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Zacks Small-Cap Research

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Transgenomic Inc. (TBIO-OTC)

TBIO: Q1 Revenue In-Line. Amgen Deal Is Encouraging

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	01/12/2011
Current Price (05/08/2013)	$0.41
Target Price	**$2.00**

OUTLOOK

New product launches will help drive revenue in the clinical lab business. C-GAAP (Plavix response) test could be a winner for TBIO. ScoliScore looks like a needle-mover too. TBIO recently added headcount to support a bigger roll-out of both tests and expects this to really take hold starting in 2013.

Early indications also suggest TBIO's novel, ultra-sensitive ICE COLD PCR testing technology is garnering significant interest from pharma companies and medical institutions. Key to longer-term revenue growth will be to gain further traction in the pharmacogenomics segment, revenue from which has been somewhat disappointing but will hopefully p/u in 2013 with increased activity from key customers. Recent deal with Amgen is clearly a good sign.
We are maintaining our Outperform rating. Our per share price target is $2.00.

SUMMARY DATA

52-Week High	**$1.10**
52-Week Low	**$0.30**
One-Year Return (%)	**-66.92**
Beta	**0.66**
Average Daily Volume (sh)	**117,744**
Shares Outstanding (mil)	**84**
Market Capitalization ($mil)	**$36**
Short Interest Ratio (days)	**0.22**
Institutional Ownership (%)	**27**
Insider Ownership (%)	**2**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**7.8**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2013 Estimate	**N/A**
P/E using 2014 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)
2012	7,206 A	9,093 A	7,889 A	7,292 A	31,480 A
2013	7,374 A	7,961 E	8,448 E	8,614 E	32,397 E
2014					38,121 E
2015					46,247 E

Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2012	-$0.05 A	-$0.01 A	-$0.04 A	-$0.03 A	-$0.13 A
2013	-$0.04 A	-$0.03 E	-$0.03 E	-$0.03 E	-$0.14 E
2014					-$0.09 E
2015					-$0.01 E

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

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Q1 2013 RESULTS: *Revenue In-Line, EPS Miss on Higher SG&A. Amgen Deal is Encouraging…*

Transgenomic reported financial results for Q1 ending March 31, 2013 on May 8th. Revenue was up 2% yoy and dead-on with our $7.4 million estimate. While Laboratory Services revenue of $4.4 million was slightly lower than our $4.6 million estimate, it rebounded nicely from a disappointing Q4 (-6%), turning in about 11% growth yoy in Q1. As we had anticipated, the revenue rebound was attributed to accelerating sales of C-GAAP, the Nuclear Mitome test and at least some (although maybe only marginal right now) contribution from the newly acquired ScoliScore test. Meanwhile, revenue from the Diagnostic Tools business (diagnostic instruments and related consumables) came in at $2.9 million, down about 8% yoy, but just ahead of our $2.8 million estimate. Also, as we had expected, instruments revenue fell yoy but consumables posted positive growth (8%). As a reminder, the majority of our modeled revenue growth of the Diagnostics Tools business relates to anticipated increasing sales of consumables, particularly with the introduction of additional assays such as new cancer kits.

The expected major catalysts to growing near-term revenue in the Lab Services business continues lie with the company's newer and higher priced tests including C-GAAP (Plavix response), Nuclear Mitome, and ScoliScore. Management laid out a multi-pronged approach to accelerating sales of ScoliScore, which as we noted in previous updates, could be a multi-million $ per year product for the company. This includes beefing up their sales force (which has already commenced), direct-to-consumer marketing, and collaborating with key opinion leaders to help drive awareness and generate clinical data - which is expected to lead to published manuscripts. TBIO is also active in pushing for greater reimbursement for the test - which as we noted in previous updates is currently somewhat spotty and has constrained its broader use. We expect the back half of 2013 will see a much greater contribution from ScoliScore as TBIO expects to have additional data to support their marketing efforts and their quest to broaden reimbursement base, has additional and more experienced feet on the ground promoting the product, and has the benefit of a full-year's worth of awareness-building.

Another potential meaningful near-term contributor to the Lab Services segment (as well as to the Diagnostic Tools segment) relates to the recently consummated agreement with Amgen (AMGN) whereby the two companies are collaborating on a KRAS an NRAS gene mutation assay kit to screen patients for colorectal cancer. The RAScan test is currently available for research use only (RUO) in the U.S. (which will run through Lab Svcs) and for clinical use in Europe - which could help accelerate instrument placements (through Menarini) as well as increase consumables sales.

