

## NeoGenomics Inc. (NEO-NASDAQ)

**NEO: record revenue for 2Q14, expecting continued growth for 2H14 and 2015--Outperform**

### OUTLOOK

NeoGenomics just reported record revenue for 2Q14. As a result, we have increased our revenue estimates for 2H14 and for 2015 to 2017. Balance sheet remains strong.

Management has done a great job to limit the impact of Medicare reimbursement by increasing test volume, launching new products, and saving costs. Going forward, revenue will continue to grow in 2H2014 and beyond. NEO is well poised for long term growth.

We continue to rate NEO shares Outperform based on the Company's strong fundamentals.

<b>Current Recommendation</b>	<b>Outperform</b>
Prior Recommendation	N/A
Date of Last Change	10/09/2011
Current Price (07/20/14)	\$5.44
<b>Twelve- Month Target Price</b>	<b>\$8.00</b>

### SUMMARY DATA

52-Week High	\$4.71
52-Week Low	\$2.10
One-Year Return (%)	36.03
Beta	1.15
Average Daily Volume (sh)	678,764

Shares Outstanding (mil)	50
Market Capitalization (\$mil)	\$218
Short Interest Ratio (days)	11.82
Institutional Ownership (%)	N/A
Insider Ownership (%)	N/A

Annual Cash Dividend	\$0.00
Dividend Yield (%)	0.00

5-Yr. Historical Growth Rates	
Sales (%)	51.6
Earnings Per Share (%)	N/A
Dividend (%)	N/A

P/E using TTM EPS	N/A
P/E using 2011 Estimate	N/A
P/E using 2012 Estimate	N/A

Zacks Rank	N/A
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Risk Level	Above Avg.,
Type of Stock	Small-Growth
Industry	Med-Biomed/Gene
Zacks Rank in Industry	N/A

### ZACKS ESTIMATES

#### Revenue

(in millions of \$)

	Q1	Q2	Q3	Q4	Year
	(Mar)	(Jun)	(Sep)	(Dec)	(Dec)
2013	15.7 A	15.6 A	16.9 A	18.3 A	66.5 A
2014	18.2 A	20.7 A	22.0 E	23.0 E	83.9 E
2015					96.0 E
2016					120.0 E

#### Earnings per Share

(EPS is operating earnings before non recurring items)

	Q1	Q2	Q3	Q4	Year
	(Mar)	(Jun)	(Sep)	(Dec)	(Dec)
2013	\$0.00 A	\$0.01 A	\$0.02 A	\$0.02 A	\$0.04 A
2014	\$0.00 A	\$0.01 A	\$0.00 E	\$0.00 E	\$0.02 E
2015					\$0.07 E
2016					\$0.16 E

Zacks Projected EPS Growth Rate - Next 3 Years % **62**

## WHAT'S NEW

- **Record revenue reported for 2Q14;**
- **We increase our revenue and earnings estimates for 2H14 and for 2015;**
- **Balance sheet remains strong;**
- **Maintain Outperform rating and raise our price target to \$8.00 from previous \$7.00 per share;**

### **Record Revenue Reported for 2Q14**

On July 17, NeoGenomics (NEO) reported its financial results for the second quarter ended June 30, 2014.

Total revenue for 2Q14 was \$20.67 million, compared to \$15.6 million for 2Q13, a 32.5% increase. This revenue growth was achieved despite a \$1.1 million reduction in revenue recorded to account for a conservative interpretation of the new National Correct Coding Initiative (NCCI) edits relating to billing Medicare for FISH testing.

This record revenue of second quarter of 2014 also beat our estimate of \$18.8 million.

The revenue growth in 2Q14 was mainly driven by 40% test volume increase.

Gross margin increased to 49.5% in 2Q14 from 45.9% in 2Q13. This increased gross margin was achieved due to reduced average cost-of-goods-sold-per-test by 11.7%, although average revenue-per-test decreased by 5.3% from the first quarter of last year due to the NCCI FISH matter.

