NeoGenomics Q1
2017 Conference Call Script

Opening Remarks

The conference call operator announces the Quarter 1 2017 conference call for NeoGenomics, Inc. and turns it over to Douglas VanOort, the Chairman and Chief Executive Officer of NeoGenomics.

Doug VanOort

Good morning. I'd like to welcome everyone to NeoGenomics' First Quarter 2017 conference call.

To begin, I'd like to introduce you to the NeoGenomics team here with us today.

Joining me in our Fort Myers headquarters is Steve Jones, our Executive Vice President, George Cardoza, our Senior Vice President and Chief Financial Officer, Fred Weidig, our Vice President of Finance, Jessica King, our Director of External Reporting, and Rob Shovlin, President of our Clinical Services Division.

Dr. Maher Albitar, our Senior Vice President, Chief Medical Officer and Director of R&D, is joining us from our Aliso Viejo lab in California.

And importantly, I'd like to welcome Bill Bonello, who has been on many of these calls but who is joining us for the first time on this side of the line as our recently appointed Vice President, Treasurer and Director of Corporate Development.

Before we begin our prepared remarks, Steve Jones will read the standard language about Forward-Looking Statements.

Steve Jones

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 it back to Doug, I want to let everyone know that based on popular demand, beginning with this call we will be making a copy of our transcript 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 that we give everyone a chance to ask questions within the one hour we have allotted for this call.

Doug's Comments

Thank you Steve.

In this morning's conference call, I will comment briefly on the company's first quarter performance, discuss the completion of our significant Integration activities, and review our initiatives, opportunities and expectations for the rest of the year.

Quarter 1 Financial Performance

Summary

Quarter 1 financial performance was largely in line with our expectations, although it was certainly not what we would expect to deliver under normal operating conditions.

During the Quarter, we were laser focused on completing the important remaining integration activities, all while maintaining high service levels. I'm pleased to report that the Integration of Clarient is now 100% complete. However, the intensive Integration work affected each month of the quarter and temporarily disrupted our business more that we would have liked.

Revenue Dynamics

Despite the fact that our sales force devoted a significant amount of their attention to helping clients manage through the Integration change process, test volume grew by over 15% compared with last year to our highest levels ever. The mix of testing was less profitable though, with a 40% increase in histology testing driven partly by significant increases in the immuno-oncology test for PD-L1.

As a result of the product mix change, average Revenue per Test was down 9% and consolidated revenue was only 3% higher than last year. Since we closed the Clarient acquisition, revenue has been relatively stable. Growth from new clients has been subdued as our efforts have been primarily focused on transitioning all our existing clients to a single laboratory process rather than on new growth. However, now that the Integration is behind us, we expect to more aggressively convert the customers in our pipeline and return to more normal and balanced test mix growth.

Cost Dynamics

Aided by the higher mix of lower-cost histology testing, cost per test declined by 10% to the lowest levels ever achieved. However, even at those lower levels, our Quarter 1 Cost-per-Test was higher than what we believe it should be under normal operating conditions. Our first Quarter costs were impacted by significant increases in overtime and inefficiencies associated with winding down activities at the Irvine CA Lab and consolidating all Southern California testing in our newly renovated Aliso Viejo Lab.

Despite these disruptions to our operations, the productivity of our Lab personnel in the first quarter increased to the highest level ever.

Profitability

These massive disruptions also put pressure on operating margins in the quarter, with Adjusted EBITDA falling to $7.1 million or 11.5% of revenue. Revenue recognition was also impacted by the timing of our CA Lab facility move, which occurred during the very last week of the Quarter.

Customer Appreciation

Before continuing with my prepared remarks, I would like to take a moment and thank our clients for their patience over the last year as we've integrated Clarient and made changes to standardize our product offerings. Change is never easy, but we are now finished, and we are returning very rapidly to the exceptional service levels to which you were accustomed prior to the integration. We know that many of our clients listen to these calls, and on behalf of all of NEO employees, I want to express our heartfelt appreciation for you and thank you for your loyalty.

We are getting stronger every day, and we are committed to delivering exceptional service to you, and your patients, on a consistent basis, all of the time.

Integration

In order to more fully understand our Quarter 1 performance, I would like now to provide more insight about the Integration of the Clarient business.