As of Q1 2013 TBIO no longer breaks out Laboratory Services revenue into the respective Clinical Lab and Pharmacogenomics segments. So while we no longer have insight into the revenue contribution from each segment, management did indicate on the call that Pharmacogenomics may take several more quarters until it's generating significant revenue related to clinical trial business from pharma partners that the company has alluded to over the recent past. The deal with Amgen, in our opinion, is a meaningful step towards potentially also seeing additional revenue from Pharmacogenomics.

Relative to the Diagnostics Tools business, instruments sales have been somewhat choppy q-to-q and not likely to be a significant driver of this segment going forward. The European introduction started in 2012 through TBIO's distributor, Menarini, but it has been somewhat anticlimactic so far. The bigger catalyst to driving growth in the Diagnostic Tools business should instead be new test kit launches. The aforementioned colorectal cancer kits should be the first of several new launches over the near-to-mid term including, eventual ICE COLD PCR kits.

Revenue
Q1 revenue was $7.4 million, up 2% yoy and in-line with our $7.4 million estimate. Laboratory Services and Diagnostic Tools revenue were $4.4 million (+11%) and $2.9 million (-8%), respectively, compared to our $4.6 million and $2.8 million estimates.

Gross Margin
Gross margin at 49.9% ticked up slightly from the previous two quarters (48.2%, 48.6%) and was substantially better than our 46.5% estimate. Management noted on the call that higher sales prices and better margins on the Nuclear Mitome test benefitted Lab Svcs margin while instruments mix aided Diagnostic Tools margin.

Over the mid-to-long term we continue to look for GM to widen with growing revenues in Pharmacogenomics, an increase in contribution from the higher margin bionconsumables (as opposed to instruments) from the Diagnostics/Tools business and potentially (depending on reimbursement) very beefy margins from ScoliScore as well as C-GAAP.

Net Income / EPS
Net income and EPS were ($3.8) million and ($0.04) compared to our ($2.8) million and ($0.03) estimates. All of the miss came from higher than modeled operating expenses - mostly SG&A expense ($6.7MM actual vs. $5.4 million estimate). SG&A jumped in part to the recent hires to promote C-GAAP and ScoliScore and also in part to a much higher than average bad debt provision.

Cash
Transgenomic exited Q1 with $7.7 million in cash and equivalents. TBIO also has ~$1.6 million available under their credit facility with Third Security. Cash used in operating and investing activities were $3.3 million and $1.1 million in Q1. About $847k of the cash used in investing activities relates to a payment for the ScoliScore acquisition.

OUR 2013 OUTLOOK

We've again made some updates to our model. We now model 2013 revenue of $32.4 million, implying growth of 3% from 2012. We look for Laboratory Services and Instruments to generate revenue of $20.0 million (+4%) and $12.4 million (+2%), respectively. We think net income and EPS come in at ($12.7) million and ($0.14).

Laboratory Services
Our $20.0 million revenue estimate for Laboratory Services assumes meaningful contribution from new products in the clinical lab segment, including the C-GAAP Plavix response, ScoliScore, and nuclear mitome tests. Very early indications are that there is real interest in TBIO's C-GAAP test. TBIO began adding headcount to promote C-GAAP earlier in 2012 and, with Medicare coverage now in place, expects the roll-out to gain even more momentum going into 2013. Management also has high expectations for ScoliScore. While reimbursement is currently somewhat spotty and payer specific, this could improve over time and with increased awareness and additional study data supporting use of the test. TBIO has already added headcount to help support their sales and marketing efforts of ScoliScore and thinks, depending on the level and prevalence of reimbursement, that they could break even on the $4.4 million purchase price in relatively short order.

As noted, 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 which is further reinforced by the ongoing and recent collaborations with elite medical institutions. 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. The recent Amgen collaboration is a meaningful step towards accelerating activity in the Pharmacogenomics segment as well as in development of new assay kits.

Instruments
We model the equipment portion of Transgenomic's instrument business to stay somewhat flat from current levels. Meanwhile we look for the consumables portion of the diagnostic tools business to turn in double digit growth in 2013, benefitting from the launch of several new product launches including new cancer kits (K-RAS, BRAF, EGFR, PIK3CA).

RECOMMENDATION / VALUATION

We value TBIO using comp P/S ratio. Based on an average P/S comp of 5.1x, Transgenomic is valued at approximately to $2.00/share. The shares currently trade at $0.41. We are maintaining our Outperform rating.

FINANCIAL MODEL

Transgenomic Inc.

