Zacks Small-Cap Research

February 20, 2014
Grant Zeng, CFA
312-265-9466
gzeng@zacks.com

scr.zacks.com
111 North Canal Street, Chicago, IL 60606

NeoGenomics Inc. (NEO-NASDAQ)

NEO: Highest revenue reported for 4Q13, accelerated growth expected in 2014-- Outperform

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	10/09/2011
Current Price (02/18/14)	$3.86
Twelve- Month Target Price	**$7.00**

OUTLOOK

NeoGenomics just reported record revenue for 4Q13, the highest in the company's history. 4Q revenue 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 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	**$2.10**
One-Year Return (%)	**13.53**
Beta	**0.92**
Average Daily Volume (sh)	**291,629**
Shares Outstanding (mil)	**49**
Market Capitalization ($mil)	**$189**
Short Interest Ratio (days)	**3.27**
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**

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	17.8 E	17.9 E	17.9 E	19.3 E	72.9 E
2015					87.0 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 E	-$0.00 E	$0.00 E	$0.01 E	$0.01 E
2015					$0.08 E
2016					$0.23 E

Zacks Projected EPS Growth Rate - Next 3 Years % **89**

© Copyright 2014, Zacks Investment Research. All Rights Reserved.

WHAT'S NEW

- **Highest revenue reported for 4Q13, and for 2013, beating our estimates;**
- **Balance sheet remains strong;**
- **Maintain Outperform rating and maintain price target of $7.00 per share;**

Highest Revenue Reported for the Fourth Quarter and Full Year of 2013

NEO reported highest revenue for the fourth quarter and the full year of 2013. Revenue for the 4Q13 was $18.3 million, a 23% increase over that for 4Q12. Fourth quarter revenue beat our estimate of $17.80 million.

The revenue growth was mainly driven by increased test volume, offset by declined average revenue per test. Fourth quarter 2013 test volume increased by 28%, while average revenue per test declined by 3.7%. However, average cost of goods sold per test in 4Q13 declined by 15.3% driven by continued productivity improvements, increased leverage from higher volumes, and other cost containment initiatives. As a result, gross profit increased by 42% to $9.2 million and gross margin increased to 50.0% from 43.2% in the prior year.

Total operating expenses increased by 27.6% from last year's fourth quarter, primarily as a result of additional sales representatives, increases in billing and information technology costs, and an increase in stock-based compensation expense related to the increase in the Company's stock price in the fourth quarter 2013.

Net income for 4Q13 was $857,000, or $0.02 per share, versus a net loss of $(113,000), or $(0.00) per share, for 4Q12.

Adjusted EBITDA improved by 90% to $2.7 million in Quarter 4 from $1.4 million last year.

For fiscal year 2013, revenue was $66.5 million, an 11% increase from 2012. Test volume increased by 20%, while average revenue per test declined by 7.3%. Revenue growth was driven by an expanded menu of tests and an increasing client base. Average cost of goods sold per test declined by 12.2%. As a result, gross profit increased by 18% to $31.7 million and gross margin increased to 47.8% from 44.8% in 2012.

Total operating expenses for fiscal year 2013 increased by 11.5% from 2012. Net income for 2013 was $2.0 million, or $0.04 per share, versus $0.00 per share in 2012. Adjusted EBITDA improved by 42% to $8.5 million in 2013 from $6.0 million in 2012.

We are pleased to see continued revenue and earnings growth for the fourth quarter and full year 2013. The company recorded record revenue for the 4Q13 and full year of 2013, despite 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 drive 80% of the year-over-year revenue increase to gross profit in the fourth quarter, and increase net income by almost $1.0 million, despite a 3.7% reduction in average revenue-per-test over the same period.

During 2013, NEO launched approximately 40 new molecular tests and NeoTYPE cancer profiles. With 68 new molecular tests launched over the last two years, NEO now has one of the broadest molecular testing menus in the diagnostics industry.

