Zacks Small-Cap Research

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NeoGenomics Inc. (NEO-NASDAQ)

NEO: becoming profitable in 2Q13, outlook in line with our expectation--Outperform

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	10/09/2011
Current Price (07/30/13)	$3.06
Twelve- Month Target Price	**$7.00**

OUTLOOK

NeoGenomics just reported 2Q13 financial results which are in line with our expectations in spite of the expiration of TC Grandfather Clause.

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 the remainder of 2013 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	**$4.17**
52-Week Low	**$2.06**
One-Year Return (%)	**48.54**
Beta	**0.93**
Average Daily Volume (sh)	**495,713**
Shares Outstanding (mil)	**49**
Market Capitalization ($mil)	**$149**
Short Interest Ratio (days)	**4.91**
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)
2012	15.2 A	15.6 A	14.2 A	14.9 A	59.9 A
2013	15.7 A	15.6 A	16.0 E	16.8 E	64.0 E
2014					75.0 E
2015					95.0 E

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

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2012	$0.01 A	$0.01 A	-$0.02 A	-$0.00 A	$0.00 A
2013	$0.00 A	$0.01 A	$0.01 E	$0.01 E	$0.02 E
2014					$0.09 E
2015					$0.20 E

Zacks Projected EPS Growth Rate - Next 3 Years % **161**

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WHAT'S NEW

- **Revenue for 2Q13 in line with our expectation;**
- **Becoming profitable in 2Q13 with EPS of $0.01 based on net income of $0.3 million;**
- **Business continues to be promising;**
- **Balance sheet boosted by recent financing;**
- **Maintain price target of $7.00 per share;**

Second Quarter Revenue In Line With Our Expectation

On July 31, Neogenomics (NEO) reported financial results for the second quarter ending June 30, 2013.

Revenue for the second quarter was $15.6 million, unchanged from second quarter 2012 revenue. 2Q13 revenue is also in line with our estimate.

Year over year revenue growth was impacted by the $1.3 million reduction in quarterly revenue that resulted from the expiration of the Medicare Technical Component Grandfather Clause (TCGF) in July 2012. Revenue growth was also impacted by decreases in reimbursement for molecular testing which were finalized by CMS in the second quarter.

NEO achieved test volume increase of 12.7% for the 2Q13 year over year. Average revenue per test declined 11.3% from last year, primarily as a result of the TCGF expiration. This decrease was partially offset by a 9.1% improvement in average cost of goods sold per test. As a result, gross profit margin decreased slightly to 45.9% in the second quarter from 47.2% in the prior year.

Total operating expenses for 2Q13 increased by 1.9%, from last year's second quarter, primarily as a result of increases in R&D expenses.

Net income for 2Q13 was $273,000, or $0.01 per share, versus net income of $551,000, or $0.01 per share, in last year's second quarter.

Adjusted EBITDA was $1.8 million for the second quarter, largely unchanged from last year's second quarter despite the approximately $1.6 million reduction in quarterly profit resulting from the TCGF expiration and molecular reimbursement changes.

We think NEO is continuing making progress in achieving its financial goals for the year 2013 and beyond. NEO recorded record revenue for the 1H13, despite the TC Grandfather Clause expiration and significant Medicare reimbursement changes as compared to last year. 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.

As a reminder, the Medicare **Technical Component** (TC) Grandfather Clause expired on June 30th, 2012. Effective as of July 1st, 2012, NeoGenomics is required to bill hospitals for the technical component of certain tests performed on behalf of Medicare in-patients and out-patients, whereas previously the Company was allowed to bill Medicare directly for such services if they were provided to hospitals that were "grandfathered" under the regulations.

About 80% of NeoGenomics' lab tests are billed off the physician fee schedule with the remainder billed off the clinical lab fee schedule. Lab tests billed off the physician fee schedule usually have two separable billing components: the **technical component** consisting of sample treatment and testing, and the **professional component** for interpretation of the test results.

