Zacks Small-Cap Research

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NeoGenomics Inc. (NEO-NASDAQ)

NEO: better than expected 1Q14 financials reported, new guidance issued for 2014-- Outperform

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	10/09/2011
Current Price (04/22/14)	$3.45
Twelve- Month Target Price	**$7.00**

OUTLOOK

NeoGenomics just reported another strong quarter of financials for 1Q14. As a result, we have increased our revenue and earnings estimates for 2Q and full year 2014. 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 2014 and beyond. NEO is well poised for long term growth.

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

SUMMARY DATA

52-Week High	**$4.51**
52-Week Low	**$2.10**
One-Year Return (%)	**-13.32**
Beta	**1.24**
Average Daily Volume (sh)	**198,551**
Shares Outstanding (mil)	**49**
Market Capitalization ($mil)	**$169**
Short Interest Ratio (days)	**5.21**
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**

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 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	15.7 A	15.6 A	16.9 A	18.3 A	66.5 A
2014	18.2 A	18.8 E	19.1 E	19.3 E	75.4 E
2015					85.0 E
2016					110.0 E

Earnings per Share
(EPS is operating earnings before non recurring items)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	$0.00 A	$0.01 A	$0.02 A	$0.02 A	$0.04 A
2014	$0.00 A	$0.00 E	$0.01 E	$0.01 E	$0.03 E
2015					$0.08 E
2016					$0.23 E

Zacks Projected EPS Growth Rate - Next 3 Years % **81**

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WHAT'S NEW

- **Better than expected financials reported for 1Q14;**
- **We increase our revenue and earnings estimates for 2Q and full year 2014;**
- **Balance sheet remains strong;**
- **Maintain Outperform rating and maintain price target of $7.00 per share;**

Total revenue for 1Q14 was $18.2 million, compared to $15.7 million for 1Q13, a 16.1% increase. This revenue growth was achieved despite a $0.7 million reduction in revenue recorded to account for a conservative interpretation of the unresolved National Correct Coding Initiative (NCCI) edits relating to billing Medicare for FISH testing.

First quarter of 2014 revenue also beat our estimated by $0.4 million.

Test volume in 1Q14 increased 29.7% over that in 1Q13.

Gross margin for 1Q14 was 47.9% compared to 46.3% for 1Q13. This increased gross margin was achieved due to reduced average cost-of-goods-sold-per-test by 6.5%, although average revenue-per-test decreased by 3.8% from the first quarter of last year due to the NCCI FISH matter.

Total operating expenses were $8.3 million for 1Q14 compared to $6.9 million for 1Q13, an increase of 19.8%. Management indicated in the conference call that 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 $0.1 million for 1Q14 ($0.00/share) compared to $3,000 ($0.00/share) for 1Q13. Net income for 1Q14 also beat our estimate of net loss of $0.1 million (-$0.00/share).

Adjusted EBITDA for 1Q14 was $1.7 million, compared to $1.8 million for 1Q13, a 6.1% decrease due to the reduction in revenues from the NCCI FISH matter.

We are pleased to see continued revenue and earnings growth for the first quarter 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, they were able to achieve revenue growth and increase net income despite a 3.9% reduction in average revenue-per-test over the same period.

As a result of the better than expected first quarter financials, we upgraded our estimates for both 2Q and the full year 2014

Specifically, we increase our revenue estimate for 2Q14 to $18.8 million from previous $17.9 million. For the year 2014, we increase our estimate for total revenue to $75.4 million from previous $73.3 million. We increase our estimated net income for 2014 to $1.4 million ($0.03 per share) from previous $0.7 million ($0.01 per share). Our estimates include the negative impact from NCCI matter. Without the NCCI matter, revenue should be increased by about $3 million.

