Zacks Small-Cap Research

February 20, 2014
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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	**$7.50**

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	18.9 E	19.0 E	19.2 E	19.3 E	76.4 E
2015					92.0 E
2016					115.0 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	$0.02 E	$0.02 E	$0.02 E	$0.01 E	$0.07 E
2015					$0.16 E
2016					$0.28 E

Zacks Projected EPS Growth Rate - Next 3 Years % **93**

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WHAT'S NEW

- **Highest revenue reported for 4Q13, and for 2013, beating our estimates;**
- **Balance sheet remains strong;**
- **Maintain Outperform rating and raise price target to $7.50 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, we 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 new **NeoSCORE™ Prostate Cancer** Test. The preliminary results of 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	$76,400	$92,000	$115,000	$145,000
% Growth	47.2%	16.6%	26.5%	37.7%	11.0%	14.9%	20.4%	25.0%	26.1%
Gross Margin	51.6%	45.9%	44.7%	44.8%	47.7%	50.0%	50.0%	50.0%	50.0%
SG&A/Revenue	57.5%	54.5%	45.6%	39.0%	39.3%	40.1%	34.8%	29.6%	26.2%
Net Income (Loss)	($2,243.0)	($3,303.0)	($1,177.0)	$66.0	$2,033.0	$3,600.0	$9,240.0	$16,575.0	$24,650.0
Diluted EPS	(0.06)	(0.09)	(0.03)	0.00	0.04	0.07	0.16	0.28	0.41
Adjusted EBITDA	$103.0	($566.0)	$2,134.0	$5,999.0	$8,515.0	$9,500.0	$10,740.0	$18,075.0	$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 February, 2013, NEO did an underwritten public offering of 3.15 million shares of common stock at a price to the public of $3.00 per share.

Of the shares offered, NeoGenomics is selling 2.85 million shares and a selling stockholder, The Mary S. Dent Gifting Trust, is selling 300,000 shares. The transaction resulted in net proceeds to NeoGenomics of about $7.8 million.

We are pleased that NEO has landed this new financing with favorable terms. The offering price was close to the market price then, and no other strings added to the common stock.

This financing greatly boosted the Company's balance sheet.

As of December 31, 2013, NeoGenomics had $4.8 million in cash. With the current cash, 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.

Price Target Raised to $7.50

We continue to rate NEO shares a Buy and raise our price target to $7.50 from previous $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. We think NEO should trade at 35 x P/E multiple. If we use this P/E multiple, the fair value of NEO shares should be between $7.0 and $8.0 per share if we use our estimated EPS of $0.41 in 2017 and $0.28 in 2016, discounted at 20% for two or three years. Therefore, we think $7.50 per share is the fair value for NEO shares, which values NEO at $368 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.

