November 11, 2011

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: Q3 Results. Plavix Test Launch This Week.

OUTLOOK

Near-term growth comes from a December 2010 acquisition which bolts on over $11MM in revenue and is already providing synergies.

Long-term growth will come from TBIO's transition away from instruments and into the high-growth market of companion diagnostics. The company is just in the infancy of this transformation and early indications already suggest their novel, ultra-sensitive testing technology is garnering significant interest from pharma companies. We are maintaining our Outperform rating. Our current price target is $3.50.

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	01/12/2011
Current Price (11/11/2011)	$1.35
Target Price	**$3.50**

SUMMARY DATA

52-Week High	**$1.85**
52-Week Low	**$0.36**
One-Year Return (%)	**170.59**
Beta	**1.87**
Average Daily Volume (sh)	**93,350**
Shares Outstanding (mil)	**49**
Market Capitalization ($mil)	**$68**
Short Interest Ratio (days)	**0.22**
Institutional Ownership (%)	**2**
Insider Ownership (%)	**2**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**-1.1**
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	**High,**
Type of Stock	**Small-Growth**
Industry	**Med Instruments**

ZACKS ESTIMATES

Revenue
(in '000 of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2010	5,442 A	5,095 A	4,419 A	5,092 A	20,048 A
2011	7,480 A	7,667 A	8,253 A	8,153 E	31,553 E
2012					36,257 E
2013					43,875 E

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

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2010	-$0.01 A	-$0.02 A	-$0.02 A	-$0.02 A	-$0.06 A
2011	-$0.06 A	-$0.13 A	-$0.03 A	-$0.03 E	-$0.25 E
2012					-$0.07 E
2013					-$0.02 E

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

© Copyright 2011, Zacks Investment Research. All Rights Reserved.

WHAT'S NEW…..

Q3 RESULTS

Transgenomic reported financial results for the third quarter ending September 30, 2011 on November 9th. While revenue and gross margin came in lighter than what we forecast, some of this difference was made up with greater than anticipated trimming of operating expenses. While we have made some slight tweaks to our model, nothing in the earnings release or mentioned on the conference call provided any significant surprises or prompted any changes to our investment thesis or long-term outlook for Transgenomic.

Revenue
Q3 revenue came in at $8.25 million, up 87% y-o-y and was about 9% lower than our $9.07 million estimate. The majority of the difference between actual and our estimated number was a result of lower than modeled revenue from the Pharmacogenomics business. On an organic basis (i.e. - ex-FAMILION), revenue increased by approximately 19% y-o-y.

- Laboratory Services revenue: Revenue from Laboratory Services, which includes TBIO's Neurology lab (or molecular reference lab), FAMILION franchise and the Pharmacogenomics research lab, was $4.65 million, up 268% y-o-y from $1.26 million in Q3 2010 but below our $5.11 million estimate. FAMILION, with $3.0 million ($2.91 million estimated) in sales, accounted for the majority of this growth, although the segment did post 31% organic growth as well. Organic growth came from 18% increase ($918k to $1,085k) in Neurology lab revenue and 60% increase ($346k to $552k) in Pharmacogenomics revenue. Neurology lab revenue came in ahead of our $860k forecast while Pharmacogenomics revenue was well below our $1.34 million estimate. Management noted on the call that they just received back two contracts related to its Pharmacogenomics lab services business - these will hopefully begin to contribute meaningfully to revenue in this segment in the near-term. In the FAMILION business, management noted on the call that they expect to launch their clopidogrel (i.e. - Plavix) response test this week concurrent with the American Heart Association Annual Scientific Sessions meeting. Transgenomic will be detailing the test to cardiologists via its FAMILION sales team which already has established key relationships in the test's target market.

  On November 8th Transgenomic announced an agreement with ScreenCell whereby Transgenomic will distribute ScreenCells filtration products. The products are used to isolate and collect rare circulating tumor cells (CTCs) from blood. Transgenomic will initially sell the devices to their pharmaceutical customers and expects to eventually develop specific assays combining both CTC technology with their high sensitivity ICE-COLD PCR technology. The CTC technology broadens Transgenomic's detection capabilities whereby they will be able to detect both circulating tumor cells as well as circulating mutated DNA. Management noted that interest in CTC from pharmaceutical companies and other research organizations is significant.