We are all very pleased – employees, clients, and investors - that the Clarient Integration is now done. This has been our most significant focus area during the past 5 quarters. It's important for all investors to view our first quarter results in the larger context of these accomplishments and how well they position us to grow and realize synergies.

"The Move"

Let's start by describing "The Move". The single most important event of the quarter was successfully executing the move of our fully functioning, and extremely busy, Irvine Laboratory operations into the newly renovated Aliso Viejo Lab facility. Several key activities needed to be accomplished flawlessly in order for this to be successful.

- First, the Aliso Viejo facility itself needed to have all construction completed. Despite construction delays, our teams worked to have the facility ready by March 25th – the last weekend of the quarter.

- Second, well-planned and detailed hour-by-hour plans to move all of Irvine's expensive and finely-calibrated instrumentation to Aliso Viejo needed to happen flawlessly on March 26th and 27th while simultaneously meeting our client's requirements. Testing was carefully choreographed between the sites in order to deliver test results to clients during this process.

- Third, we needed to move all our computer systems and network infrastructure - essentially unplugging everything, and reinstalling hundreds of servers and computers – and having it up and running again in a new location within a 24 hour period.

- Fourth, we had to successfully navigate the cultural differences to combine two previously competitive Laboratory and Medical teams into one team in one location, and have everyone seated and fully functioning on Monday morning, March 27th.

That was a massive undertaking. There are thousands of details involved in a move this complex, and it was fraught with risk. I am extremely pleased with our team's performance. They planned and executed the move flawlessly, and demonstrated what NeoGenomics is capable of achieving. I personally was in Aliso Viejo the day after the move, and you would hardly have known that "the Move" had just happened. I couldn't have been more proud of our team!

Aliso Viejo Lab

Those of you attending our Annual Shareholders Meeting and Investors' Day on May 25th will be able to tour our newly renovated Aliso Viejo Lab facility – and it's impressive. You will see over 50 Automated Immunohistochemistry instruments, a large number of sophisticated digital Image Analysis platforms, over 20 Automated FISH and Cytogenetics instruments, nearly a dozen advanced Flow Cytometers, a large number of Next Generation Sequencers and other molecular instrumentation, and much more.

You will also see one of the largest groups of highly-trained, engaged, and motivated employees, ever to staff a sophisticated Pathology Lab. We invested several million dollars into the Aliso Viejo facility and it truly is a first-class laboratory with a great team of laboratory professionals.

Employee retention and Culture Change

Retention of our great team of Laboratory Professionals is very important. Our people and our Culture are vital to our success, and are our number one asset. Therefore, we've made significant efforts to retain our key people and stay focused on our Mission and Values.

In particular, we have made a number of changes to our Commercial structure, Operations structure, and in Finance. Our efforts have included reassigning people to more appropriate roles, realigning people in better teams, promoting people, training people, encouraging growth, and making other changes necessary to strengthen our team. All of this has prepared us for the next stage of growth.

We are also in the hunt for additional talent, and intend to build a "Dream Team" capable of capitalizing on the many opportunities we have in our business. Our appointment of Bill Bonello as an Officer of NeoGenomics, is an example of our efforts to strengthen our finance team. We are actively recruiting for more great people to join our team as well.

We're pleased that retention of our key employees has been excellent, and that our efforts around culture are working, and that our people are engaged, excited, and motivated.

Client retention

Client retention is vitally important to us as well, and this also has been a key area of focus during this past 15 month Integration period. Throughout the past year, we've made many changes impacting our clients to standardize product offerings and improve our laboratory information system.

Our Sales and customer-facing teams worked very hard to manage through these changes with clients, and they have done a remarkable job. We are fortunate to be able to report that, as of today, we have retained nearly all of our clients.

We are now working hard to return to the consistently rapid turnaround times and strong service levels for which we are known --- and we are making good progress. We still have SWAT teams in place and extra effort is being made in this area, but we've made excellent strides and are intently focused.

Billing

I also want to comment briefly on the status of Billing, which was also affected by the Integration.

I mentioned on our last call that our billing operations were stressed in the fourth quarter of last year, which resulted in a large backlog of unbilled claims at year end. This was the result of significant changes in billing operations as we shifted all Clarient clients to the NeoGenomics billing system.

