

NeoGenomics Q1 2020 Earnings Conference Call Script

Doug VanOort

Good morning. I'd like to welcome everyone to NeoGenomics' First 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.

The format for today's call will be a little different than that of our typical quarterly conference call. I will begin by discussing our response to the COVID-19 pandemic and the impact that we are seeing on our business.

Kathryn McKenzie will then provide a more detailed review of the Quarter One financial results and I will wrap up with some thoughts on our strategy for operating and growing the business in these difficult times. We will then have time for Questions and Answers.

COVID-19 Impact and Response

Let's begin with a discussion of our response to the COVID-19 pandemic.

Fortunately, we were in a relatively good position going into this challenging time of Covid-19. Our business is strong, it is profitable, and we have a solid balance sheet with available borrowing capacity. We had positive momentum going into this crisis, with both revenue and volume tracking at or above expectations prior to the onset of the virus.

We strongly believe that we will come out of this crisis with positive momentum as well. Our services are critical for cancer patients. We fully expect that, when it is safe for cancer patients to seek treatment, and when their Oncologists and Hospitals resume more normal patient schedules again, our test volumes and growth rates will gradually return to normal levels.

In responding to the crisis, our guiding principle has been first to secure the safety and well-being of our employees, and thereby to maintain the continuity of our critical oncology testing for cancer patients.

Our response was also influenced by our desire to emerge from this crisis in a relatively superior competitive position. As a result, rather than implementing layoffs or furloughs, we focused on short term actions to invest in our workforce, strengthen our culture, and focus on the initiatives and strategies designed to strengthen our long-term competitiveness.

Actions Taken

To protect our employees, early on, we de-densified our laboratories and facilities, adjusted laboratory shifts to put space and distance between our people, restricted visitors to facilities, restricted employee travel, and implemented an Emergency Paid Time Off policy for employees who were personally affected by the virus.

We also quickly implemented a remote work-environment and provided training and support for that. For the past several weeks, we have had well over 2/3 of our employees working productively from home.

We communicated extensively with our employees and implemented a comprehensive array of actions in response to employee feedback as well as medical, scientific and governmental guidance.

We have also been managing our supply chain carefully to ensure that we have adequate inventory to continue testing. In certain cases, we added months of supply to our inventory levels.

These actions have worked. Importantly, all of our main lab facilities have remained open throughout this crisis, and we have been able to continue all of our testing services, with excellent quality and turn-around-time, without interruption or delay.

Covid-19 testing

We've also responded by doing our part to help our Country. Although we are an Oncology company, we do have extremely strong expertise in molecular testing, and have dedicated a number of R&D and laboratory experts to develop Covid-19 testing capabilities. Like some other commercial laboratories, we are now offering the PCR test, and are ramping our capacity up quickly.

Within the week, we will have capacity to perform over 5,000 Covid-19 PCR tests per day. If there is demand, we can quickly ramp that up significantly higher. We also have invested in instrumentation and other equipment to be able to offer the Covid-19 serology test, and should be ready soon.

At this point it is too early to estimate the financial impact from the COVID-19 test offering. We do know that testing is critical to help people safely get back to work, a number of organizations have reached out to us for help, and we are doing this because we feel it's the right thing to do.

Covid-19 Impact

Overall, our team feels very good about the actions that we have taken in response to COVID-19; however, the pandemic has had an impact on our business.

Although clinical test volume was quite strong for most of the quarter, it was only up 7% for the full Quarter compared with last year because, in the last two weeks of March, it was down by approximately 20%. In April, clinical test volume declined slightly more and was down between 25% and 30% year-over-year, although it has appeared to stabilize on a week-over-week basis.

The volume decline is understandable. In many regions of the country, Oncology practices reduced their hours of operation and postponed or cancelled patient appointments. Similarly, many hospitals reduced surgeries as they devoted resources to Covid-19 preparations and urgent needs. Cancer patients, some of whom have compromised immune systems, were reluctant to see Physicians even if they were available. We believe this is a temporary condition.

We have also seen an impact on our Pharma Services Division revenue, as some clinical trials projects in our backlog of signed contracts have been delayed due to COVID-19. Sponsors have told us that they are unable to start certain new clinical trials as that effort typically involves visiting enrollment sites to train on-site staff. Clinical trials typically account for about 50% of our business. The other half of our Pharma Services business is largely in support of Pharma companies' Research and Development work, and that has not been affected by the pandemic so far.

Significantly, and encouragingly, we have not seen an impact on the amount of new Pharma Services contracts we are signing. In fact, we signed contracts for an additional \$28 million of new business during the quarter, our second highest bookings quarter of all time.

Like most companies, NeoGenomics has not been immune to the impacts of this unprecedented situation. Unlike a lot of companies though, we have not furloughed employees or reduced our employee levels. Although it may reduce short-term profitability, we are investing in our people and our culture. We're providing more training, more development, and even a small cash bonus of appreciation to those employees that are on the front line working in one of our laboratories during this critical time.

