

## NeoGenomics Inc. (NEO-NASDAQ)

**NEO: record revenue reported for 3Q13, accelerated growth expected in 2014-- Outperform**

### OUTLOOK

NeoGenomics just reported record revenue for 3Q13 which also beat our estimate. Balance sheet remains strong.

Management has done a great job to limit the impact of the TC Grandfather Clause expiration and Medicare reimbursement by increasing test volume, launching new products, and saving costs. Going forward, revenue will continue to grow in the remainder of 2013 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 (10/22/13)	\$2.99
<b>Twelve- Month Target Price</b>	<b>\$7.00</b>

### SUMMARY DATA

52-Week High	\$4.17
52-Week Low	\$2.10
One-Year Return (%)	8.73
Beta	0.95
Average Daily Volume (sh)	142,062

Shares Outstanding (mil)	49
Market Capitalization (\$mil)	\$146
Short Interest Ratio (days)	8.09
Institutional Ownership (%)	1
Insider Ownership (%)	43

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)
2012	15.2 A	15.6 A	14.2 A	14.9 A	59.9 A
2013	15.7 A	15.6 A	16.9 A	17.8 E	65.9 E
2014					73.5 E
2015					95.0 E

#### Earnings per Share

(EPS is operating earnings before non recurring items)

	Q1	Q2	Q3	Q4	Year
	(Mar)	(Jun)	(Sep)	(Dec)	(Dec)
2012	\$0.01 A	\$0.01 A	-\$0.02 A	-\$0.00 A	\$0.00 A
2013	\$0.00 A	\$0.01 A	\$0.02 A	\$0.01 E	\$0.04 E
2014					\$0.07 E
2015					\$0.17 E

Zacks Projected EPS Growth Rate - Next 3 Years % **111**

## WHAT'S NEW

- **Record Revenue reported for 3Q13, beating our estimate;**
- **We raise our estimates for 4Q13 and the fiscal year of 2013;**
- **Balance sheet remains strong;**
- **Maintain Outperform rating and reiterate price target of \$7.00 per share;**

### ***Record Revenue Reported for Third Quarter of 2013***

NEO recorded revenue of \$16.9 million for the third quarter 2013, an 18.9% increase from third quarter 2012 revenue. Third quarter revenue 2013 also beat our estimate of \$16.0 million.

The company achieved test volume increase of 19.1% year over year, while average revenue per test was largely unchanged. Average cost per test declined by 12% as a result of continued productivity improvements, increased leverage from higher volumes, and other cost containment initiatives. As a result, gross profit increased by 38.7% from the prior year and gross margin improved by 16.6% (48.4% in 3Q13 vs 41.5% in 3Q12).

Solid growth in test volume for 3Q13 was driven by continued success with new products and growth in the number of customer accounts. The productivity of sales team improved with gains in all geographic territories across the country. NEO added five sales representatives and two product managers during the third quarter to further accelerate growth.

Total operating expenses increased by 6.6% from last year's third quarter, primarily as a result of additional sales representatives and increases in billing and information technology expenses. This was partially offset by a decrease in stock compensation expenses related to the decline in the Company's stock price for the quarter.

Net income for the quarter was \$900,000, or \$0.02 per share, versus a net loss of \$(975,000), or \$(0.02) per share, in last year's third quarter.

Adjusted EBITDA improved by 157% to \$2.2 million for the quarter from \$842,000 last year.

We think NEO is continuing making progress in achieving its financial goals for the year 2013 and beyond. NEO recorded record revenue for the 3Q13, despite the TC Grandfather Clause expiration and significant Medicare reimbursement changes as compared to last year. 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.

Due to the decrease of non-cash stock option expense for the 3Q13, R&D expense decreased to \$0.34 million for 3Q13, compared to \$0.81 million for 3Q12. As always, NEO is committed to R&D spending and new products offering. 36 new tests have been launched so far this year, and these new products have contributed to the top line growth significantly.

NEO continues to strengthen its sales team by adding new experienced sales professionals. The Company now has a total of 26 sales representatives covering the country and plans to hire additional 46 sales reps in the next 13 months or so to expand its marketing efforts. At the same time, the Company is focused on continuously improving laboratory operations and driving down costs. NEO also has increased its investment in Information Technology and expect to make significant improvements in electronic ordering and other methods to increase efficiencies. As a result of these initiatives, the Company drove a 12% reduction in average cost-per-test in 3Q13 over the same period of last year and improved gross margins to 48.4% for 3Q13 from 41.5% for 3Q12.