As a result of the TC Grandfather Clause expiration and Medicare reimbursement changes, revenue was adversely impacted in approximately $275,000. But test volume continued to grow with a record number of new clients starting in June. Test volume grew despite a slight increase in in-sourcing of certain tests by a few clients.

NEO continues to strengthen its sales team by adding five experienced sales professionals. The Company now has a total of 26 sales representatives covering the country. At the same time, the Company is focused on continuously improving laboratory operations and driving down costs. NEO also has increased its investment in Information Technology and expect to make significant improvements in electronic ordering and other methods to increase efficiencies. As a result of these initiatives, the Company drove a 9.1% reduction in average cost-per-test over the last year and maintained gross margins of around 46% despite an 11.3% reduction in average revenue per test. The Company finished the second quarter with the lowest average cost-per-test ever reported.

Summary of Quarterly Performance

($, 000's)	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13
Total Revenue	**10,466**	**11,320**	**12,893**	**15,160**	**15,611**	**14,202**	**14,893**	**15,657**	**15,603**
% Growth	23.3%	30.0%	47.3%	72.2%	49.2%	25.5%	15.5%	3.3%	-0.1%
Gross Margin	**44.5%**	**44.8%**	**45.2%**	**47.1%**	**47.2%**	**41.5%**	**43.2%**	**46.3%**	**45.9%**
SG&A as a % of Revenue	45.6%	44.5%	42.3%	38.2%	38.4%	40.6%	38.9%	39.0%	38.7%
Net Income (Loss)	**($293.0)**	**($143.0)**	**$152.0**	**$603.0**	**$839.0**	**($975.0)**	**($113.0)**	**$3.0**	**$273.0**
Diluted EPS	($0.01)	($0.00)	$0.00	$0.01	$0.01	($0.02)	$0.00	$0.00	$0.01
Adjusted EBITDA	$483.0	$693.0	$1,055.0	$1,775.0	$1,943.0	$842.0	$1,439.0	$1,794.0	$1,825.0
Test Volume	**18,358**	**19,978**	**22,557**	**26,932**	**28,846**	**28,315**	**30,513**	**32,088**	**32,519**
% Growth	26.9%	38.0%	57.2%	74.9%	57.1%	41.7%	35.3%	19.1%	12.7%
Average Price/Test	570.00	567.00	571.59	562.89	541.20	501.58	488.09	488.00	480.00
% Growth	-2.9%	-5.8%	-6.3%	-1.6%	-5.1%	-11.5%	-14.6%	-13.3%	-11.3%

Summary of Annual Performance

$, 000's	2008	2009	2010	2011	2012	2013E	2014E	2015E
Total Revenue	20,015	29,469	34,371	43,484	59,866	64,010	75,000	95,000
% Growth	74.0%	47.2%	16.6%	26.5%	37.7%	6.9%	17.2%	26.7%
Gross Margin	53.3%	51.6%	45.9%	44.7%	44.8%	46.1%	47.0%	47.0%
SG&A as a % of Revenue	57.7%	57.5%	54.5%	45.6%	39.0%	38.3%	35.3%	30.5%
Net Income (Loss)	(1,383.0)	(2,243.0)	(3,303.0)	(1,177.0)	66.0	1,046.0	4,700.0	11,450.0
Diluted EPS	(0.04)	(0.06)	(0.09)	(0.03)	0.00	0.02	0.09	0.20
Adjusted EBITDA	809.0	103.0	(566.0)	2,134.0	5,999.0	2,546.0	6,200.0	12,950.0
Annual Test Volume Growth	56.4%	39.1%	25.5%	33.1%	50.2%	45.0%	40.0%	37.0%

Business Continues To Bo Promising

In the past six quarters, NEO developed and launched over 60 new molecular tests and now have comprehensive oncology-focused molecular test menu in America.