Revenue will be further boosted in 2014 and beyond by the following events:

- NEO expects to launch **Next Generation Sequencing** testing in March;
- The company is making significant progress developing its new **NeoSCORE™ Prostate Cancer** Test. The preliminary results of the first trial have been published online in the Genetic Testing and Molecular Biomarkers Journal and the company recently completed a second trial which has largely confirmed the results of the first trial.
- In addition, NEO is off to a good start in its new strategic alliance with **Covance**, and expect growth of its clinical trials business as the year progresses.

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.

Although there is uncertainty regarding new guidance from CMS' National Correct Coding Initiative (NCCI) on how to properly bill for FISH testing for Medicare beneficiaries, reimbursement for the rest of the company's testing and from its non-Medicare payers will remain reasonably stable in 2014. NEO also expects to reduce costs per test by another 8-10% this year. In addition, NEO is also increasingly focused on exploring mergers and/or acquisitions as a means to increase its scale and to diversify its portfolio.

Summary of Quarterly Performance

	4Q11	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13
Total Revenue ($, 000's)	**$12,893**	**$15,160**	**$15,611**	**$14,202**	**$14,893**	**$15,657**	**$15,603**	**$16,884**	**$18,323**
% Growth	47.3%	72.2%	49.2%	25.5%	15.5%	3.3%	-0.1%	18.9%	23.0%
Gross Margin	**45.2%**	**47.1%**	**47.2%**	**41.5%**	**43.2%**	**46.3%**	**45.9%**	**48.4%**	**50.0%**
SG&A as a % of Revenue	42.3%	38.2%	38.4%	40.6%	38.9%	39.0%	38.7%	39.5%	39.9%
Net Income (Loss) ($,000's)	**$152.0**	**$603.0**	**$839.0**	**($975.0)**	**($113.0)**	**$3.0**	**$273.0**	**$929.0**	**$963.0**
Diluted EPS	$0.00	$0.01	$0.01	($0.02)	$0.00	$0.00	$0.01	$0.02	$0.02
Adjusted EBITDA ($, 000's)	$1,055.0	$1,775.0	$1,943.0	$842.0	$1,439.0	$1,794.0	$1,825.0	$2,163.0	$2,733.0
% Growth		6020.7%	302.3%	21.5%	36.4%	1.1%	-6.1%	156.9%	89.9%
Test Volume (000's)	**22,557**	**26,932**	**28,846**	**28,315**	**30,513**	**32,088**	**32,519**	**33,723**	**38,987**
% Growth	57.2%	74.9%	57.1%	41.7%	35.3%	19.1%	12.7%	19.1%	27.8%
Average Price/Test	$571.59	$562.89	$541.20	$501.58	$488.09	$488.00	$480.00	$501.00	$469.99
% Growth	-6.3%	-1.6%	-5.1%	-11.5%	-14.6%	-13.3%	-11.3%	-0.1%	-3.7%
Average Cost/Test					$277.25				$234.96
% Growth									-15.3%

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	$72,900	$87,000	$110,000	$145,000
% Growth	47.2%	16.6%	26.5%	37.7%	11.0%	9.7%	19.3%	26.4%	31.8%
Gross Margin	51.6%	45.9%	44.7%	44.8%	47.7%	48.2%	48.0%	50.0%	50.0%
SG&A/Revenue	57.5%	54.5%	45.6%	39.0%	39.3%	42.0%	37.9%	31.8%	26.2%
Net Income (Loss)	($2,243.0)	($3,303.0)	($1,177.0)	$66.0	$2,033.0	$511.0	$4,452.8	$13,600.0	$24,650.0
Diluted EPS	(0.06)	(0.09)	(0.03)	0.00	0.04	0.01	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

In March, 2013, NEO did an underwritten public offering of 3.3 million shares of common stock at a price to the public of $3.00 per share. The transaction resulted in net proceeds to NeoGenomics of about $9.2 million. This financing greatly boosted the Company's balance sheet.

As of December 31, 2013, NeoGenomics had $4.8 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.

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.

NEO Shares Are Still Undervalued

We continue to rate NEO shares a Buy 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 $3.3 per share which values the Company at $162 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.