- Instruments revenue: Revenue from the Instruments business, which includes sales of proprietary and OEM molecular diagnostic instruments and related consumables, was $3.6 million, an increase of 15% from $3.2 million in Q3 2010 but below our $4.0 million estimate. Bioinstruments revenue increased 70% to $2.3 million ($2.1 million estimate) and benefitted from 3 orders that were placed in Q2 but weren't booked as revenue until Q3 (as also noted on the Q2 call). Meanwhile, bioconsumables revenue fell 28% and missed our $1.8 million estimate by about $500k.

  On November 7th Transgenomic announced a distribution agreement with A. Menarini Groups whereby Menarini will act as the exclusive European distributor for Transgenomic's new WAVE MCE (Micro-Capillary Electrophoresis) testing instrument and related consumables. Menarini is a large medical device distributor in Europe and should provide Transgenomic with significant sales and marketing reach in that area of the world. WAVE MCE is expected to launch via Menarini in early 2012. This distribution agreement, coupled with near-term expected launches of new assays, could reignite growth of Transgenomic's instrument's business. As a result of the announcement of the Menarini distribution agreement, we have made some updates to our forecasted instruments business revenue - most notably that we now model this business to return to annualized growth beginning in 2013 (changed from 5% contraction in 2013 and flat to slight growth beginning in 2014).

  Transgenomic also announced that they are nearing completion of their first assay incorporating ICE-COLD PCR. The assay, which detects drug resistance to mutations in K-RAS gene, is expected to enter clinical testing in Q4 and should be commercially available shortly afterwards. Launch of the assay will be a significant

symbolic milestone for Transgenomic, as ICE-COLD PCR is expected to be a big long-term driver of the both the Pharmacogenomics and Bioconsumables businesses.

Gross Margins

Gross margin came in at 53.9% in Q3, below our 58.6% estimate. The difference largely due to margin in the Instruments business coming in well below our forecast (48.3% actual vs. 57.3% estimate). Meanwhile, the Laboratory Services margin was 58.1%, slightly below our 59.6% estimate but relatively very strong compared to the 29% logged for the full-year 2010, which was prior to the FAMILION acquisition. Efficiencies and synergies gained as a result of the FAMILION acquisition and leveraging fixed costs over a bigger revenue base has pushed Transgenomic's combined gross margin from 49.4% in the first nine months of 2010 to 56.2% through the first nine months of 2011. We model the current year gross margin to come in at approximately 56% and to creep upwards in later years with growth in the Pharmacogenomics business, which has mostly a fixed cost base which should be highly leverageable.

Operating Expenses

Operating expenses were $634k less than our estimate ($4.9 million actual vs. $5.5 million estimate), partially reflecting no stock option expense in the quarter and about $100k less than estimated R&D expense ($515k actual vs. $606k estimate).

Net Income / EPS

Net Income and EPS came in at ($1.55) and ($0.03) compared to our $0.04 and $2.71 million estimate. The difference is highly distorted, however, as we had to make essentially blind guesses to the expense on preferred stock line item - which is driven by the value of the embedded convertible options in the preferred stock, which is a function of the change in Transgenomic's stock price over the course of the quarter. This is also a non-cash expense. If we remove the effect of this from the income statement, actual and estimated net income and EPS would have been approximately ($954)k / ($0.02) and ($700)k / ($0.01).

Concurrent with the earnings release, Transgenomic announced that the holders of their Series A convertible preferred stock agreed to amend certain terms of the securities, including the elimination anti-dilution provisions and redemption features. The changes have the effect of reclassifying the preferred stock from a liability on the balance sheet to shareholders equity - which, going forward, eliminates the non-cash expense that has hit the income statement. In exchange for amending the terms, the preferred shareholders received common stock valued at approximately $300k.

Cash

Transgenomic exited Q3 with $1.4 million in cash and equivalents, compared to $2.6 million at the end of Q2. Cash used in operations was $986k in Q3 but stripping out changes in working capital, this was an inflow of $18 (i.e. - basically break-even). Cash used in investing activities was negligible.