On July 25, 2013, NEO announced that it has validated and launched a number of clinical molecular tests for the comprehensive profiling of myelodysplastic syndrome **(MDS).**

MDS is a highly complex and difficult to diagnose disease with a wide variety of clinical behaviors. MDS is diagnosed in more than 10,000 people in the United States annually with an approximate incidence rate of 4.5 cases per 100,000 people. MDS is a myeloid malignancy characterized by peripheral blood cytopenias. The disease can arise de novo or after exposure to chemicals, chemotherapy or radiation therapy for other cancers. Establishing diagnosis can be very difficult and the presentation of MDS can overlap with multiple other reactive processes.

NeoGenomics' comprehensive MDS testing covers all of the known relevant molecular mutations associated with the disease. NeoGenomics now provides mutation analysis of the following genes, either individually or as a group: SF3B1, U2AF1, SRSF2, ZRSR2, RUNX1, EZH2, ASXL1, TET2, TP53, NRAS, CBL, PTPN11, IDH1/2 and ETV6. NeoGenomics comprehensive MDS tests can be used for confirming diagnosis, predicting prognosis, determining therapeutic strategy and monitoring response.

NEO is also working on new plasma and urine-based, **NeoSCORE^{TM}** prostate cancer test. There are two goals for this test, to diagnose the presence of cancer in patients with BPH (benign prostatic hyperplasia), and to distinguish high-grade from low-grade prostate cancer in patients with prostate cancer.

The Company expects to launch NeoSCORE^{TM} in the first half of 2014.

New tests will continue to drive revenue growth down the road.

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 June 30, 2013, NeoGenomics had $4.6 million in cash with little debt. 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 2H2013 and beyond.

VALUATION AND RECOMMENDATION

We continue to rate NEO shares a Buy and maintain our price target of $7.00 per share.

Since we initiated coverage of NeoGenomics in early October 2011 at $1.15 per share, price has appreciated 160% as of this writing. But we think there is still room for further price appreciation.

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 $59.9 million in 2012, a tremendous 39% compound annual growth rate (CAGR) for the five-year period. We estimate revenue will further grow to $125 million in 2016, a CAGR of 20% from 2013 to 2016.

We are also impressed by the Company's strong balance sheet, which is in contrast with most small cap biotech companies. NeoGenomics held $4.6 million in cash as of June 30, 2013 with little debt. With profitability at its fingertips, the Company should be able to focus on its long term strategic development plan without fearing short term cash strains.

We are optimistic about the strength of the Company's business model. Fundamentals remain strong for NEO. Pipeline is strong. 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 160% 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 $3.0 per share which values the Company at $150 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 20% CAGR from 2013 to 2015. We think NEO should trade at 35 x P/E multiple. If we use this P/E multiple, coupled with our estimated EPS of $0.35 in 2016, discounted at 20% for three years, we come up with a price target of $7.0 per share.

We still think NEO is 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.