Total operating expenses were \$9.7 million in 2Q14, compared to \$6.7 million in 2Q13, an increase of 45.2%. This increase was driven by an increase in the size of its sales team, increased commission and bad debt expense related to the increase in revenue, and continued investments in facilities, information technology, and new test development activities.

Net income was \$0.3 million for 2Q14 (\$0.01/share) compared to \$0.3 million (\$0.01/share) for 2Q13. Net income for 2Q14 also beat our estimate of \$0.1 million (\$0.00/share).

Adjusted EBITDA for 2Q14 was \$2.1 million, a 15.8% increase from last year.

Absent the impacts of the NCCI FISH matter, the Company estimates that Adjusted EBITDA would have been \$3.1 million and net income would have been approximately \$1.1 million, or \$0.02/share.

### **We Increase Our Estimates for 2H14 and 2015**

We are pleased to see continued revenue and earnings growth for the first half of 2014, especially when the company is faced with continued pressure on reimbursement. The reimbursement challenge is for the whole industry, but NEO management is doing a great job to manage its negative impact on both top line and bottom line of the Company.

NEO is attracting new clients and **gaining market share** due to its stream of innovative new tests and consistently high service levels. The company has been successful at increasing productivity and reducing costs. As a result, NEO achieved a 32.5% growth in revenue and 360 basis point expansion in gross margin in 2Q14, particularly in the face of a 5.2% reduction in average unit price. We think this is a significant accomplishment. NEO also achieved a 12% reduction in average cost/test in the second quarter. According to management, average cost per test can be further reduced by 8-10% in both 2014 and in 2015 on a full year basis.

As a result of the better than expected first half financials, we increased our estimates for 2H14 and full year of 2015.

Specifically, we increase our revenue estimate for 3Q14 to \$22 million from previous \$19.1 million and for 4Q14 to \$23 million from previous \$19.3 million. For the year 2014, we increase our estimate for total revenue to \$83.9 million from previous \$75.4 million.

We increase our revenue estimate to \$96, \$120 and \$150 million from previous \$85, \$110 million and \$145 million respectively for 2015, 2016 and 2017. Our estimates include revenue from Path Logic and the negative impact from NCCI matter.

Revenue increase should be achieved from new accounts, new products offering, test services for biopharmaceutical companies and from expansion to new geographies.

### Summary of Quarterly Performance

	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14
<b>Total Revenue (\$, 000's)</b>	<b>\$14,202</b>	<b>\$14,893</b>	<b>\$15,657</b>	<b>\$15,603</b>	<b>\$16,884</b>	<b>\$18,323</b>	<b>\$18,182</b>	<b>\$20,670</b>
<b>% Growth</b>	25.5%	15.5%	3.3%	-0.1%	18.9%	23.0%	16.1%	32.5%
<b>Gross Margin</b>	41.5%	43.2%	46.3%	45.9%	48.4%	50.0%	47.9%	49.5%
<b>SG&amp;A as a % of Revenue</b>	40.6%	38.9%	39.0%	38.7%	39.5%	39.9%	42.3%	43.7%
<b>Net Income (Loss) (\$,000's)</b>	<b>(\$975.0)</b>	<b>(\$113.0)</b>	<b>\$3.0</b>	<b>\$273.0</b>	<b>\$929.0</b>	<b>\$963.0</b>	<b>\$102.0</b>	<b>\$274.0</b>
<b>Diluted EPS</b>	<b>(\$0.02)</b>	\$0.00	\$0.00	\$0.01	\$0.02	\$0.02	\$0.00	\$0.01
<b>Adjusted EBITDA (\$, 000's)</b>	\$842.0	\$1,439.0	\$1,794.0	\$1,825.0	\$2,163.0	\$2,733.0	\$1,685.0	\$2,116.0
<b>% Growth</b>	21.5%	36.4%	1.1%	-6.1%	156.9%	89.9%	-6.1%	15.9%
<b>Test Volume (000's)</b>	<b>28,315</b>	<b>30,513</b>	<b>32,088</b>	<b>32,519</b>	<b>33,723</b>	<b>38,987</b>	<b>38,734</b>	<b>45,475</b>
<b>% Growth</b>	41.7%	35.3%	19.1%	12.7%	19.1%	27.8%	20.7%	39.8%
<b>Average Price/Test</b>	\$501.58	\$488.09	\$488.00	\$480.00	\$501.00	\$469.99	\$469.00	\$455.00
<b>% Growth</b>	-11.5%	-14.6%	-13.3%	-11.3%	-0.1%	-3.7%	-3.9%	-5.2%
<b>Average Cost/Test</b>		\$277.25	\$262.00	\$260.00		\$234.96	\$245.00	\$229.00
<b>% Growth</b>						-15.3%	-6.5%	-11.9%