OUR 2011 OUTLOOK

We model 2011 revenue of $31.5 million, down from our $33.0 million estimate prior to Q3 results. Our current revenue estimate implies growth of 57% from 2010 (flat on an organic, ex-FAMILION, basis). We look for Laboratory Services and Instruments to generate revenue of $18.1 million and $13.5 million, respectively. We think EPS comes in at ($0.25) in 2011 or about ($0.11) if the preferred stock revaluation expense and QTDP grant income are eliminated.

Laboratory Services
Our $18.1 million revenue estimate for Laboratory Services includes $15.6 million ($4.1MM ex-FAMILION) from the Clinical Lab segment and $2.5 million from Pharmacogenomics. We assume sales of the FAMILION tests, which are seasonally soft in 1H due to the reset of insurance deductibles at the beginning of the year, to grow sequentially from Q3 but on an annual basis come in about 12% lower than 2010. We think FAMILION returns to growth in 2012, benefitting from new product launches, including the imminent introduction of the Plavix response test. We model revenue from Transgenomic's legacy clinical lab (neurology) business to grow about 14% in 2011. Meanwhile, the pharmacogenomics business should experience strong growth throughout 2011 - we look for $2.4 million in revenue from this segment, implying growth of 80% from 2010.

Instruments
We model the equipment portion of Transgenomic's instrument business to fall 13% in 2011 to $7.3MM (average of ~ $1.8MM/qtr) but revenue from the consumables business to hold up much better due to new cancer kit launches and selling to a larger installed base. We model bioconsumables to fall 8% in 2011 to $6.2MM. Benefitting from the Menarini distribution agreement, along with new consumable product launches including several new cancer kits, we think the instruments business can stem the slide in revenue in 2013 and return to growth the following year.

RECOMMENDATION / VALUATION

Given that we model Transgenomic to post negative income and EPS through 2013, valuing the company using a near-term P/E multiple is not reasonable. Instead, we value the company using competitor price/sales multiples, calculated using estimated 2012 revenue. We looked at ten competitors which had at least one analyst estimate for 2012 sales - P/S multiples range from a low of 0.7x to a high of 16x. We removed both the high and low ratio in order to reduce the bias from outliers to the overall averages This left average comp P/S of 4.7x.

We model Transgenomic to post revenue of $36.3MM in 2012. Using the comp P/S ratio values TBIO at approximately $3.50/share. Based on the price that the shares currently trade at ($1.35), we think the stock continues to be significantly undervalued and, as such, we are maintaining our Outperform rating.

