August 2, 2012

Zacks Small-Cap Research

Brian Marckx, CFA
bmarckx@zacks.com
Ph (312) 265-9474

scr.zacks.com

111 North Canal Street, Chicago, IL 60606

Transgenomic Inc. (TBIO-OTC)

TBIO: Good Q2. Future Shaping Up Nicely.

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	01/12/2011
Current Price (08/02/2012)	$1.00
Target Price	**$2.50**

OUTLOOK

New product launches will help drive revenue in the clinical lab business. C-GAAP (Plavix response) test could be a winner for TBIO. Test launched in late 2011, announcement that Medicare will cover the test came in Q3 2012. Early indications are there is real interest in this product and TBIO has been gearing for a more substantial roll-out going into 2013.

Early indications also suggest TBIO's novel, ultra-sensitive testing technology is garnering significant interest from pharma companies. Key to longer-term revenue growth will be to gain further traction in the pharmacogenomics segment.
We are maintaining our Outperform rating. Our per share price target is $2.50.

SUMMARY DATA

52-Week High	**$1.52**
52-Week Low	**$0.70**
One-Year Return (%)	**-24.46**
Beta	**1.78**
Average Daily Volume (sh)	**97,532**
Shares Outstanding (mil)	**72**
Market Capitalization ($mil)	**$72**
Short Interest Ratio (days)	**0.22**
Institutional Ownership (%)	**7**
Insider Ownership (%)	**2**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**3.8**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2012 Estimate	**N/A**
P/E using 2013 Estimate	**N/A**
Zacks Rank	**N/A**

Risk Level	**Above Avg.,**
Type of Stock	**Small-Blend**
Industry	**Med Instruments**

ZACKS ESTIMATES

Revenue
(in '000 of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2011	7,480 A	7,667 A	8,253 A	8,571 A	31,971 A
2012	7,206 A	9,093 A	9,029 E	10,044 E	35,372 E
2013					41,742 E
2014					50,448 E

Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2011	-$0.06 A	-$0.13 A	-$0.03 A	$0.00 A	-$0.22 A
2012	-$0.05 A	-$0.01 A	-$0.02 E	-$0.01 E	-$0.08 E
2013					-$0.04 E
2014					-$0.00 E

Zacks Projected EPS Growth Rate - Next 5 Years % **N/A**

© Copyright 2012, Zacks Investment Research. All Rights Reserved.

WHAT'S NEW…..

Q2 2012 RESULTS

Transgenomic reported financial results for Q2 ending June 30, 2012 on August 1st. Revenue was up almost 19% and set an all-time quarterly record. Very strong sales from clinical lab partially due to the reversal of the backlog in Q2 from the software glitch (as well as strong organic growth in clinical lab) and materially better than estimated sales from the diagnostic tools business helped offset weaker than estimated pharmacogenomics revenue. Total revenue was about 3% below our number due solely to the difference in pharmacogenomics sales, which can be choppy quarter-to-quarter and are inherently difficult to estimate due to the nature of the business. Gross margin, while significantly improved from Q1, was still materially softer than our estimate. Management noted that the hangover from the software issue in Q1 and an FX headwind (US$ / Euro exchange rate) both impacted GM in Q2. We model incremental improvement in GM in the second half of 2012. Meanwhile, operating expenses in Q2 were largely in-line with our numbers.

Management noted that they expect revenue growth in every business segment in 2012, which continues to be commensurate with our model. Several recent events should provide a meaningful tailwind going into the back half of the year and beyond. The clinical lab business should benefit from the ongoing roll-out of the C-GAAP (Plavix response) test, which TBIO just announced will be covered by Medicare. The pharmacogenomics business is awaiting the green-light from a pharma customer that TBIO has alluded to over the recent past to commence processing for a phase III trial, work for the phase II study which TBIO just recently completed. The recent launch of the first ICE COLD PCR kit (K-RAS), which is expected to be followed in the near-term with kits for other cancer markers including BRAF, PIK3CA and EGFR should really facilitate revenue growth in the lab and tools businesses. Finally, CE Marking of WAVE MCE, TBIO's next-gen genetic mutation detection instrument, and the company's SURVEYOR K-RAS kit which came in May has already helped jump-start the tools/consumables business, the benefits of which we expect to continue to see throughout the remainder of 2012 and likely beyond.