Our employees are responding very positively, and we believe the level of employee engagement, and our culture, is as strong as ever. A strong team is an important competitive strength of our company.

I think you would be as proud as I am about our NeoGenomics employees' response to this unprecedented situation. Throughout this crisis they have continued to provide critical testing services to cancer patients with excellent quality, turn-around time, and customer service. My hat's off to them.

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 One financial results.

Kathryn's Comments

Thank you Doug. And Good Morning everyone.

First quarter Review

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

Consolidated Revenue increased 11% year-over-year to \$106 million. First Quarter results include a modest contribution from the acquisition of the Oncology Division assets of Human Longevity on January 10th. The Genoptix acquisition was completed on December 10th, 2018, so Genoptix results are fully reflected in the 2019 comparisons.

We estimate that the COVID-19 pandemic reduced First Quarter revenue by approximately \$4 million, due to reductions in Clinical Services testing volume and delays in Pharma Services work.

In the first quarter, Clinical Division test volumes increased 7% year-over-year. Prior to the impact of COVID-19, we were once again seeing growth across all testing modalities, with particular strength in Next Generation Sequencing and molecular testing.

We estimate that the COVID-19 situation reduced Clinical volume by at least 4% during the quarter. As Doug mentioned, Clinical Volumes were down approximately 20% in the last two weeks of March and between 25% and 30% in April.

Clinical Division revenue-per-test was essentially flat both year-over-year and sequentially at \$371. Revenue per test was not significantly impacted by the COVID-19 pandemic.

Pharma Services revenue increased 39% year-over-year to \$13 million. This increase was primarily due to additional next generation sequencing work associated with our acquisition of the Oncology Division assets of Human Longevity. As discussed on prior calls, we did have two very large projects complete in Quarter 4 of last year. Also, several large projects that had been scheduled to start late in the quarter have been delayed by several months due to Covid-19.

Despite the challenging environment, the Pharma Team continued to sign new contracts and grow the backlog of signed contracts. New contracts signed in the quarter were \$28 million, and the backlog of signed contracts increased 47% year-over-year to \$148 million. The acquisition of HLI-Oncology increased the backlog by approximately \$15 million. Excluding the contribution from HLI-Oncology, the backlog grew approximately 32%.

Clinical Gross Margin and Cost per Test

For the First Quarter, Clinical Services Gross Margin was down approximately 300 basis points year-over-year to 47.4% and our average cost-of-goods-sold per clinical test (also known as our "Cost per Test") increased by 7% year-over-year to \$195. These impacts are mainly due to the lower-than expected volume levels and additional expenses caused by COVID-19.

Pharma Gross Margin

Pharma Services Gross Margin decreased to 17.7% in the first quarter, primarily due to lower revenue resulting from the timing of projects. As a reminder, we have been building an independent testing capacity for the Pharma Services business to support our growth projections, and this has resulted in a temporarily negative impact on Pharma Services Gross Margin. With a signed contract backlog of more than \$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. However, this change results in short-term decreases in cost effectiveness in each Division.

This quarter also reflects the acquisition of the oncology Division assets from HLI on January 10th, 2020, and we expect the acquisition to be dilutive to gross margin this year. Gross Margin was also impacted by costs associated with the COVID-19 pandemic. 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 13%, or \$4 million, year-over-year to \$36 million, in large part due to the addition of HLI-Oncology and the associated acquisition related expenses.

Sales and Marketing costs increased 18% year-over-year to \$13 million, driven by the expanded size of our overall sales team and commissions on higher revenues.

While we will continue to fund our key growth initiatives we are being prudent in evaluating our operating expense and other costs and reducing or delaying certain capital expenditures where appropriate.

Adjusted EBITDA

First quarter Adjusted EBITDA was \$7.1 million, which was approximately \$1 million lower than the guidance that we provided in February. The shortfall relative to guidance is due entirely to the COVID-19 impact.

As we discussed on our last earnings call, First Quarter Adjusted EBITDA was negatively impacted by a number of factors in addition to the COVID-19 impact. Most significantly, our Pharma Services revenue was lower than normal, simply due to the timing of New Project starts and stops. As we noted earlier, our new business wins remain robust.

Balance Sheet

We exited Quarter One with \$125 million in cash including \$39 million in restricted cash designated for construction of our new state-of-the art laboratory and global headquarters in Fort Myers, Florida. Cash was reduced by approximately \$37 million during the quarter for the acquisition of the Oncology Division assets of Human Longevity. We ended the quarter with \$104 million in total debt, including financing obligations. We have approximately \$103 million of available borrowing capacity on our credit facilities.