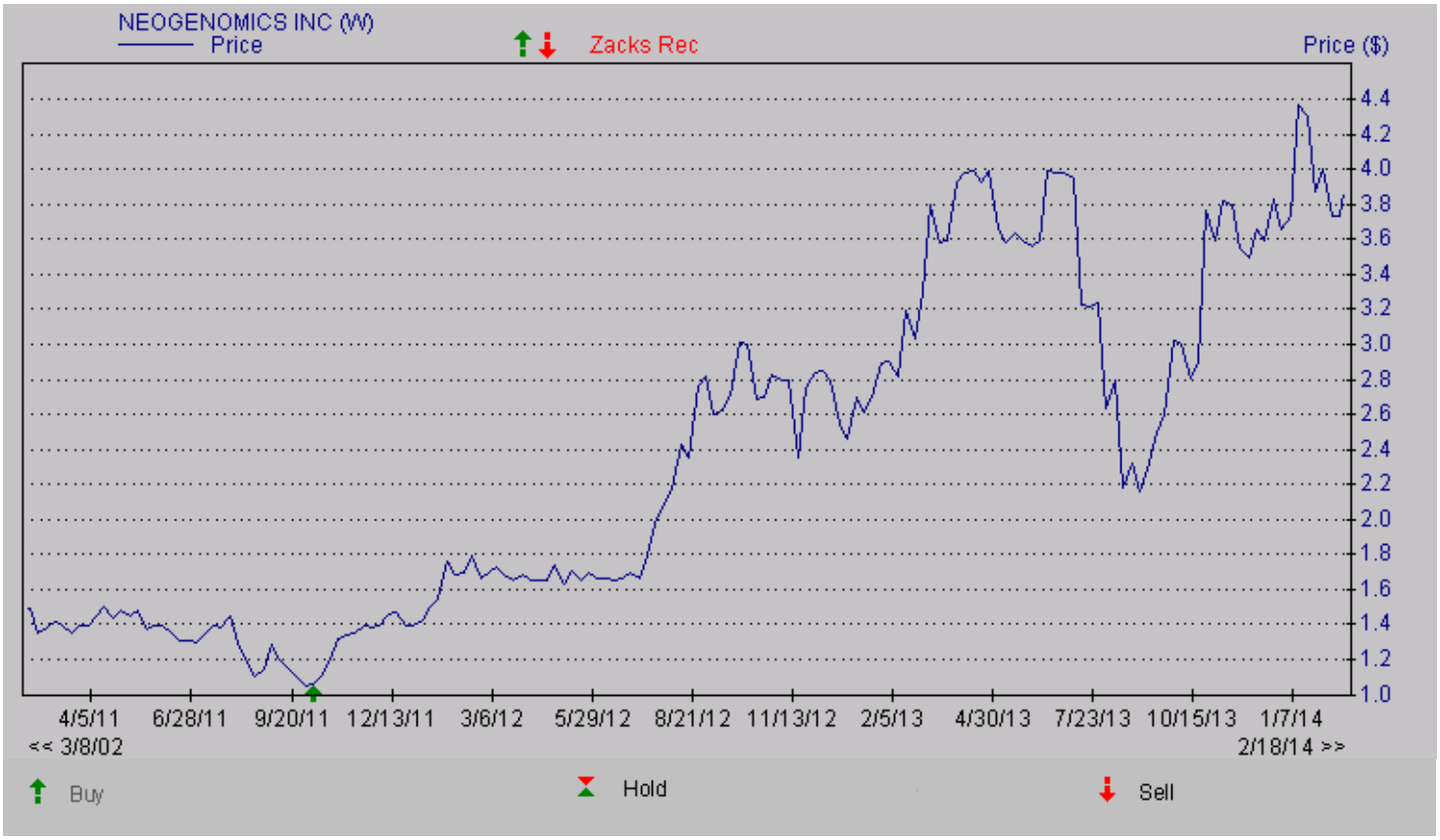
PROJECTED INCOME STATEMENT

	2011A (Dec)	2012A (Dec)	2013A (Dec)					2014E (Dec)					2015E (Dec)	2016E (Dec)	2017E (Dec)
$ in million except per share data	FYA	FYA	Q1A	Q2A	Q3A	Q4A	FYA	Q1	Q2	Q3	Q4	FYE	FYE	FYE	FYE
Total Revenues	**$43.48**	**$59.87**	**$15.66**	**$15.60**	**$16.88**	**$18.32**	**$66.47**	**$17.80**	**$17.90**	**$17.90**	**$19.30**	**$72.90**	**$87.00**	**$110.00**	**$145.00**
YOY Growth	26.5%	37.7%	3.3%	-0.1%	18.9%	23.0%	11.0%	13.7%	14.7%	6.0%	5.3%	9.7%	19.3%	26.4%	31.8%
CoGS	24.06	33.03	8.41	8.45	8.71	9.16	34.73	9.52	9.49	9.13	9.65	37.79	45.24	55.00	72.50
Gross Income	**$19.43**	**$26.84**	**$7.25**	**$7.16**	**$8.17**	**$9.16**	**$31.74**	**$8.28**	**$8.41**	**$8.77**	**$9.65**	**$35.11**	**$41.76**	**$55.00**	**$72.50**
Gross Margin	44.7%	44.8%	46.3%	45.9%	48.4%	50.0%	47.7%	46.5%	47.0%	49.0%	50.0%	48.2%	48.0%	50.0%	50.0%
SG&A	$19.84	$23.34	$6.11	$6.04	$6.67	$7.31	$26.12	$7.45	$7.50	$7.70	$8.00	$30.65	$33.00	$35.00	$38.00
% SG&A	45.6%	39.0%	39.0%	38.7%	39.5%	39.9%	39.3%	41.9%	41.9%	43.0%	41.5%	42.0%	37.9%	31.8%	26.2%
R&D	$0.00	$2.28	$0.84	$0.62	$0.34	$0.65	$2.44	$0.60	$0.65	$0.70	$0.80	$2.75	$3.20	$3.50	$5.00
% R&D	-	3.8%	5.3%	3.9%	2.0%	3.5%	3.7%	3.4%	3.6%	3.9%	4.1%	3.8%	3.7%	3.2%	3.4%
Operating Income	**($0.4)**	**$1.2**	**$0.3**	**$0.5**	**$1.2**	**$1.2**	**$3.2**	**$0.2**	**$0.3**	**$0.4**	**$0.9**	**$1.7**	**$5.6**	**$16.5**	**$29.5**
Operating Margin	-0.9%	2.0%	1.9%	3.2%	6.9%	6.6%	4.8%	1.3%	1.5%	2.1%	4.4%	2.3%	6.4%	15.0%	20.3%