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

	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13	1Q14
Total Revenue ($, 000's)	**$15,160**	**$15,611**	**$14,202**	**$14,893**	**$15,657**	**$15,603**	**$16,884**	**$18,323**	**$18,182**
% Growth	72.2%	49.2%	25.5%	15.5%	3.3%	-0.1%	18.9%	23.0%	16.1%
Gross Margin	**47.1%**	**47.2%**	**41.5%**	**43.2%**	**46.3%**	**45.9%**	**48.4%**	**50.0%**	**47.9%**
SG&A as a % of Revenue	38.2%	38.4%	40.6%	38.9%	39.0%	38.7%	39.5%	39.9%	42.3%
Net Income (Loss) ($,000's)	**$603.0**	**$839.0**	**($975.0)**	**($113.0)**	**$3.0**	**$273.0**	**$929.0**	**$963.0**	**$102.0**
Diluted EPS	$0.01	$0.01	($0.02)	$0.00	$0.00	$0.01	$0.02	$0.02	$0.00
Adjusted EBITDA ($, 000's)	$1,775.0	$1,943.0	$842.0	$1,439.0	$1,794.0	$1,825.0	$2,163.0	$2,733.0	$1,685.0
% Growth	6020.7%	302.3%	21.5%	36.4%	1.1%	-6.1%	156.9%	89.9%	-6.1%
Test Volume (000's)	**26,932**	**28,846**	**28,315**	**30,513**	**32,088**	**32,519**	**33,723**	**38,987**	**38,734**
% Growth	74.9%	57.1%	41.7%	35.3%	19.1%	12.7%	19.1%	27.8%	20.7%
Average Price/Test	$562.89	$541.20	$501.58	$488.09	$488.00	$480.00	$501.00	$469.99	$469.00
% Growth	-1.6%	-5.1%	-11.5%	-14.6%	-13.3%	-11.3%	-0.1%	-3.7%	-3.9%
Average Cost/Test				$277.25	262.00			$234.96	245.00
% Growth								-15.3%	-6.5%

Summary of Annual Performance

$, 000's	2009	2010	2011	2012	2013	2014E	2015E	2016E	2017E
Total Revenue	$29,469	$34,371	$43,484	$59,866	$66,467	$75,382	$85,000	$110,000	$145,000
% Growth	47.2%	16.6%	26.5%	37.7%	11.0%	13.4%	12.8%	29.4%	31.8%
Gross Margin	51.6%	45.9%	44.7%	44.8%	47.7%	48.5%	48.9%	50.0%	50.0%
SG&A/Revenue	57.5%	54.5%	45.6%	39.0%	39.3%	41.4%	38.8%	31.8%	26.2%
Net Income (Loss)	($2,243.0)	($3,303.0)	($1,177.0)	$66.0	$2,033.0	$1,397.0	$4,312.0	$13,600.0	$24,650.0
Diluted EPS	(0.06)	(0.09)	(0.03)	0.00	0.04	0.03	0.08	0.23	0.41
Adjusted EBITDA	$103.0	($566.0)	$2,134.0	$5,999.0	$8,515.0	$8,500.0	$9,500.0	$15,000.0	$26,150.0
Test Volume Growth	39.1%	25.5%	33.1%	50.2%	19.8%	20.0%	25.0%	30.0%	35.0%

Balance Sheet Remains Strong

As of March 31, 2014, NeoGenomics had $5.4 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 March 31, 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.

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

We Maintain Our Outperformance Rating

We continue to rate NEO shares an Outperformance and reiterate our price target of $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 $145 million in 2017, a CAGR of 22% 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.

Although price has appreciated about 288% 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 $3.5 per share which values the Company at $172 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 22% CAGR from 2013 to 2017. If we use 30 x P/E multiple, the fair value of NEO shares should be at about $7.0 per share when coupled with our estimated EPS of $0.41 in 2017, discounted at 20% for three years. This valuation corresponds to 4 times our 2015 estimated revenue of $87 million. Our price target values NEO at $343 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. 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.