NEO is in the process of redesigning and expanding its Fort Myers, Florida laboratory to incorporate lean workflow concepts and improved automation. This new lab is expected to be completed in the first quarter of 2014 and will yield further process improvements down the road.

### Summary of Quarterly Performance

(\$, 000's)	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13
<b>Total Revenue</b>	11,320	12,893	15,160	15,611	14,202	14,893	15,657	15,603	16,884
<b>% Growth</b>	30.0%	47.3%	72.2%	49.2%	25.5%	15.5%	3.3%	-0.1%	18.9%
<b>Gross Margin</b>	44.8%	45.2%	47.1%	47.2%	41.5%	43.2%	46.3%	45.9%	48.4%
<b>SG&amp;A as a % of Revenue</b>	44.5%	42.3%	38.2%	38.4%	40.6%	38.9%	39.0%	38.7%	39.5%
<b>Net Income (Loss)</b>	(\$143.0)	\$152.0	\$603.0	\$839.0	(\$975.0)	(\$113.0)	\$3.0	\$273.0	\$929.0
<b>Diluted EPS</b>	(\$0.00)	\$0.00	\$0.01	\$0.01	(\$0.02)	\$0.00	\$0.00	\$0.01	\$0.02
<b>Adjusted EBITDA</b>	\$693.0	\$1,055.0	\$1,775.0	\$1,943.0	\$842.0	\$1,439.0	\$1,794.0	\$1,825.0	\$2,163.0
<b>Test Volume</b>	19,978	22,557	26,932	28,846	28,315	30,513	32,088	32,519	33,723
<b>% Growth</b>	38.0%	57.2%	74.9%	57.1%	41.7%	35.3%	19.1%	12.7%	19.1%
<b>Average Price/Test</b>	567.00	571.59	562.89	541.20	501.58	488.09	488.00	480.00	501.00
<b>% Growth</b>	-5.8%	-6.3%	-1.6%	-5.1%	-11.5%	-14.6%	-13.3%	-11.3%	-0.1%

### Summary of Annual Performance

\$, 000's	2009	2010	2011	2012	2013E	2014E	2015E	2016E
<b>Total Revenue</b>	29,469	34,371	43,484	59,866	65,944	73,500	95,000	125,000
<b>% Growth</b>	47.2%	16.6%	26.5%	37.7%	10.2%	11.5%	29.3%	31.6%
<b>% Growth Adjusted *</b>	70.0%	25.4%						
<b>Gross Margin</b>	51.6%	45.9%	44.7%	44.8%	47.4%	48.0%	47.0%	47.0%
<b>SG&amp;A as a % of Revenue</b>	57.5%	54.5%	45.6%	39.0%	39.1%	36.7%	31.1%	26.0%
<b>Net Income (Loss)</b>	(2,243.0)	(3,303.0)	(1,177.0)	66.0	1,876.0	4,100.0	9,950.0	19,750.0
<b>Diluted EPS</b>	(0.06)	(0.09)	(0.03)	0.00	0.04	0.07	0.17	0.33
<b>Adjusted EBITDA</b>	103.0	(566.0)	2,134.0	5,999.0	7,982.0	9,500.0	11,450.0	21,250.0
<b>Test Volume Growth</b>	39.1%	25.5%	33.1%	50.2%	15.9%	20.0%	25.0%	30.0%

### Continued Growth Expected for 4Q13 and Beyond

NEO also issued guidance for 4Q13 and fiscal year 2013:

The company expects revenue of \$17.6-\$18.1 million and earnings of \$0.01 to \$0.02 per share in Quarter 4. For the full year 2013, NEO expects revenue to be \$65.7-\$66.2 million with earnings per share of \$0.03 to \$0.04.

Based on the strong performance of 3Q13, we expect revenue will continue to grow in 4Q13 and beyond. Specifically, we expect revenue of 4Q13 of \$17.8 million, vs our previous estimate of \$16.8. For fiscal year 2013, our new estimate of revenue is \$65.9 vs our previous estimate of \$64.0.

For fiscal 2014, revenue will grow to \$74 million, an increase of 12%. Revenue will reach \$125 million in fiscal 2016, a compound annual growth rate (CAGR) of 20% from 2012 to 2016. Earnings per share will grow to \$0.33 per share in fiscal 2016.

### ***Balance Sheet Remains Strong***

In February, 2013, NEO did an underwritten public offering of 3.15 million shares of common stock at a price to the public of \$3.00 per share.