Other Net	($0.8)	($1.1)	($0.3)	($0.2)	($0.2)	($0.2)	($1.0)	($0.2)	($0.2)	($0.2)	($0.2)	($0.8)	($0.5)	($0.5)	($0.5)
Pre-Tax Income	**($1.2)**	**$0.1**	**$0.0**	**$0.3**	**$0.9**	**$1.0**	**$2.2**	**$0.0**	**$0.1**	**$0.2**	**$0.7**	**$0.9**	**$5.1**	**$16.0**	**$29.0**
Income taxes(benefit)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.1	$0.2	$0.1	$0.1	$0.1	$0.1	$0.4	$0.6	$2.4	$4.4
Tax Rate	0.0%	0.0%	85.0%	0.0%	3.1%	11.0%	7.0%	370.4%	158.7%	58.5%	15.4%	43.9%	12.0%	15.0%	15.0%
Reported Net Income	**($1.2)**	**$0.1**	**$0.0**	**$0.3**	**$0.9**	**$0.9**	**$2.0**	**($0.1)**	**($0.0)**	**$0.1**	**$0.6**	**$0.5**	**$4.5**	**$13.6**	**$24.7**
YOY Growth	-64.4%	-	-99.5%	-50.5%	-	-	2980.3%	- 2533.3%	-113.6%	-92.1%	-35.8%	-74.9%	771.4%	205.4%	81.3%
Net Margin	-2.7%	0.1%	0.0%	1.7%	5.3%	4.7%	3.1%	-0.4%	-0.2%	0.4%	2.8%	0.7%	5.1%	12.4%	17.0%
Diluted Shares Out	43.2	46.4	50.9	53.7	53.2	53.6	52.9	53.8	54.0	54.2	54.4	54.1	57.0	60.0	62.0
Reported EPS	**($0.03)**	**$0.00**	**$0.00**	**$0.01**	**$0.02**	**$0.02**	**$0.04**	**($0.00)**	**($0.00)**	**$0.00**	**$0.01**	**$0.01**	**$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*	*$0.00*	*$0.00*	*$1.00*
Non GAAP Net Income	**($1.2)**	**$0.1**	**$0.0**	**$0.3**	**$0.9**	**$0.9**	**$2.0**	**($0.1)**	**($0.0)**	**$0.1**	**$0.6**	**$0.5**	**$4.5**	**$13.6**	**$25.7**
Non GAAP EPS	**($0.03)**	**$0.00**	**$0.00**	**$0.01**	**$0.02**	**$0.02**	**$0.04**	**($0.00)**	**($0.00)**	**$0.00**	**$0.01**	**$0.01**	**$0.08**	**$0.23**	**$0.41**