PROJECTED INCOME STATEMENT

	2010A (Dec)	2011A (Dec)	2012A (Dec)					2013E (Dec)					2014E (Dec)	2015E (Dec)	2016E (Dec)
$ in million except per share data	FYA	FYA	Q1	Q2	Q3	Q4	FYA	Q1A	Q2A	Q3E	Q4E	FYE	FYE	FYE	FYE
Total Revenues	**$34.37**	**$43.48**	**$15.16**	**$15.61**	**$14.20**	**$14.89**	**$59.87**	**$15.66**	**$15.60**	**$16.00**	**$16.75**	**$64.01**	**$75.00**	**$95.00**	**$125.00**
YOY Growth	16.6%	26.5%	72.2%	49.2%	25.5%	15.5%	37.7%	3.3%	-0.1%	12.7%	12.5%	6.9%	17.2%	26.7%	31.6%
CoGS	18.59	24.06	8.02	8.24	8.31	8.46	33.03	8.41	8.45	8.64	8.99	34.49	39.75	50.35	66.25
Gross Income	**$15.78**	**$19.43**	**$7.14**	**$7.37**	**$5.89**	**$6.43**	**$26.84**	**$7.25**	**$7.16**	**$7.36**	**$7.76**	**$29.52**	**$35.25**	**$44.65**	**$58.75**
Gross Margin	45.9%	44.7%	47.1%	47.2%	41.5%	43.2%	44.8%	46.3%	45.9%	46.0%	46.3%	46.1%	47.0%	47.0%	47.0%
SG&A	$18.75	$19.84	$5.79	$6.00	$5.77	$5.79	$23.34	$6.11	$6.04	$6.15	$6.25	$24.54	$26.50	$29.00	$32.50
% SG&A	54.5%	45.6%	38.2%	38.4%	40.6%	38.9%	39.0%	39.0%	38.7%	38.4%	37.3%	38.3%	35.3%	30.5%	26.0%
R&D	$0.00	$0.00	$0.50	$0.53	$0.81	$0.45	$2.28	$0.84	$0.62	$0.65	$0.70	$2.80	$3.25	$3.50	$4.00
% R&D	-	-	3.3%	3.4%	5.7%	3.0%	3.8%	5.3%	3.9%	4.1%	4.2%	4.4%	4.3%	3.7%	3.2%
Operating Income	**($3.0)**	**($0.4)**	**$0.9**	**$0.8**	**($0.7)**	**$0.2**	**$1.2**	**$0.3**	**$0.5**	**$0.6**	**$0.8**	**$2.2**	**$5.5**	**$12.2**	**$22.3**
Operating Margin	-	-0.9%	5.7%	5.4%	-4.8%	1.3%	2.0%	1.9%	3.2%	3.5%	4.8%	3.4%	7.3%	12.8%	17.8%
Other Net	($0.3)	($0.8)	($0.3)	($0.3)	($0.3)	($0.3)	($1.1)	($0.3)	($0.2)	($0.3)	($0.3)	($1.1)	($0.8)	($0.5)	($0.5)
Pre-Tax Income	**($3.3)**	**($1.2)**	**$0.6**	**$0.6**	**($1.0)**	**($0.1)**	**$0.1**	**$0.0**	**$0.3**	**$0.3**	**$0.5**	**$1.1**	**$4.7**	**$11.7**	**$21.8**
Income taxes(benefit)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.2	$0.5
Tax Rate	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	1.6%	0.0%	1.7%	2.3%
Reported Net Income	**($3.3)**	**($1.2)**	**$0.6**	**$0.6**	**($1.0)**	**($0.1)**	**$0.1**	**$0.0**	**$0.3**	**$0.3**	**$0.5**	**$1.0**	**$4.7**	**$11.5**	**$21.3**
YOY Growth	-	-64.4%	-	-	-	-174.3%	-	-99.5%	-50.5%	-	-	1484.8%	349.3%	143.6%	85.6%
Net Margin	-	-2.7%	4.0%	3.5%	-6.9%	-0.8%	0.1%	0.0%	1.7%	1.6%	3.0%	1.6%	6.3%	12.1%	17.0%
Diluted Shares Out	37.3	43.2	47.4	47.7	45.2	45.3	46.4	50.9	53.7	50.0	55.0	52.4	55.0	57.0	60.0
Reported EPS	**($0.09)**	**($0.03)**	**$0.01**	**$0.01**	**($0.02)**	**($0.00)**	**$0.00**	**$0.00**	**$0.01**	**$0.01**	**$0.01**	**$0.02**	**$0.09**	**$0.20**	**$0.35**
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*	*$0.00*
Non GAAP Net Income	**($3.3)**	**($1.2)**	**$0.6**	**$0.6**	**($1.0)**	**($0.1)**	**$0.1**	**$0.0**	**$0.3**	**$0.3**	**$0.5**	**$1.0**	**$4.7**	**$11.5**	**$21.3**
Non GAAP EPS	**($0.09)**	**($0.03)**	**$0.01**	**$0.01**	**($0.02)**	**($0.00)**	**$0.00**	**$0.00**	**$0.01**	**$0.01**	**$0.01**	**$0.02**	**$0.09**	**$0.20**	**$0.35**

