reflecting the impact of the COVID-19 pandemic.

For the quarter overall, Clinical Division test volumes excluding COVID-19 testing declined 18% year-over-year. Consistent with what we previously disclosed, April represented our low for the quarter as tests per day declined between 25% and 30% in the month. Fortunately, we experienced a sequential improvement in both May and June. Volume in each week of June was better than the last and we are especially encouraged that the last week of June this year was better that the last week of June in 2019.

Clinical Division revenue-per-test was $351, down 1% year-over-year and down sequentially from $371. The revenue-per-test reflects lower revenue during the quarter on non-contracted claims related to legacy Genoptix. As a result, AUP was unusually low in the quarter.

We would like to note that we have now completed the Genoptix integration after just 18 months, despite the distractions from the COVID pandemic. As a result, we are now in position to drive increased efficiencies, including improvements in billing processes and collections, over the next several quarters. We continue to believe that our original synergy projections will be realized as expected.

Pharma Services revenue increased 3% year-over-year to $13 million. Research oriented revenue growth remained strong, bolstered by the acquisition of HLI - Oncology. As a reminder, we acquired this state-of-the-art NGS lab in La Jolla, CA in January of this year, giving us advanced NGS capabilities. Clinical trials work was down significantly as a result of COVID-19 pressures on clinical trial activity around the world.

Despite the challenging environment, the Pharma Team continued to sign new contracts and grow the backlog of signed contracts. In fact, new contracts signed in the quarter were $40 million representing the highest quarterly number yet, and the backlog of signed contracts increased 63% year-over-year to $173 million.

Gross Margin
For the Second Quarter, Gross Margin declined year-over-year to 32.2% as a result of the volume and cost impact of the COVID-19 pandemic.

Operating Expenses
Operating expenses increased 5%, or $2 million, year-over-year to $47 million due to investments in informatics, Pharma services growth initiatives, and the acquisition of HLI – Oncology. The increases were partially offset by lower commissions, significantly reduced travel, and decreased trade show and marketing expenses.

While we will continue to fund our key growth initiatives, we remain disciplined in evaluating and controlling our operating expenses and other costs, and we have reduced or delayed certain expenses and capital expenditures where appropriate.

Adjusted EBITDA
Second quarter Adjusted EBITDA was negative $7.2 million, reflecting the impact of significant volume declines and other challenges experienced related to the COVID-19 pandemic. And as Doug previously noted, we also made important investments in our people and other strategic initiatives which we believe positions us for a strong recovery.

Balance Sheet
Turning to the balance sheet, we exited Quarter Two with $295 million in cash excluding $36 million in restricted cash designated for construction of our new state-of-the art laboratory and global headquarters in Fort Myers, Florida. Construction of that facility continues to be on track for opening in the Fall of 2021.

We were busy this quarter. We significantly enhanced our financial position by raising approximately $320 million in total net proceeds from our concurrent equity and convertible debt offerings in late April. We utilized a portion of these proceeds to retire our outstanding term loan and related hedge for approximately $100 million. Additionally, we invested $13 million as a part of a $25 million total minority investment in, and strategic alliance with, Inivata that we announced in late May. We also received $7.9 million in provider disbursements under the CARES Act, of which $4.0 million was received during the second quarter with the remainder received in early July.

Days Sales Outstanding

DSO increased 6 days sequentially to 92 days, primarily due to the distribution of our revenue in the quarter being heavily weighted towards June.

Guidance
As a reminder, we withdrew our full year 2020 financial guidance on April 9th, 2020, in light of the COVID-19 pandemic. While we are expecting recovery in the second half of the year, we recognize that uncertainty remains given the resurgence in COVID cases and potential downstream impacts.

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.

As I noted at the beginning of the call, Quarter 2 financial results were quite difficult, but we expected as much. We made strategic decisions to invest for long-term growth opportunities rather than cutting costs as a response to the short term reduction in volume. We think these were the right decisions.

There is no disputing the fact that our decision to stand up COVID testing reduced earnings in Quarter 2. However, we believe that providing COVID testing is not only the right thing to do, but will prove to have been financially prudent. We started to see an uptake in testing volume at the very end of Quarter 2 and that has grown considerably in the first several weeks of Quarter 3.

Our decision to retain our employees during the pandemic, despite the volume decline, also had a significant impact on profit in the quarter. Again, we believe this was the right thing to do, but also has long-term cultural and customer service benefits for our company and the clients and patients we serve.

One data point that supports this belief is our most recent customer survey Net Promotor Score. We surveyed clients in the midst of the pandemic, and received our highest response rate and highest score ever, with a score that is nearly 10 fold higher than the average score for our peer group.

We have competitive strategies that continue to change and evolve, but our fundamental business model remains unchanged; we try to lead with a culture that is purpose-driven and values-based, and we continue to believe that high levels of employee engagement drives high levels of customer satisfaction and retention, which in turn drives shareholder returns.

Finally, we believe that our strategic decision to invest in growth is enhancing our competitive positioning, and will pay dividends in both the near-term and the long-term. In fact, we believe that we are even better positioned for growth than we were before the pandemic hit. We now have a full suite of liquid biopsy tests which further strengthens our Next Generation Sequencing product portfolio and solidifies our comprehensive oncology test menu. We also have a strong balance sheet to support further M&A. We have a very large backlog of signed Pharma Services contracts and are well positioned for growth with an increasingly global presence. And we are advancing our Informatics initiatives and are very excited about what that team has already accomplished.

All and all, we continue to run our business for the long-run and we are looking forward to a bright future.

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 1,675 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.