### Summary of Annual Performance

\$, 000's	2010	2011	2012	2013	2014E	2015E	2016E	2017E
<b>Total Revenue</b>	\$34,371	\$43,484	\$59,866	\$66,467	\$83,852	\$96,000	\$120,000	\$150,000
<b>% Growth</b>	16.6%	26.5%	37.7%	11.0%	26.2%	14.5%	25.0%	25.0%
<b>Gross Margin</b>	45.9%	44.7%	44.8%	47.7%	48.9%	50.0%	50.0%	50.0%
<b>SG&amp;A as a % of Revenue</b>	54.5%	45.6%	39.0%	39.3%	43.2%	41.7%	37.1%	32.0%
<b>Net Income (Loss)</b>	(\$3,303.0)	(\$1,177.0)	\$66.0	\$2,033.0	\$856.0	\$3,960.0	\$9,775.0	\$18,700.0
<b>Diluted EPS</b>	(0.09)	(0.03)	0.00	0.04	0.02	0.07	0.16	0.32
<b>Adjusted EBITDA</b>	(\$566.0)	\$2,134.0	\$5,999.0	\$8,515.0	\$8,500.0	\$9,500.0	\$15,000.0	\$20,200.0
<b>Test Volume Growth</b>	25.5%	33.1%	50.2%	19.8%	30.0%	35.0%	40.0%	45.0%

### Balance Sheet Remains Strong

As of June 30, 2014, NeoGenomics had \$5.0 million in cash. The company also has approximate \$5.7 million of availability under its credit line. In addition, the company has \$100 million shelf registration statement currently effective at SEC.

There is no debt for NEO as of June 30, 2014.

With the strong balance sheet, NEO will be able to focus on its long term growth strategy without concern about short term cash strain.

### We Raise Our Price Target to \$8.00 Per Share

We continue to rate NEO shares an Outperform and raise our price target to \$8.00 per share from previous \$7.00 per share.

NeoGenomics is an emerging leader in the genetic/molecular cancer testing market. The Company holds numerous competitive advantages over its competitors. We are especially impressed by the Company's fast turn-around times, tech-only reporting solution and state of the art laboratory information system (LIS), which are key elements that drive top line growth.

NeoGenomics has achieved strong financial performance. Revenue grew from \$11.5 million in 2007 to \$66.5 million in 2013, a tremendous 34% compound annual growth rate (CAGR) for the six-year period. We estimate revenue will further grow to \$150 million in 2017, a CAGR of 23% from 2013 to 2017.

We are optimistic about the strength of the Company's business model. Fundamentals remain strong for NEO. Pipeline is strong too. The Company is executing plans to gain further efficiencies. By growing its business, lowering its costs and driving innovation, NeoGenomics is becoming America's premier cancer testing laboratory.