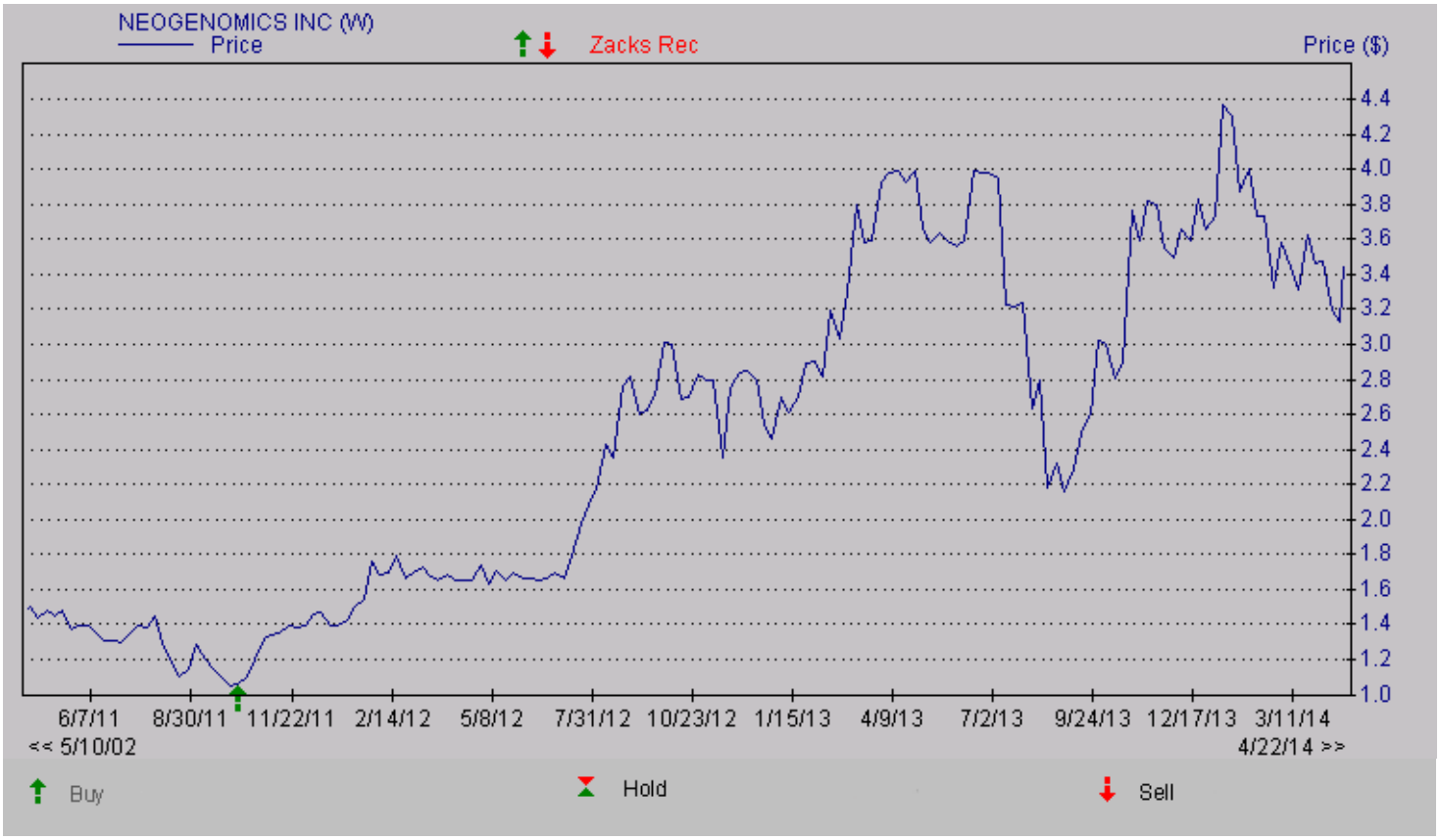
PROJECTED INCOME STATEMENT

	2013A (Dec)					2014E (Dec)					2015E (Dec)	2016E (Dec)	2017E (Dec)
$ in million except per share data	Q1A	Q2A	Q3A	Q4A	FYA	Q1	Q2	Q3	Q4	FYE	FYE	FYE	FYE
Total Revenues	**$15.66**	**$15.60**	**$16.88**	**$18.32**	**$66.47**	**$18.18**	**$18.80**	**$19.10**	**$19.30**	**$75.38**	**$85.00**	**$110.00**	**$145.00**
YOY Growth	3.3%	-0.1%	18.9%	23.0%	11.0%	16.1%	20.5%	13.1%	5.3%	13.4%	12.8%	29.4%	31.8%
CoGS	8.41	8.45	8.71	9.16	34.73	9.47	9.96	9.74	9.65	38.83	43.40	55.00	72.50
Gross Income	**$7.25**	**$7.16**	**$8.17**	**$9.16**	**$31.74**	**$8.71**	**$8.84**	**$9.36**	**$9.65**	**$36.55**	**$41.60**	**$55.00**	**$72.50**
Gross Margin	46.3%	45.9%	48.4%	50.0%	47.7%	47.9%	47.0%	49.0%	50.0%	48.5%	48.9%	50.0%	50.0%
SG&A	$6.11	$6.04	$6.67	$7.31	$26.12	$7.69	$7.80	$7.70	$8.00	$31.19	$33.00	$35.00	$38.00
% SG&A	39.0%	38.7%	39.5%	39.9%	39.3%	42.3%	41.5%	40.3%	41.5%	41.4%	38.8%	31.8%	26.2%
R&D	$0.84	$0.62	$0.34	$0.65	$2.44	$0.63	$0.65	$0.70	$0.80	$2.78	$3.20	$3.50	$5.00
% R&D	5.3%	3.9%	2.0%	3.5%	3.7%	3.5%	3.5%	3.7%	4.1%	3.7%	3.8%	3.2%	3.4%
Operating Income	**$0.3**	**$0.5**	**$1.2**	**$1.2**	**$3.2**	**$0.4**	**$0.4**	**$1.0**	**$0.9**	**$2.6**	**$5.4**	**$16.5**	**$29.5**
Operating Margin	1.9%	3.2%	6.9%	6.6%	4.8%	2.2%	2.1%	5.0%	4.4%	3.4%	6.4%	15.0%	20.3%