	2012 A	Q1A	Q2E	Q3E	Q4E	2013 E	2014 E	2015 E	2016 E
Laboratory Services	$19,329.0	$4,427.0	$4,975.0	$5,286.0	$5,333.0	$20,021.0	$25,029.5	$32,262.0	$40,831.2
% of total revenue	61.4%	60.0%	62.5%	62.6%	61.9%	61.8%	65.7%	69.8%	73.0%
YOY Growth	*5.3%*	*10.6%*	*-14.3%*	*12.0%*	*11.1%*	*3.6%*	*25.0%*	*28.9%*	*26.6%*
Instruments	$12,151.0	$2,947.0	$2,986.0	$3,162.0	$3,281.0	$12,376.0	$13,091.6	$13,984.8	$15,117.3
% of total revenue	38.6%	40.0%	37.5%	37.4%	38.1%	38.2%	34.3%	30.2%	27.0%
YOY Growth	*-10.9%*	*-8.0%*	*-9.1%*	*-0.3%*	*31.8%*	*1.9%*	*5.8%*	*6.8%*	*8.1%*
Total Revenues	$31,480.0	$7,374.0	$7,961.0	$8,448.0	$8,614.0	$32,397.0	$38,121.0	$46,246.8	$55,948.5
YOY Growth	*-1.5%*	*2.3%*	*-12.4%*	*7.1%*	*18.1%*	*2.9%*	*17.7%*	*21.3%*	*21.0%*
Laboratory Services	$10,013.0	$2,234.0	$2,433.3	$2,443.6	$2,752.2	$9,863.0	$10,783.9	$11,295.1	$13,172.3
Lab Svcs margin	*48.2%*	*49.5%*	*51.1%*	*53.8%*	*48.4%*	*50.7%*	*56.9%*	*65.0%*	*67.7%*
Instruments	$6,457.0	$1,459.0	$1,490.0	$1,574.7	$1,607.7	$6,131.4	$6,428.0	$6,796.6	$7,241.2
Instruments margin	*46.9%*	*50.5%*	*50.1%*	*50.2%*	*51.0%*	*50.5%*	*50.9%*	*51.4%*	*52.1%*
Cost of Revenues	$16,470.0	$3,693.0	$3,923.3	$4,018.2	$4,359.9	$15,994.4	$17,211.8	$18,091.7	$20,413.5
Gross Income	$15,010.0	$3,681.0	$4,037.7	$4,429.8	$4,254.2	$16,402.7	$20,909.2	$28,155.1	$35,535.0
Gross Margin	*47.7%*	*49.9%*	*50.7%*	*52.4%*	*49.4%*	*50.6%*	*54.8%*	*60.9%*	*63.5%*
SG&A	$22,023.0	$6,737.0	$6,130.0	$6,336.0	$6,202.1	$25,405.1	$24,778.7	$25,435.7	$27,974.3
% SG&A	*70.0%*	*91.4%*	*77.0%*	*75.0%*	*72.0%*	*78.4%*	*65.0%*	*55.0%*	*50.0%*
R&D	$2,491.0	$764.0	$671.0	$685.0	$635.0	$2,755.0	$3,166.0	$3,440.0	$3,821.0
% R&D	*7.9%*	*10.4%*	*8.4%*	*8.1%*	*7.4%*	*8.5%*	*8.3%*	*7.4%*	*6.8%*
Restructuring charges	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Operating Income	($9,504.0)	($3,820.0)	($2,763.2)	($2,591.2)	($2,582.9)	($11,757.4)	($7,035.5)	($720.7)	$3,739.7
Operating Margin	*-30.2%*	*-51.8%*	*-34.7%*	*-30.7%*	*-30.0%*	*-36.3%*	*-18.5%*	*-1.6%*	*6.7%*
Interest income, net	($886.0)	($153.0)	($150.0)	($150.0)	($150.0)	($603.0)	($400.0)	$0.0	$45.0
Expense on preferred stock	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Other income	$2,210.0	$453.0	$0.0	$0.0	$0.0	$453.0	$0.0	$0.0	$0.0
Pre-Tax Income	($8,180.0)	($3,520.0)	($2,913.2)	($2,741.2)	($2,732.9)	($11,907.4)	($7,435.5)	($720.7)	$3,784.7
Taxes	$148.0	$66.0	$4.0	$4.0	$4.0	$78.0	$0.0	$0.0	$0.0
Tax Rate	*-1.8%*	*-1.9%*	*-0.1%*	*-0.1%*	*-0.1%*	*-0.7%*	*0.0%*	*0.0%*	*0.0%*
Preferred Dividends	($660.0)	($181.0)	($165.0)	($165.0)	($165.0)	($676.0)	($660.0)	($660.0)	($660.0)
Net Income	($8,988.0)	($3,767.0)	($3,082.2)	($2,910.2)	($2,901.9)	($12,661.4)	($8,095.5)	($1,380.7)	$3,124.7
YOY Growth	*-16.7%*	*31.7%*	*323.4%*	*-0.3%*	*17.0%*	*40.9%*	*-36.1%*	*-82.9%*	*-326.3%*
Net Margin	*-28.6%*	*-51.1%*	*-38.7%*	*-34.4%*	*-33.7%*	*-39.1%*	*-21.2%*	*-3.0%*	*5.6%*
EPS	($0.13)	($0.04)	($0.03)	($0.03)	($0.03)	($0.14)	($0.09)	($0.01)	$0.03
YOY Growth	*-40.8%*	*-1.7%*	*243.5%*	*-19.2%*	*-5.4%*	*12.0%*	*-38.6%*	*-83.8%*	*-313.0%*
Diluted Shares O/S	69,405	84,004	88,320	88,400	88,600	87,331	91,000	96,000	102,000