We initiated coverage of NEO in early Oct 2011 when share price was about \$1.00 per share. Right now, shares of NEO are trading at about \$5.00. We think there is still room for further price appreciation. Based on its strong fundamentals, we think shares of NeoGenomics are still undervalued at current market price. Currently, NEO is trading at about \$5.0 per share which values the Company at \$250 million in market cap based on 50 million shares outstanding. This is still a discount compared to its peers. Based on our financial model, revenue will grow at 23% CAGR from 2013 to 2017. We arrive at

our price target of \$8.00 per share by using 35 x P/E multiple and coupled with our estimated EPS of \$0.32 in 2017, discounted at 20% for two years. This valuation corresponds to approximately 4 times our 2015 estimated revenue of \$96 million. Our price target values NEO at \$400 million in market cap which we think is still conservative.

NEO could be an acquisition target for big players. The genetic/molecular industry is quite fragmented currently, but merger & acquisition activity is looming. We all know that big players like LabCorp and Quest Diagnostics are increasingly acquiring smaller players in this field. Qiagen NV, a research service company based in Netherland, entered into genetic/molecular testing market in 2007 by acquiring Digene Corp. Since then, Qiagen has been quite aggressive in acquisition of other small genetic/molecular testing companies.

With the increased activity in M&A in the industry, NEO could be an easy target for acquisition.

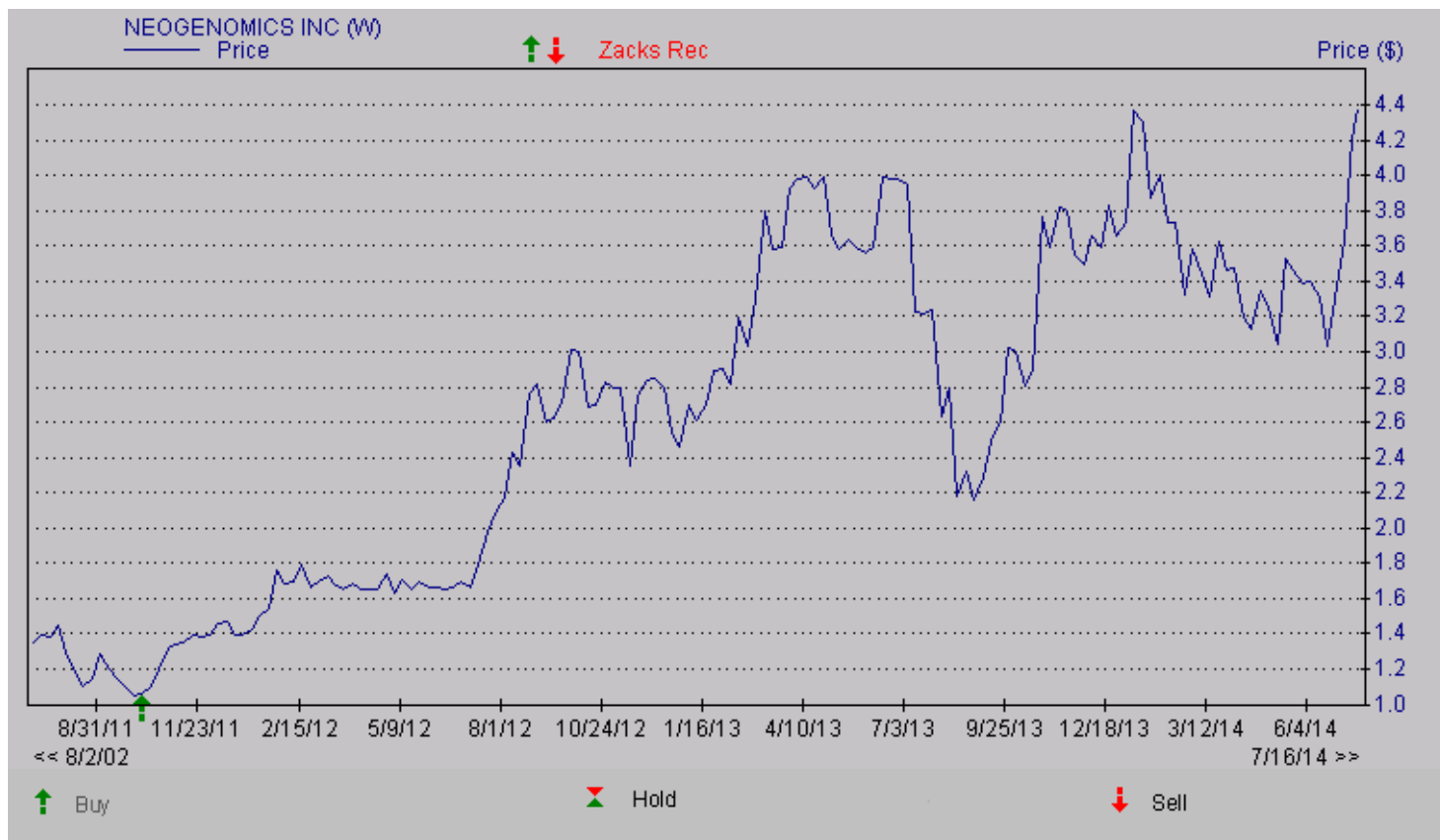
At this point, we think NEO is a stock with low risk and high return.