Other Net	($0.3)	($0.2)	($0.2)	($0.2)	($1.0)	($0.3)	($0.2)	($0.2)	($0.2)	($0.9)	($0.5)	($0.5)	($0.5)
Pre-Tax Income	**$0.0**	**$0.3**	**$0.9**	**$1.0**	**$2.2**	**$0.1**	**$0.2**	**$0.8**	**$0.7**	**$1.7**	**$4.9**	**$16.0**	**$29.0**
Income taxes(benefit)	$0.0	$0.0	$0.0	$0.1	$0.2	$0.0	$0.1	$0.1	$0.1	$0.3	$0.6	$2.4	$4.4
Tax Rate	85.0%	0.0%	3.1%	11.0%	7.0%	20.9%	53.8%	13.2%	15.4%	19.0%	12.0%	15.0%	15.0%
Reported Net Income	**$0.0**	**$0.3**	**$0.9**	**$0.9**	**$2.0**	**$0.1**	**$0.1**	**$0.7**	**$0.6**	**$1.4**	**$4.3**	**$13.6**	**$24.7**
YOY Growth	-99.5%	-50.5%	-	-	2980.3%	3300.0%	-68.5%	-26.8%	-35.8%	-31.3%	208.7%	215.4%	81.3%
Net Margin	0.0%	1.7%	5.3%	4.7%	3.1%	0.6%	0.5%	3.5%	2.8%	1.9%	5.1%	12.4%	17.0%
Diluted Shares Out	50.9	53.7	53.2	53.6	52.9	53.5	54.0	54.2	54.4	54.0	57.0	60.0	62.0
Reported EPS	**$0.00**	**$0.01**	**$0.02**	**$0.02**	**$0.04**	**$0.00**	**$0.00**	**$0.01**	**$0.01**	**$0.03**	**$0.08**	**$0.23**	**$0.40**
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*	*$1.00*
Non GAAP Net Income	**$0.0**	**$0.3**	**$0.9**	**$0.9**	**$2.0**	**$0.1**	**$0.1**	**$0.7**	**$0.6**	**$1.4**	**$4.3**	**$13.6**	**$25.7**
Non GAAP EPS	**$0.00**	**$0.01**	**$0.02**	**$0.02**	**$0.04**	**$0.00**	**$0.00**	**$0.01**	**$0.01**	**$0.03**	**$0.08**	**$0.23**	**$0.41**

Source: Company filings and Zacks Investment Research

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