Revenue
Q2 revenue was $9.1 million, up 19% y-o-y and $249k (3%) less than our $9.3 million estimate. The difference came from a $1.5 million ($348k A vs. $1.9 million) variance in pharmacogenomics revenue which was offset by a beat of $1.1 million ($5.5 million A vs. $4.4 million E) in clinical lab and a $215k beat ($3.3 million A vs. $3.1 million E) in diagnostic tools/consumables. The backlog reversal from Q1 in clinical lab amounted to roughly $600k, which implies organic y-o-y growth in that business of almost 25% in Q2. We model 10% growth in Q3 which could end up conservative, especially depending on the early success of C-GAAP. The tools/consumables business was also stronger than we anticipated and surprisingly so given that we had incorporated continued inventory stocking sales of MCE to Menarini (European distributor) in Q2.

Gross Margin
Similar to Q1, GM came in well softer than our estimate. Q2 GM was 50% compared to our 59% estimate. Also similar to Q1, the software glitch and initial orders of MCE from Menarini (distributor sales naturally carry a lower margin to TBIO) hurt GM in the most recent quarter. Relatively meager revenue from pharmacogenomics (which is mostly a fixed-cost base business) and a strong foreign exchange headwind coming out of Europe also both negatively impacted the margin in Q2. We expect all of these to have a much smaller impact over the longer-term (or in the case of the software problem, no impact whatsoever) and continue to model incremental improvement of GM going forward. At the point that pharmacogenomics revenue begins to show material growth, GM should significantly improve given the scalability of that business.

Net Income / EPS
Despite the 3% miss on revenue and softer than expected GM, net income and EPS of ($728k) and (0.01) were just about dead-on with our ($615k) and ($0.01) numbers due to a $1 million (non-cash) benefit from change in fair value of outstanding warrants

Cash
Transgenomic exited Q2 with $15.3 million in cash and liquid investments, compared to $19.3 million at the end of Q1. The $4 million reduction in cash balance included $2.4 million used in operating activities and $1.2 million (financing activities) for the initial payment to PGx Health for the repayment of the outstanding promissory note. TBIO is current under the agreement with PGx Health and we expect TBIO to have no problem repaying the remainder of the note (~$6 million).

OUR 2012 OUTLOOK

We've again made some slight tweaks to our model. We model 2012 revenue of $35.4 million, implying growth of 11% from 2011. We look for Laboratory Services and Instruments to generate revenue of $21.4 million (+16%) and $14.0 million (+3%), respectively. We think net income and EPS come in at ($5.4) million and ($0.08).

Laboratory Services

Our $21.4 million revenue estimate for Laboratory Services assumes meaningful contribution from recently launched new products in the clinical lab segment, including the C-GAAP Plavix response and atrial fibrillation tests. Very early indications are that there is real interest in TBIO's C-GAAP test. Management noted on the Q1 call that they had already began dedicating more sales and marketing resources to promote the product. On the Q2 call management indicated that they expect to add more headcount to support the anticipated interest in the test - clearly implying that C-GAAP is a high potential product for the company. Medicare coverage, as we noted in a recent investor note, is an obvious positive in helping to drive awareness, interest and demand for the test. We think C-GAAP, which we had only moderate expectations for about 12 months ago due to competing tests already on the market, could be a real dark horse for TBIO and provide meaningful growth of the clinical lab business. We will be very interested to hear how the roll-out progresses over the next several quarters.

Pharmacogenomics revenue has been somewhat lackluster recently, but will hopefully rebound with the initiation of work on one or more phase III clinical trials which management has alluded to. Clearly there's real and growing interest in ICE COLD PCR. Management continues to indicate that there is substantial interest in their technology from some prominent names in pharma and they continue to score more and more clinical trials business. This remains the impetus to our expectations of significant growth in pharmacogenomics revenue over the longer term. And, as noted, due to its scalability, as this business grows TBIO's overall gross margins and profitability should accelerate at an even faster pace.

Instruments

We model the equipment portion of Transgenomic's instrument business to grow 4% in 2012 largely as a result of the recent roll-out of WAVE MCE to Menarini. We look for the consumables portion of the diagnostic tools business to turn in growth of 3% in 2012. Benefitting from the Menarini distribution agreement, along with new consumable product launches including several new cancer kits (K-RAS, BRAF, EGFR, PIK3CA) we think the instruments business can eke out low to mid single-digit growth through at least 2013.