## PROJECTED INCOME STATEMENT

	2012 A (Dec)	2013A (Dec)					2014E (Dec)					2015E (Dec)	2016E (Dec)	2017E (Dec)
\$ in million except per share data	FYA	Q1	Q2	Q3	Q4	FYA	Q1	Q2	Q3	Q4	FYE	FYE	FYE	FYE
<b>Total Revenues</b>	<b>\$59.87</b>	<b>\$15.66</b>	<b>\$15.60</b>	<b>\$16.88</b>	<b>\$18.32</b>	<b>\$66.47</b>	<b>\$18.18</b>	<b>\$20.67</b>	<b>\$22.00</b>	<b>\$23.00</b>	<b>\$83.85</b>	<b>\$96.00</b>	<b>\$120.00</b>	<b>\$150.00</b>
YOY Growth	37.7%	3.3%	-0.1%	18.9%	23.0%	11.0%	16.1%	32.5%	30.3%	25.5%	26.2%	14.5%	25.0%	25.0%
CoGS	33.03	8.41	8.45	8.71	9.16	34.73	9.47	10.43	11.22	11.70	42.82	48.00	60.00	75.00
<b>Gross Income</b>	<b>\$26.84</b>	<b>\$7.25</b>	<b>\$7.16</b>	<b>\$8.17</b>	<b>\$9.16</b>	<b>\$31.74</b>	<b>\$8.71</b>	<b>\$10.24</b>	<b>\$10.78</b>	<b>\$11.30</b>	<b>\$41.03</b>	<b>\$48.00</b>	<b>\$60.00</b>	<b>\$75.00</b>
Gross Margin	44.8%	46.3%	45.9%	48.4%	50.0%	47.7%	47.9%	49.5%	49.0%	49.1%	48.9%	50.0%	50.0%	50.0%
SG&A	\$23.34	\$6.11	\$6.04	\$6.67	\$7.31	\$26.12	\$7.69	\$9.03	\$9.50	\$10.00	\$36.22	\$40.00	\$44.50	\$48.00
% SG&A	39.0%	39.0%	38.7%	39.5%	39.9%	39.3%	42.3%	43.7%	43.2%	43.5%	43.2%	41.7%	37.1%	32.0%
R&D	\$2.28	\$0.84	\$0.62	\$0.34	\$0.65	\$2.44	\$0.63	\$0.63	\$0.65	\$0.65	\$2.56	\$3.00	\$3.50	\$4.50
% R&D	3.8%	5.3%	3.9%	2.0%	3.5%	3.7%	3.5%	3.1%	3.0%	2.8%	3.1%	3.1%	2.9%	3.0%
<b>Operating Income</b>	<b>\$1.2</b>	<b>\$0.3</b>	<b>\$0.5</b>	<b>\$1.2</b>	<b>\$1.2</b>	<b>\$3.2</b>	<b>\$0.4</b>	<b>\$0.6</b>	<b>\$0.6</b>	<b>\$0.7</b>	<b>\$2.3</b>	<b>\$5.0</b>	<b>\$12.0</b>	<b>\$22.5</b>
Operating Margin	2.0%	1.9%	3.2%	6.9%	6.6%	4.8%	2.2%	2.8%	2.9%	2.8%	2.7%	5.2%	10.0%	15.0%
Other Net	(\$1.1)	(\$0.3)	(\$0.2)	(\$0.2)	(\$0.2)	(\$1.0)	(\$0.3)	(\$0.3)	(\$0.3)	(\$0.3)	(\$1.1)	(\$0.5)	(\$0.5)	(\$0.5)