DSO increased 5 days sequentially to 86 days due to revenue from retroactive rate increases secured late in the quarter and timing of pharma and informatics revenue.

Cash used in Operating Activities was approximately \$7 million for the quarter. Cash from Operations was reduced by approximately \$6 million from increases in inventory as we adjusted our supply chain management strategy for a COVID-19 environment, \$3.3 million for costs related to the construction of our new Fort Myers Headquarters which is included in operating cash flow, and acquisition related expenses.

Guidance

As a reminder, we withdrew our full year 2020 financial guidance on April 9th, 2020, in light of the COVID-19 pandemic.

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.

I would like to take some time to further discuss our strategy for operating and growing the business in these difficult times.

We believe that we are well positioned competitively with excellent growth potential and plans, and we are continuing to invest in important and compelling growth initiatives.

Obviously, we are closely monitoring and containing our costs. While we are continuing construction of our new Fort Myers Laboratory and Headquarters facility, we are substantially scaling back or postponing plans for changes and upgrades to all other facilities. We are not hiring unless it's strategically important. We are continuing to invest in automation, as that will allow us to continue our long-term improvement in cost-per-test.

While volume levels remain lower than normal we are engaging employees in activities to better prepare for that growth by sustainably improving processes – to improve turn-around-time, enhance customer service, strengthen our test menu, and decrease cost. Our Sales Team is also engaged in value-added activities and planning, and they are fired up.

As I mentioned, we are also redeploying a certain number of employees to be able to perform Covid-19 PCR and Serology testing in order to help fill the capacity to support America's needs.

We realize that some may question our decision to retain employees during this temporary volume slowdown. And we are also well aware it will have a short-term impact on earnings. However, we believe this is an investment worth making. Based on our experience in this business, having an experienced, skilled, and loyal workforce is necessary to accommodate the rebound in test volume we expect as the crisis wanes. We feel fortunate that our company is strong enough that we can invest in our workforce in this current environment, and we believe that this investment will allow us to retain our strong company culture for years to come.

Strategically, we intend to be prudently aggressive. We will continue to make growth investments, particularly in next generation sequencing, pharma services, informatics, and companion diagnostics.

Next Generation Sequencing

Next Generation sequencing remains an area of particular focus for us. We plan to continue our substantial investment in this area, and expect to introduce several new products in 2020.

Liquid biopsy is one area of particular interest for us. Although the market is still relatively small, we expect it to grow quickly. Our validation of a pan-cancer assay is proceeding and we expect to introduce a pan-cancer liquid biopsy test by the middle of this year.

We are also expanding our offering of RNA-based next-generation-sequencing assays, for both solid tumor and hematologic malignancies. We are developing a rapid Next Generation Sequencing panel designed for acute myeloid leukemia, which often requires prompt treatment. This panel will replace the rapid AML therapeutic panel comprised of both single gene molecular and FISH assays that we released earlier in the month. Finally we continue to investigate assays for identifying minimal residual disease, particularly for hematologic neoplasms.

Pharma Services

Another area of focus is Pharma Services. While we are seeing some near-term disruption in clinical trials projects due to delays in the timing of clinical trials, we continue to sign new contracts for future work. Our broad global testing capabilities to perform both research-type work and clinical trials support continues to be in strong demand. Our multiplexed immunochemistry, expanded flow cytometry, and new next generation sequencing capabilities are unique. And companion diagnostics projects are growing rapidly.

As many of you know, we made an important strategic move to expand our Pharma Services Next-Generation-Sequencing capabilities with the acquisition of the Oncology Division assets of Human Longevity, Inc. in early January. This Lab provides germline, whole exome and whole genome sequencing specifically for Pharma companies. This business generated approximately \$10 million in revenues in 2019 and ended the year with a backlog of approximately \$15 million of signed contracts. Thus far in 2020, the business is performing in line with our initial forecasts, despite the COVID-19 situation.

Informatics

We are also continuing to invest in our Informatics Division – both in terms of product development and early commercial engagement. 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. We are still in the very early innings in terms of product development, but we already have significant engagement from various stakeholders including global pharmaceutical firms, large national health systems and major managed care payors.

Synergistic Division Strategy

Importantly, we continue to create synergistic opportunities across our three divisions, particularly with regard to companion diagnostics. We 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.

Intent to be Prudently Aggressive

While we will be particularly sensitive to liquidity in this current environment, we will continue to consider select, strategic, financially prudent acquisitions and investments – particularly in the areas of growth opportunity that I just discussed.

Conclusion

In summary, the short term environment will be challenging. We are seeing an impact on revenue in both our Clinical and Pharma Services Divisions, and we are likely to see a near-term impact on earnings.

However, these near-term challenges are entirely attributable to the COVID-19 pandemic and should dissipate with time. We remain excited about our long-term opportunities for growth.

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 1,685 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.