FINANCIAL MODEL

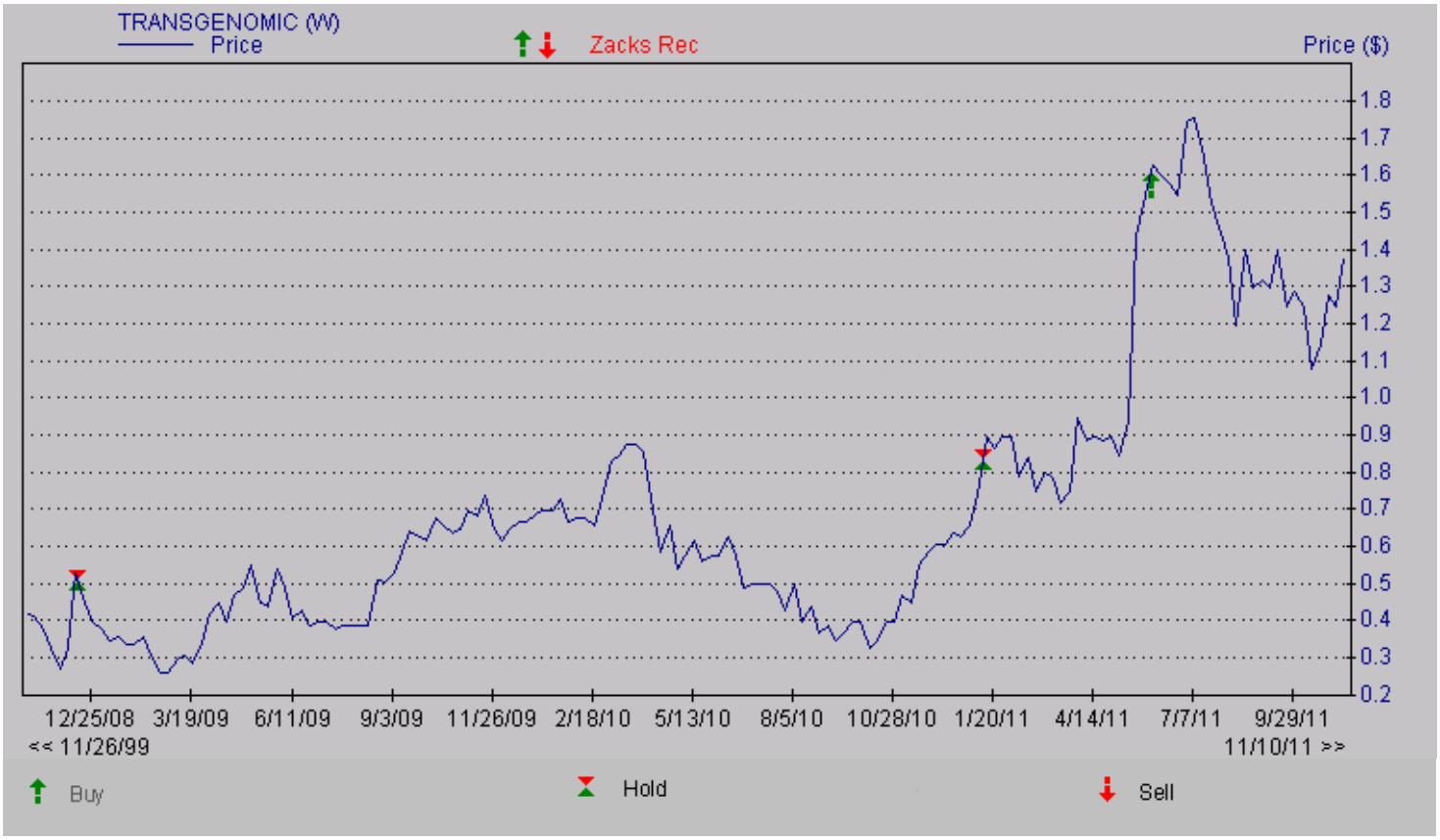
Transgenomic Inc.