<b>Pre-Tax Income</b>	<b>\$0.1</b>	<b>\$0.0</b>	<b>\$0.3</b>	<b>\$0.9</b>	<b>\$1.0</b>	<b>\$2.2</b>	<b>\$0.1</b>	<b>\$0.3</b>	<b>\$0.3</b>	<b>\$0.4</b>	<b>\$1.1</b>	<b>\$4.5</b>	<b>\$11.5</b>	<b>\$22.0</b>
Income taxes(benefit)	\$0.0	\$0.0	\$0.0	\$0.0	\$0.1	\$0.2	\$0.0	\$0.1	\$0.1	\$0.1	\$0.3	\$0.5	\$1.7	\$3.3
Tax Rate	0.0%	85.0%	0.0%	3.1%	11.0%	7.0%	20.9%	15.7%	30.3%	28.6%	24.5%	12.0%	15.0%	15.0%
<b>Reported Net Income</b>	<b>\$0.1</b>	<b>\$0.0</b>	<b>\$0.3</b>	<b>\$0.9</b>	<b>\$0.9</b>	<b>\$2.0</b>	<b>\$0.1</b>	<b>\$0.3</b>	<b>\$0.2</b>	<b>\$0.3</b>	<b>\$0.9</b>	<b>\$4.0</b>	<b>\$9.8</b>	<b>\$18.7</b>
YOY Growth	-	-99.5%	-50.5%	-	-	2980.3%	3300.0%	0.4%	-74.4%	-70.8%	-57.9%	362.6%	146.8%	91.3%
Net Margin	0.1%	0.0%	1.7%	5.3%	4.7%	3.1%	0.6%	1.3%	1.0%	1.1%	1.0%	4.1%	8.1%	12.5%
Diluted Shares Out	46.4	50.9	53.7	53.2	53.6	52.9	53.5	53.7	54.2	54.4	54.0	57.0	60.0	62.0
<b>Reported EPS</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.01</b>	<b>\$0.02</b>	<b>\$0.02</b>	<b>\$0.04</b>	<b>\$0.00</b>	<b>\$0.01</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.02</b>	<b>\$0.07</b>	<b>\$0.16</b>	<b>\$0.30</b>
One time charge	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$1.00
<b>Non GAAP Net Income</b>	<b>\$0.1</b>	<b>\$0.0</b>	<b>\$0.3</b>	<b>\$0.9</b>	<b>\$0.9</b>	<b>\$2.0</b>	<b>\$0.1</b>	<b>\$0.3</b>	<b>\$0.2</b>	<b>\$0.3</b>	<b>\$0.9</b>	<b>\$4.0</b>	<b>\$9.8</b>	<b>\$19.7</b>
<b>Non GAAP EPS</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.01</b>	<b>\$0.02</b>	<b>\$0.02</b>	<b>\$0.04</b>	<b>\$0.00</b>	<b>\$0.01</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.02</b>	<b>\$0.07</b>	<b>\$0.16</b>	<b>\$0.32</b>

Source: Company filings and Zacks Investment Research

## HISTORICAL ZACKS RECOMMENDATIONS



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Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

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