Source: Company filings and Zacks Investment Research

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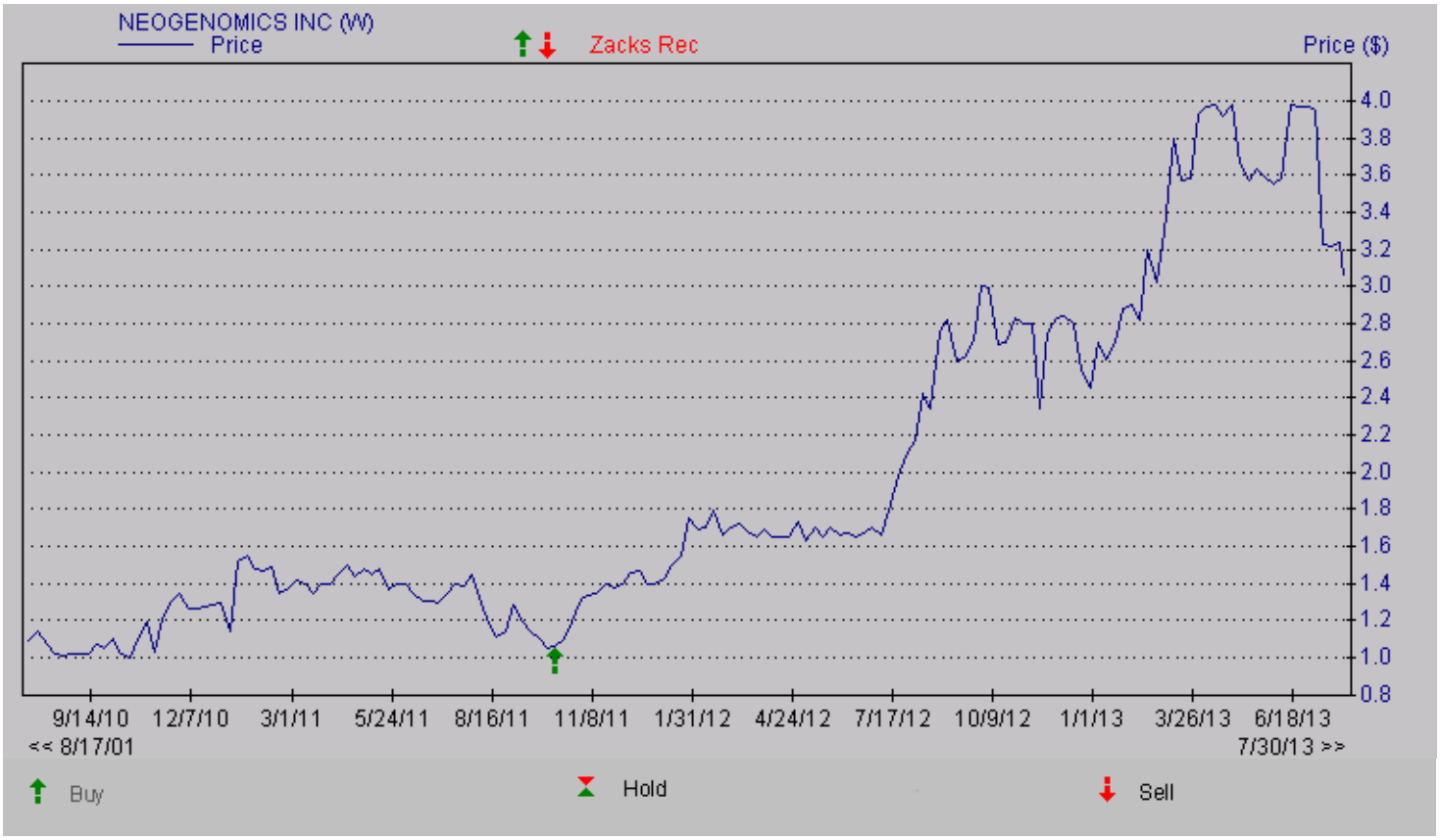
HISTORICAL ZACKS RECOMMENDATIONS



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