NeoGenomics Q2
2017 Conference Call Script

Opening Remarks

The conference call operator announces the Quarter 2 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' Second Quarter 2017 conference call.

To begin, I'd like to introduce 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, Bill Bonello, our Treasurer and Director of Corporate Development, Fred Weidig, our Vice President of Finance, Jessica King, our Director of External Reporting, Rob Shovlin, President of our Clinical Services Division and Jennifer Balliet, our Vice President and Chief Culture Officer.

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.

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 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 to give more people a chance to ask questions within the one hour we have allotted for this call.

Doug's Comments

Thanks Steve.

In this morning's conference call, I will focus my comments on the company's second quarter performance, and then briefly discuss a few key dynamics related to our expectations for the second half of the year.

Quarter 2 Financial Performance

We reported very good second Quarter financial results this morning.

Second quarter revenue was a record $66.1 million and exceeded the guidance we provided just 3 months ago. This was driven by strong 16.2% year over year volume growth in our core clinical genetic testing business and accelerating momentum in our Pharma Services business. Sequential growth was also strong with revenue growing by 7% from Quarter 1.

We are also pleased with the improvement in profitability compared with last quarter. Gross profit increased by $4 million on a revenue increase of $4.4 million. In fact, gross margin of 47.2% was the highest we have achieved since 2014. Also, Adjusted EBITDA of $9.2 million was a 30% improvement over last quarter, and represented a 47% contribution on the sequential revenue growth.

The improvement compared with last quarter was driven by dramatic improvements in service, productivity and cost with nearly every measure of quality and service improving significantly.

At the same time that service improved, we drove efficiencies in our labs. Cost per test declined by 13.4% compared with last year to a record low, and Lab productivity increased by 6.1% to a record high. We are realizing synergies in our Laboratories, and we have more opportunities to pursue.

We've also made very good progress in our Billing process and function. Cash collections were strong as Cash from Operations totaled $6.5 million in the quarter, and Days Sales Outstanding were reduced by 5 days from March 31st.

We are very pleased with our Quarter 2 performance and are looking forward to more improvement as the year progresses. In this regard, and anticipating questions you may have, there are a few dynamics and special areas of interest that I would like to comment on.

Net Promoter Score and implications for Growth

I'd like to begin by talking about a hallmark of our company's success, and that is our passion to deliver exceptional service to clients. As a part of our Quality process, like many companies, we regularly survey our clients and ask for their feedback as to their satisfaction with our service and performance.

Just 2 weeks ago, we received results from our semi-annual client satisfaction survey, which was initiated on May 23rd. Honestly, we were worried about the feedback after coming through a rapid

and challenging integration. We received a lot of feedback – nearly 1,000 people responded and we received over 2,000 write-in comments.

What surprised us was the score. Our Net Promoter Score or NPS was a record high 54. You may be aware of the Net Promoter Score. It was developed by Bain & Company and is a tool for gauging the loyalty of a firm's customer relationships. It is based on the survey question asking: "How likely are you to recommend NeoGenomics to a friend or colleague?" on a scale of 1 – 10. The NPS is the percentage of customers who are "promoters" that give scores of 9 or 10 minus the percentage who are "detractors" that give scores of 0 to 6. Passive scores of 7 or 8 are ignored.

Fully 63% of respondents were promoters that rated NeoGenomics a 9 or 10, and only 9% were detractors. The resulting score of 54 is considered world class by proponents of the NPS system.

Achieving world-class client satisfaction is important, and we're pleased to once again deliver consistently exceptional service. It gives our sales team confidence that we will consistently meet or exceed client requirements. And, it allows us to grow by taking market share.

Our Sales team's current pipeline of new accounts is very long, and it's healthy. As we progress through the sales cycle with these new accounts, we expect to increase revenue growth momentum in the second half of the year and beyond.

Pharma Division and Geneva

I also want to comment on our Pharma Services Division. As we've discussed in prior public statements, we have been investing in our Pharma Division as an important area of future growth. We've built a strong team which is working well together, and we are building the infrastructure to accelerate growth.

We are starting to see results. After three straight quarters of relatively flat Pharma division revenue, second quarter revenue increased by approximately 26% from the first quarter.

We also closed a number of new contracts. Backlog increased once again to its highest level ever at $46.5 million and is nearly 80% higher than in Quarter 2 of last year. As is the case with our Clinical division, our team is working hard to close a large pipeline of projects and there is excitement about our growing capabilities.