RECOMMENDATION / VALUATION

We value TBIO using comp P/S ratio. Based on an average P/S comp of 4.7x, Transgenomic is valued at approximately to $2.50/share. The shares currently trade at $1.00, indicating significant upside. We are maintaining our Outperform rating.

FINANCIAL MODEL

Transgenomic Inc.

	2011 A	Q1A	Q2A	Q3E	Q4E	2012 E	2013 E	2014 E	2015 E
Laboratory Services	$18,360.0	$4,001.0	$5,808.0	$5,251.0	$6,307.0	$21,367.0	$27,024.6	$34,795.8	$44,431.4
% of total revenue	57.4%	55.5%	63.9%	58.2%	62.8%	60.4%	64.7%	69.0%	72.5%
YOY Growth	*268.7%*	*6.5%*	*19.4%*	*13.2%*	*23.7%*	*16.4%*	*26.5%*	*28.8%*	*27.7%*
Instruments	$13,640.0	$3,205.0	$3,285.0	$3,778.0	$3,737.0	$14,005.0	$14,717.0	$15,652.1	$16,825.0
% of total revenue	42.7%	44.5%	36.1%	41.8%	37.2%	39.6%	35.3%	31.0%	27.5%
YOY Growth	*-9.5%*	*-13.9%*	*17.3%*	*4.5%*	*6.8%*	*2.7%*	*5.1%*	*6.4%*	*7.5%*
Total Revenues	$31,971.0	$7,206.0	$9,093.0	$9,029.0	$10,044.0	$35,372.0	$41,741.6	$50,447.9	$61,256.4
YOY Growth	*59.5%*	*-3.7%*	*18.6%*	*9.4%*	*17.2%*	*10.6%*	*18.0%*	*20.9%*	*21.4%*
Laboratory Services	$7,916.0	$2,353.0	$2,691.0	$2,270.0	$2,477.5	$9,791.4	$11,436.0	$14,024.7	$15,289.6
Lab Svcs margin	*56.9%*	*41.2%*	*53.7%*	*56.8%*	*60.7%*	*54.2%*	*57.7%*	*59.7%*	*65.6%*
Instruments	$6,255.4	$1,749.0	$1,840.0	$1,818.9	$1,707.3	$7,115.3	$6,761.2	$7,197.2	$7,654.9
Instruments margin	*54.1%*	*45.4%*	*44.0%*	*51.9%*	*54.3%*	*49.2%*	*54.1%*	*54.0%*	*54.5%*
Cost of Revenues	$13,532.0	$4,102.0	$4,531.0	$4,088.9	$4,184.8	$16,906.7	$18,197.2	$21,221.9	$22,944.5
Gross Income	$18,439.0	$3,104.0	$4,562.0	$4,940.1	$5,859.2	$18,465.3	$23,544.4	$29,226.0	$38,311.9
Gross Margin	*57.7%*	*43.1%*	*50.2%*	*54.7%*	*58.3%*	*52.2%*	*56.4%*	*57.9%*	*62.5%*
SG&A	$19,154.0	$4,994.0	$5,278.0	$5,218.8	$5,474.0	$20,964.7	$22,637.9	$25,557.0	$29,219.3
% SG&A	*59.9%*	*69.3%*	*58.0%*	*57.8%*	*54.5%*	*59.3%*	*54.2%*	*50.7%*	*47.7%*
R&D	$2,219.0	$549.0	$654.0	$582.0	$618.0	$2,403.0	$2,887.0	$3,166.0	$3,440.0
% R&D	*6.9%*	*7.6%*	*7.2%*	*6.4%*	*6.2%*	*6.8%*	*6.9%*	*6.3%*	*5.6%*
Restructuring charges	$41.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Operating Income	($2,975.0)	($2,439.0)	($1,370.0)	($860.6)	($232.8)	($4,902.4)	($1,980.5)	$503.0	$5,652.6
Operating Margin	*-9.3%*	*-33.8%*	*-15.1%*	*-9.5%*	*-2.3%*	*-13.9%*	*-4.7%*	*1.0%*	*9.2%*
Interest income, net	($954.0)	($273.0)	($231.0)	($176.0)	($135.0)	($815.0)	($330.0)	$150.0	$200.0
Expense on preferred stock	($6,066.0)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Other income	$258.0	$20.0	$1,008.0	$0.0	$0.0	$1,028.0	$0.0	$0.0	$0.0
Pre-Tax Income	($9,737.0)	($2,692.0)	($593.0)	($1,036.6)	($367.8)	($4,689.4)	($2,310.5)	$653.0	$5,852.6
Taxes	$46.0	$4.0	($30.0)	$37.8	$37.4	$49.2	($346.6)	$117.5	$1,287.6
Tax Rate	*-0.5%*	*-0.1%*	*5.1%*	*-3.6%*	*-10.2%*	*-1.0%*	*15.0%*	*18.0%*	*22.0%*
Preferred Dividends	($1,009.0)	($165.0)	($165.0)	($165.0)	($165.0)	($660.0)	($660.0)	($660.0)	($660.0)
Net Income	($10,792.0)	($2,861.0)	($728.0)	($1,239.4)	($570.2)	($5,398.6)	($2,624.0)	($124.6)	$3,905.1
YOY Growth	*-244.4%*	*-5.8%*	*-88.4%*	*-19.8%*	*-1118.1%*	*-50.0%*	*-51.4%*	*-95.3%*	*-3235.0%*
Net Margin	*-33.8%*	*-39.7%*	*-8.0%*	*-13.7%*	*-5.7%*	*-15.3%*	*-6.3%*	*-0.2%*	*6.4%*
EPS	($0.22)	($0.05)	($0.01)	($0.02)	($0.01)	($0.08)	($0.04)	($0.00)	$0.04
YOY Growth	*243.5%*	*-25.9%*	*-92.0%*	*-45.2%*	*-797.9%*	*-64.6%*	*-54.2%*	*-96.1%*	*-3200.2%*
Diluted Shares O/S	49,361	62,684	71,646	72,150	72,250	69,682	74,000	89,000	90,000