On the surface, it appears that billing may still be moving in the wrong direction in Quarter 1. Days Sales Outstanding ended the quarter at nearly 90 days compared with 85 days reported three months ago at year end 2016.

However, I want to assure you. Billing is not moving in the wrong direction – in fact, it's a lot better than the DSO number would suggest. Three months ago, we had over 33,000 unbilled tests in our system representing about 21 days worth of unbilled work. At the end of Quarter 1, our teams had reduced that to about 20,000 unbilled tests, representing about 11 days of unbilled work. As of today the backlog is even lower still and is back to pre-integration levels.

We have made additional hires and corrected a number of procedural issues. We still have work to do in our Billing processes, but Billing is getting back to its normal rhythm - claims are going out on time, teams are working hard on detailed processes, and cash is beginning to come in. We expect DSO's to begin to come down in Quarter 2 and to reach more normal levels in the second half of 2017.

Our finance and billing teams are doing a remarkable job, and we appreciate them and their work.

Summary

I'd like to summarize my comments about the Integration by saying "It certainly wasn't easy"; but, in just 15 months, we successfully assimilated a larger company, with a similar sized clinical lab operation, into NeoGenomics.

With the integration now complete, every customer is being serviced from a single laboratory information system and a common billing system – and all by one highly-dedicated group of NeoGenomics team members.

We're very happy it's done, and this is the very last quarterly earnings call that we are going to talk about Integration.

Getting back to growth

Now, I want to comment about getting back to growth. I've commented previously about the strength of our Sales team, and historically we've demonstrated industry leading levels of growth and market share gains. Since the acquisition, that growth has abated somewhat as our teams have focused largely on managing change for our existing clients during the integration period, rather than focusing on and closing new clients. Thus, our growth has come largely from existing clients ordering more IHC and molecular tests.

Our Sales team is now beginning to get back to what it does best and that's sell. In fact, they can't wait. Pipelines are in good shape, and with our operations and service levels getting back to normal, they are ready to execute once again on their growth strategies. We expect this activity to begin to ramp up and begin to show better year over year revenue growth as the year unfolds.

Histology Mix and Account Profitability

We had 15% test volume growth during Quarter 1, but that growth was not as tightly managed as is normal for us. Many clients came to NeoGenomics because of our capability in histology and PD-L1 testing – and our mix of business became somewhat different than we have had in the past.

With more stable and normal operations, we are beginning to, once again, more actively manage our mix of business. Now that all clients are being serviced from the same systems and under the same processes, we have the necessary information to better analyze and evaluate profitability of our client relationships.

We're going to get back to our normal process now to ensure acceptable levels of profitability by client. Clients that use our services for only one testing line – especially for histology-only testing – will be introduced more assertively to our comprehensive test menu as a way to improve both growth and profitability.

What I'm excited about

Pharma Services

Finally, I want to comment on a number of areas that I am excited about, beginning with our Pharma Services Division.

Pharma services revenue was essentially flat at $5 million during the quarter. In fact, it's been flat for the past three quarters. During that time, we rebuilt our Sales team and invested in other areas needing attention. We have a strong capability in immuno-oncology testing and molecular diagnostics. As a result, we are winning contracts and building our reputation for quality and innovation in this dynamic market.

Encouragingly, our backlog of signed contracts is growing. At the end of the first quarter, our backlog grew to $41.5 million, up from $37 million at year end, and up 75% from Quarter 1 of 2016. We expect this to begin to result in higher levels of revenue and profitability in coming quarters.

Our plans to open a new Lab near Geneva, Switzerland to support European Clinical Trials are also moving along nicely. Recently, we received notification that our application for a ten year tax-holiday was approved. We are excited about being able to offer our services outside the United States, and our clients seem to be excited as well. We continue to expect the Geneva Lab to be fully operational in the second half of this year.

We believe strongly that our Pharma Services business has great long-term growth potential, and we are planning to invest in it. The Pharma business is important to our diversification, and it has the added benefit of helping NeoGenomics stay at the forefront of medical and scientific developments in the field of Oncology.

Building our business for the future

I am also excited and looking forward to moving our attention, once again, to growth as a result of innovation and great service --- and to being operationally disciplined to translate revenue growth into earnings and cash flow growth.