Of the shares offered, NeoGenomics is selling 2.85 million shares and a selling stockholder, The Mary S. Dent Gifting Trust, is selling 300,000 shares. The transaction resulted in net proceeds to NeoGenomics of about \$7.8 million.

We are pleased that NEO has landed this new financing with favorable terms. The offering price was close to the market price then, and no other strings added to the common stock.

This financing greatly boosted the Company's balance sheet.

As of September 30, 2013, NeoGenomics had \$4.9 million in cash with little debt. With the current cash, NEO will be able to focus on its long term growth strategy without concern about short term cash strain.

With all these in mind, we believe the Company is poised to grow dramatically in 2014 and beyond.

### ***Valuation is still Attractive at Current Level***

We continue to rate NEO shares a Buy and maintain our price target of \$7.00 per share.

Since we initiated coverage of NeoGenomics in early October 2011 at \$1.15 per share, price has appreciated 188% as of this writing. But we think there is still room for further price appreciation.

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 \$59.9 million in 2012, a tremendous 39% compound annual growth rate (CAGR) for the five-year period. We estimate revenue will further grow to \$125 million in 2016, a CAGR of 20% from 2013 to 2016.

We are also impressed by the Company's strong balance sheet, which is in contrast with weak balance sheets from most small cap biotech companies. NeoGenomics held \$4.9 million in cash as of September 30, 2013 with little debt. With profitability at its fingertips, the Company should be able to focus on its long term strategic development plan without fearing short term cash strains.

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.

Although price has appreciated about 188% since our initiation in early October 2011, there is still room for further price appreciation in our view. Based on NeoGenomics strong fundamentals, we think the shares of NeoGenomics are still undervalued at current market price. Currently, NEO is trading at about \$3.0 per share which values the Company at \$150 million in market cap based on 49 million shares outstanding. This is still a discount compared to its peers. Based on our financial model, revenue will grow at 20% CAGR from 2013 to 2016. We think NEO should trade at 35 x P/E multiple. If we use this P/E multiple, coupled with our estimated EPS of \$0.33 in 2016, discounted at 20% for three years, we come up with a price target of \$7.0 per share. This will value NEO at \$350 million in market cap which we think is still conservative.

We still think NEO is 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. If acquired by big players, share price of NEO may soar.

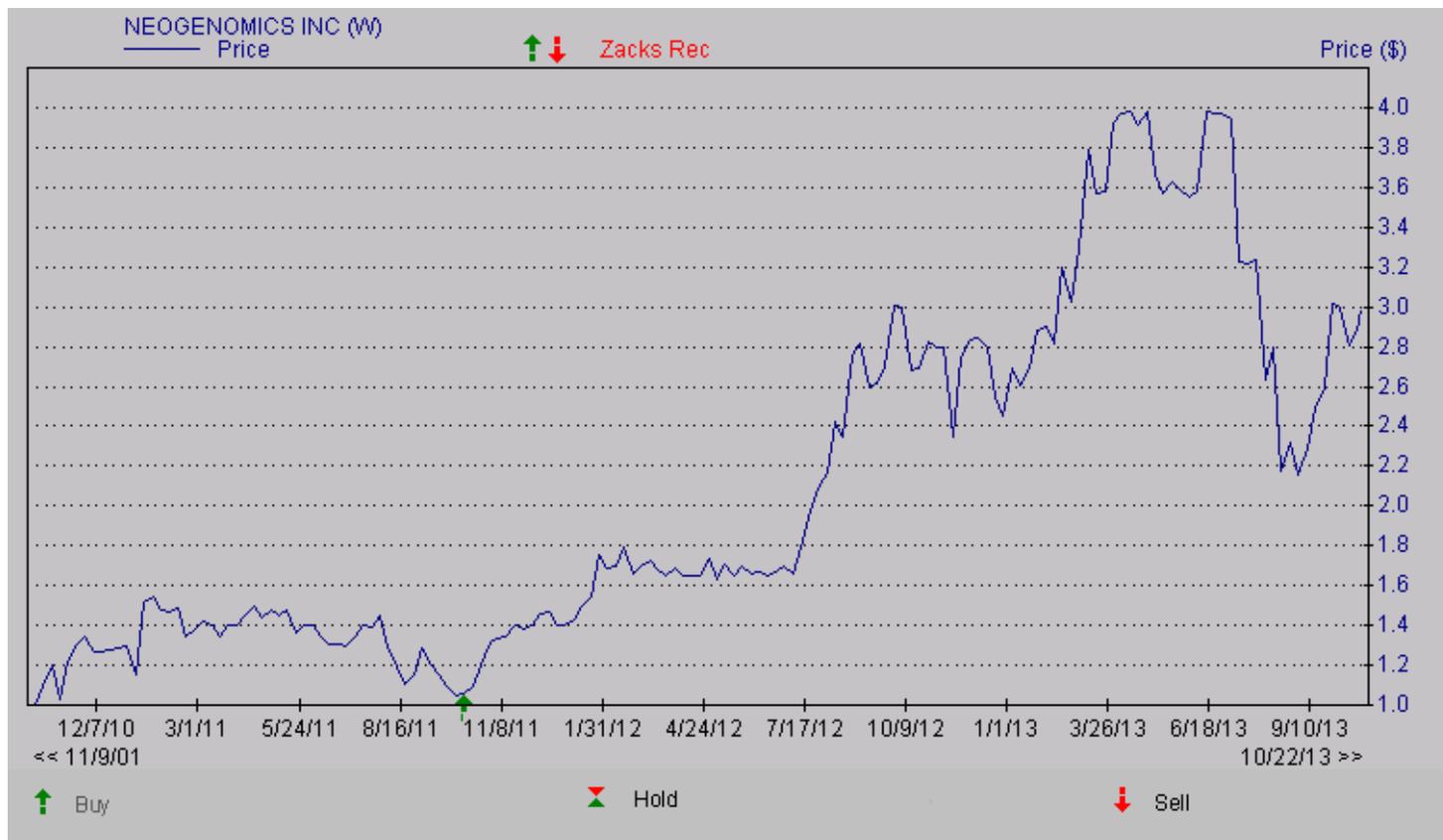
At this point, we think NEO is a stock with low risk and high return.