We are also excited to expand our business outside the U.S., and we are making great progress on opening our new facility just outside of Geneva Switzerland.

We moved forward with this project at the request of several customers. One of those customers has already approved a $1.5 million project for the Lab before the facility is even open.

Products and Test Mix

I also want to comment briefly on our product line and test mix. One of the important attributes of our company is our test menu, which we believe to be the most comprehensive oncology test menu in the country. Certainly, our ability to offer comprehensive multi-modality testing all in one Lab is relatively unique in our industry.

During the quarter, we continued to see strong growth in molecular testing and in immunohistochemistry. In each of these technologies, our advanced test menu is unparalleled. These tests, in particular, are in high demand as a result of the need to profile tumors precisely, and to determine a patient's responsiveness to exciting new immuno-therapies.

Testing for PD-L1, an important biomarker for immuno-oncology, continued to grow in Quarter 2; however, we are also now beginning to see an increasing demand for other tests related to immuno-oncology such as Micro Satellite Instability, DNA Mismatch Repair and Tumor Mutation Burden. These tests are being sought after by Pharma companies as well as by Pathologists and clinicians.

One new testing technology that is growing quickly is our proprietary MultiOmyx testing service. This unique technology, for which we have an exclusive license from G.E., is particularly useful to Pharma researchers as they attempt to more fully understand how the immune system may be harnessed to kill cancer. We are investing to build our MultiOmyx capabilities to meet the increased demand.

Average Price-per-test, PAMA, and PFS

Many investors ask about trends and dynamics in test mix and clinical genetic Revenue per Test., and we want to comment briefly about that.

We are pleased that, after a reduction in Revenue per Test over the past five straight quarters, Revenue-per-test was nearly unchanged in Quarter 2 compared with Quarter 1.

Looking forward to 2018, we continue to believe that pricing will be relatively stable. The preliminary 2018 Physician Fee Schedule was released by CMS on July 13th, and there were no surprises for us. In fact, we estimate the impact of these Medicare reimbursement changes, which will also impact certain Medicare Advantage plans, will be less than a 1% of our clinical testing revenue.

The Clinical Lab Fee Schedule is expected to change in 2018 because of the implementation of the Protecting Access to Medicare Act which is referred to as PAMA. Currently, we only bill two types of tests using CPT codes that fall on the Clinical Lab Fee Schedule - Cytogenetics and Molecular testing - which together represent about 28% of our clinical revenue. If PAMA moves forward, rate cuts would be limited to a maximum of 10% for any given test in any given year. We estimate that a worst case impact would be less than $1 million, or approximately 0.4% of clinical test revenue in 2018.

Cost Reductions and Synergies

Investors often inquire about the status of synergies resulting from the Clarient acquisition. It's sometimes difficult to differentiate between a synergy and normal cost reduction activities and productivity increases. The 13.5% reduction in cost per test is partially attributable to a lower cost mix of testing, but primarily to the realization of cost synergies.

After the Irvine Lab was vacated at the end of Quarter 1, we began to realize some of the scale benefits of consolidating testing in one facility. We expect that benefit to increase over time as we more fully settle in and optimize a variety of our processes. We are also beginning to realize

synergies from supply cost reductions. Similarly, we expect to see further reductions in supply costs as we optimize processes and renegotiate agreements with suppliers as contracts end.

We expect other synergies and cost reductions to be realized in our labs as we optimize logistics, move testing to the most cost-effective site, automate processes, reduce paper in our Labs, increase the use of our on-line ordering system, and continually improve our processes.

In SG&A, we have clearly realized synergies in Sales, Information Technology, and in many Administrative areas. These gains have been somewhat offset by investments we've made to improve our marketing, increase our IT security, build a new IT system for Pharma, invest in our Geneva operation, and to build our culture and retain our great people and teams.

Synergies in SG&A were also offset by much higher bad debt expense in Quarter 2 related primarily to moving all Clarient accounts to the NeoGenomics Billing system and associated changes in our processes. It's important to note that Clarient's level of DSO prior to the acquisition was 108, and now our entire company's DSO is 85. Clearly we are realizing synergies in our billing process, but the result hasn't been realized yet in bad debt expense. We expect bad debt expense to decline as a percentage of sales as the year progresses, and believe we can drive DSO down to approximately 80-82 days.