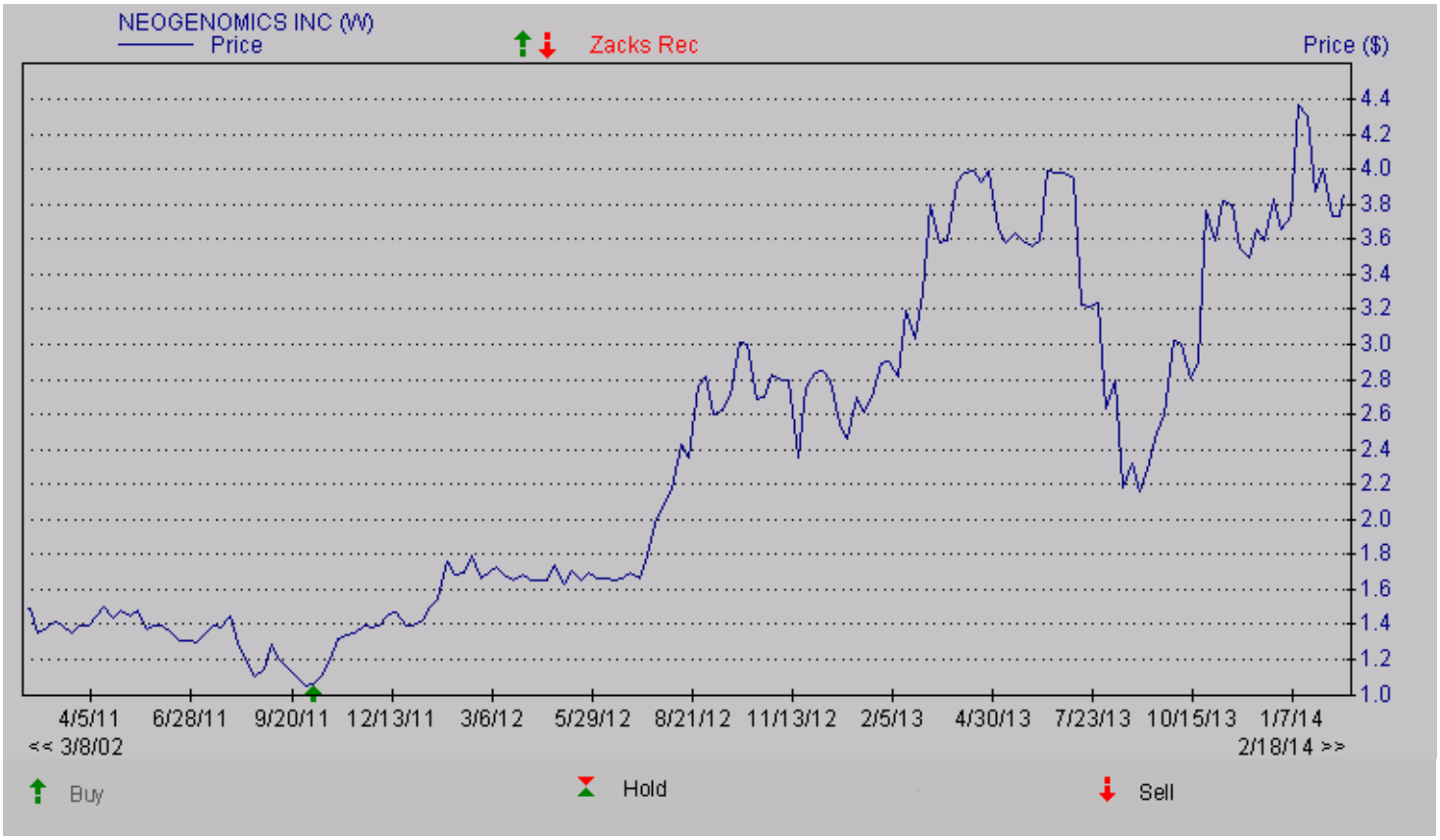
PROJECTED INCOME STATEMENT

	2011A (Dec)		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**	**$18.90**	**$19.00**	**$19.20**	**$19.30**	**$76.40**	**$92.00**	**$115.00**	**$145.00**
YOY Growth	26.5%	37.7%	3.3%	-0.1%	18.9%	23.0%	11.0%	20.7%	21.8%	13.7%	5.3%	14.9%	20.4%	25.0%	26.1%
CoGS	24.06	33.03	8.41	8.45	8.71	9.16	34.73	9.45	9.50	9.60	9.65	38.20	46.00	57.50	72.50
Gross Income	**$19.43**	**$26.84**	**$7.25**	**$7.16**	**$8.17**	**$9.16**	**$31.74**	**$9.45**	**$9.50**	**$9.60**	**$9.65**	**$38.20**	**$46.00**	**$57.50**	**$72.50**
Gross Margin	44.7%	44.8%	46.3%	45.9%	48.4%	50.0%	47.7%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	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	$32.00	$34.00	$38.00
% SG&A	45.6%	39.0%	39.0%	38.7%	39.5%	39.9%	39.3%	39.4%	39.5%	40.1%	41.5%	40.1%	34.8%	29.6%	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	$3.00	$3.50	$5.00
% R&D	-	3.8%	5.3%	3.9%	2.0%	3.5%	3.7%	3.2%	3.4%	3.6%	4.1%	3.6%	3.3%	3.0%	3.4%
Operating Income	**($0.4)**	**$1.2**	**$0.3**	**$0.5**	**$1.2**	**$1.2**	**$3.2**	**$1.4**	**$1.4**	**$1.2**	**$0.9**	**$4.8**	**$11.0**	**$20.0**	**$29.5**
Operating Margin	-0.9%	2.0%	1.9%	3.2%	6.9%	6.6%	4.8%	7.4%	7.1%	6.3%	4.4%	6.3%	12.0%	17.4%	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**	**$1.2**	**$1.2**	**$1.0**	**$0.7**	**$4.0**	**$10.5**	**$19.5**	**$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	$1.3	$2.9	$4.4
Tax Rate	0.0%	0.0%	85.0%	0.0%	3.1%	11.0%	7.0%	8.3%	8.7%	10.0%	15.3%	10.0%	12.0%	15.0%	15.0%
Reported Net Income	**($1.2)**	**$0.1**	**$0.0**	**$0.3**	**$0.9**	**$0.9**	**$2.0**	**$1.1**	**$1.1**	**$0.9**	**$0.6**	**$3.6**	**$9.2**	**$16.6**	**$24.7**
YOY Growth	-64.4%	-	-99.5%	-50.5%	-	-	2980.3%	36618.2%	285.2%	0.2%	-35.6%	77.1%	156.7%	79.4%	48.7%
Net Margin	-2.7%	0.1%	0.0%	1.7%	5.3%	4.7%	3.1%	5.8%	5.5%	4.7%	2.9%	4.7%	10.0%	14.4%	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**	**$0.02**	**$0.02**	**$0.02**	**$0.01**	**$0.07**	**$0.16**	**$0.28**	**$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**	**$1.1**	**$1.1**	**$0.9**	**$0.6**	**$3.6**	**$9.2**	**$16.6**	**$25.7**
Non GAAP EPS	**($0.03)**	**$0.00**	**$0.00**	**$0.01**	**$0.02**	**$0.02**	**$0.04**	**$0.02**	**$0.02**	**$0.02**	**$0.01**	**$0.07**	**$0.16**	**$0.28**	**$0.41**

Source: Company filings and Zacks Investment Research

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