## PROJECTED INCOME STATEMENT

	2010A (Dec)	2011A (Dec)	2012A (Dec)					2013E (Dec)					2014E (Dec)	2015E (Dec)	2016E (Dec)
\$ in million except per share data	FYA	FYA	Q1	Q2	Q3	Q4	FYA	Q1A	Q2A	Q3A	Q4E	FYE	FYE	FYE	FYE
<b>Total Revenues</b>	<b>\$34.37</b>	<b>\$43.48</b>	<b>\$15.16</b>	<b>\$15.61</b>	<b>\$14.20</b>	<b>\$14.89</b>	<b>\$59.87</b>	<b>\$15.66</b>	<b>\$15.60</b>	<b>\$16.88</b>	<b>\$17.80</b>	<b>\$65.94</b>	<b>\$73.50</b>	<b>\$95.00</b>	<b>\$125.00</b>
YOY Growth	16.6%	26.5%	72.2%	49.2%	25.5%	15.5%	37.7%	3.3%	-0.1%	18.9%	19.5%	10.2%	11.5%	29.3%	31.6%
CoGS	18.59	24.06	8.02	8.24	8.31	8.46	33.03	8.41	8.45	8.71	9.10	34.67	38.20	50.35	66.25
<b>Gross Income</b>	<b>\$15.78</b>	<b>\$19.43</b>	<b>\$7.14</b>	<b>\$7.37</b>	<b>\$5.89</b>	<b>\$6.43</b>	<b>\$26.84</b>	<b>\$7.25</b>	<b>\$7.16</b>	<b>\$8.17</b>	<b>\$8.70</b>	<b>\$31.27</b>	<b>\$35.30</b>	<b>\$44.65</b>	<b>\$58.75</b>
Gross Margin	45.9%	44.7%	47.1%	47.2%	41.5%	43.2%	44.8%	46.3%	45.9%	48.4%	48.9%	47.4%	48.0%	47.0%	47.0%
SG&A	\$18.75	\$19.84	\$5.79	\$6.00	\$5.77	\$5.79	\$23.34	\$6.11	\$6.04	\$6.67	\$7.00	\$25.81	\$27.00	\$29.50	\$32.50
% SG&A	54.5%	45.6%	38.2%	38.4%	40.6%	38.9%	39.0%	39.0%	38.7%	39.5%	39.3%	39.1%	36.7%	31.1%	26.0%
R&D	\$0.00	\$0.00	\$0.50	\$0.53	\$0.81	\$0.45	\$2.28	\$0.84	\$0.62	\$0.34	\$0.70	\$2.49	\$3.40	\$4.50	\$5.50
% R&D	-	-	3.3%	3.4%	5.7%	3.0%	3.8%	5.3%	3.9%	2.0%	3.9%	3.8%	4.6%	4.7%	4.4%
<b>Operating Income</b>	<b>(\$3.0)</b>	<b>(\$0.4)</b>	<b>\$0.9</b>	<b>\$0.8</b>	<b>(\$0.7)</b>	<b>\$0.2</b>	<b>\$1.2</b>	<b>\$0.3</b>	<b>\$0.5</b>	<b>\$1.2</b>	<b>\$1.0</b>	<b>\$3.0</b>	<b>\$4.9</b>	<b>\$10.7</b>	<b>\$20.8</b>
Operating Margin	-	-0.9%	5.7%	5.4%	-4.8%	1.3%	2.0%	1.9%	3.2%	6.9%	5.6%	4.5%	6.7%	11.2%	16.6%
Other Net	(\$0.3)	(\$0.8)	(\$0.3)	(\$0.3)	(\$0.3)	(\$0.3)	(\$1.1)	(\$0.3)	(\$0.2)	(\$0.2)	(\$0.3)	(\$1.0)	(\$0.8)	(\$0.5)	(\$0.5)