Brian Marckx, CFA

© Copyright 2012, Zacks Investment Research. All Rights Reserved.

HISTORICAL ZACKS RECOMMENDATIONS



DISCLOSURES

The following disclosures relate to relationships between Zacks Investment Research ("ZIR") and Zacks Small-Cap Research ("Zacks SCR") and the issuers covered by the Zacks SCR analysts in the Small-Cap Universe.

ZIR or Zacks SCR Analysts do not hold or trade securities in the issuers which they cover. Each analyst has full discretion on the rating and price target based on their own due diligence. Analysts are paid in part based on the overall profitability of Zacks SCR. Such profitability is derived from a variety of sources and includes payments received from issuers of securities covered by Zacks SCR for non-investment banking services. No part of analyst compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in any report or blog.

ZIR and Zacks SCR do not make a market in any security nor do they act as dealers in securities. Zacks SCR has never received compensation for investment banking services on the small-cap universe. Zacks SCR does not expect received compensation for investment banking services on the small-cap universe. Zacks SCR has received compensation for non-investment banking services on the small-cap universe, and expects to receive additional compensation for non-investment banking services on the small-cap universe, paid by issuers of securities covered by Zacks SCR. Non-investment banking services include investor relations services and software, financial database analysis, advertising services, brokerage services, advisory services, investment research, and investment management.

Additional information is available upon request. Zacks SCR reports are based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Because of individual objectives, the report should not be construed as advice designed to meet the particular investment needs of any investor. Any opinions expressed by Zacks SCR Analysts are subject to change. Reports are not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. Zacks SCR uses the following rating system for the securities it covers. Buy/Outperform: The analyst expects that the subject company will outperform the broader U.S. equity market over the next one to two quarters. Hold/Neutral: The analyst expects that the company will perform in line with the broader U.S. equity market over the next one to two quarters. Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

The current distribution of Zacks Ratings is as follows on the 1035 companies covered: Buy/Outperform- 15.7%, Hold/Neutral- 77.2%, Sell/Underperform – 6.5%. Data is as of midnight on the business day immediately prior to this publication.

© Copyright 2012, Zacks Investment Research. All Rights Reserved.