	2010 A	Q1A	Q2A	Q3A	Q4E	2011 E	2012 E	2013 E	2014 E
Laboratory Services	$4,979.0	$3,757.0	$4,866.0	$4,637.0	$4,810.0	$18,070.0	$22,887.9	$29,926.3	$37,546.5
% of total revenue	24.8%	50.2%	63.5%	56.2%	59.0%	57.3%	63.1%	68.2%	71.7%
YOY Growth	*9.0%*	*195.6%*	*292.1%*	*266.9%*	*299.8%*	*262.9%*	*26.7%*	*30.8%*	*25.5%*
Instruments	$15,069.0	$3,723.0	$2,801.0	$3,616.0	$3,343.0	$13,483.0	$13,368.9	$13,949.0	$14,841.6
% of total revenue	75.2%	49.8%	36.5%	43.8%	41.0%	42.7%	36.9%	31.8%	28.3%
YOY Growth	*-13.7%*	*-10.7%*	*-27.3%*	*14.6%*	*-14.0%*	*-10.5%*	*-0.8%*	*4.3%*	*6.4%*
Total Revenues	$20,048.0	$7,480.0	$7,667.0	$8,253.0	$8,153.0	$31,553.0	$36,256.8	$43,875.3	$52,388.2
YOY Growth	*-9.0%*	*37.4%*	*50.5%*	*86.8%*	*60.1%*	*57.4%*	*14.9%*	*21.0%*	*19.4%*
Laboratory Services	$3,541.0	$1,970.0	$1,802.0	$1,945.0	$2,007.8	$7,724.8	$8,637.8	$10,631.2	$12,692.8
Lab Svcs margin	*28.9%*	*47.6%*	*63.0%*	*58.1%*	*58.3%*	*57.3%*	*62.3%*	*64.5%*	*66.2%*
Instruments	$6,743.0	$1,356.0	$1,310.0	$1,868.0	$1,644.5	$6,178.5	$6,230.6	$6,410.9	$6,789.4
Instruments margin	*55.3%*	*63.6%*	*53.2%*	*48.3%*	*50.8%*	*54.2%*	*53.4%*	*54.0%*	*54.3%*
Cost of Revenues	$10,284.0	$3,326.0	$3,112.0	$3,808.0	$3,652.3	$13,898.3	$14,868.5	$17,042.1	$19,482.2
Gross Income	$9,764.0	$4,154.0	$4,555.0	$4,445.0	$4,500.7	$17,654.7	$21,388.3	$26,833.2	$32,906.0
Gross Margin	*48.7%*	*55.5%*	*59.4%*	*53.9%*	*55.2%*	*56.0%*	*59.0%*	*61.2%*	*62.8%*
SG&A	$10,933.0	$4,323.0	$5,589.0	$4,364.0	$4,760.8	$19,036.8	$20,023.1	$22,911.7	$25,534.4
% SG&A	*54.5%*	*57.8%*	*72.9%*	*52.9%*	*58.4%*	*60.3%*	*55.2%*	*52.2%*	*48.7%*
R&D	$2,305.0	$557.0	$579.0	$515.0	$660.0	$2,311.0	$3,060.0	$3,180.0	$3,480.0
% R&D	*11.5%*	*7.4%*	*10.7%*	*10.2%*	*9.1%*	*7.3%*	*8.4%*	*7.2%*	*6.6%*
Restructuring charges	$138.0	$24.0	$11.0	$5.0	$0.0	$40.0	$0.0	$0.0	$0.0
Operating Income	($3,612.0)	($750.0)	($1,624.0)	($439.0)	($920.1)	($3,733.1)	($1,694.8)	$741.5	$3,891.5
Operating Margin	*-18.0%*	*-10.0%*	*-21.2%*	*-5.3%*	*-11.3%*	*-11.8%*	*-4.7%*	*1.7%*	*7.4%*
Interest income, net	($4.0)	($238.0)	($240.0)	($238.0)	($230.0)	($946.0)	($800.0)	($780.0)	$10.0
Expense on preferred stock	$0.0	($2,027.0)	($4,239.0)	($600.0)	($200.0)	($7,066.0)	$0.0	$0.0	$0.0
Other income	$632.0	$231.0	$1.0	($2.0)	$0.0	$230.0	$0.0	$0.0	$0.0
Pre-Tax Income	($2,984.0)	($2,784.0)	($6,102.0)	($1,279.0)	($1,350.1)	($11,515.1)	($2,494.8)	($38.5)	$3,901.5
Taxes	$150.0	($6.0)	($104.0)	($9.0)	$33.4	($85.6)	$133.7	$139.5	$148.4
Tax Rate	*-5.0%*	*0.2%*	*1.7%*	*0.7%*	*-2.5%*	*0.7%*	*-5.4%*	*-362.4%*	*3.8%*
Expense on Preferred	$0.0	($260.0)	($267.0)	($275.0)	($262.0)	($1,064.0)	($1,042.0)	($1,042.0)	($1,042.0)
Net Income	($3,134.0)	($3,038.0)	($6,265.0)	($1,545.0)	($1,645.6)	($12,493.6)	($3,670.5)	($1,220.0)	$2,711.1
YOY Growth	*-63.2%*	*-837.7%*	*-446.7%*	*72.0%*	*114.8%*	*-298.6%*	*-70.6%*	*-66.8%*	*-322.2%*
Net Margin	*-15.6%*	*-40.6%*	*-81.7%*	*-18.7%*	*-20.2%*	*-39.6%*	*-10.1%*	*-2.8%*	*5.2%*
EPS	($0.06)	($0.06)	($0.13)	($0.03)	($0.03)	($0.25)	($0.07)	($0.02)	$0.04
YOY Growth	*-63.0%*	*835.7%*	*445.6%*	*71.9%*	*113.9%*	*297.7%*	*-71.8%*	*-68.0%*	*-280.4%*
Diluted Shares O/S	49,244	49,293	49,300	49,328	49,500	49,355	51,500	53,500	65,900

Brian Marckx, CFA

© Copyright 2011, 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 1027 companies covered: Buy/Outperform- 17.5%, Hold/Neutral- 74.9%, Sell/Underperform – 6.7%. Data is as of midnight on the business day immediately prior to this publication.

© Copyright 2011, Zacks Investment Research. All Rights Reserved.