PathLogic Impact and Closure

Investors have also inquired about PathLogic, and clearly our results continue to be impacted by poor results from PathLogic. Finally, after exploring a variety of strategic options, we're very close to a resolution. PathLogic generated approximately $1.6 million of revenue, zero gross margin, and lost approximately $600K of Adjusted EBITDA during the quarter. We expect to be able to announce a resolution in August.

In summary, we saw very solid improvement during the second quarter. Our lab teams have come together and service has improved and has returned to the levels we're used to seeing at Neo. Our NPS score shows that our customers are also seeing the improvement. Our lab teams are making progress reducing our cost per test and our billing team is making progress reducing our DSOs and driving cash collections. With the integration over, our Sales teams are now back to being completely focused on growth, and we are starting to see it reflected in accelerating revenue growth. We made a lot of progress as an organization in the second quarter and we look forward to continuing that in future quarters.

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 second 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.

Second Quarter Review

Second quarter consolidated revenue was $66.1 million, a 5% increase over the prior year. Clinical genetic testing revenue increased 7.1%, PathLogic revenue decreased 18.8%, and Pharma Services revenue decreased 7.6%% versus the prior year. As Doug noted, we expect to have a resolution for PathLogic shortly. Although Pharma services posted a modest decline in revenue year over year, there was 26% sequential growth from Q1. As we have discussed, Pharma Services revenue can be a bit lumpy.

Average Revenue per Clinical Genetic Test was $355, a 7.8% reduction from the prior year, but a $1.00 increase relative to the Quarter 1 level. Sequential growth in PD-L1 testing moderated to 10% in Quarter 2, which lessened some of the pressure on Average Unit Price as a result of mix shifts that we have seen in recent quarters. We continue to believe that it is appropriate to use estimates of Average Revenue per Test in the range of $345 - $355 for the balance of the year.

Consolidated gross margin was 47.2%, a 190 basis point increase from the 45.3% reported in Q2 2016, and a 310 basis point sequential increase from the 44.1% reported in Quarter 1. Fully 90% of the sequential $4.4 million increase in revenue from Q1 dropped to gross margin in Quarter 2. This level of incremental contribution was the result of increasing lab productivity and unlocking cost synergies. In addition, the increased revenue in the Pharma Services Division improved Pharma margins as many of the Pharma Services costs are fixed and more revenue can have a dramatic impact on margins in this business.

We expect gross margin to continue to increase during the balance of the year as we unlock additional synergies, further grow the Pharma Services Divison and resolve PathLogic

Consolidated SG&A costs increased by 13.1%, or $3.5 million from Q2 2016, primarily as a result of increased personnel, bad debt, and non-cash stock based compensation expenses. In addition, we incurred approximately $264,000 of one-time expense related to the facility move in the second quarter, which was removed from Adjusted EBITDA as well. We also incurred approximately $300,000 of expense associated with opening the Geneva facility, which was not removed from Adjusted EBITDA.

As we discussed on the last call, bad debt expense has been running 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 historical levels by the end of 2017, but we do expect bad debt in Quarter 3 to be in the 6% of revenue range.

Adjusted EBITDA was flat to last year's second quarter, but increased by $2.1 million relative to the first quarter. While revenue growth and gross margin were higher than expected in Quarter 2, Adjusted EBITDA margin was a little below our expectations, primarily due to continued investments in our Pharma Services business and higher bad debt expense.

Given these incremental expenses, which we expect will carry into the second half of the year at higher than normal levels, we expect full year Adjusted EBITDA to be near the low end of our previously issued guidance range with Quarter 3 Adjusted EBITDA at levels that are consistent with Quarter 2 levels.

As we continue to unlock more synergies, our Geneva operations begin generating revenue, and our bad debt expense becomes more normalized with historical levels, we expect Adjusted EBITDA margin to improve considerably.

Second Quarter GAAP net loss available to common shareholders was ($2.7) million compared to ($5.2) million in the second quarter of last year, and Diluted EPS was ($0.03) 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 certain non-cash items and, if applicable, one-time costs. 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 second quarter, Adjusted Net Income was $3.9 million, a 5.8% increase from the $3.7 million reported in last year's second quarter. And Adjusted Diluted EPS was $0.04 per share compared to $0.04 per share in Quarter 2, 2016.

We finished the second quarter with 1,024 full-time equivalent employees, contract doctors, and temps, versus 1012 as of March 31, 2017 and 969 as of December 31, 2016.

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.

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 third quarter 2017 earnings call will be on or around October 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.