<b>Pre-Tax Income</b>	<b>(\$3.3)</b>	<b>(\$1.2)</b>	<b>\$0.6</b>	<b>\$0.6</b>	<b>(\$1.0)</b>	<b>(\$0.1)</b>	<b>\$0.1</b>	<b>\$0.0</b>	<b>\$0.3</b>	<b>\$0.9</b>	<b>\$0.7</b>	<b>\$1.9</b>	<b>\$4.1</b>	<b>\$10.2</b>	<b>\$20.3</b>
Income taxes(benefit)	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.2	\$0.5
Tax Rate	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	2.4%	0.0%	2.0%	2.5%
<b>Reported Net Income</b>	<b>(\$3.3)</b>	<b>(\$1.2)</b>	<b>\$0.6</b>	<b>\$0.6</b>	<b>(\$1.0)</b>	<b>(\$0.1)</b>	<b>\$0.1</b>	<b>\$0.0</b>	<b>\$0.3</b>	<b>\$0.9</b>	<b>\$0.7</b>	<b>\$1.9</b>	<b>\$4.1</b>	<b>\$10.0</b>	<b>\$19.8</b>
YOY Growth	-	-64.4%	-	-	-	-174.3%	-	-99.5%	-50.5%	-	-	2742.4%	118.6%	142.7%	98.5%
Net Margin	-	-2.7%	4.0%	3.5%	-6.9%	-0.8%	0.1%	0.0%	1.7%	5.3%	3.9%	2.8%	5.6%	10.5%	15.8%
Diluted Shares Out	37.3	43.2	47.4	47.7	45.2	45.3	46.4	50.9	53.7	53.2	55.0	53.2	55.0	57.0	60.0
<b>Reported EPS</b>	<b>(\$0.09)</b>	<b>(\$0.03)</b>	<b>\$0.01</b>	<b>\$0.01</b>	<b>(\$0.02)</b>	<b>(\$0.00)</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.01</b>	<b>\$0.02</b>	<b>\$0.01</b>	<b>\$0.04</b>	<b>\$0.07</b>	<b>\$0.17</b>	<b>\$0.33</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	\$0.00	\$0.00
<b>Non GAAP Net Income</b>	<b>(\$3.3)</b>	<b>(\$1.2)</b>	<b>\$0.6</b>	<b>\$0.6</b>	<b>(\$1.0)</b>	<b>(\$0.1)</b>	<b>\$0.1</b>	<b>\$0.0</b>	<b>\$0.3</b>	<b>\$0.9</b>	<b>\$0.7</b>	<b>\$1.9</b>	<b>\$4.1</b>	<b>\$10.0</b>	<b>\$19.8</b>
<b>Non GAAP EPS</b>	<b>(\$0.09)</b>	<b>(\$0.03)</b>	<b>\$0.01</b>	<b>\$0.01</b>	<b>(\$0.02)</b>	<b>(\$0.00)</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.01</b>	<b>\$0.02</b>	<b>\$0.01</b>	<b>\$0.04</b>	<b>\$0.07</b>	<b>\$0.17</b>	<b>\$0.33</b>

Source: Company filings and Zacks Investment Research

## HISTORICAL ZACKS RECOMMENDATIONS



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