Source: Company filings and Zacks Investment Research

© Copyright 2014, Zacks Investment Research. All Rights Reserved.

HISTORICAL ZACKS RECOMMENDATIONS



DISCLOSURES

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

ANALYST DISCLOSURES

I, Grant Zeng, hereby certify that the view expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the recommendations or views expressed in this research report. I believe the information used for the creation of this report has been obtained from sources I considered to be reliable, but I can neither guarantee nor represent the completeness or accuracy of the information herewith. Such information and the opinions expressed are subject to change without notice.

INVESMENT BANKING, REFERRALS, AND FEES FOR SERVICE

Zacks SCR does not provide nor has received compensation for investment banking services on the securities covered in this report. Zacks SCR does not expect to receive compensation for investment banking services on the Small-Cap Universe. Zacks SCR may seek to provide referrals for a fee to investment banks. Zacks & Co., a separate legal entity from ZIR, is, among others, one of these investment banks. Referrals may include securities and issuers noted in this report. Zacks & Co. may have paid referral fees to Zacks SCR related to some of the securities and issuers noted in this report. From time to time, Zacks SCR pays investment banks, including Zacks & Co., a referral fee for research coverage.

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 Analysts. Non-investment banking services include investor relations services and software, financial database analysis, advertising services, brokerage services, advisory services, investment research, investment management, non-deal road shows, and attendance fees for conferences sponsored or co-sponsored by Zacks SCR. The fees for these services vary on a per client basis and are subject to the number of services contracted. Fees typically range between ten thousand and fifty thousand per annum.

POLICY DISCLOSURES

© Copyright 2014, Zacks Investment Research. All Rights Reserved.

Zacks SCR Analysts are restricted from holding or trading securities in the issuers which they cover. ZIR and Zacks SCR do not make a market in any security nor do they act as dealers in securities. Each Zacks SCR Analyst has full discretion on the rating and price target based on his or her 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 services described above. 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 article.

ADDITIONAL INFORMATION

Additional information is available upon request. Zacks SCR reports are based on data obtained from sources we believe to be reliable, but are not guaranteed as to be accurate nor do we purport to be complete. Because of individual objectives, this 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 without notice. Reports are not to be construed as an offer or solicitation of an offer to buy or sell the securities herein mentioned.

ZACKS RATING & RECOMMENDATION

ZIR uses the following rating system for the 1061 companies whose securities it covers, including securities covered by Zacks SCR:
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 is as follows: Buy/Outperform- 17.5%, Hold/Neutral- 75.3%, Sell/Underperform – 6.4%. Data is as of midnight on the business day immediately prior to this publication.