As we've discussed in other conference calls, we believe we have tremendous opportunities to:

- Take Market share in a growing market.
- Cross-sell to capitalize on our comprehensive oncology test menu.
- Partner with Oncology groups.
- Grow the Pharma Services business.
- Develop and commercialize Liquid biopsy tests.
- Develop Information products based on our vast oncology database.
- Add testing for early detection, predisposition testing and treatment monitoring.
- Capture cost synergies from the Clarient acquisition.
- Automate our laboratories, and
- Participate in the future consolidation of our industry.

Each one of these 10 areas are opportunities that we are actively pursuing. We believe that individually and collectively these opportunities can create a lot of value for our clients, for patients, and for our investors.

Doug transitions to Steve.

Now we're going to turn the floor over to Steve Jones, our Executive Vice President and Director of Investor Relations, to review first quarter results in more detail and lead us through a Q&A Session.

Steve's Comments

Thanks Doug.

Before we open it up for questions, I would like to briefly touch on a few financial highlights from the quarter.

First Quarter Review

First quarter revenue was $61.7 million, a 3% increase over the prior year, and in-line with our expectations for the quarter. Clinical genetic testing revenue increased 4.5% over the prior year to approximately $55.1 million; PathLogic revenue decreased 16% to approximately $1.6 million; and Pharma Services revenue decreased 2% to approximately $5.0 million.

Average Revenue per Test was $354, which was 9.4% below the prior year and 3% below the Quarter 4 level. This was slightly below our expectations and was the result of continued mix changes. In addition, Quarter 1 was the first quarter that we had all tests being billed out of the same billing system for the entire quarter. When we migrated the Clarient clients to the NEO billing system, we had to standardize pricing with the NEO pricing. In many cases we had to bring certain Clarient prices up to where the NEO pricing was, and in other cases, we had to bring certain prices down.

Now that we have a good baseline for where our overall average Revenue per Test has settled, we believe it is prudent to reset expectations for average Revenue per Test in the clinical genetic testing business to $345 - $355. Recall that on our last call, we thought that we would be somewhere in the $355 - $360 range for the full year 2017.

Consolidated gross margin was 44.1%, a 140 basis point decrease from the 45.5% reported in Q1 2016. This decrease in gross margin was driven primarily by the negative gross margin at PathLogic, but also by underutilization in the Pharma Services Division.

It is important to note that our gross margin in the clinical genetic testing business has not been impacted at all by the recent reduction in average Revenue per Test. In fact, the gross margin for this business was up at about 10 basis points year over year to 47.5% in Q1, because the 9.4% reduction in average Revenue per Test was more than offset by the 9.7% reduction in average Cost per Test. Incidentally, the $186 Cost per Test in Q1 was the lowest in our history, and it would have been even lower were it not for the added costs of overtime and other inefficiencies created by integration activities and the move.

As mentioned in the press release, now that the integration is complete, we expect to unlock the additional cost synergies from having all clients on one Laboratory Information System and one billing system and having all of our Orange County, California employees in the same facility. As a result we expect that average Cost per Test will continue to fall and our clinical genetic gross margin will continue to expand. We believe that this combined with growth in our Pharma Services division will drive consolidated gross margin higher over the course of the year.

Consolidated SG&A costs increased by $2.0 million, or 8% from Q1 2016, primarily as a result of increased personnel, bad debt and depreciation costs. Bad debt has been higher than normal for the past two quarters as a result of normalizing the reserves for former Clarient clients now that they are on the NeoGenomics billing system. We expect bad debt reserves as a percent of revenue to return to more normal levels as 2017 progresses.

Adjusted EBITDA decreased by 14% year-over-year to a $7.1 million in Quarter 1, which was slightly below our guidance due to higher than expected inefficiencies and overtime charges incurred in connection with the move. Now that the integration is complete, we expect visibility into Adjusted EBITDA to improve as the year progresses.

First Quarter GAAP net loss available to common shareholders was ($3.2) million compared to ($5.4) million in the first quarter of last year, and Diluted EPS was ($0.04) per share versus ($0.07) per share last year. These reductions were largely driven by a reduction of preferred stock charges as a result of redeeming 55% of the Series A Preferred Stock last December.