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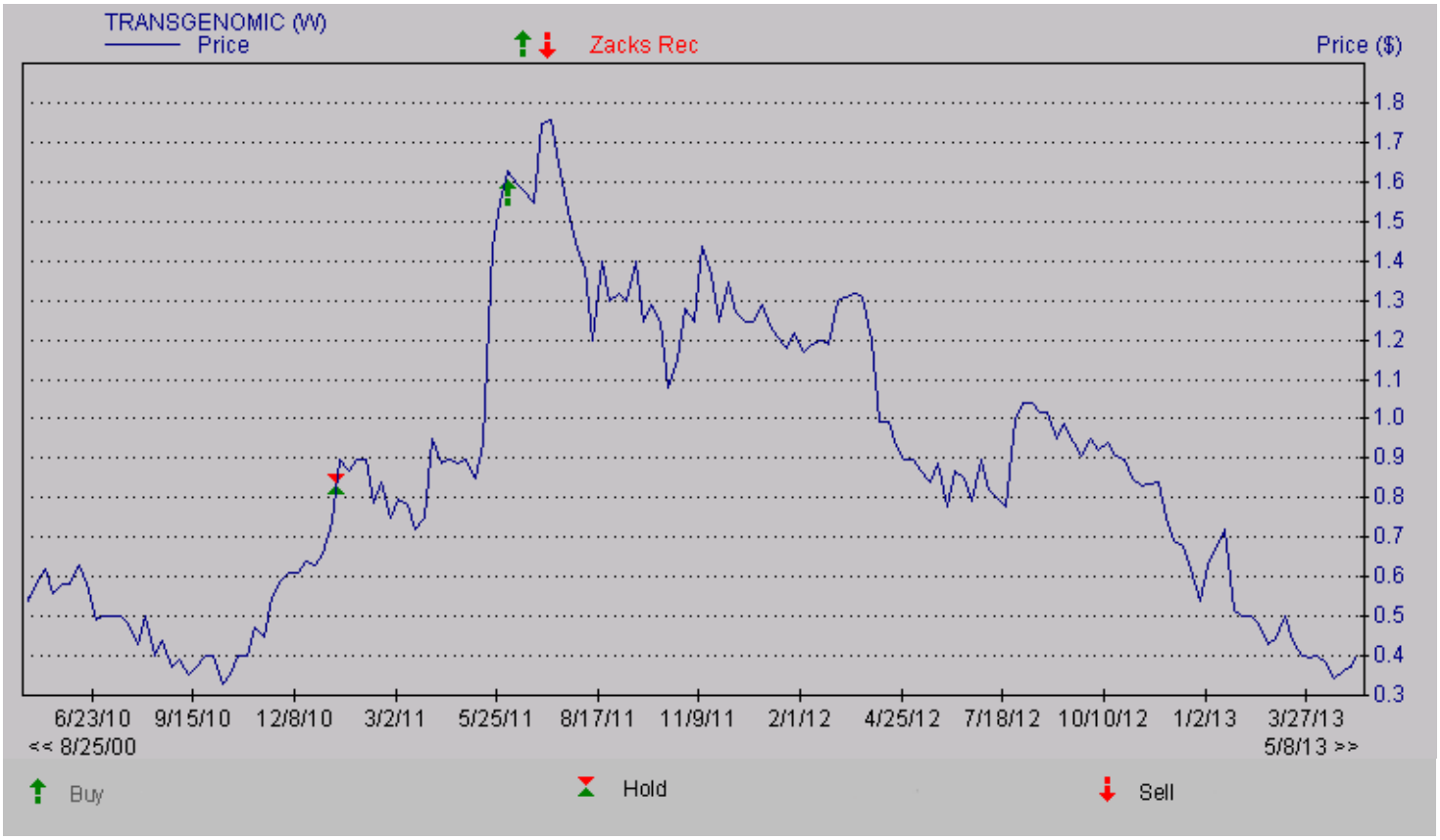

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