As disclosed in the press release and in previous earnings calls, 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 (loss) available to common shareholders to exclude 1) non-cash amortization of intangibles, 2) non-cash stock-based compensation expenses that are partially driven by changes in the Company's underlying stock price in any given quarter, 3) non-cash, deemed preferred stock dividends required by GAAP accounting, 4) non-cash amortization of the beneficial conversation feature related to the preferred stock that is also required by GAAP accounting, and, if applicable in a reporting period any non-cash impairments of intangible assets, acquisition related transaction expenses, debt termination fees, and other one-time or non-recurring income or loss items. 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 this is calculated in our earnings release.

In the first quarter, Adjusted Net Income was $2.6 million, an 11.7% decrease from the $2.9 million reported in last year's first quarter. And Adjusted Diluted EPS was $0.03 per share compared to $0.03 per share in Q1 2016.

We finished the first quarter with 1,012 full-time equivalent employees, contract doctors, and temps, versus 969 as of December 31, 2016. This is a milestone for NeoGenomics as we now have over 1,000 employees processing over 600,000 tests on an annualized basis. During Quarter 1, we added an additional 32 laboratory personnel and 9 sales, and marketing and customer care personnel to help with client integration activities. Notably, we hired 10 IHC technicians in Aliso Viejo and another 5 since the end of the quarter to help with the increased IHC volumes.

Before opening it up for questions, I would like to comment briefly on the Quarter 2 and revised full-year 2017 guidance we issued this morning. Given the difficulty of the Integration efforts and the lower than expected Average Revenue per Test in our core clinical genetic testing business, we believe it is prudent to lower growth expectations in Quarter 2 and for the full year 2017.

We expect Quarter 2 revenue to be in the range of $62 - $64 million and GAAP Diluted EPS to be a loss of ($0.04) – ($0.03) per share. We expect Adjusted EBITDA to be $8 - $10 million and Adjusted Diluted EPS to be positive $0.03 - $0.04 per share.

For the full year 2017, we now expect revenue to be in the range of $255 - $265 million and GAAP Diluted EPS to be a loss of ($0.10) – ($0.06) per share. We expect Adjusted EBITDA to be $39 - $46 million, and Adjusted Diluted EPS to be positive $0.17 - $0.21 per share.

The lowered guidance is largely the result of the lowered expectations for Revenue Per Test in the clinical genetic testing business. As mentioned previously, we believe it is prudent to assume Revenue per Test will decrease to $345 - $355 on average for the full year. We also expect average Cost per Test to decrease $175-$185 on average for the full year. These estimates factor in the continued evolution in our test mix toward lower priced IHC tests, although we do expect to get back to more balanced growth later in the year. Importantly, we still expect volume growth to be 13-17% for the full year, with some volatility exhibited from quarter to quarter.

Our revised guidance also factors in some of the delays in recognizing more revenue in Pharma Services and resets our growth expectations to approximately 18% year over year at the midpoint of our range, but we believe there is upside to this if we can begin to realize more revenue from the backlog quickly.

I would also like to remind everyone that we are planning on having our 2017 Annual Meeting of Shareholders at 8:00 AM on May 25, 2017 at Renaissance ClubSport Aliso Viejo Laguna Beach Hotel in Aliso Viejo, California. This hotel is just a mile from our Aliso Viejo laboratory facility. Following the Annual Meeting, we will hold our first ever Analyst/Investor day to highlight recent developments of interest and showcase our new lab. If you would like to attend, please let us know by contacting Ms. Sherry Terzian so that we can get an accurate count for the hotel. Sherry's contact information is on the bottom of the press release.

At this point, I would like to close down our formal remarks and open it up 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 sjones@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.

Question and Answer Session

Closing Remarks

As we end the call, I would like to recognize the approximately 1,000 NeoGenomics team members around the US for their dedication and commitment to building a world-class cancer-genetics testing company.

On behalf of our NeoGenomics team, I want to thank you for your time in joining us this morning, and let you know that our second quarter 2017 earnings call will be on or around July 25, 2017. For those of you listening that are investors or are considering an investment in NeoGenomics, we thank you for your interest in our Company.

Good bye.